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Interest rate hike could halt recovery before it reaches all workers

By Michael Shields

Members of the Federal Reserve committee responsible for setting interest rates should not raise rates at next week's meeting starting June 14. Doing so could hurt job growth and wages at a time when the recovery has not been strong enough to pull in many workers. This was true even before last month's weak national jobs report, and is even more true now.

The committee has kept rates near zero throughout the post-recession period, in part because the recovery has been weak. Last December, the Federal Reserve Bank raised rates by a quarter percent for the first time since the recession. While last month's poor job report makes an immediate increase less likely, The Fed will nonetheless consider doing so again next week. It's not just investors who have a stake in the outcome. When the Fed raises rates, it does so to stem inflation *by slowing the economy.* That translates into slower job growth and weaker bargaining power for workers – in short, fewer job opportunities and lower wages.

Last week's job numbers have almost certainly forestalled a raise in the Federal Funds Rate for June, but the Fed has warned that it may raise rates up to three times this year. Why raise rates at all?

The Federal Reserve is charged with a delicate balancing act of achieving full employment, while keeping inflation at a manageable level. Part of the challenge is that "full employment" itself is an elusive concept; it doesn't mean everyone has a job. Economists categorize unemployment based on its cause, and consider some unemployment natural as workers transition to new jobs. The natural rate of unemployment is also regarded as the lowest rate we can sustain without causing inflation. The trouble is, we don't actually know what that level is.

Low interest rates are meant to boost consumer spending and business investment by making borrowing inexpensive. Both of those create jobs. The trade-off is that low interest rates correlate with inflation.

Officials have cited concerns as recently as this spring that inflation could grow in the future if steps aren't taken early to head it off. However, inflation slowed to near zero last year, and Congressional Budget Office projections don't show it recovering to the target rate of 2 percent before next year. By moving too quickly to head off remote concerns of higher inflation, the Fed could in fact miss the 2 percent target it deems as ideal for price stability and employment for another year.

Central banks don't target zero inflation rates because *deflation,* not inflation, actually poses more serious risks to the economy. Modest price gains drive consumers to buy things they can afford now, and help firms take on debt for new equipment with confidence that rising income will help them to pay those investments off. Both of these things drive growth. That's why moving to slow the economy now – before interest rate targets are even in sight – is both premature and risky.

That slowdown is already being borne out in lower productivity growth in the first quarter and in the weakness of the most recent jobs report. Slow growth is harmful to workers, many of whom remain worse off than they were before the recession.

Ohio workers feel the squeeze - still

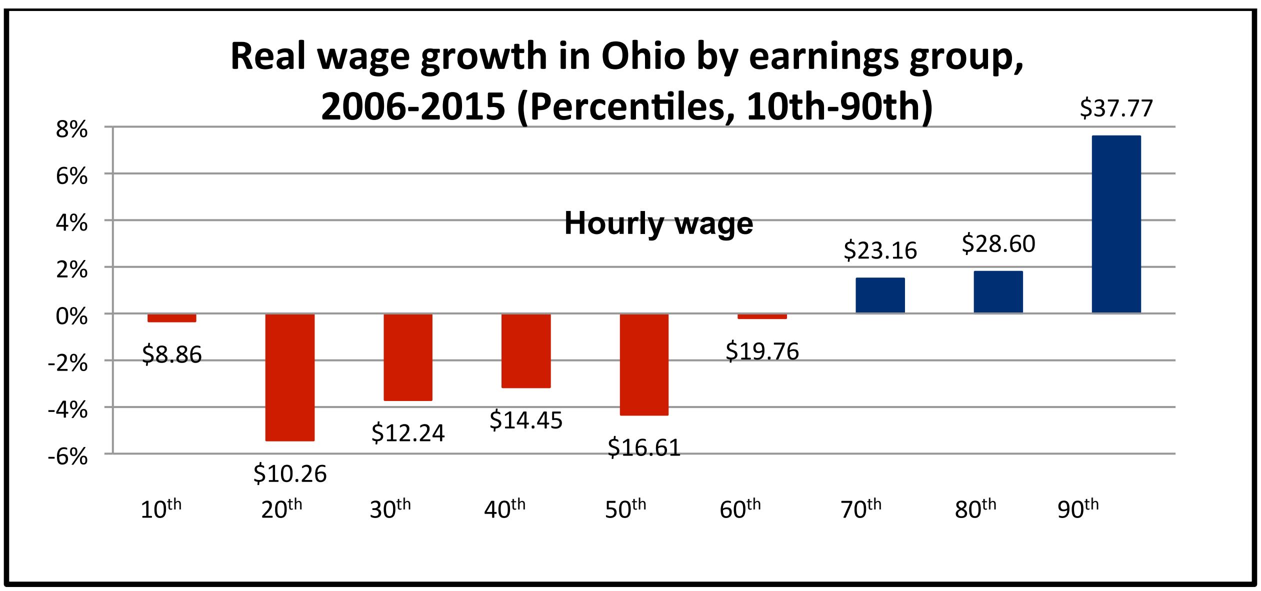
Ohio has added 72,000 jobs in the recovery to date, but just 2,400 from December to April. Although we don't like to draw strong conclusions from one month of data, last month was particularly bad, with a 13,000 job loss, giving the state only a 1.3 percent total job growth over the past year. Ohio consistently lags the nation in growth rate. Signs point to a modest, bumpy and uneven recovery.[1]

