The Recession of America's New Economy — The Paradox of Low Unemployment and Stagnant Wage Growth in the United States

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Abstract. On September 18, the interest rate cut announced by the US Federal Reserve Board was the first interest rate cut since March 2020, and the industry generally analyzed that this will also open the curtain of the Fed's interest rate cut cycle. The Federal Reserve's practice of regulating monetary policy for its interests has improved the US economy. Still, the inhibitory effect of high interest rates on the economy is also emerging. The prolonged period of high interest rates has created a cost-of-living crisis for Americans, whose real standard of living is not as good as the economy looks. The pace of rate cuts is not expected to be as rapid as the pace of rate increases, which may have a contractionary effect on economic development in the United States and other economies. This article will start with the paradox between low unemployment and slow wage growth in the United States. The close relationship between inflation and wage levels is introduced. This analysis explores the factors contributing to the slow economic growth in the United States from various perspectives and offers predictions for the country's short- and long-term economic outlook. While domestic tensions are gradually easing in the short term, the long-term prospects for the U.S. economy appear less optimistic. This is due to enduring structural issues within the country, a significant decline in consumption levels, and external influences that continue to pose challenges to sustained growth.

Keywords: Unemployment rate, inflation, wages level, slow economic growth.

1. Introduction

1.1. Background

As one of the dominant features of the current US economy, low unemployment is also the underlying logic of its economic market operation. And that is what the US has been pursuing since the 2008 financial crisis. But in recent years, the U.S. job market has become increasingly weak, and many companies have faced layoffs, bankruptcies, and falling market values. It can be seen that high interest rates have a lot of negative effects on the U.S. economy, manufacturing activity continues to slow, housing sales are weak, and loan defaults are rising, which shows that the economic downturn has spread to several sectors in the figure 1.

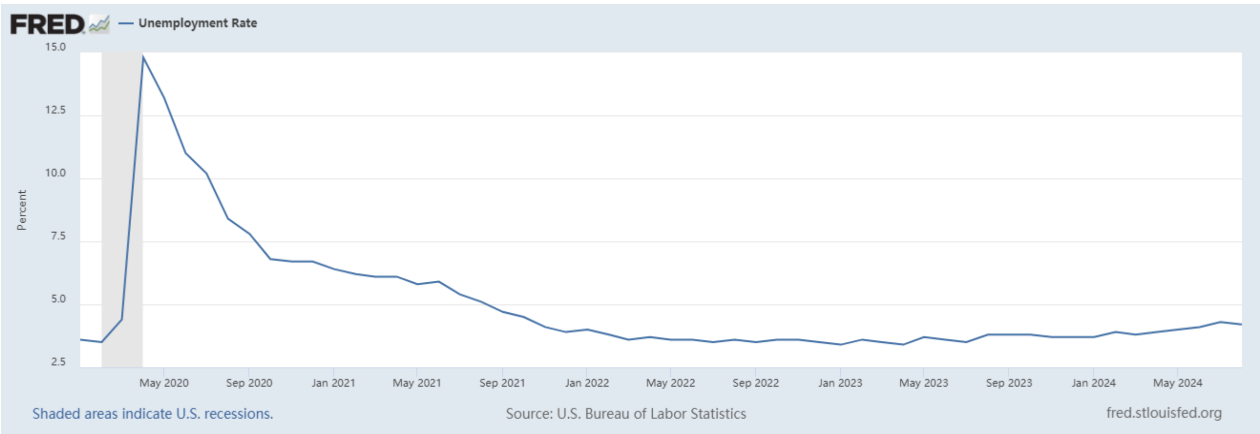

Figure 1. US unemployment rate from 2020 to 2024 [1]

Specifically, according to labor department data, U.S. jobs in July were 1.76 million, the highest since March 2023. According to data released by Standard & Poor's Global Market Intelligence company, 63 public and private companies in the United States filed for bankruptcy in August this year, of which three companies have debts of more than $1 billion. In the first eight months of this year, 452 companies have filed for bankruptcy, the highest level for the same period since 2020 and the second highest level for the same period since 2010.

