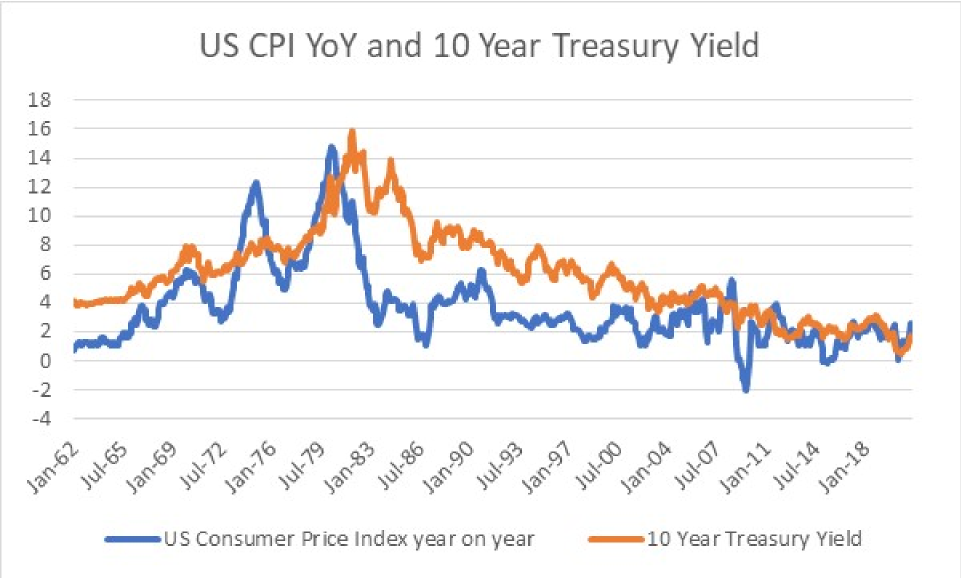
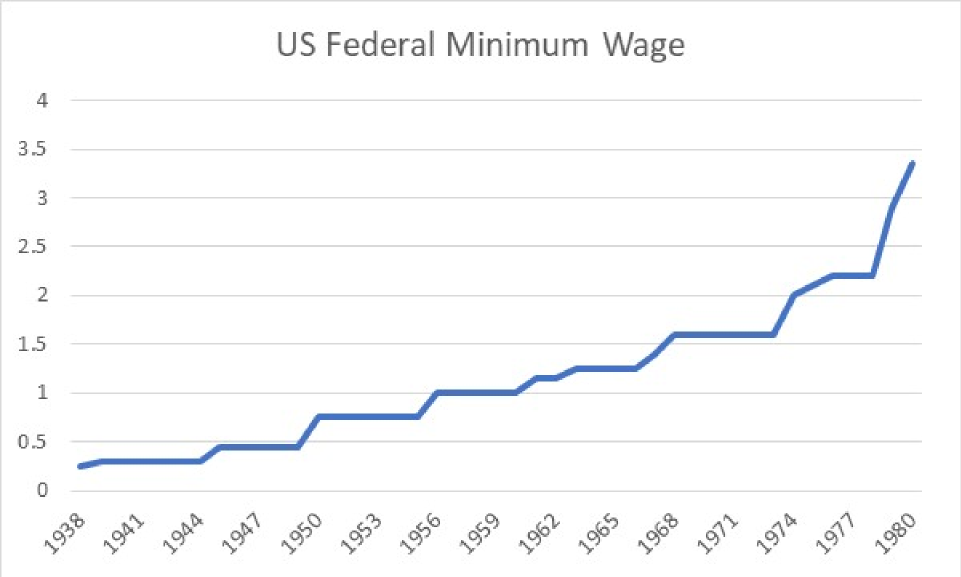
WAGE INFLATION

