

If Inflation Is the Problem, Why Aren't Wages?

Macro Signposts highlights takeaways from the data analysis conducted by our team of economists and other experts.



Tiffany Wilding

9/2/2026 | 5 min read

Kevin Warsh's Jackson Hole speech struck a decidedly hawkish tone and was arguably the clearest signal yet that the Federal Reserve is actively considering additional tightening. Markets responded by raising the probability of a September hike to roughly 60% and pricing approximately 60 basis points of cumulative tightening through the middle of next year.

The speech did three things simultaneously.

1. Re-established 2% Personal Consumption Expenditures (PCE) as the operative inflation target and observed that across a range of underlying

PIMCO United States

Change Your Location 

Tell us a little about you to help us personalize the site to your needs.



Financial Advisor

I'm a broker dealer, registered investment advisor, or a trust or bank financial professional. I'm looking for investments for my clients along with timely insights.



Institutional Investor

I'm an institutional investor looking to review investment strategies, timely insights and connect with my PIMCO relationship management team.



Individual Investor

I'm an individual investor looking for investment solutions for myself along with timely insights from the PIMCO team.

Accept

If the committee hikes, it will be because they want to lean against the *risk* that inflation expectations will drift higher as progress on reducing inflation has been slow.

That risk hinges on a specific mechanism: Inflation expectations increase labor costs, which in turn feed through to prices. We think the risk is relatively low. While elevated demand for scarce workers may be impacting certain small segments of the economy, we think structural factors are putting downward pressure on wages (see *Macro Signpost*, "[Counterintuitive Labor Market Shifts Constrain Measured U.S. Wage Gains](#)"). Nevertheless, the policy decision will come down to a collective judgement call.

Is the labor market actually the problem?

A useful starting point for assessing labor market dynamics and inflation risks is what economists refer to as the unit labor cost (ULC) identity. Specifically, it says nominal wage growth equals price inflation, plus productivity growth, plus any change in labor’s share of income. Equivalently, unit labor costs – wage growth net of productivity growth – equals price inflation *only when* labor’s share is stable. When labor’s share is falling, ULC growth runs below inflation; when labor’s share is rising, ULC growth runs above it. This is the standard proxy for real marginal cost in the New Keynesian Phillips curve (Gertler and Galí, 1999), and it is the reason the Fed has historically treated ULC trends as one of the more reliable

indicators of transmission from the labor market to underlying inflation (see Figure 1). (For more on ULC, read Rich Clarida’s “[The Key Inflation Signal for Investors.](#)”)

Figure 1: Core inflation has risen recently, while unit labor cost has declined

PIMCO United States



Tell us a little about you to help us personalize the site to your needs.

	Financial Advisor	I'm a broker dealer, registered investment advisor, or a trust or bank financial professional. I'm looking for investments for my clients along with timely insights.
	Institutional Investor	I'm an institutional investor looking to review investment strategies, timely insights and connect with my PIMCO relationship management team.
	Individual Investor	I'm an individual investor looking for investment solutions for myself along with timely insights from the PIMCO team.

Figure 2: Profits are soaring, while labor's share of national income declines

PIMCO United States

Tell us a little about you to help us personalize the site to your needs.

Financial Advisor

I'm a broker dealer, registered investment advisor, or a trust or bank financial professional. I'm looking for investments for my clients along with timely insights.

Institutional Investor

I'm an institutional investor looking to review investment strategies, timely insights and connect with my PIMCO relationship management team.

Individual Investor

I'm an individual investor looking for investment solutions for myself along with timely insights from the PIMCO team.

3. *Cost-side margin compression from rising non-labor costs.* Margins could also compress because tariffs, energy, power, chips, and depreciation on a rapidly built-out capital stock raise input costs, independent of both wages and aggregate demand. This is effectively a supply shock in that it is potentially inflationary for goods and services tied to trade and artificial intelligence (AI) infrastructure in the near term. However, higher inflation weighs on real incomes, and demand eventually fades. Standard doctrine is to look through shocks of this kind unless they threaten to de-anchor expectations, since tightening does little to resolve an input-cost problem and only adds unnecessary drag on already cooling demand.

Only the first scenario implies the kind of labor-cost-driven inflation persistence that monetary policy needs to guard against. Neither of the other two scenarios points to labor-driven inflation persistence – the second because it's a disinflationary negative demand shock, and the third because it doesn't touch labor costs at all.

We see the wage-catchup scenario as the least likely at least in the near-term as unionization remains weak, higher profits remain concentrated in tech company earnings, and AI adoption is a substitute for, not a complement to, a broad range of tasks, which should if anything continue to weigh on labor's bargaining power rather than restore it. Inflation should cool, as input-cost inflation fades.

Bottom line

We still expect core inflation to moderate over the coming months. The current pace of core PCE inflation is an outlier and will likely be revised down, while the labor market is not a source of inflationary pressure. Labor bargaining power, as measured by labor's share of income, has been falling for several years and just hit a record low, raising real questions about whether workers are in a position to negotiate higher wages, let alone drive wage-price induced inflation persistence. We aren't convinced that the FOMC, by hiking rates, needs to create more slack in the economy – certainly not in the labor market, which by this metric isn't generating the inflation problem in the first place. As a result, a patient approach still seems warranted to us, especially as the latest data are encouraging.

Nevertheless, public comments from various FOMC officials, including more recently Warsh, suggests that the central bank may be more eager to manage the risk that inflation more persistently remains above target as workers are eventually able to negotiate catch-up wage adjustments after recent real income drag. Like most things, this is a judgement call. And after years of above target inflation, the FOMC could judge that hiking to ensure inflation expectations remain anchored is the best approach in meeting their long-run inflation goal.

Did you find this insight helpful?

PIMCO United States



Tell us a little about you to help us personalize the site to your needs.

	Financial Advisor	I'm a broker dealer, registered investment advisor, or a trust or bank financial professional. I'm looking for investments for my clients along with timely insights.
	Institutional Investor	I'm an institutional investor looking to review investment strategies, timely insights and connect with my PIMCO relationship management team.
	Individual Investor	I'm an individual investor looking for investment solutions for myself along with timely insights from the PIMCO team.

First Name: *

Last Name: *

Email Address: *

Company Name: *

This site is protected by reCAPTCHA.

Submit

More To Know

MACRO SIGNPOSTS



MS

Disclosures —

A word about risk: All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise. Many investors seek to diversify their portfolios with fixed-income investments to reduce overall portfolio volatility. Bond funds do not have the same level of risk as individual bonds, but they still carry some risk. Bond funds are subject to the same risks as the securities they hold. Be aware of the particular risks associated with the fund's investment strategy. Read the prospectus carefully before investing.

PIMCO United States



Tell us a little about you to help us personalize the site to your needs.

Financial
Advisor

I'm a broker dealer, registered investment advisor, or a trust or bank financial professional. I'm looking for investments for my clients along with timely insights.



Institutional Investor

I'm an institutional investor looking to review investment strategies, timely insights and connect with my PIMCO relationship management team.



Individual Investor

I'm an individual investor looking for investment solutions for myself along with timely insights from the PIMCO team.