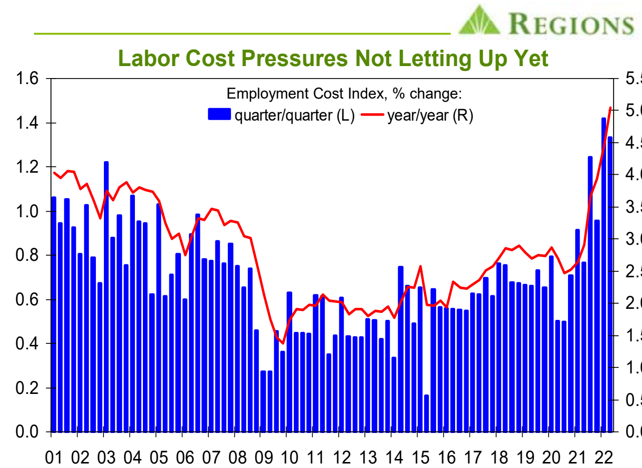
ECONOMIC UPDATE
REGIONS
July 29, 2022

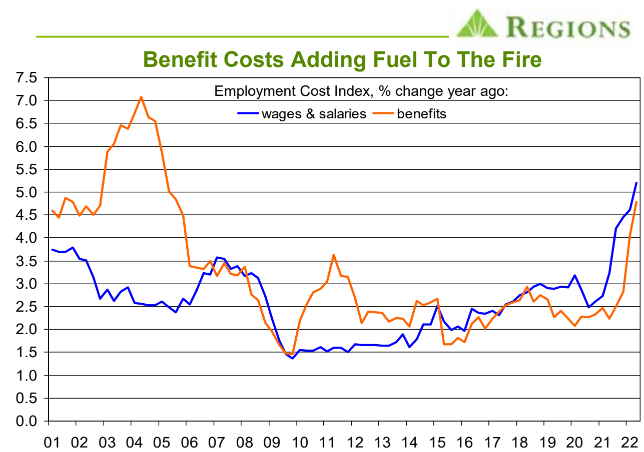
Q2 2022 Employment Cost Index: Labor Cost Pressures Not Letting Up Yet

- The total ECI was up 1.3 percent in Q2 2022, with the wages/salaries component up 1.4 percent and the benefits component up 1.2 percent.
- Year-on-year, the total ECI was up by 5.0 percent in Q2 with wage costs up 5.2 percent and benefit costs up 4.8 percent.

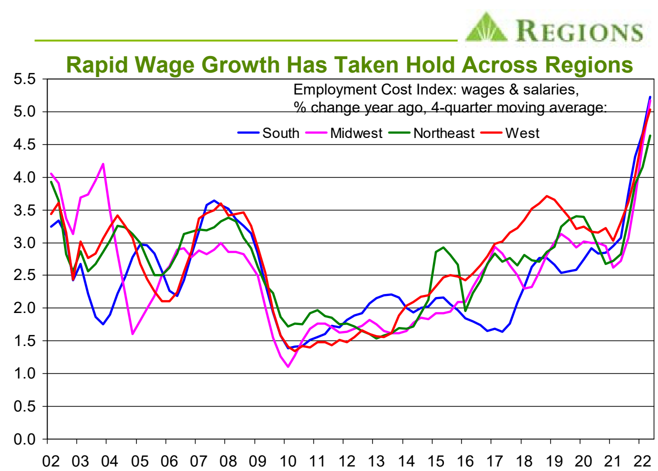
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 1.3 percent in Q2, bettering our forecast (1.0 percent) and the consensus forecast (1.2 percent), leaving them up 5.0 percent year-on-year, the largest such increase in the series as now constituted. We missed on both fronts in our below-consensus forecast, with both wage costs and benefit costs up more than we anticipated. Wage costs rose 1.4 percent in Q2 while benefit costs rose by 1.2 percent, yielding over-the-year increases of 5.2 percent and 4.8 percent, respectively. So, not only did wage growth not moderate as we and many others expected would be the case, but the past two quarters have seen a marked acceleration in the pace of growth in benefit costs, further fueling upward pressure on firms' total comp costs. While there are signs, such as initial claims for unemployment insurance benefit costs rising, that labor market conditions have begun to soften, any such softening seems more isolated, such as retailers paring down staffing and many tech companies slowing the pace of hiring, than globalized. And even if job openings are falling, they are falling from a level of over eleven million open jobs at a time when the unemployment rate is well below four percent. This is why even though we expected some cooling in the pace of wage growth, we didn't expect much cooling, and we've consistently stated our expectation that wage growth, and growth in total labor compensation costs, would remain well above the rate that prevailed prior to the pandemic. This in turn would be either a persistent weight on profit margins or a source of persistent inflation pressures, if not a blend of both.



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.



Wage pressures are broad based across private sector industry groups. And, while some of the jump in wage costs in Q1 reflected jumps in one-off bonuses, the growth in Q2 reflects faster growth in straight wage and salary earnings which pushed year-on-year growth in private sector wages up to 5.7 percent. What many lose sight of, however, is that wage growth was accelerating and increasingly broad based across private sector industry groups well before the onset of the pandemic, but since the pandemic labor supply constraints have become even more pronounced. It is also the case that faster wage growth reflects not only the difficulty firms have had finding labor but also in retaining labor, with each having become increasingly expensive for firms. Moreover, as our bottom chart shows, in addition to being broad based across industry groups, wage growth has also become increasingly broad based, and more consistent, across geographies.



As do we, the FOMC sees the ECI as the most reliable gauge of trends in labor costs, and the FOMC will not be at all encouraged by the Q2 data. Some FOMC members have characterized the labor market as being "tight to an unhealthy degree" and see their task as reducing the demand for labor as a means of alleviating wage pressures and, in turn, inflation pressures in the broader economy. Though we see the world differently, we will note that wage growth has been significantly outpacing productivity growth, even after smoothing out the sharp swings in the latter over recent quarters. As such, the FOMC will judge that they have much further to go in reining in inflation.

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