ECONOMIC UPDATE

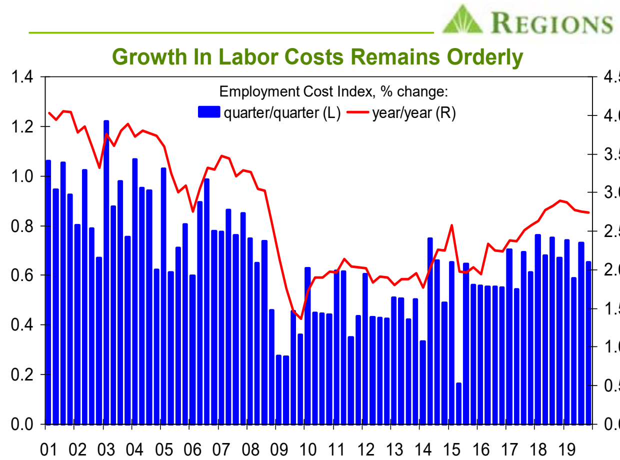
REGIONS

January 31, 2020

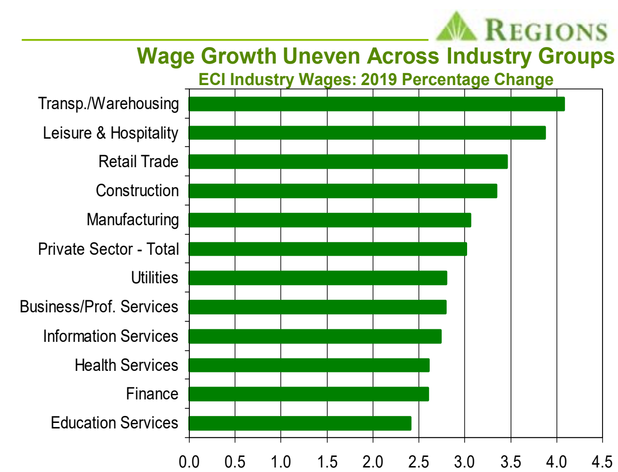
Q4 2019 Employment Cost Index: Growth In Labor Costs Remains Orderly

- The total ECI was up 0.7 percent in Q4 2019, with the wages/salaries component up 0.7 percent and the benefits component up 0.5 percent.
- Year-on-year, the total ECI was up by 2.7 percent in Q4 with wage costs up 2.9 percent and benefit costs up 2.2 percent.

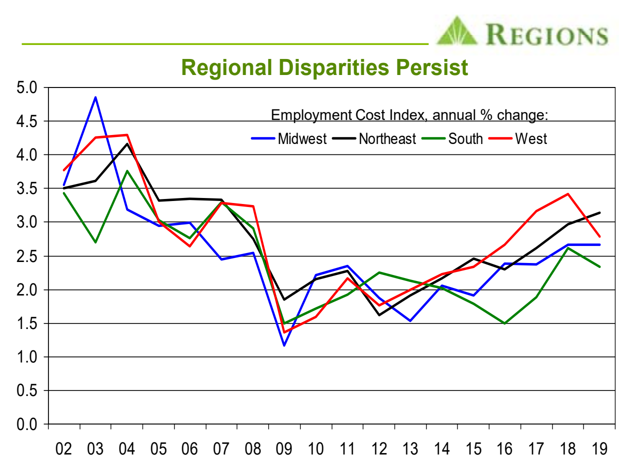
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.6 percent in Q4, with wage costs up 0.7 percent and benefit costs up 0.5 percent, in each instance one-tenth shy of our forecasts. As of Q4, the ECI is up 2.7 percent year-on-year, with wage costs up 2.9 percent and benefit costs up 2.2 percent. Growth in wage costs has flattened out – year-on-year growth of 2.9 percent in each quarter of 2019 – while growth in benefit costs has slowed, with the net result a gentle deceleration in total labor costs over the course of 2019. This is a significant, even if often overlooked point – firms are focused on overall compensation costs, of which wages are the main, but not the only, component. The broader point is that the ECI data are in line with other measures of labor costs, which show that while there is some upward pressure on wages, there is nothing to suggest a labor market on the boil. While we're not big on the wage growth-inflation link that endures despite ample evidence to the contrary, many FOMC members are, and for those who are the Q4 ECI data offer no rationale to begin considering an increase in the Fed funds rate.



The ECI is one of the three main data series – the others being average hourly earnings from the monthly employment report and unit labor costs from the quarterly labor productivity and costs report – showing trends in labor costs. The ECI tends to get less attention than its two counterparts but to us is the most meaningful of the three series. The ECI is designed to measure changes in total labor costs, for both money wages and salaries and noncash fringe benefits (such as health insurance and pensions), and also includes employer-paid taxes such as Social Security and Medicare. One distinction between the wage component of the ECI and the more widely followed average hourly earnings metric is the ECI is not affected by shifts in the composition of employment across industry groups. Instead, the wage component of the ECI effectively measures wage costs for the same jobs over time and the total ECI measures labor costs (i.e., wages and benefits) for the same jobs over time. One drawback of the average hourly earnings metric is that it is skewed by changes in the composition of employment and hence will mask earnings differentials across industry groups. These differences aside, the alternative series are showing faster, but not full employment fast, wage growth.



One advantage of the ECI is that it gives us detailed data on compensation costs across the major industry groups, which is a more informative way to look at growth in labor costs than the broad average hourly earnings metric. As in 2018, the transportation/warehousing industry group posted the fastest wage growth in 2019, followed closely by leisure & hospitality services and retail trade. Though the placing of the latter two industry groups may seem surprising, wage growth has been lifted in these industry groups by higher minimum wages and by many of the larger chains raising entry level wages to attract/retain workers, increases which tend to filter up the seniority chain. Perhaps a bigger surprise is that wages in construction have not grown at a faster rate, given what for some time have been industry complaints of labor shortages. Still, over the past two years, the only industry group that has seen a bigger jump in wage growth than construction has been transportation/warehousing.



As is the case across industry groups, disparities in the growth of labor costs persist across the broad geographic regions. The Northeast saw the fastest growth in overall labor costs in 2019, displacing the West region, where the pace of wage growth slowed markedly over the course of 2019. Amongst the sub-regions, the Middle Atlantic region (New Jersey, New York, Pennsylvania) posted the fastest wage growth in 2019, with the slowest growth in the West South Central region (Arkansas, Louisiana, Oklahoma, Texas).

The ECI is in line with other measures showing moderately accelerating wage growth, but the ECI offers the added dimension of benefit costs, which continue to moderate. While we expect to see growth in labor compensation costs accelerate a bit over the course of 2020, nothing in the data suggests this acceleration will be anything but orderly.

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