ECONOMIC UPDATE
REGIONS
January 31, 2018

Q4 2017 Employment Cost Index: Faster Growth, But Not "Full Employment" Fast

- The total ECI was up 0.6 percent in Q4 2017, with the wages/salaries component up 0.5 percent and the benefits component up 0.5 percent.
- Year-on-year, the total ECI was up by 2.6 percent in Q4 with wage costs up 2.5 percent and benefit costs up 2.5 percent.

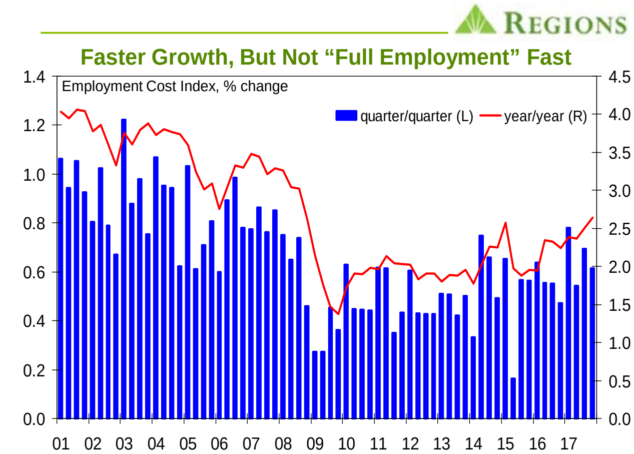
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.6 percent, as we and the consensus expected. Both the wage component and the benefits component posted 0.5 percent increases in Q4, smaller increases than those seen in Q3. As of Q4, the total ECI is up 2.6 percent year-on-year, with both wages and benefits up 2.5 percent. The quarter-to-quarter data can be a bit jumpy, even if less so for the ECI than for many other series, so the annual data are more indicative of underlying trends in labor costs. For 2017 as a whole, the total ECI increased by 2.5 percent, with wages up 2.5 percent and benefits up 2.4 percent. On the whole, the ECI data show continued moderate growth in labor costs, consistent with a labor market with far less slack than in the recent past but more than implied by a 4.1 percent headline unemployment rate.

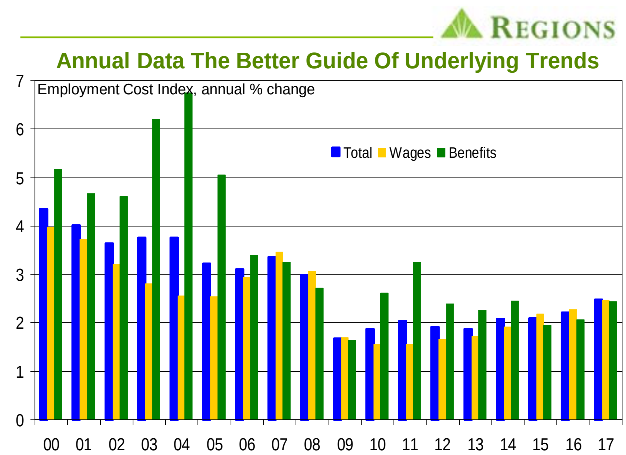
The ECI is one of the three main data series – the others being average hourly earnings from the monthly employment report and unit labor costs from the quarterly labor productivity and costs report – showing trends in labor costs. The ECI tends to get less attention than its two counterparts but to 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. These differences aside, the alternative series are at present showing moderately accelerating wage growth.

It will come as no surprise that wage growth was uneven across industry groups in 2017. What may come as a surprise, however, is that the two industry groups posting the largest increases in wages in 2017 were leisure & hospitality services and retail trade. Wages in leisure & hospitality services were up 4.07 percent in 2017, with wages in retail trade up 3.37 percent; transportation/warehousing was a close third, with wages up 3.35 percent in 2017. The wage growth seen in leisure & hospitality services and retail trade (and to a lesser extent the warehousing segment) should not be that much of a surprise when one accounts for higher minimum wages across many parts of the U.S. in 2017 and what were on the part of many firms in these industry groups discretionary increases in entry level wages, increases that tend to filter up through the seniority chain. These two effects will be in play again in 2018, with higher minimum wages taking effect in many states on January 1 and many firms announcing higher entry level wages – the difference this year is that those announcements have come across a wider swath of industry groups than has been seen over the past couple years. This "base effect" will lead to faster reported year-on-year growth in comp costs in 2018, which won't necessarily be the case with the one-off bonus payment many firms announced in the wake of the 2017 tax bill.

To us, what is more striking in the annual data is that wage growth in so many industry groups is clustered in the 2.0-2.5 percent range, as seen in our bottom chart. For the private sector as a whole, the 2.57 percent growth in wages in 2017 is better, but only marginally so, than the 2.35 percent increase in 2016 and the 2.26 percent increase in 2015, but still far from indicative of an overheating labor market. One benefit of the ECI is that is gives us a look at growth in benefit costs – firms manage growth in total comp costs, not simply wage costs, and benefit costs are also accelerating, but moderately.

Even so, the ECI data are consistent with other measures showing moderately accelerating labor costs. This acceleration will continue as the labor market tightens further in 2018, but growth in labor costs will remain shy of a pace consistent with full employment.





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