Labour markets will avoid a wage-price spiral

Central banks are watching second-round wage effects from the Gulf shock, but modern labour markets mute that channel

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The near-closure of the Strait of Hormuz continues to disrupt Gulf oil flows.

Union members march at Labor Day parade in Boston on September 7, 2026 (Joseph Prezioso/AFP/Getty Images)

As households face costlier fuel, an old fear has returned in markets and official institutions: that this cost-of-living squeeze will trigger catch-up wage demands and a wage-price spiral. The IMF has warned that firms and workers may try to recoup losses from the war-driven commodity shock, “risking wage-price spirals”.

What next

Oil prices will remain sensitive to military activity, insurance costs and reliability of shipping routes, and headline inflation and real incomes will feel the first-round hit for some time, but nominal wage growth is unlikely to re-accelerate. In more unionised economies, or sectors with indexed contracts, the spiral risk is higher. For US-style private employment, it is modest. Wage pressure will remain concentrated where hiring is hard, not where oil prices have risen.

Subsidiary impacts

- For business, energy costs will squeeze margins and household purchasing power more than they will force broad pay rises.
- The wage channel for broadening inflation is weaker than union-era models imply, and wages are unlikely to follow oil higher.
- For investors, the key indicator for persistent wage inflation is labour-market tightness.

