ECONOMIC UPDATE
REGIONS
July 31, 2024

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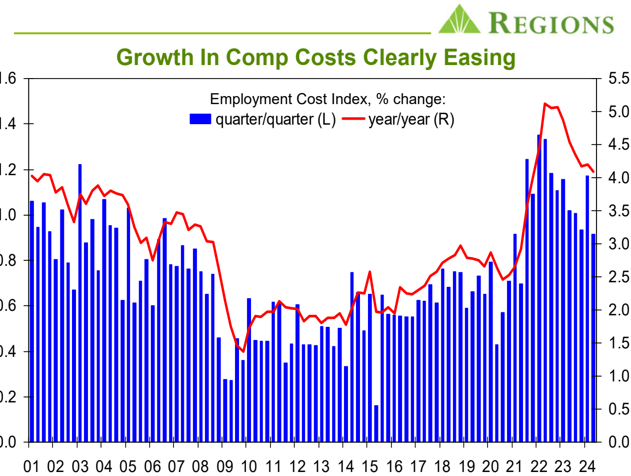
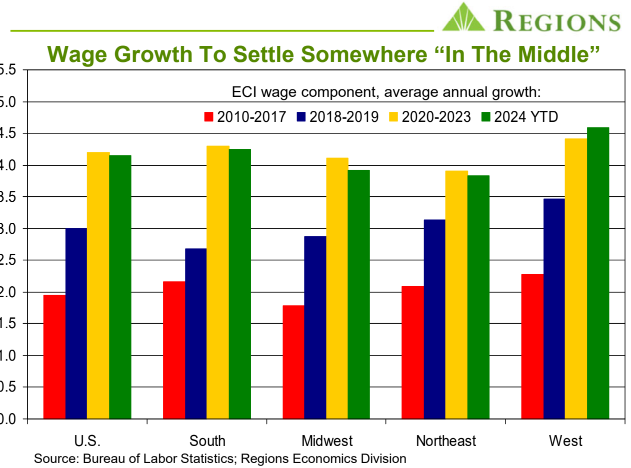
Q2 2024 Employment Cost Index: Growth In Comp Costs Clearly Easing

- The total ECI was up 0.9 percent in Q2 2024, with the wages/salaries component up 0.9 percent and the benefits component up 1.0 percent.
- The total ECI was up 4.1 percent year-on-year, with wage costs up 4.2 percent and benefit costs up 3.8 percent.

Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.9 percent in Q2, matching our below-consensus forecast, leaving the total ECI up 4.1 percent year-on-year. The wages component of the ECI was up by 0.9 percent, as our forecast anticipated, marking the smallest quarterly increase since Q2 2021 but, at 1.0 percent, the increase in the benefits component was a bit stronger than we anticipated; on a year-on-year basis, the wages component is up 4.2 percent, and the benefits component is up 3.8 percent. In keeping with a host of other indicators showing cooling labor market conditions, the ECI clearly shows decelerating growth in labor compensation costs, particularly wage costs. That trend had been in place well before the Q1 ECI data surprised many to the upside, but we noted at the time the Q1 data were almost surely an outlier as opposed to a reacceleration in the trend rate of wage growth. That growth in labor costs continues to moderate but continues to run ahead of inflation while the trend rate of labor productivity growth is perking up is pretty much the ideal set of circumstances for workers, firms, and, oh by the way, central bankers. While we do expect further moderation in the growth of labor costs, we nonetheless expect wage growth to settle into a trend rate higher than that seen prior to the onset of the pandemic which, absent further acceleration in labor productivity growth, may not be all that ideal of a set of circumstances for firms or central bankers.



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 helps set up an argument we've been making over the past couple years, which is that we do not expect wage growth to settle all the way back to the pace seen prior to the pandemic. Recall that after a lengthy run of middling wage growth, reflecting the degree of labor market slack wrought by the 2007-09 recession, we finally began to see faster and more broadly based (across industries and geographies) wage growth in 2018. That wage growth took a great leap forward after the onset of the pandemic was not surprising given the disruptions in labor supply triggered by the pandemic. Our argument has been that wage growth would ultimately settle somewhere between the average rate seen over 2018-19 and the rate seen over 2020-23, in part because we did not expect the labor force participation rate to fully rebound from the sharp decline seen at the onset of the pandemic, and in part because we've looked for an increase in trend productivity growth. The significant increase in foreign born labor over the past couple years has likely helped dampen wage growth, but whether or to what extent that increase will be sustained remains to be seen. Our sense is that the magnitude of this inflow will begin to diminish, which would support wage growth ahead of the pace seen over 2018-19. That remains to be seen, but barring a more pronounced slowing in the broader economy and, in turn, the labor market, than we anticipate, we do see a higher floor for wage growth.

Decelerating wage growth is seen across most industry groups, though we will caution that the effects of the UPS wage contract remain evident in wages in transportation/warehousing. It is no surprise to see health care leading wage growth amongst other industry groups given the extent to which health care continues to dominate overall job growth.

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