https://www.wsj.com/economy/inflation-is-down-to-3-why-that-isnt-good-enough-884c1136

Inflation Is Down to 3%. Why That Isn't Good Enough.

Even inflation this low could feed consumer frustration, workplace friction and an inflationary psychology

By Matt Grossman Follow

Feb. 2, 2025 at 7:30 am ET

How much harm inflation causes turns on mass psychology. PHOTO: SPENCER PLATT/GETTY IMAGES

Inflation finished 2024 at 2.9%, a vast improvement over the 9% peak hit in June 2022. Using the Federal Reserve's preferred gauge, inflation was 2.6% in December, not far from the central bank's 2% target and well below the 7.2% it reached in 2022.

So is the anger over high prices that left Americans seething and helped return President Trump to the White House now finished?

Don't bet on it.

The difference between 2% and 3% might not seem large. Yet it could matter quite a lot. That's because how much harm inflation causes turns on mass psychology. People aggrieved by sticker shock are likelier to press for a big raise, which might push employers to raise prices further. Shoppers speed up their purchases to get ahead of price increases, which further lifts prices.

That logic backed former Fed Chairman Alan Greenspan's intuition that price stability is achieved when inflation doesn't affect how people behave.

A clutch of research has shown that anxiety about inflation spikes once it passes 4% a year, said Tara Sinclair, a former Biden Treasury official. On the way back down, the Fed probably needs to get it definitively back to 2% to soothe the rage—especially given that the bank has put its name behind that target, she said.

"Is 3% the same as 2% when we're coming down from above? It's pretty clear that it's not," Sinclair said. "From the Fed's credibility standpoint, they will really need to stick the landing."

Alan Greenspan, a former Federal Reserve chairman, in 1987. PHOTO: BETTMANN ARCHIVE/GETTY IMAGES

That might still take a while. In December, the Fed projected it will get inflation only part of the way back to 2% by the end of 2025. Last month, New York Fed President John Williams said he expects inflation to fall to 2% "in the coming years."

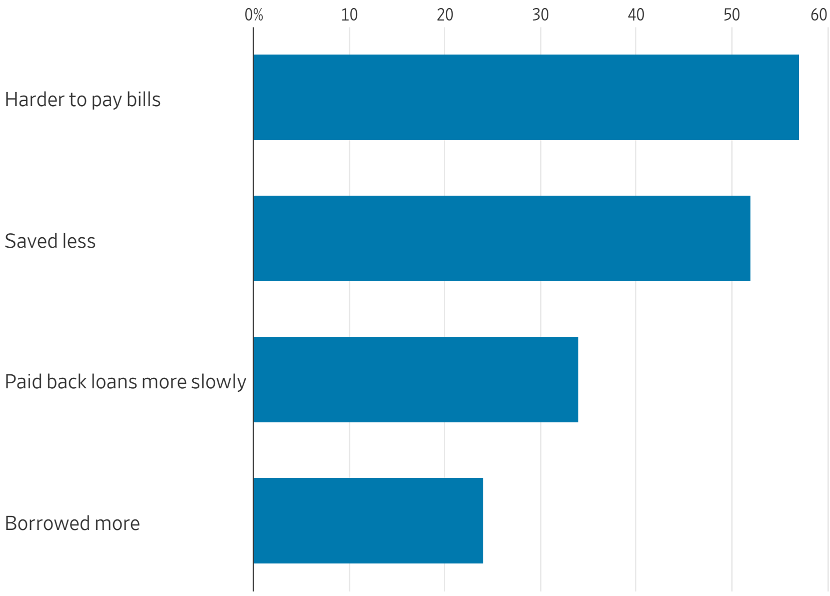
After cutting interest rates at its previous three meetings, the Fed kept rates stable this past week. “We know that reducing policy restraint too fast or too much could hinder progress on inflation,” Fed Chair Jerome Powell said. He also said that when the Fed reviews its monetary framework this year—an exercise that occurs every five years—the 2% target won’t be up for debate.

If today’s inflation is still not low enough for the public, that poses a particular challenge to Trump because some of his policies, such as tariffs, could slow or even halt the descent of inflation. The Peterson Institute for International Economics has projected that 25% tariffs on Canada and Mexico and a 10% tariff on China could boost U.S. inflation by about half a percentage point in 2025 and by a quarter point in 2026. That is close to the policy Trump announced Saturday, though his plan applies a lower tariff to Canadian energy imports.