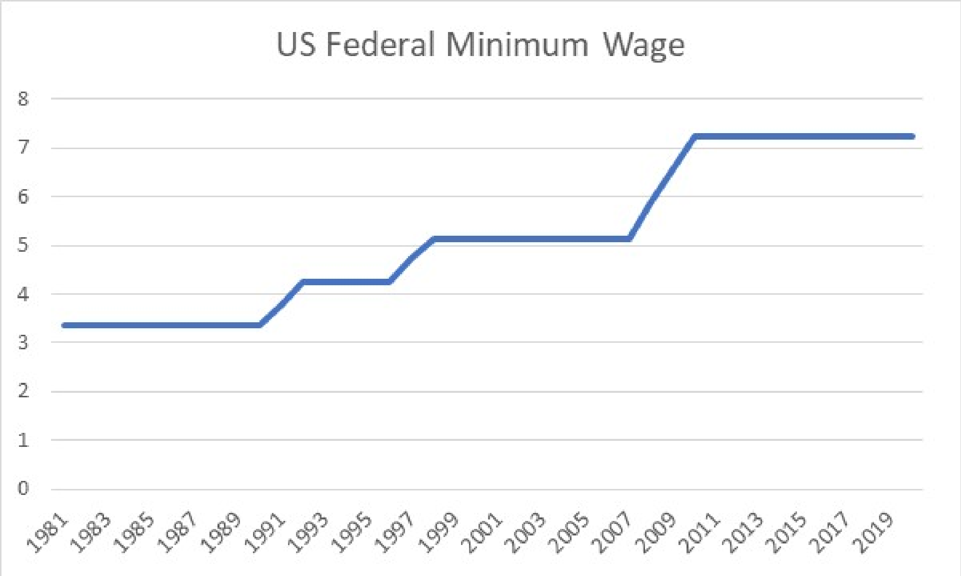
The post-World War II period can be divided into two distinct periods in financial markets. The first is from the end of the Second World War until 1980, inflation and bond yields rose to levels never seen outside of war time, and the second is from the 1980s onwards, where inflation and bond yields have fallen to levels never seen outside of the depression era.



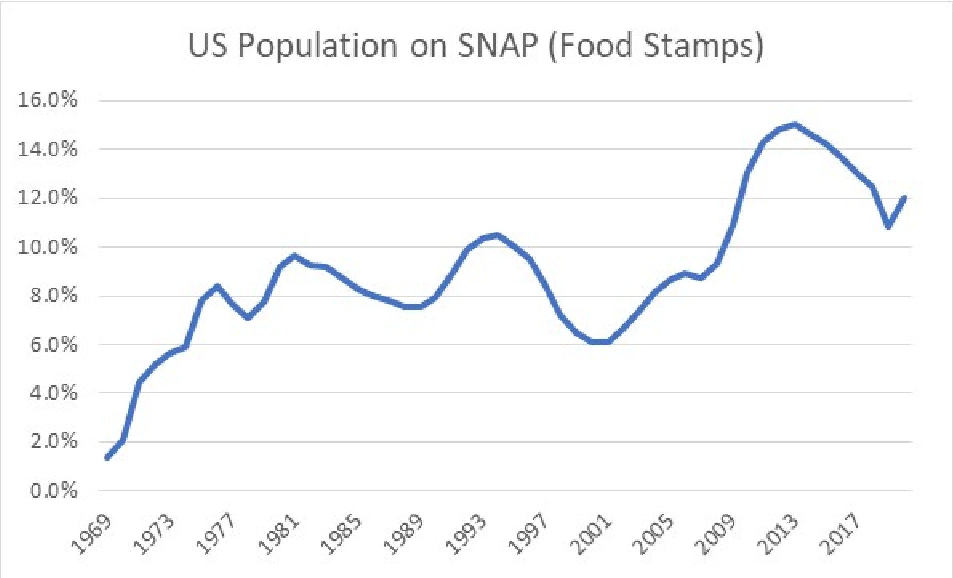
Many different reasons are given for the difference between the 1940s to 1970s period and the 1980s onwards. These reasons include the OPEC oil shock of the 1970s, the Nixon shock when the link between the US dollar and gold was severed, central bank independence and changing economic theory. All these theories have been disproved in recent years, because post 2000 a commodity boom came and went. US fiscal deficits have exploded, and central banks make no attempt at restraining money supply and actively invited inflation. But perhaps wage inflation is the only inflation that counts? Looking at the US, the Federal minimum wage rose over 1300% from 1938 to 1979.



