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Running up that (price) hill with 8.5% inflation

By **CONTENT CONTRIBUTOR** |
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On August 10, the Bureau of Labor Statistics at the Department of Labor released the latest inflation numbers for the U.S. There is good news and there is bad news.

The bad news, for the average person living in the Inland Empire, is that if the current 8.5% inflation persists for a while, then prices would double in roughly eight years. So let's try some prices that actually mean something to you. At the current inflation rate, your gasoline price per gallon will reach $10 by 2030, your hamburger patty will sell at $9.40 per pound by that time, and your pound of (whole) chicken will reach $3.80.

The good news is that the annual inflation rate peaked at 9.1% in June and has been coming down more than most analysts predicted. Even better, prices were stable when compared to the previous month. If you take out two particularly volatile components, food and energy, the picture gets rosier. According to that measure, the annual inflation rate is "only" 5.9%. Then again, food and energy (gasoline) matter to you, so you probably don't want to ignore it. However, this

So, how did we get into the inflation mess and should you blame the Biden administration for it?

Here is where we have to add some speculation, but we find the following scenario plausible. Think back to the depth of the Great Recession (December 2007 to June 2009). The Inland Empire was one of the epicenters of the contraction due to the housing bubble bursting and the coinciding decline in employment in construction and manufacturing. It took until mid 2014, or roughly five years, for employment to recover to the prerecession levels. The, what seemed to be at the time, large economic stimulation package of the Obama administration — $787 billion — clearly was not potent enough for people to find desirable jobs within a reasonably short time. The payback for that was the loss in the 2016 presidential election for the Democrats, with President Trump winning blue-collar states (Michigan, Wisconsin, Pennsylvania) that had experienced severe downturns and a "not so great recovery."

The Biden administration was not going to make the same mistake again. This time the initial stimulus was $3.1 trillion dollars, and as of last month's labor report, we have now recovered all jobs lost during the COVID-19 downturn (we were luckier in the Inland Empire where this happened some time back due to the role logistics played in the current recovery). It did not take six years — although the current employment recovery was the fourth longest of the 12 post World War II employment recoveries.

Bottom line, the labor market is back at 3.5% unemployment and the Inland Empire is at historic lows as well. It is clear by now that the $3.1 trillion injection was too generous, especially given the supply side constraints the national economy was facing. Think of the government as a doctor trying to administer medicine (fiscal and monetary policy) to cure a patient (the economy) from a disease (inflation, unemployment). Economic forecasting of the effects of economic policy is similarly imprecise as medical science itself: those of you who have experienced doctors trying to figure out initially the right amount of insulin to administer to a diabetic patient know what we are talking about. There seems to be a lot of trial and error. Similarly here the expansion of national overall demand coinciding with supply chain constraints is not a situation policy makers have seen often before. With higher demand chasing fewer goods, prices took off — and not just temporarily, but over an extended period of time where the danger is that this becomes a permanent state which would filter into wage negotiations

The bigger question for you is: Should you be worried about the current inflation rate?

We often hear people longing for the “good old days” (say the 1960s or even the 1980s) when you didn’t have to lock the front door of your house and the pound of chicken cost 71 cents. However, it is worth asking: Is it really cheaper to live in the 1980s? Many are tempted to say yes, since a weekly Costco run used to set us back around $80 and now it’s easily more than $200. If you think so, then you have fallen into the money/price illusion trap, meaning you are looking only at nominal prices or the listed price on the price tag.

When economists think about price increases, we tend to think of it in relation to the growth of other things, which in this case would be wages. If all prices double over the next decade but your wages triple in the meantime, there’s nothing to worry about, since you’ll be able to afford more things given that your wage rose faster. Or, putting it differently, you would have to work fewer hours to buy a pair of jeans or book a flight to Hawaii. Therefore, what really matters in your case is not how much nominal prices have increased (“inflation”), but whether your wages can keep pace or even outgrow prices.

So did your wage grow faster? Well there’s really no way for us to know your wage, so we’ll go with the wage of an average person and do some simple algebra to figure this out (don’t move on yet, we promise there will be no calculus involved).

The average wage of a non-supervisory employee was $6.85 per hour in 1980, meaning that an average worker needed to work roughly 6 minutes to afford a pound of chicken. In 2022, the average wage rose to $27.32 per hour, and while prices, including that of meat, also rose, the same worker now only needs to work 4 minutes to afford a pound of chicken. If you think about it this way, prices have actually decreased over the last two decades, since now you need to work less to buy goods and services.

To make it more intuitive, in 1980, you could buy 9.6 pounds of chicken with one hour of work. In 2022, you can buy 14.5 pounds of chicken with one hour of work, though the nominal price of chicken has nearly tripled in the last decades. This is pretty counterintuitive, but really the idea is that your wages have grown faster than prices.

So “the good old days” are really not that great after all, given that now you can

So next time when you hear people complain about the inflation rate and how goods are twice as expensive compared to when they were young, ask yourself (or the person) this question: "haven't wages also doubled since when you were young?" And while the average car price in the good old days was $7,500, you had to work longer to purchase it. If you don't find any of this convincing, consider that the average life expectancy is roughly five years more than in the "good old days" of the '60s. We doubt that you want to trade in five years of your life to go back to those "cheaper" days.

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