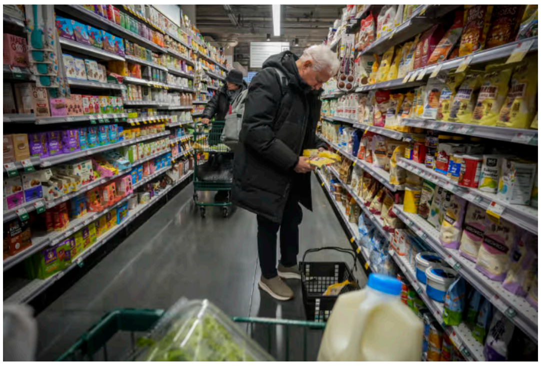
Last week, Trump also threatened tariffs on products such as oil and gas, computer chips and pharmaceuticals from other countries as soon as mid-February.

In the University of Michigan’s latest monthly survey, the median expectation of consumers is for 3.3% inflation this year, up from 2.8% expected in December. Tariffs are the prime source of anxiety, survey director Joanne Hsu said.

Consumer poll: What were the effects of inflation?



Source: Stefanie Stantcheva, Harvard University



Inflation makes people feel that they are falling behind. PHOTO: RICHARD B. LEVINE/ZUMA PRESS

Anticipating the public’s reaction is tricky, not least because economists still argue about why people hate inflation so much in the first place. In textbook models and in many real-world instances—including during the 2020s—wages tend to catch up to prices, so inflation doesn’t, over time, erode the purchasing power of the average worker’s paycheck.

Even so, inflation makes people feel that they are falling behind, a finding laid out in detail by Nobel Prize-winning economist Robert Shiller in 1997. Harvard economist Stefanie Stantcheva found similar frustration when she polled Americans about post-Covid inflation a year ago.

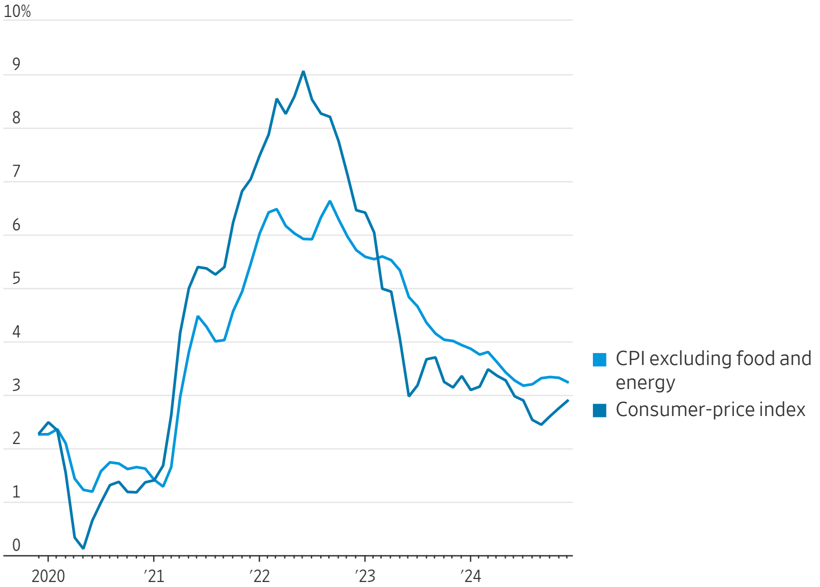
“People dislike inflation for a simple reason: They think it erodes their living standard,” Stantcheva said.

For some workers, this is true. While wages on average may stay ahead of inflation, some people’s don’t. Or wages may take months or years to catch up. Yet researchers find that even those who do get raises resent rising prices for eroding a hard-earned higher salary.

“They’ll blame inflation on the government, but when you ask them why their wages are rising, they’ll ascribe it to themselves,” said Jón

Steinsson, a University of California, Berkeley economist.

12-month inflation rate



Source: Labor Department

Other researchers are peering deeper into the consumer psyche. Backed by fresh surveys, economist Joao Guerreiro of the University of California, Los Angeles, and three co-authors suggest people really hate inflation because getting a matching raise at work doesn't happen automatically. Instead, workers often have to ask for it.

That means steeling yourself for a negotiation, risking the boss's ire and sometimes going to the trouble of getting a competing job offer from another company. Union workers might have to go on strike, which is stressful. Guerreiro and his co-authors think that these hurdles are what inflation-haters really despise—so much that many would rather take a small pay cut than do something about it.

If they are right, 2025 might not feel much better for consumers. Although inflation has cooled substantially, so has the labor market.

There are now about half as many job openings per job seeker as during early 2022. It is taking more workers months, not weeks, to secure another offer for negotiating leverage. Fewer managers will be feeling generous.

"When the labor market is hotter, the employer may even try to prevent you from leaving with a pre-emptive wage increase," Guerreiro said. "In a cooler labor market, that's going to be less frequent."

Write to Matt Grossman at matt.grossman@wsj.com

Videos