

# Why Inflation Hurts More Now Than 30 Years Ago

WASHINGTON (AP) — Inflation spooked the nation in the early 1980s. It surged and kept rising until it topped 13 percent.

These days, inflation is much lower. Yet to many Americans, it feels worse now. And for a good reason: Their income has been even flatter than inflation.

Back in the '80's, the money people made typically more than made up for high inflation. In 1981, banks would pay nearly 16 percent on a six-month CD. And workers typically got pay raises to match their higher living costs.

No more.

Over the 12 months that ended in February, consumer prices increased just 2.1 percent. Yet wages for many people have risen even less — if they're not actually frozen.

Social Security recipients have gone two straight years with no increase in benefits. Money market rates? You need a magnifying glass to find them.

That's why even moderate inflation hurts more now. And it's why if food and gas prices lift inflation even slightly above current rates, consumer spending could weaken and slow the economy.

"It feels far more painful now than in the '80s," says Judy Bates, who lives near Birmingham, Ala. "Money in the bank was growing like crazy because interest rates were high. My husband had a union job at a steel company and was getting cost-of-living raises and working overtime galore."

Bates, 58, makes her living writing and speaking about how people can stretch their dollars. Her husband, 61, is retired. They've paid off their mortgage and have no car payments. But they're facing higher prices for food, gas, utilities, insurance and health care, while fetching measly returns on their savings.

"You want to weep," Bates says.

Consumer inflation did pick up in February, rising 0.5 percent, because of costlier food and gas. Still, looked at over the past 12 months, price increases have remained low. Problem is, these days any inflation tends to hurt.

Not that everyone has been squeezed the same. It depends on personal circumstances. Some families with low expenses or generous pay increases have been little affected.

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Others who are heavy users of items whose prices have jumped — tuition, medical care, gasoline — have been hurt badly. But almost everyone is being pinched because nationally, income has stagnated.

The median U.S. inflation-adjusted household income — wages and investment income — fell to \$49,777 in 2009, the most recent year for which figures are available, the Census Bureau says. That was 0.7 percent less than in 2008.

Incomes probably dipped last year to \$49,650, estimates Lynn Reaser, chief economist at Point Loma Nazarene University in San Diego and a board member of the National Association for Business Economics. That would mark a 0.3 percent drop from 2009. And incomes are likely to fall again this year — to \$49,300, she says.

Significant pay raises are rare during periods of high unemployment because workers have little bargaining power to demand them.

They surely aren't making it up at the bank. Last year, the average nationwide rate on a six-month CD was 0.44 percent. The rate on a money market account was even lower: 0.21 percent.

Now go back three decades, a time of galloping inflation, interest rates and bond yields. When Paul Volcker took over the Federal Reserve in 1979, consumer inflation was 13.3 percent, the highest since 1946. To shrink inflation, Volcker raised interest rates to levels not seen since the Civil War.

As interest rates soared, CD and money-market rates did, too. The average rate on money market accounts topped 9 percent. Treasury yields surged, pushing up rates on consumer and business loans. The 10-year Treasury note yielded more than 13 percent; today, it's 3.5 percent.

By 1984, consumers were enjoying a sweet spot: Lower prices but rising incomes and still-historically high rates on CDs and other savings investments. Consumer inflation had slid to 3.9 percent. Yet you could still get 10.7 percent on a six-month CD.

Even after accounting for inflation, the median income rose 3.1 percent from 1983 to 1984. At the time, workers were demanding — and receiving — higher wages.

More than 20 percent of U.S. workers belonged to a union in 1983. Labor contracts typically provided cost-of-living adjustments tied to inflation. And competition for workers meant those union pay increases helped push up income for non-union workers, too.

Last year, just 12 percent of U.S. workers belonged to unions. And among union members, a majority now work for the government, not private companies. Wages of government workers are under assault as state governments and the federal government seek to cut spending and narrow gaping budget deficits.

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Workers' average weekly wages, adjusted for inflation, fell in February to \$351.89. It was the third drop in four months.

The result is that even historically low inflation feels high. So "when you mention low inflation to real people on the street, they immediately roll their eyes," says Greg McBride, senior financial analyst at Bankrate.com.

Falling behind inflation is something many people hadn't experienced much in their working careers until now. In the 1990s and 2000s, for instance, most Americans kept ahead of rising prices. Inflation averaged under 3 percent.

And inflation-adjusted incomes rose steadily from 1994 to 1999. Once the 2001 recession hit, incomes did falter. But after that, they resumed their growth, rising each year until the most recent recession hit in December 2007.

Rates on six-month CDs were also much higher than they are now: They averaged 5.4 percent from 1990 to 1999 and 3.3 percent from 2000 to 2009.

These days, though, Americans face the certainty of higher prices ahead.

Whirlpool, Kraft, McDonald's, Clorox, Kellogg, and clothing companies such as Wrangler jeans maker VF Corp., J.C. Penney Co., and Nike say they plan to raise prices. Whirlpool, which makes Maytag and KitchenAid appliances, says it's raising prices in response to higher raw material costs.

Kellogg, which makes Frosted Flakes and Pop Tarts, is increasing prices on some products to offset costlier ingredients. Kellogg is responding to soaring costs for commodities including wheat, corn, sugar, cotton, beef and pork.

Vickens Moscova, a self-employed marketer in Elizabeth, N.J., says he's paying more for staples like cereal, bread, eggs and public transportation. Yet he's making little from his savings.

"It is a huge pinch," says Moscova, 25.

Though higher gasoline and food prices may lift the inflation rate in coming months, the Fed says it doesn't think inflation will pose a long-term threat to the economy. The central bank projects that inflation won't exceed 1.7 percent this year.

But if oil prices, now around \$101 a barrel, were to go much higher, economists say heavier fuel bills would cause people and consumers to cut back spending on cars, appliances and other items.

Another recession would be possible if prices began to approach \$150 a barrel. Back in 1983, a barrel of oil cost just \$29.40 — or \$65 in today's prices, adjusted for inflation.

All that said, today's consumers are fortunate that today's lower rates mean one major household cost remains far lower than in the 1980s: a mortgage.

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Thanks, in part, to the Fed's efforts to push down loan rates starting with the financial crisis, the average rate on a 30 year fixed mortgage is below 5 percent.

The comparable rate in 1981? 18 percent.

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