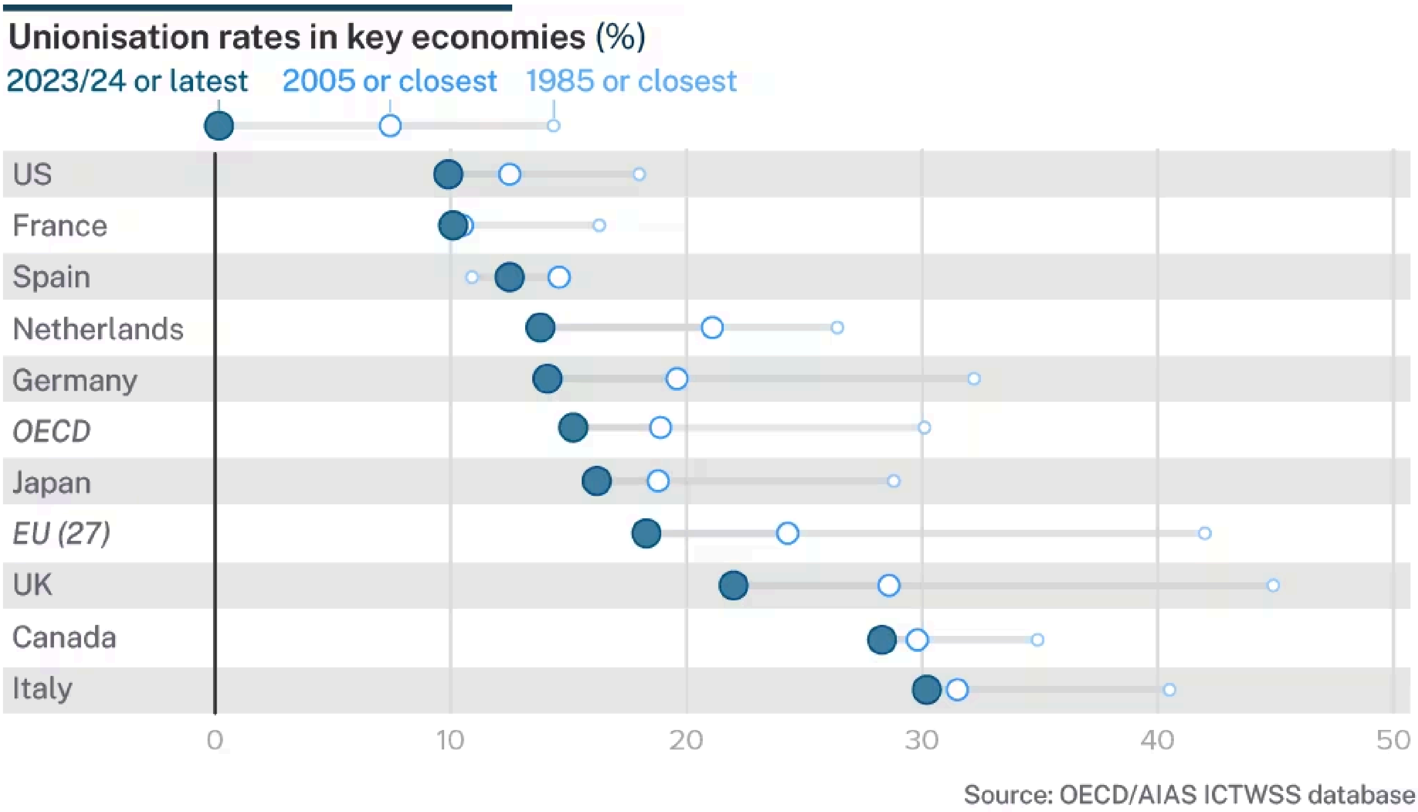
Analysis

Concerns about a wage-price spiral are not confined to market investors. ECB President Christine Lagarde said in March that the key task was to judge when higher energy costs spill into broader inflation through “second-round effects via wages and inflation expectations,” and has flagged the risk of “tit-for-tat” inflation between firms and workers.

> Global concern about a wage-price spiral is rising

The Bank of England (BoE)'s scenario work similarly focuses on whether wage- and price-setting behaviour outlasts an original oil shock. For most advanced economies today, especially the US, this anxiety is largely misplaced.

The last wage-price spiral of the 1970s was driven by labour-market institutions that have since faded. Union coverage was high, and many contracts included automatic cost-of-living adjustments. Wages were often bargained rather than posted.



In the US, only about one in ten workers is now unionised, and firm wage posting — take it-or-leave-it offers, rather than continuous renegotiation — is the dominant way pay is set.

When firms set wages and employed workers actively search for better jobs, a pure rise in the cost of living does little to force nominal wages higher. Real pay falls, but generalised wage inflation does not follow.

From Hormuz to wages

The current shock is a cost-of-living disturbance. Closure of shipping through Hormuz raises the landed cost of energy without raising the productivity of most workers.

In a wage-price spiral, when prices rise, workers reclaim purchasing power through higher nominal pay, which then feeds into higher prices again.

That mechanism is natural if unions bargain over real wages or if contracts index wages to inflation. However, most firms set wages and raise them when they need to fill vacancies faster or stop workers from leaving. After an energy shock, the key question for firms is not whether living costs have risen, but whether it will become harder to recruit or retain workers.

Higher energy and consumer prices reduce the real value of a worker's current wage, but they also reduce the real value of wages at other firms. Relative to the alternatives that matter for 'quits' (voluntary resignations) and recruitment, little has changed.

Indeed, workers may be less likely to leave if they fear uncertainty or weaker job market prospects ahead (see US: AI's impact on labour will be a key public concern – August 3, 2026). They do not become more likely to leave for a rival paying the same as before.

A wage-price spiral requires a labour-market mechanism that firm wage setting and on-the-job search largely shut down. A recent paper from the ECB shows that on-the-job search is widespread and persistent in the US and eleven euro-area economies (see INT: US-Iran war will drive ECB to hike rates – July 23, 2026).

