

ECONOMIC UPDATE

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Q4 2023 Employment Cost Index: Q4 Brings Further Moderation

- The total ECI was up 0.9 percent in Q4 2023, with the wages/salaries component up 0.9 percent and the benefits component up 0.7 percent.
- For full-year 2023, the total ECI was up by 4.5 percent, with wage costs up 4.6 percent and benefit costs up 4.2 percent.

Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.9 percent in Q4, matching our below-consensus forecast, with wage costs up 0.9 percent and benefit costs up 0.7 percent. On a year-on-year basis, the total ECI was up 4.2 percent in Q4, with wage costs up 4.3 percent and benefit costs up 3.8 percent. Private sector wage costs were up 0.9 percent while public sector wage costs were up 1.1 percent, in keeping with other measures of labor earnings showing growth in public sector earnings outpacing growth in private sector earnings, which reflects the stepped-up pace of hiring amongst state and local governments over recent quarters. The 0.9 percent increase in overall wage costs is the smallest quarterly increase since Q2 2021, which is also the last quarter in which benefit costs rose as slowly as they did in Q4. Though growth in labor compensation costs has moderated over recent quarters, it nonetheless remains easily ahead of the pre-pandemic pace. It has for some time been our contention that wage growth would settle somewhere between the pre-pandemic trend rate and the frenzied pace seen over 2021-22.

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.

Patterns in wage growth across industry groups shifted again in 2023. Reflecting notably robust hiring, health services saw the fastest wage growth of any private sector industry group in 2023. Leisure and hospitality services and retail trade both saw moderation in wage growth in 2023, though that doesn't come as a surprise as these two industry groups saw the fastest growth over the prior two years. Wage growth picked up considerably in transportation and warehousing services in 2023, with a 4.8 percent increase, which in part reflects the effects of the new UPS contract – the quarter/quarter increase in wages was 3.6 percent in Q4. Wage costs in manufacturing also posted a much larger increase in Q4, which to some degree reflects the new UAW contract. The sharp variances in wage growth across industry groups and the year-to-year shifts are useful illustrations of a point we frequently make, which 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.

It also bears noting that as wage growth has moderated over recent quarters, the pace of labor productivity growth has accelerated. Aside from the positive implications for profit margins, this will bring some comfort to the FOMC given the links they see between wage growth and inflation. As we expect wage growth to settle at a pace faster than seen prior to the pandemic, it is critical that the faster pace of productivity growth be sustained, but it is far too soon to make any calls on that.

