GM & Inflation

If you can wait and not be tired by waiting ...
Rudyard Kipling

News & Waves

The way I proceed, as an economist is very much unlike a journalist. Like the latter, I observe on a daily basis the facts of the economic life, which are instantaneously projected on various media screens such as Bloomberg, Reuters.
Like the incoming waves on the beach, I have mostly nothing to comment about any of them. Journalists do.

Tip of the Iceberg

But sometimes, one of these news surprises me. It is as if I had suddenly seen an iceberg drifting by. And here comes my thinking along with my in-depth research. Is there much below that iceberg - aka that unusual piece of news?

Research

Am I able to unearth a theory that would explain 90% of what I see floating by? If not, I ignore it and get back to monitoring. But if on the contrary I can find a specific rationale for that totally unexpected news, there I began building an economic scenario. When I have to choose among several theories, there can I rely on my educational training as an economist.

GM

Let me reveal it though an example how this discipline process works. Of late, GM in the United States just let go 14’000 of its employees, mind you at a time when demand for the automobile industry remained quite healthy if not strong worldwide. That piece of news also threw off President Trump, who abundantly «Twitter(ed) » back, as a result. It also rung a bell in my head because I wonder how was it possible that such a huge company could be taken on the wrong foot and finally be coerced to take such a dramatic anti-social management decision?

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Theory

For millions of firms throughout the world, the rule of the game in a competitive environment is to maximize profits. In theoretical terms it means for each firm to find the widest difference in their profit function, namely,

$$\underset{\text{(profits)}}{\Pi} = \underset{\text{(Revenue)}}{P*Q} - \underset{\text{(Labor Cost)}}{w*L}$$

Microeconomics, not Macroeconomics, teaches us that it is found when a so-called first-order condition is met, that is when…

$$L' = w/P$$

…or equivalently when the marginal productivity of Labor (L') is equal to the average real wage within the firm (w/P).

Facts

Back to facts, (w)ages have been increasing at a clip of 5% within the United-States in the course of 2018. Hence, unless net investment had increased by the same token a lot of U.S. firms were not anymore maximizing profits at the end of it. In the case of GM, the lack of pre-emptive investments most probably caused a huge gap between productivity and real wage so that only a sharp reduction in the labor force could help restoring productivity and profit margins. But for most U.S. firms, which have not been surprised by wage gains, the restoration of both are more likely to entail a rise in their selling price (P) quarter after quarter.

Micro vs. Macro

My hereto methodology leads me to conclude that inflation in the United-States will be supply-side driven in the course of 2019 and beyond. This cost-push inflation will be taking place in a hostile environment to inflation since:

- Any growth rate above normal capacity utilization (2%) translates into squeezing the labor market. Growth being expected to score 2.3% in 2019, wage growth will extend its longest uptrend (120M).
- The so-called NAIRU level was reached when unemployment dropped below 4%. Only wage increases can henceforth maintain the labor force in place.
- The deflationary impact of Chinese imported goods into the U.S. is being toned down by excessive tariffs.

Oil

At $40, a barrel, oil currently prevents inflation to shoot up. At $70 a barrel, its deflationary impact will be bygone.

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