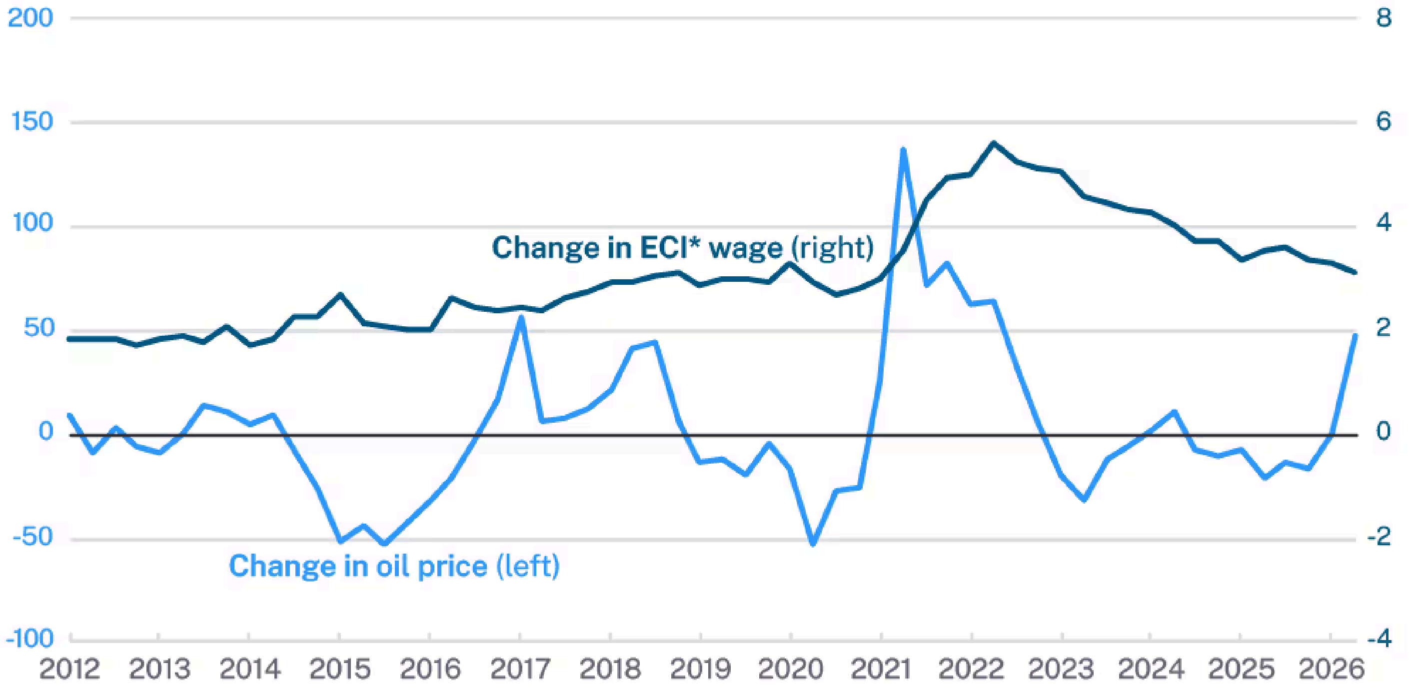
Commodities and salaries

Before the pandemic, the US saw large swings in commodity prices with little corresponding movement in wages. In the oil price collapse of 2015, spot crude prices roughly halved, driven by a surge in OPEC production. Aggregate US wage growth, measured by the Employment Cost Index for wages and salaries, barely moved.

WTI spot crude oil price (USD/barrel, seven-day moving average)

Source: Federal Reserve Bank of St Louis

US: Change in ECI wage vs change in oil price (% change year-on-year)



* Employment Cost Index

Source: Federal Reserve Bank of St Louis

If a large fall in oil did not pull wages down, there is little reason to expect a rise in oil to force wages up through the cost-of-living channel alone.