This is not the worst thing. Since February 2022, the US unemployment rate has consistently hovered in the 3.5-3.8% range, well below the natural rate of 4.4%. The unemployment rate fell further to 3.4% in January 2023, the lowest level since 1969 [1]. That seems like a very encouraging number, but real wages are extremely volatile as the rate of inflation moves. Not only is economic growth slow, but people are increasingly dissatisfied with their wages and benefits, and most still expect higher pay levels. On August 19, the New York Fed released the July 2024 Survey of Consumer Expectations (SCE) Labor Market Survey report. Respondents' satisfaction with salary compensation, non-wage benefits, and promotion opportunities in their current jobs decreased by 3.2%, 8.6%, and 9.3% compared with July 2023, to 56.7%, 56.3%, and 44.2%, respectively in the Figure 2 [2].

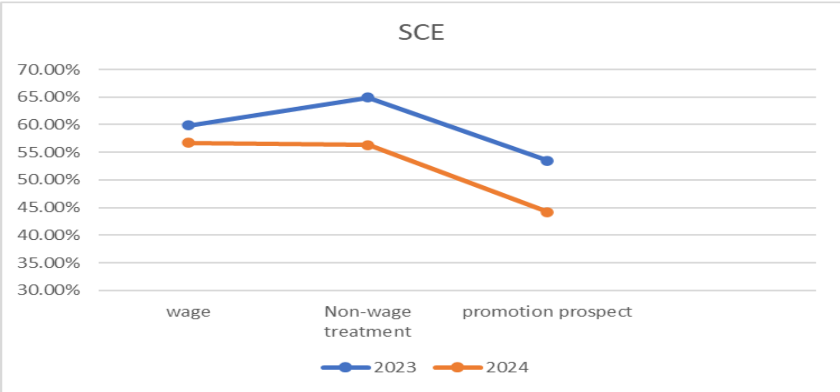

Figure 2. July 2024 Survey of Consumer Expectations Labor Market Survey report [2]

1.2. The relationship between wage levels and inflation

Wages grow faster than prices most of the time, but not always in the figure 3. From 1973 to 1976, wage growth was slower than inflation for 36 months straight. Then, from late 1978 through the end of 1982, real wage growth was negative for 50 consecutive months. This time around, wage growth was lower than the inflation rate for 21 out of 23 months from 2021 through early 2023. This paper currently on a streak of 14 straight months where wages have outpaced inflation [3].

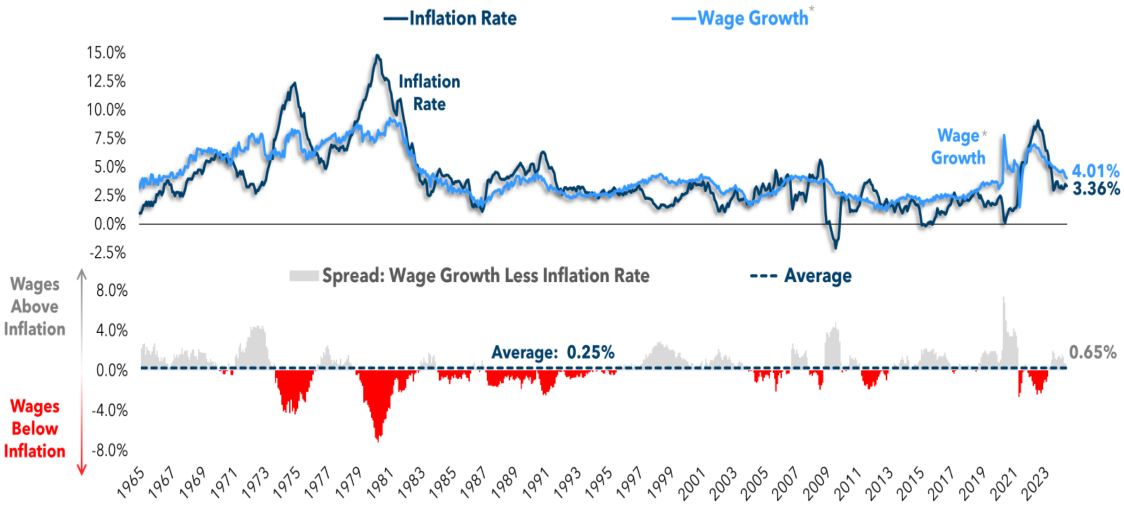

Figure 3. Inflation rate vs wage growth and spread [3]

1.2.1 Personage

Because inflation reduces the purchasing power of money, the real value of the same amount of savings will continue to decrease in an inflationary environment. This reduces individuals' ability to save and accumulate wealth, which in turn affects their investment decisions.

