

How Inflation Expectations Pass Through to Wages

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Introduction

- ▶ To help achieve its 2% annual inflation goal, Fed strives to “anchor” inflation π expectations at 2 percent
- ▶ Conventional narrative:
 - ▶ If Fed is expected to meet target, workers/consumers/firms less likely to react when inflation deviates temporarily
 - ▶ If not, $\uparrow \pi$ expectations $\rightarrow \uparrow$ wage demands $\rightarrow \uparrow$ prices, *causally* raising inflation (wage-price spiral)

Objectives

- ▶ What evidence do we have for the “bad” scenario? How might this narrative actually come to fruition?
- ▶ Revisit the notion of “anchoring” in this context
- ▶ Point out overlooked costs of inflation in the labor market

Inflation Expectations and Nominal Wage Growth Expectations

- ▶ Recent work looks at “pass-through” of (worker/firm) inflation expectations π^e to nominal wage growth expectations:
 - ▶ Uses cross-sectional inflation expectations, RCT-like information intervention, or hypothetical scenario
 - ▶ Hadjini et. al (2023, U.S.) ; Buchheim et. al. (2024, Germany) (workers/employers) ; Abberger et. al. (2023, U.S) (employers)
- ▶ Pass-through is incomplete, but non-negligible (think 20%-ish)

Wage Growth in the Labor Market

- ▶ Cyclical wage growth correlates strongly with **J2J** rate; conditional on J2J, JFR/U has no explanatory power (Karahan et. al. (2017), Moscarini and Postel-Vinay (2023))
 - ▶ Fluid labor market (like the U.S.) → wage improvements obtained through J2J transitions/wage renegotiation via outside offers

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 - ▶ Fluid labor market (like the U.S.) → wage improvements obtained through J2J transitions/wage renegotiation via outside offers
- ▶ If so, what are nominal wage growth expectations measuring for workers? Conditional on **no action**? Conditional on the remaining with the same firm?
- ▶ Notion of **wage demands** in *spiral* narrative more subtle

Wage Demands: Impetus is Decline in Purchasing Power

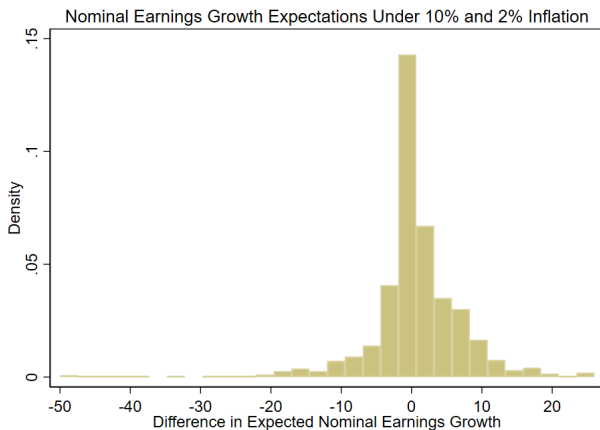
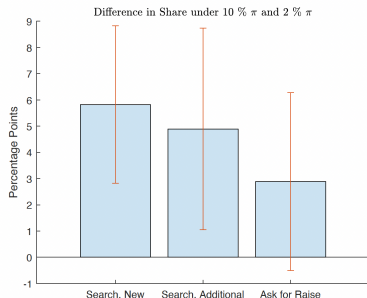


Figure 1: Differences in Expected 12-month Nominal Earnings Growth Conditional on Remaining at Same Employer (*Source*: Pilossoph and Ryngaert (2024))

What Workers Do to Combat Decline in Purchasing Power

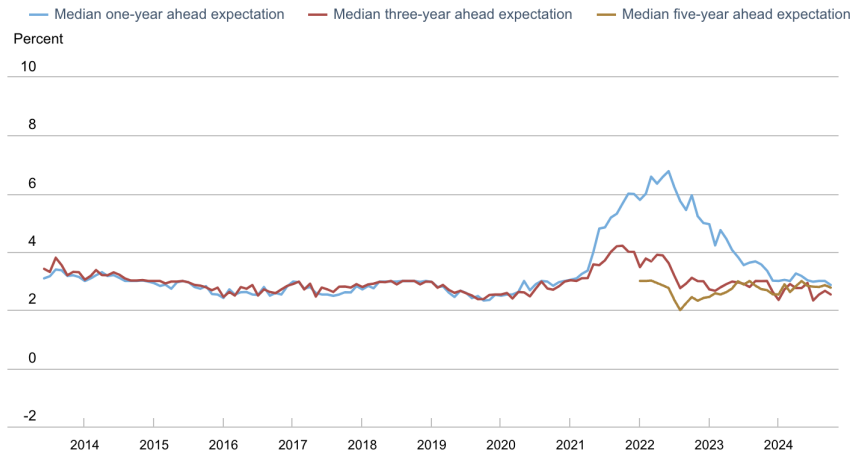


- ▶ Measured pass-through not larger because people will leave their employer to get wage increases?

Further Evidence from the NY Fed's Survey of Consumer Expectations

- ▶ Pilossoph and Ryngaert (2024) show:
 - ▶ π^e correlates + with (extensive/intensive) search (Faberman et. al. 2022)
 - ▶ π^e correlates - with reported reservation wages
 - ▶ π^e correlates + with job-to-job transitions... through increased search
- ▶ **Wage demands** channel primarily operates through changing jobs
- ▶ What is the nature of these job changes? \geq or \leq productive firms
 \iff **are these job changes themselves inflationary?**

What is the Correct Notion of Anchoring?



Source: New York Fed Survey of Consumer Expectations

- ▶ Aforementioned evidence holds even with 1 year inflation forecast horizons

A New Cost of Inflation

- ▶ Evidence highlights overlooked cost of inflation: **search** and **reallocation** costs on the worker side
- ▶ ... **Re-hiring** costs on the firm side
- ▶ Pilossoph, Ryngaert, and Wedewer (2024) aims to measure these costs, and get handle on productivity question (see also Afrouzi, Blanco, Drenik, and Hurst (2024), Guerreiro, Hazell, Lian, and Patterson (2024))

Summary

- ▶ Non-negligible **passthrough** of inflation expectations to wage growth
- ▶ Looking under the hood, could be larger, and seems to operate through **search effort** and **J2J** transitions
- ▶ Responses are triggered even at shorter-run, **near-term expectations** horizons
- ▶ ... and point to overlooked **costs of inflation** in the labor market
- ▶ Need more empirical evidence on the nature of J2J transitions!