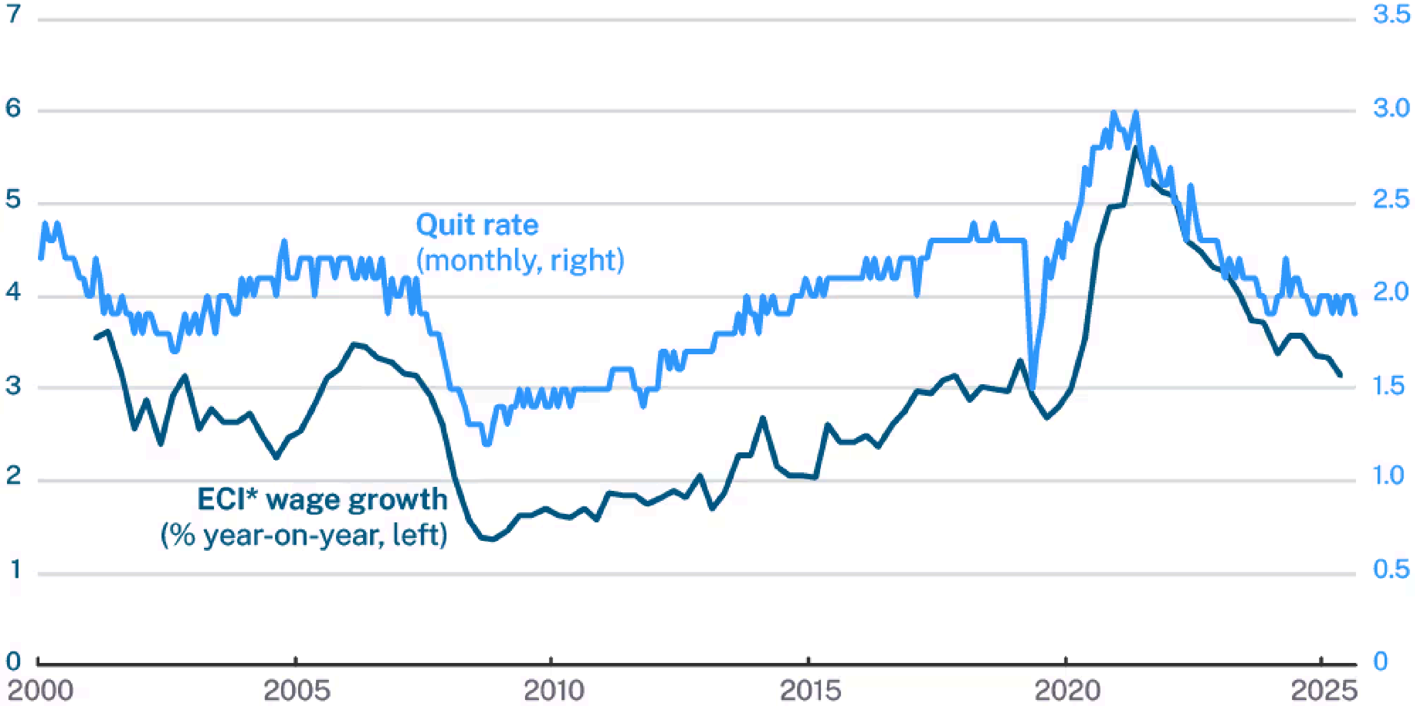
Across advanced economies during the post-pandemic inflation surge, wage ‘catch-up’ to unexpected price increases was likewise close to zero. Surveys suggest that US workers expect only limited pass-through from aggregate inflation into their own wages.

Early euro-area wage settlements since the Iran war have also yet to show a clear jump in response to energy prices, which is consistent with ECB monitoring and with a muted wage channel.

Setting the wage pace

If wages are set mainly to compete for people who already have jobs, the unemployment rate will be a weak guide to wage pressure. What matters more is whether employed workers are quitting and being hired elsewhere. In US data, the quit rate tracks wage growth more closely than unemployment.

US: Quit rate vs ECI wage growth



* Employment Cost Index

Source: US Bureau of Labor Statistics and Labor Turnover Survey

When labour markets are hot, quits rise and firms raise wages to defend their workforce. When they cool, wage growth slows, even if consumer prices remain elevated. The Iran war can therefore lift consumer price inflation while leaving hiring and quitting roughly unchanged.

Pass-through possibility

Muted pass-through is not universal. It can reappear if higher living costs make not working more attractive relative to working. More importantly for Europe, it can also reappear where collective bargaining and indexation shape pay.

> Risks are still present in markets with wage bargaining

Lagarde's vigilance is more warranted in economies with stronger wage bargaining than in the US (see SOUTH KOREA: Labour issues could disrupt supply chains – May 12, 2026). Even then, on-the-job search limits how much an oil price shock feeds into aggregate wages. For the average US worker, the Hormuz-to-wage channel is weak.

Implications and outlook

The Iran war could still be macroeconomically costly, with energy prices likely to remain elevated through next year, and many central banks likely to raise interest rates. The IMF, ECB and BoE are right to take second-round risks seriously if the shock is large and persistent.

However, a wage-price spiral from Hormuz alone remains unlikely, unless resignations, vacancies and job-to-job hiring also tighten.

As long as firms set most wages and employed workers remain the main source of labour-market competition, a Hormuz-centred energy shock will raise prices and squeeze real incomes without reliably igniting a self-sustaining wage-price spiral.

Unless labour markets tighten for other reasons, such as strong demand, scarce workers or a surge in resignations, nominal wage growth is unlikely to rise. Households will feel Gulf disruption as lost purchasing power, not as a round of raises. Wages will remain an important indicator for labour-market tightness.