1.2.2 Firm

Inflation leads to higher costs for businesses, including higher costs for raw materials and labor. While companies can also respond to inflation by raising the prices of their products, the elasticity of consumer demand for products can also be affected. Once the purchasing power of consumers decreases and the demand for products decreases, enterprises may face sales difficulties and lower profits. This could lead businesses to reduce investment and expansion plans, with adverse effects on employment.

1.2.3 Market

Moderate inflation can stimulate consumption and investment and promote economic growth. However, the persistence of high inflation could lead to economic contraction and instability. The uncertainty caused by inflation can reduce the confidence of businesses and individuals in the future economy, thus reducing the desire to invest and consume. That could lead to slower economic growth and fewer jobs.

2. Analysis

2.1. The origin of low unemployment

2.1.1 An aging population and a shortage of workers due to the pandemic

Widespread layoffs and bankruptcies have raised concerns about the reliability of the low unemployment rate in the United States. Despite a 243% increase in productivity over recent decades, wages have only risen by 109%, highlighting the emerging trend of "labor hoarding" in the U.S. market. This trend could hinder the Federal Reserve's efforts to reach its inflation target, as an overly tight labor market may drive wages up, potentially triggering a wage-inflation spiral that further elevates prices. Additionally, the aging population in the U.S. is steadily reducing the available labor supply, with the pandemic accelerating the retirement rate—an estimated 2.34 million people retiring due to COVID-19. This trend underscores the negative correlation between labor supply gaps and the unemployment rate, with a persistent decline in the labor force caused by COVID-19 infections and an aging workforce. Shimer, a famous professor at the University of Chicago, also wrote in his book that the answer to why the U.S. unemployment rate is so much lower is that the population is so much older [4]. Consequently, while the reduced labor supply might lower the unemployment denominator, it will continue to exert downward pressure on the unemployment rate overall.

2.1.2 Employment Structure Change

It is undeniable that the epidemic has changed people's working attitudes and habits to a certain extent, resulting in a rapid rise in the number of part-time jobs for non-economic reasons, which has reduced the unemployment rate. The reason for the increase in the number of non-economic factors is that the new coronavirus has led to a decline in physical fitness or a change in attitude towards life, and people generally choose to reduce the length and intensity of work. Second, the supply of jobs is tight, and companies cannot find people willing to work full-time, so they are lowering their standards to recruit people who are only willing to work part-time. Third, high inflation has caused some of the non-labor forces to convert to part-time workers to subsidize the cost of living. Finally, the popularity of "online working" has also led to a sharp drop in the cost of part-time work, which has reduced the number of molecules and thus the unemployment rate.

2.1.3 The Beveridge curve has shifted significantly

The Beveridge curve is a curve that reflects the negative correlation between the job vacancy rate and the unemployment rate in the job market. If the decrease in labor demand leads to a decrease in the job vacancy rate and an increase in the unemployment rate, the change in economic activity moves down along the Beveridge curve, and vice versa. It can be found that since 2008, the Beveridge curve in the United States has begun to slowly shift outward. The pandemic has further boosted the situation, with the outward shift of the curve becoming even more pronounced since 2020, meaning that the number of job vacancies is significantly higher than before at the same level of unemployment. This is structural unemployment, mainly caused by increased demand and inefficient matching of supply and demand for jobs.

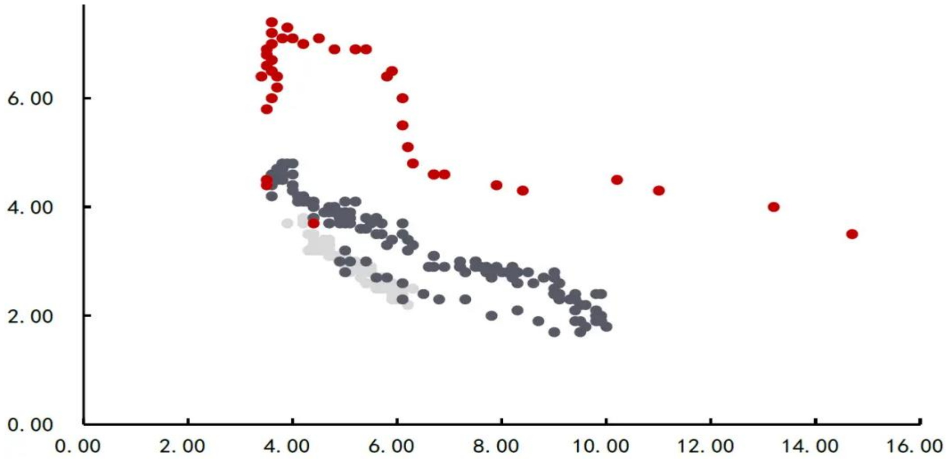

Figure 4. The Beveridge curve from 2000 to 2024 [5]

