ECONOMIC UPDATE

REGIONS

July 28, 2023

Q2 Employment Cost Index/June Personal Income & Spending

- The Employment Cost Index rose by 1.0 percent in Q2, with wage costs up by 1.0 percent and benefit costs up by 0.9 percent
- Total personal income rose by 0.3 percent in June and total personal spending rose by 0.5 percent

Employment Cost Index (ECI): The total ECI rose by 1.0 percent in Q2, a touch lighter than the 1.1 percent increase we and the consensus expected, with wage costs up by 1.0 percent and benefit costs up 0.9 percent. On an over-the-year basis, the total ECI is up 4.5 percent, with wage costs up 4.6 percent and benefit costs up 4.2 percent. That growth in labor costs moderated in Q2 is consistent with other indicators of cooling demand for labor, but at the same time still leaves growth in labor costs far above the pre-pandemic trend rate. While it is reasonable to growth in labor costs to slow further as labor market conditions soften over coming quarters, we think it unlikely that growth in labor costs will settle all the way back to that pre-pandemic trend rate.

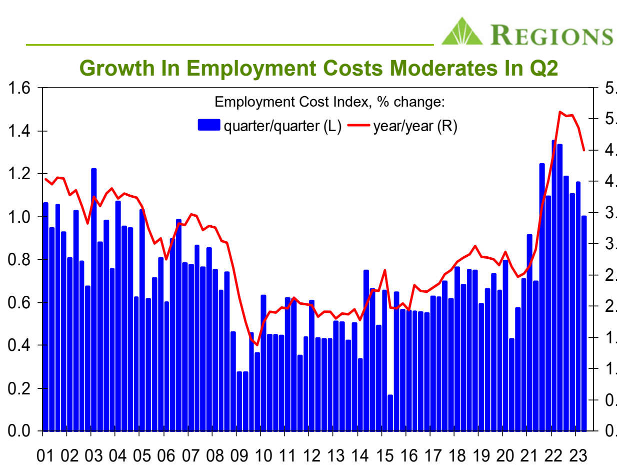
The ECI is designed to measure changes in total labor costs, for both wages/salaries and noncash fringe benefits (such as health insurance) and includes employer-paid taxes such as Social Security and Medicare. One distinction between the wage component of the ECI and the more widely followed average hourly earnings metric is the ECI is not affected by shifts in the composition of employment across industry groups. Instead, the total ECI measures labor costs (i.e., wages and benefits) for the same jobs over time. As such, the ECI is considered the superior gauge of trends in labor costs.

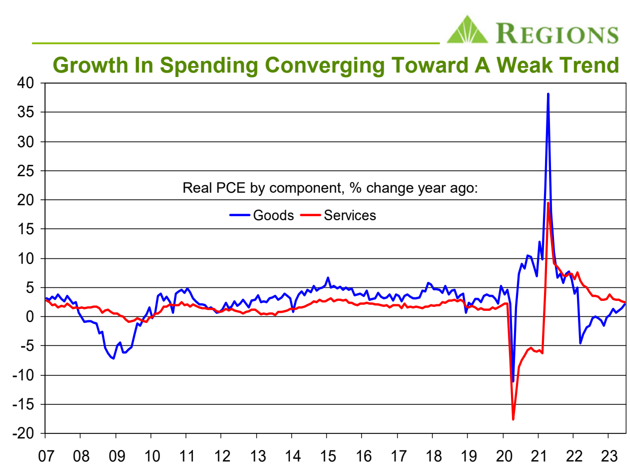
The Q2 data show a sharp slowdown in growth in labor costs amongst the goods producing industries but no let-up in growth amongst services providing industries. The latter is a bit of a surprise given the marked weakening in hiring amongst industry groups such as wholesale and retail trade and transportation/warehousing. In many cases, tough base effects weighed on the over-the-year changes in wages, so that the quarterly changes amongst the services providing industry groups have not let up bears noting. Also deserving mention is that health care, which has been leading job growth over the past several months, saw the largest over-the-year increase in wages (5.6 percent), ending an eight-quarter run in which leisure and hospitality services posted the fastest wage growth, though the 5.5 percent increase there is a close second. Thus far, there are few signs that growth in labor costs amongst the services providing industries, which the FOMC sees as a primary source of inflation pressures, is moderating. As such, the FOMC will see it as being too soon to take much comfort from the June inflation data having come in on the mild side.

Personal Income/Spending: Total personal income was up by 0.3 percent in June, short of the 0.5 percent increase our forecast called for but at the same time May income growth was revised higher. Private sector wage and salary earnings were up 0.6 percent, a smaller increase than we expected. Nonfarm proprietors' income, a proxy for small business profits, was up by 0.6 percent while interest income posted a third straight monthly increase of 0.7 percent. Also worth noting is the third straight monthly increase of 0.6 percent in public sector wage and salary earnings, with the trend rate of growth lifted in recent months by hiring amongst state and local governments as infrastructure work has ramped up. On an over-the-year basis, total personal income is up 5.3 percent with private sector wage and salary earnings up 5.9 percent while public sector earnings are up 6.4 percent.

Personal spending was up 0.5 percent, as our above-consensus forecast anticipated. Spending on goods rose by 0.8 percent, led by consumer durables (motor vehicles, furniture, appliances), while services spending rose by 0.4 percent. Real total consumer spending was up 0.4 percent in June. Our proxy for discretionary services spending was up by 0.2 percent on a nominal basis but was unchanged after accounting for price changes. This continues the pattern we've noted over recent months, i.e., higher prices are behind the growth in nominal spending with real spending virtually flat over the past nine months. We continue to expect a sharp pullback in discretionary services spending come the fall, which will weigh on growth in total consumer spending.

The PCE Deflator, the FOMC's preferred gauge of inflation, was up by 0.2 percent in June, as was the core PCE Deflator, yielding over-the-year changes of 3.0 percent and 4.1 percent, respectively. Core goods prices fell slightly in June but aside from a drop in prices for used motor vehicles were flat, while core services prices were up by 0.3 percent. There was some moderation in core services prices outside of shelter, but this still remains a primary source of overall inflation pressures.





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