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COMMENTARY

The Fed Has the Tools to Fight Stagflation. The 1970s Aren't Coming Back.

By Matthew Jeffrey Vegari

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(ILLUSTRATION BY RIKI BLANCO)

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June's [jobs report](#)  offered the latest snapshot of a cooling U.S. labor market, marked by steady, if modest, hiring. Even as employment holds up, however, talk of stagflation is reaching a fever pitch.

Expectations for a tariff-induced resurgence in price growth—a legitimate near-term prospect for the economy, as inflation shows [signs of accelerating](#) —are renewing fears of a return to the 1970s. Such predictions, however, are misguided.

Stagflation is an adverse cocktail of economic maladies: high inflation, low to no economic growth, and, crucially, high unemployment. While the first two could emerge this year, the third—high unemployment—is missing in consensus forecasts. This distinction is critical. A resilient labor market serves as the backbone of the economy. Since the Covid-19 pandemic, it has kept U.S. growth afloat, despite the barrage of warnings of impending recessions.

Furthermore, stagflation isn't simply an undesirable macroeconomic environment. The crux of true stagflation is a loss of control, a failure in policymaking—something that is also missing in today's economy.

The stagflation of the 1970s was a confluence of macro shocks like an embargo by the Organization of the Petroleum Exporting Countries, excessive fiscal policy brought about by the Vietnam War and the Great Society programs, and bad monetary policy. Inflation persisted above 5% for nearly a decade, hitting a high of nearly 15% in 1980. But the Federal Reserve, in part [responding to political pressure](#)  from the White House, kept policy too accommodative. As an official history of the Fed [recounts](#) , monetary policymakers had a “clear sense that addressing the inflation problem head-on would have been too costly to the economy and jobs.”

Unwilling to stomach short-term pain and unsure of their tool kit, policymakers let inflation run away for years. It ultimately took former Fed Chairman Paul

Volcker's [aggressive, credibility-restoring stance](#)—and a bruising, double-dip recession—to break the vicious cycle.

Critics of today's monetary policy warn that the U.S. is on the cusp of recession and argue that a weaker labor market would itself help alleviate inflation by curbing demand. Yet if this scenario unfolded, higher prices would then be missing from the stagflation equation.

But what if both inflation and unemployment *do* rise together? Even here, cries of '70s-style stagflation are overblown. Today's monetary policymakers are determined to avoid such a structural break. As the labor market continues to cool this year, they have signaled patience when it comes to easing restrictive policy.

Given history, the Fed's [caution](#)  is justified. The inflation regime matters profoundly for long-term economic health. Even if there is a material rise in unemployment—a necessary pillar of stagflation—the central bank likely won't ease as quickly as some hope it would in the face of rising inflation.

Fed officials know that if they cut rates too soon as tariff price pressures build, they risk letting inflation metastasize. In this instance, a one-off price shock could create unwanted ripple effects. The Fed's dual mandate is to pursue full employment and price stability. The quiet truth is that the latter is a prerequisite for the former. And the prerequisite for price stability is anchored inflation expectations.

[Markets](#)  and [consumers](#)  don't foresee inflation spiraling persistently higher; they actually expect inflation to slightly decline. This is the result of a multidecade effort from policymakers to keep expectations anchored. A danger emerges if this status quo changes—that is, if inflation expectations become unmoored.

When households and businesses start to believe prices will keep rising, they adapt their behavior accordingly: Workers demand larger, more frequent wage increases to keep up with anticipated costs, while firms pre-emptively raise prices to protect their margins. This creates a self-fulfilling cycle—higher expected inflation leads to higher actual inflation, as stakeholders act to stay ahead of the curve.

Today, the inflation regime is not under threat. Economic growth might be [stunted](#) this year and next, but high unemployment is missing in consensus forecasts. Policymakers have done an admirable job slowing a hot economy without sinking it. If unemployment were to surge alongside prices, the Fed's balancing act will become trickier. But monetary policymakers won't abandon their inflation mandate; steep rate cuts won't come as swiftly as some hope.

We should fear “stagflation” the moment policymakers become less independent or hyper-focused on price stability. In those scenarios, policy enters a morass: low growth, high inflation, high unemployment, and few immediate tools to make things better.

Stagflation of the '70s didn't manifest overnight; it was the result of years of inflation tolerance. Might there be a period of elevated inflation and rising unemployment? Yes. Is inflation likely to persist in such a scenario, as it did during the '70s? Not on this Fed's watch.

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