Although our extensive analysis found that the negative correlation between unemployment and wage growth still exists. But more factors can affect wage growth. So, this relationship may not be considered absolute or necessarily have lasting effects over time. As Aaronson and Sullivan put it, traditional methodology depends upon both the relationship between unemployment and expected wage growth and the relationship between wage growth and price inflation [6]. Of course, considering the many structural changes that may affect the labor market, it is natural to look for changes in the relationship between employment problems and wage growth in the figure 4.

2.2. Slow economic growth

2.2.1 Increase in welfare spending

According to a report by the Pew Research Center, American companies have been increasing their spending on benefits, especially health care. Adjusted for inflation, wages and salaries have increased by 5.3% since 2011, while benefit costs have climbed by 22.5% [7]. In essence, increasing benefits does not improve wages, not only because the proportion of welfare spending in the overall enterprise is small, but also because many employees in the United States only receive basic or minimum income, and do not enjoy their share of so-called "benefits".

2.2.2 Real wages are not rising

Due to the current period of inflation in the United States, the average hourly wage rose 2.8 percent during the same period, the U.S. consumer price Index rose 2.7 percent. This is the equivalent of wage increases being offset by the negative effects of inflation. In other words, people whose incomes have not kept up with inflation have had their cost of living increased out of thin air. It is not difficult to explain that while domestic production has increased in general, people's real purchasing power and quality of life have declined.

2.2.3 The gap between rich and poor is widening

Corporate profits and workers' wages have been rising at similar rates for a long time. But since 2002, corporate profits have grown much faster than workers' wages. Most of a company's profits go to its investors and executives, not to ordinary workers. This has been controversial since the introduction of quantitative easing, which allows savers to earn less interest while debtors can borrow more cheaply, partly exacerbating inequality. According to the Federal Reserve's Survey of Consumer Finances, the top 5 percent of Americans own about two-thirds of assets including stocks, bonds, and funds, the next 45 percent own about a third of those assets, and the bottom 50 percent of Americans own only about 2 percent of those assets in the figure 5 [8].

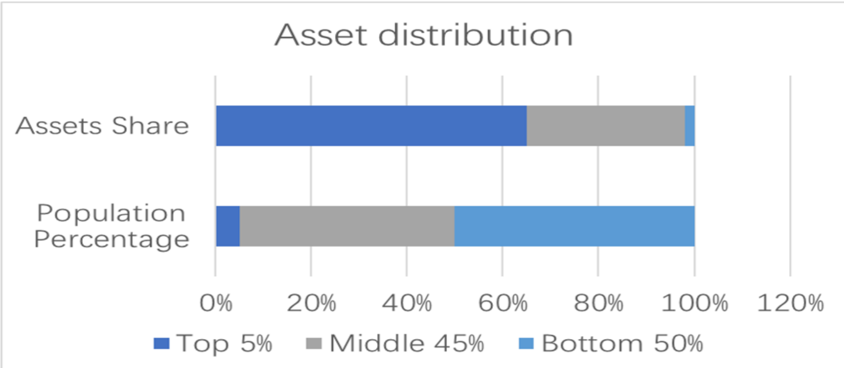

Figure 5. The US Asset distribution [8]

2.2.4 Labor is not scarce

In economic theory, Labor scarcity should force employers to raise wages. With the long-term industrial change and technological progress, the crowding-out effect of capital on labor is becoming more and more obvious. This is also a constraint on the growth of personal income. As can be seen from the chart, the share of American workers' income in gross domestic income fell sharply in 2000, from 65.4 in 1947 to 56.7 in 2016. Since 2000 alone, it has fallen by 76% year-on-year [9]. In addition, Leduc et al. 's previous regression of state unemployment rates using the OLS model has shown that labor market volatility and tightening can slow wage growth in the figure 6 [10].

