ECONOMIC UPDATE

REGIONS

April 30, 2021

Q1 2021 Employment Cost Index: Comp Costs Perking Up Despite Elevated Slack

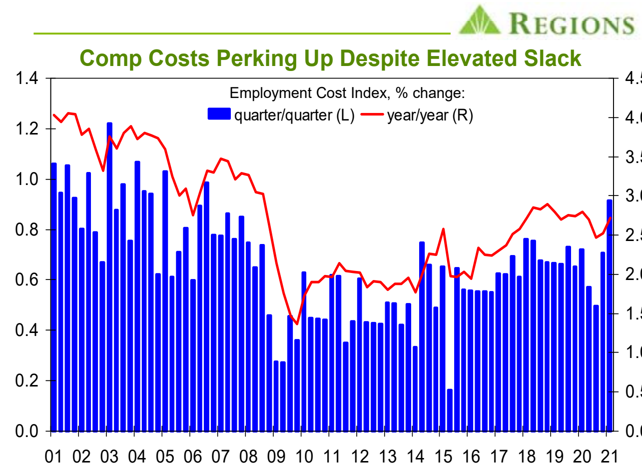
- The total ECI was up 0.9 percent in Q1 2021, with the wages/salaries component up 1.0 percent and the benefits component up 0.6 percent.
- Year-on-year, the total ECI was up by 2.7 percent in Q1 with wage costs up 2.7 percent and benefit costs up 2.5 percent.

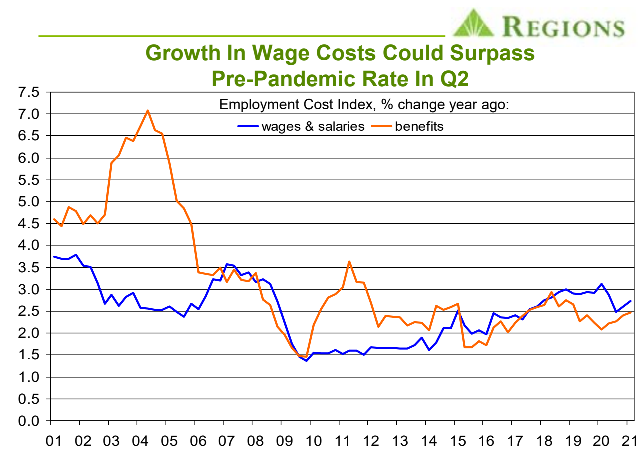
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.9 percent in Q1, with wage costs up 1.0 percent and benefit costs up 0.6 percent, ahead of what we and the consensus expected. The increase in the total ECI is the largest quarterly increase since Q3 2006, while the increase in the wages component is the largest quarterly increase since Q1 2001. As of Q1, the ECI is up 2.7 percent year-on-year, with wage costs up 2.7 percent. That wage costs jumped in Q1 to some extent reflects the ongoing recovery in the labor market, but the extent to which wage costs increased despite the degree of labor market slack being notably elevated should not escape notice, particularly that it comes in conjunction with broad based increases in costs of non-labor inputs.

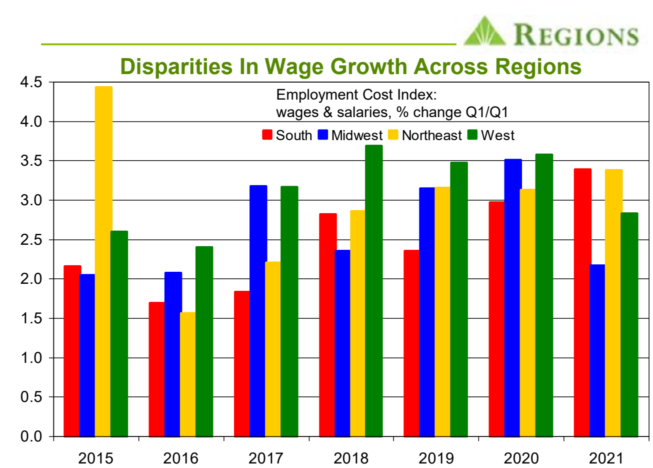
The ECI is one of the three main data series – the others being average hourly earnings from the monthly employment report and unit labor costs from the quarterly labor productivity and costs report – showing trends in labor costs. The ECI tends to get less attention than its two counterparts but to 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. That distinction will become increasingly pronounced over coming months. Recall that when nonfarm employment plummeted last spring, leisure and hospitality services was the industry group which saw the largest decline in employment. That hourly wages in this industry group are so far below the overall average pushed up average hourly earnings despite the sizable decline in total nonfarm employment. Beginning with the April 2021 data, we think average hourly earnings will decline on an over-the-year basis as more and more leisure and hospitality services jobs come back on the books, dragging down the overall average wage. As such, average hourly earnings will be an even less reliable guide to changes in labor costs than is typically the case. Again, the ECI is free of this bias, and this distinction should be kept in mind in the months ahead when trying to interpret the data on average hourly earnings.

That wage costs rose to the extent they did in Q1 in part reflects the difficulty firms in many industry groups are having finding workers to fill open positions. The supplemental unemployment insurance (UI) benefits provided over the course of the pandemic are playing some part in this, particularly when it comes to filling open jobs in lower wage industry groups. Keep in mind that, in normal times, one requirement to be eligible for UI benefits is that one be actively looking for work. During the pandemic, that rule has not been enforced, which made sense with much of the economy shut down, and as of yet it remains largely unenforced. Still, there are other drags on labor force participation, particularly amongst females who have taken on responsibilities for at-home schooling and filling in gaps left by lower levels of day care services. Whatever the reasons, firms are finding it difficult to fill open positions, leaving offering higher wages one means of being able to do so. It is also interesting that the South region has uncharacteristically seen the fastest growth in wage costs over the past year. Many parts of the region are ahead of the rest of the U.S. in terms of reopening their economies and, as such, firms operating in these states may be feeling labor supply pressures more intensely.

With the economy reopening more fully, labor demand will pick up, and labor costs will rise at a faster rate. This, along with higher non-labor input costs, will force firms to pick between accepting slimmer margins or raising prices, and may not prove to be transitory.







Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com