ECONOMIC UPDATE
REGIONS
October 31, 2017

Q3 2017 Employment Cost Index: Growth In Comp Costs Accelerates Further in Q3

- The total ECI was up 0.7 percent in Q3 2017, with the wages/salaries component up 0.7 percent and the benefits component up 0.8 percent.
- Year-on-year, the total ECI was up by 2.5 percent in Q3 with wage costs up 2.4 percent and benefit costs up 2.4 percent.

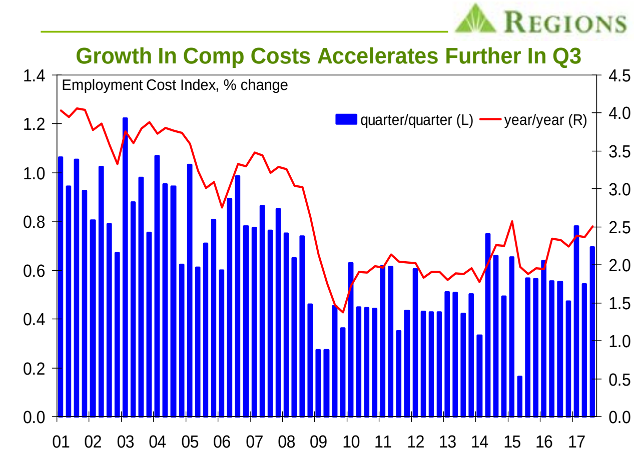
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.7 percent in Q3 2017 in line with the consensus forecast but slightly above our forecast of a 0.6 percent increase. The wage component of the ECI was up 0.7 percent and the benefits component was up 0.8 percent, the largest increase in this component since Q2 2014. Year-on-year, the total ECI was up 2.5 percent in Q3, with the wage component up 2.5 percent and the benefits component up 2.4 percent. Business services, manufacturing, and retail trade were the industry groups posting the largest increases in total compensation costs in Q3. On the whole, the ECI data show continued moderate growth in labor costs, consistent with a labor market approaching but not yet at full employment.

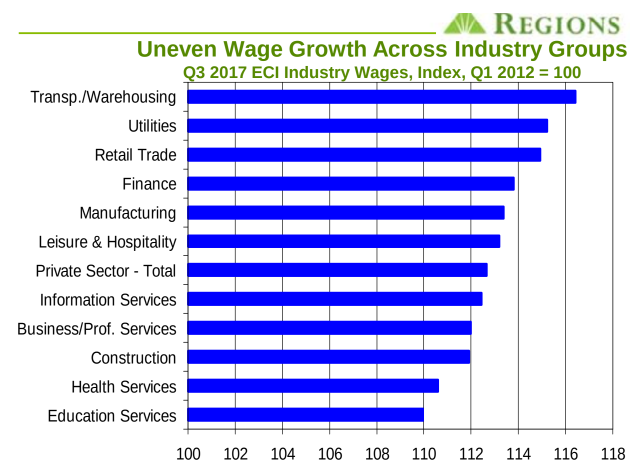
The ECI is one of the three main data series – the others being average hourly earnings from the monthly employment report and unit labor costs from the quarterly labor productivity and costs report – showing trends in labor costs. The ECI tends to get less attention than its two counterparts but to 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 pensions). 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 differentials in earnings across industry groups (the September 2017 employment report is a perfect illustration of this point). These differences aside, the alternative series are at present showing moderately accelerating wage growth.

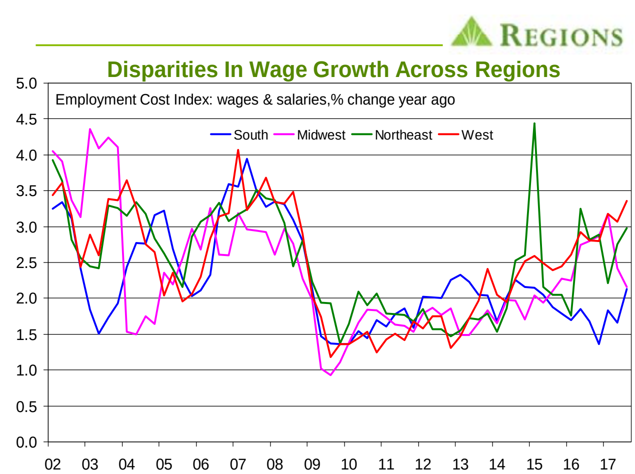
Wages in business and professional services rose by 1.2 percent in Q3, which yields year-on-year growth of 2.7 percent, well above the pace that has prevailed over recent quarters. Wages in transportation and warehousing were up 1.0 percent in Q3, which translates into a year-on-year increase of 3.4 percent. As seen in our middle chart, this industry group has posted the fastest growth in wages since Q2 2012 and this above-average growth is likely to persist in part due to the shifting nature of consumer spending, i.e., the steadily growing share of spending accounted for by online sales. Wages in retail trade were up 0.8 percent in Q3, for a 3.4 percent year-on-year increase. As seen in our middle chart, retail trade has posted easily above-average wage growth since Q1 2012, which reflects the impact of minimum wages increases as well as many of the larger, national retailers raising entry level wages, increases that filtered up through the seniority chain.

In addition to disparities in wage growth across industry groups, the ECI data also show disparities across the broad geographic regions, which we highlight in our bottom chart. As measured in the ECI data, wages for private sector workers in the West region were up 3.4 percent year-on-year, followed by a 3.0 percent increase in the Northeast. Growth in the Midwest region tailed off sharply, with year-on-year growth slipping to 2.2 percent in Q3. Wages in the South region were up just 2.1 percent, and the South has lagged the other three regions since mid-2015. Much of this weakness has been centered in the West South Central sub-region, which consists of Arkansas, Louisiana, Oklahoma, and Texas. Clearly the sharp shifts in the fortunes of the energy sector have weighed on growth in labor costs in the latter three states, but these effects should soon fade from the data.

The Q3 ECI data are consistent with other measures showing moderately accelerating labor costs. As the labor market tightens further, this acceleration will continue, but contrary to some who see the causality running in the other direction, our view is that somewhat limited pricing power on the part of firms will keep growth in labor costs in check, though service providers will have a bit more latitude to raise wages.







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