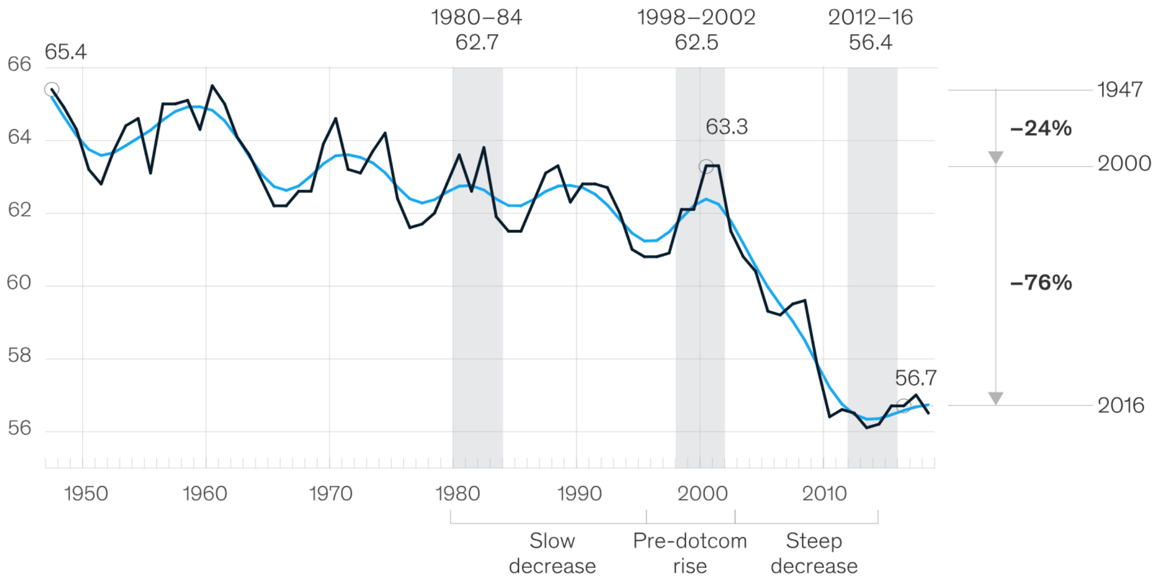

Figure 6. Labor share of nonfarm business sector, total compensation shares of gross value added, % [9]

3. Conclusion

3.1. In short term

The Federal Reserve predicts that the current rise in workers' wages is helping the U.S. economy keep growing at a moderate pace without adding to the inflationary pressures they are trying to suppress. Recent gains in worker productivity have coincided with a reduction in the average hours worked by employees, making it a reason for companies to raise prices, even though it leaves workers with more money to spend. What is sustainable in a modest way is that inflation continues to slow and does not collapse outright in the course of a recession.

But now is not sure whether the progress is slow, most people still on the feed to realize the goal of "soft landing" feel worried. The current US economic downturn is already very severe, and the Fed's September rate cut came too late and was insufficient. That means the Fed may still need to let unemployment rise further for inflation to keep falling.

3.2. In long term

The current monetary policy, economic policy, and international relations of the United States have contributed to long-term inflation in the United States and inhibited long-term economic growth and consumption levels. As an international financial currency, when the United States significantly raises interest rates, the capital of various countries returns to the United States financial market in dollars, forming capital idling. And while the Fed continues to expand the scale of monetary easing, other central banks have followed suit, making the global economic recovery highly dependent on continued easing of monetary liquidity. This has undoubtedly led to a decline in the value of the money market. It eventually led to more intense global trade friction and the rise of trade protectionism. Tensions in global trade cooperation have undoubtedly exacerbated global political conflicts and global inflation.

On the other hand, enterprise development is bound to long-term structural problems. The data show that the continuous rise of the US stock market in the past decade is mainly dominated by seven NASDAQ technology companies, such as Google's parent company, Apple, and Nvidia, while other traditional enterprises, such as traditional manufacturing and traditional service industries, have weak growth. At the same time, the Russell 2000 index of the operating conditions of small and medium-sized enterprises in the United States, the 2023 index EPS only increased by 12.5% compared with 2018, and there was a sharp decline in the first half of 2024. These structural problems indicate that the US economy has not achieved a virtuous circle and the fact that the central decline in the unemployment rate in the United States in the future may be difficult to change. The Fed will also face tougher pressures to push inflation back to 2%.

What's more, in the past year U.S. residents in travel and spending cuts in the auto industry, which also illustrates people's economic situation is not optimistic. Even, the total expenditure of US residents in disposable income accounted for more than 95%, which means that most of the income of US residents must be used in the daily expenditure of necessities and cannot afford more consumer items. The savings rate of households is decreasing, and many households cannot make ends meet. However, domestic consumption is the main driver of the US economy, and the deterioration of consumption will not only affect the future economic growth of the US but also affect equity asset prices and bank risks.

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