ECONOMIC UPDATE

REGIONS

July 31, 2019

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Q2 2019 Employment Cost Index: Growth In Labor Costs Remains Orderly

- The total ECI was <u>up</u> 0.6 percent in Q2 2019, with the wages/salaries component <u>up</u> 0.7 percent and the benefits component <u>up</u> 0.5 percent.
- Year-on-year, the total ECI was <u>up</u> by 2.8 percent in Q1 with wage costs <u>up</u> 3.0 percent and benefit costs <u>up</u> 2.3 percent.

Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.6 percent in Q2, matching our below-consensus forecast, with wage costs rising by 0.7 percent and benefit costs rising by 0.5 percent. As of Q2, the total ECI is up 2.8 percent year-on-year, with wage costs up 3.0 percent and benefit costs up 2.3 percent. Though growth in wage costs continues to gently accelerate, growth in benefit costs continues to ebb, which is acting as a brake on the pace of growth of total labor compensation costs. 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 Q2 ECI data will alleviate any concerns they may have that lowering the Fed funds rate will unleash significantly faster inflation.

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. Still, the ECI data can be jumpy from one quarter to the next, which is why we prefer to look at longer-term trends, Our middle chart shows a four-quarter moving average of (over-the-year) growth in wages across the broad industry groups. While it may seem surprising to see that leisure & hospitality services and retail trade rank first and third, respectively, in this measure of wage growth as of Q2, keep in mind that these industry groups are amongst those most impacted by mandated increases in minimum wages and firms in these industry groups have been amongst the most aggressive in implementing higher entry-level wages, with these increases tending to filter up through the seniority chain. Transportation/warehousing/distribution has added jobs at a rapid clip over recent quarters, which has been reflected in steadily accelerating wage growth. Conversely, job growth in construction has slowed a bit in 2019, and wage growth is running at a slightly slower pace than was the case in 2018. Amongst the broad geographic regions, though the pace has slowed a bit in 2019, the West continues to see the most rapid wage growth. Wage growth continues to accelerate in the Midwest and, mainly driven by the New England sub-region, the Northeast. Wage growth in the South has slowed over the past four quarters and remains well below the overall average.

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 further over the remainder of 2019, nothing in the data suggests this acceleration will be anything but orderly.

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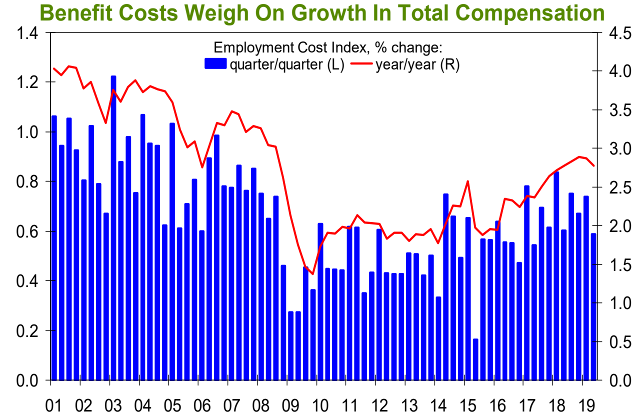
Benefit Costs Weigh On Growth In Total Compensation



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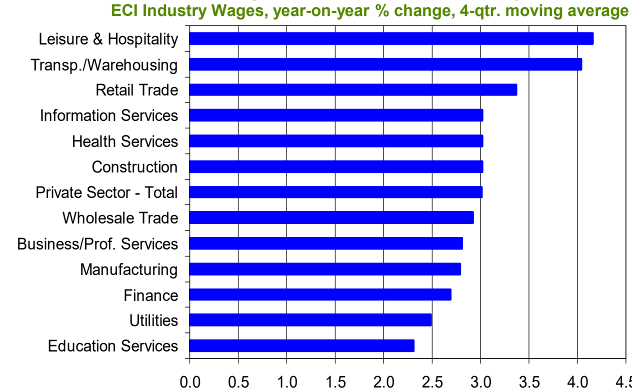
Uneven Wage Growth Across Industry Groups

ECI Industry Wages, year-on-year % change, 4-qtr. moving average



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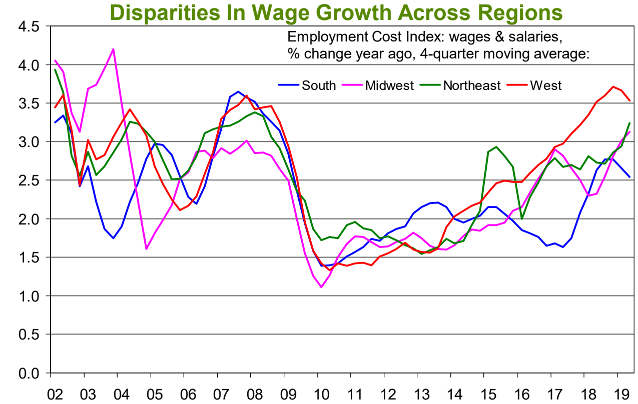
Disparities In Wage Growth Across Regions



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