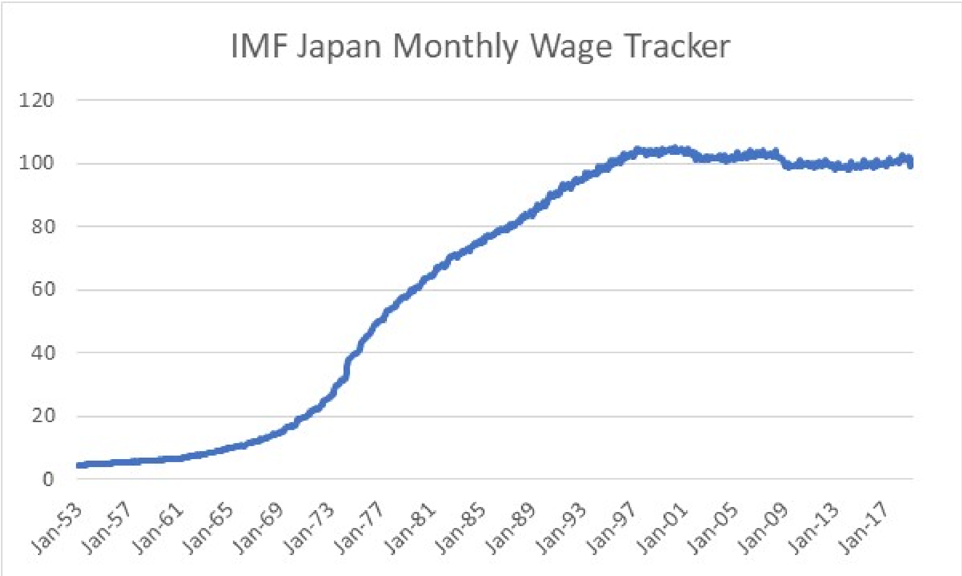
However, from the 1980s onwards, the minimum wage has barely doubled.



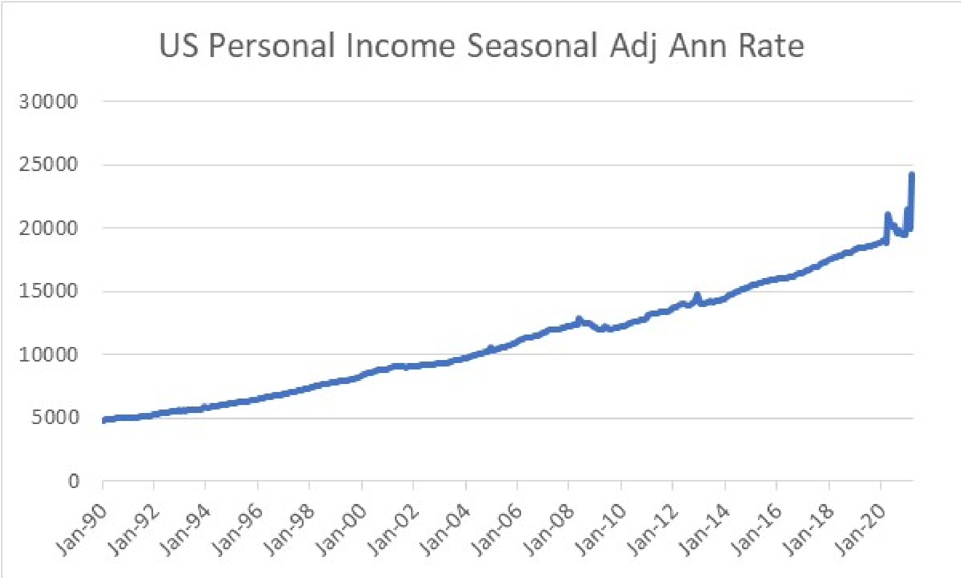
It is not hard to understand why generalised inflation would be very low in an era when there is little wage inflation. Asset inflation is also very different to wage inflation, as asset price can (or used to?) fall, whereas wage levels cannot fall easily (although workers can move from high paying to low paying jobs). In recent years, the percentage of Americans on food stamps has been rising, suggesting that the number of workers on very low pay has been rising.



The logic of wage inflation and bond yields is quite compelling. If you are buying a 30-year bond, you don't even know what product you might want to buy when that bond comes due. However, assuming we don't reach the singularity before then, you can be fairly sure you will need to hire a person to do "something". A time travelling Japanese person from 1994 would be shocked to find it still costs the same number of yen to hire someone to do something today.



This line of thinking changes the mystery of low inflation and low bond yields from a financial conundrum to a political conundrum. Contrary to widespread belief in the 1970s and 1980s that democracies with widespread enfranchisement would see political parties compete to see who could give workers more money, the last twenty to thirty years have seen political parties fight to who could be more accommodating to corporates. While politically, there are few politicians openly calling for higher wages, the US response to the pandemic suggests emphasising rising wages has become an unofficial policy.



If politics is moving to favour labour over capital, then current bond investors are looking at substantial losses in real terms.

INFORMATION

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