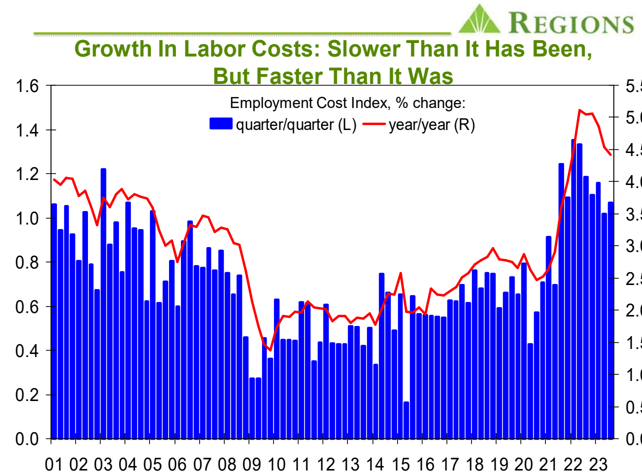
ECONOMIC UPDATE
REGIONS
October 31, 2023

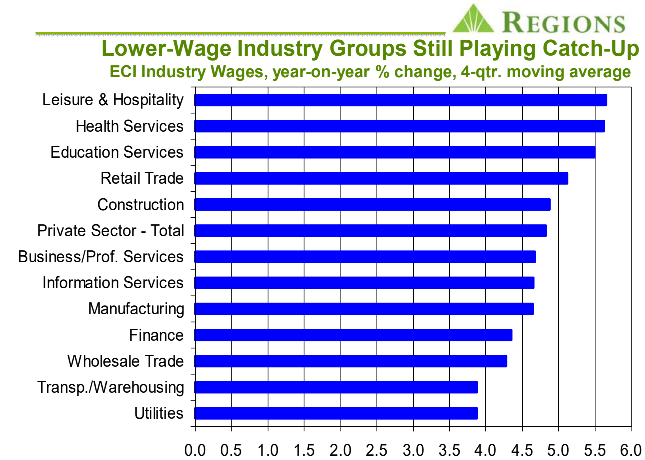
Q3 2023 Employment Cost Index: Growth In Comp To Remain Above Pre-Pandemic Norms?

- The total ECI was up 1.1 percent in Q3 2023, with the wages/salaries component up 1.2 percent and the benefits component up 0.9 percent.
- On a year-over-year basis, the total ECI is up by 4.3 percent, with wage costs up 4.6 percent and benefit costs up 4.1 percent.

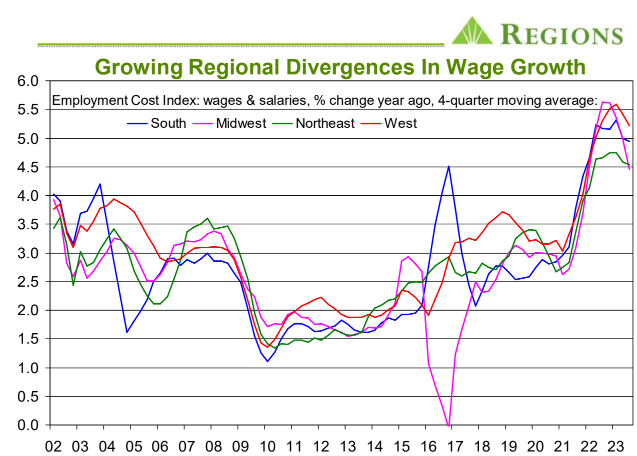
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 1.1 percent in Q3, topping the 0.9 percent increase we expected and the 1.0 percent increase the consensus forecast anticipated, with wage costs up 1.2 percent and benefit costs up 0.9 percent. Private sector wage costs were up 1.1 percent while public sector wage costs were up 1.5 percent. Though off the peak rate seen in 2022, growth in labor compensation costs remains well ahead of the pre-pandemic pace, even allowing for the acceleration seen leading up to the pandemic. As was the case then, wage growth over recent quarters has been highly uneven across private sector industry groups, with some of the fastest growth posted by industry groups with the lowest levels of wages. One thing that is different, however, is that wage growth amongst public sector workers has been outpacing growth amongst private sector workers, which to some degree is consistent with the stepped-up pace of hiring amongst state and local governments over recent months.



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 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, and these distortions have been even more pronounced since the onset of the pandemic.



Our middle chart goes to our earlier point about industries with lower levels of wages putting up some of the fastest wage growth over recent quarters. Leisure and hospitality services is far and away the industry group with the lowest average hourly wage and is also the industry group with the highest rate of job vacancies, with the level of payrolls in the broad industry group still below the pre-pandemic peak. It is also worth noting that health care has posted the strongest job growth across private sector industry groups over the past several months, and rising wages have helped facilitate hiring. It is also worth noting that wage accords, such as those achieved by the Teamsters on behalf of UPS workers and those achieved by the UAW (still awaiting ratification) will turn up in the ECI data over coming quarters. The point here is that, despite the attention it garners, the average hourly earnings metric is not all that useful as a gauge of trends in wage growth let alone as a gauge of how tight, or slack, labor market conditions are. The ECI is a useful reminder that conditions vary, often sharply, across industry groups, which manifests in variances in wage growth.



We can make that same point across geographies. After being unusually uniform for several quarters after the onset of the pandemic, wage growth across the broad Census regions has diverged sharply over the past few quarters. Growth has slowed across the board, but that slowdown has been more pronounced in the Midwest and Northeast regions while growth has held up better in the South and West, consistent with regional job growth patterns.

That the pace of wage growth has slowed is consistent with some cooling in labor market conditions, but we think it a mistake to expect the pace of wage growth to fall back in line with pre-pandemic growth rates. Many will see wage growth as having implications for inflation and, in turn, for the path of monetary policy, but most who do so ignore the role of productivity growth. While the trend rate of productivity growth remains dismal, finding ways to enhance productivity growth will be the key to sustaining faster economic growth and faster wage growth without sparking inflation pressures.

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