ECONOMIC UPDATE

REGIONS

January 28, 2022

Q4 2021 Employment Cost Index: Growth In Labor Costs Accelerates Sharply In 2021

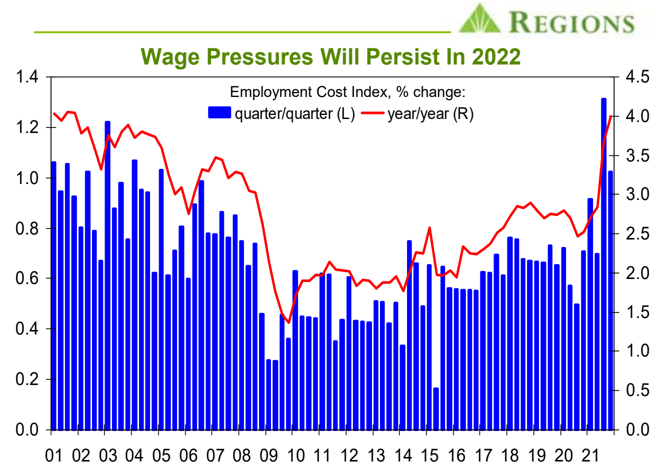
- The total ECI was up 1.0 percent in Q4 2021, with the wages/salaries component up 1.1 percent and the benefits component up 0.9 percent.
- Year-on-year, the total ECI was up by 4.0 percent in Q4 with wage costs up 4.5 percent and benefit costs up 2.8 percent.

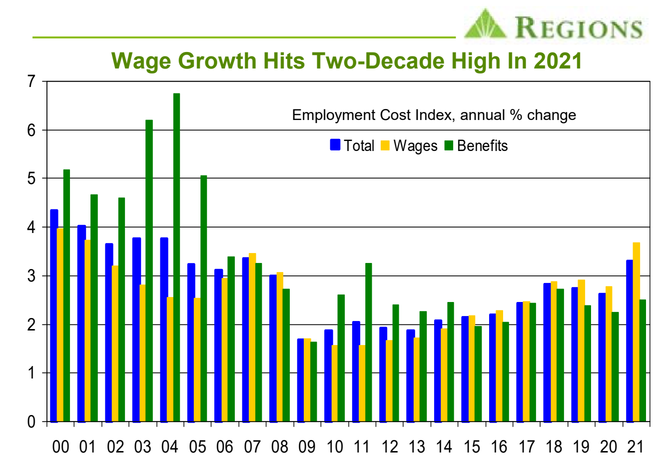
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 1.0 percent in Q4 2021, a smaller increase than expected following a 1.3 percent increase in Q3 2021, which was the largest quarterly increase in the life of the current series. Wage costs rose by 1.1 percent in Q4 after having risen by 1.5 percent in Q3, while benefit costs posted a second consecutive quarterly increase of 0.9 percent. On an over-the-year basis, total comp costs rose by 4.0 percent in Q4 with wage costs up 4.5 percent, which is the largest over-the-year increase in the life of the current series. For full-year 2021, total comp costs rose by 3.3 percent, with wage costs up 3.7 percent and benefit costs up 2.5 percent. Given that growth in labor compensation costs accelerated so significantly over the second half of 2021, however, the full-year increases seen in 2021 will be easily eclipsed in 2022. Labor supply constraints remain a vexing problem for firms, and the labor market is very much a seller's market, which is being reflected in wage growth. Even if growth in costs for non-labor inputs eases over the course of 2022 as we anticipate will be the case, continued rapid growth in labor costs will continue to weigh on margins.

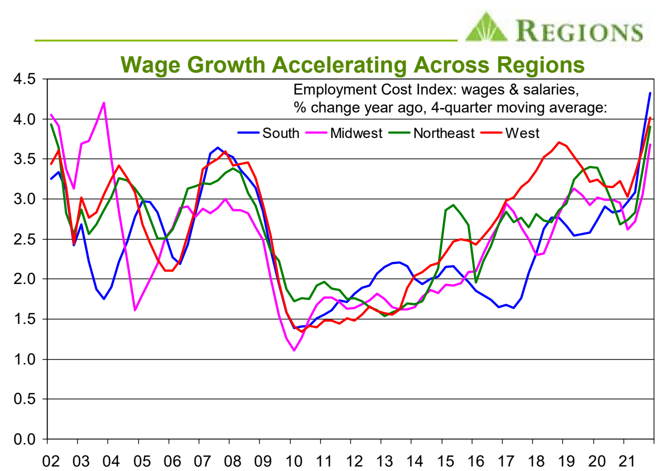
The ECI is one of the three main data series – the others being average hourly earnings from the monthly employment report and unit labor costs from the quarterly labor productivity and costs report – showing trends in labor costs. The ECI tends to get less attention than its two counterparts but to 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.

The 3.7 percent increase in wage costs for full-year 2021 was the largest annual increase since 2001, and this year's increase will easily be higher. Wages in leisure and hospitality services rose by 6.8 percent in 2021, the largest increase amongst the broad industry groups. This comes as no surprise as firms in this industry group continue to struggle to find workers, with the level of employment still over 1.2 million jobs below the pre-pandemic peak. Wages in finance/insurance rose by 5.6 percent in 2021, while wages in retail trade were up 5.4 percent. That wage growth is so broad based across private sector industry groups is a resumption of the patterns seen prior to the pandemic. Recall, however, that it took several years following the 2007-09 recession for wage growth to become so broad based, which was a reflection of the tremendous degree of labor market slack left in the wake of that recession. That rapid and broad based wage growth has taken hold so quickly in this cycle is a testament to the difficulty firms are having not only in finding workers but also in retaining workers already on their books. One difference between this cycle and the prior cycle, however, is that even though growth in nominal wages was slower then than is the case now, wage growth was nonetheless running ahead of inflation prior to the pandemic, which is not the case at present.

As our bottom chart shows, in addition to being broad based across industry groups, wage growth is also geographically broad based. For full-year 2021, the South and West regions saw the fastest wage growth, which could reflect economies across of much of those regions being relatively more open and thus supporting stronger growth in labor demand, which would have helped to push wage growth higher. Either way, given that labor supply constraints are broad based across regions, wage growth will likely be faster across all regions in 2022 than was the case in 2021.







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