Ohio's labor force is still smaller than it was before the start of the recession by 157,000 workers,[2] even before accounting for population growth. Workers have just begun to reenter the labor force consistently over the last seven months. The labor force grew by more than 10,000 for the first time in the recovery this January, and has done so each of the past four months.[3] Ohio's labor market is not demonstrating consistent growth, and boosting interest rates now could derail the progress we are making.

Wages yet to recover

Median wages for Ohio have just begun to recover lost ground from the recession, and remain lower than they were a generation ago. Ohio's median wage hit $16.61 last year, still shy of the $16.67 inflation adjusted wage in 2009. This level is 4.8 percent lower than the $17.44 reached in 1979, and 4.6 percent lower than Ohio's most recent peak in 2000.[4]

In the bigger picture, wages have been falling for workers in the bottom 70 percent for a generation, while total annual income has grown by more than two-thirds in Ohio.[5] Low and middle wage workers also lost ground in the recession, and have yet to recover it. And that only accounts for those who have jobs. The chart below shows the change in wages from 2006 to 2015, broken out by earnings percentile and adjusted for inflation.



[1] Halbert, Hannah, May 20, 2016. http://www.policymattersohio.org/jobwatch-april2016
[2] Ibid.
[3] http://data.bls.gov/timeseries/LASST390000000000003?data_tool=XGtable, extracted April 29, 2016.
[4] Economic Policy Institute analysis of data from Current Population Survey, 1979-2015
[5] Hanauer, Amy, September 6, 2015, http://www.policymattersohio.org/sowo-aug2015

Expansionary policy from the Federal Reserve is a vital step – but only the first step - needed to encourage growth, increase labor demand, and enable workers to bargain for higher wages. Without sustained job growth, not only will some workers be left unemployed, but wages will remain low, and wage earners and the communities they live in will be left out of the recovery.

Left out

For some workers, unemployment remains devastatingly high. African Americans faced 10.9 percent unemployment through 2015: a figure that nearly matched the 11 percent peak unemployment rate for all workers during the recession.[6] Raising interest rates to slow the economic recovery harms these workers, who still face conditions similar to what the typical Ohio worker experienced during the worst months of the recession.

Likewise, wages for African American workers are down more than $1 per hour compared with the early 2000's. As of 2015, black workers earned just 76 cents on the dollar compared with white workers, down from 85 cents in 2006. Median wages have not fully recovered for white workers either.[7]

Because weak labor markets disproportionately harm some communities, the Fed should aggressively target full employment. The committee should weigh the known damage of suppressing labor demand heavily against the hypothetical risk of triggering spikes in inflation. The sluggish recovery indicates that fast inflation is unlikely. In fact, as the Economic Policy Institute's Josh Bivens explains, higher price growth for a few years might actually help both workers and the economy. Price increases give workers more bargaining power by making raises easier for firms to afford, boosting demand which encourages increased production, and encouraging hiring, which takes slack out of the labor market. With these factors in mind, the Fed should work to push unemployment levels as low as possible until inflation becomes much more of a reality.

[6] http://www.bls.gov/opub/ted/2016/unemployment-rates-for-african-americans-by-state-in-2015.htm, http://data.bls.gov/timeseries/LASST390000000000003?data_tool=XGtable, extracted April 29, 2016.
[7] Economic Policy Institute analysis of Current Population Survey data, 2015, to be published in forthcoming Policy Matters *State of Working Ohio 2016.*