ECONOMIC UPDATE

REGIONS

January 31, 2019

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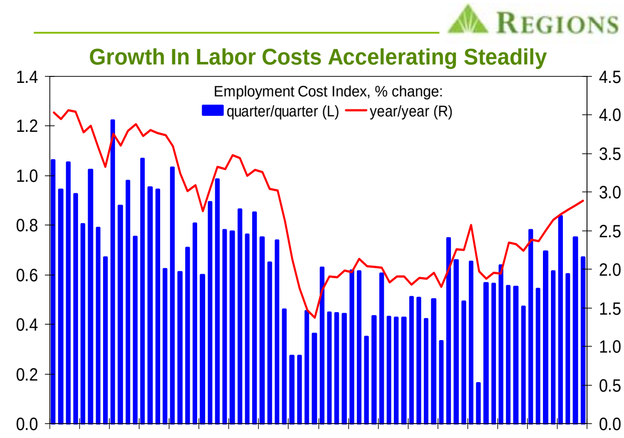
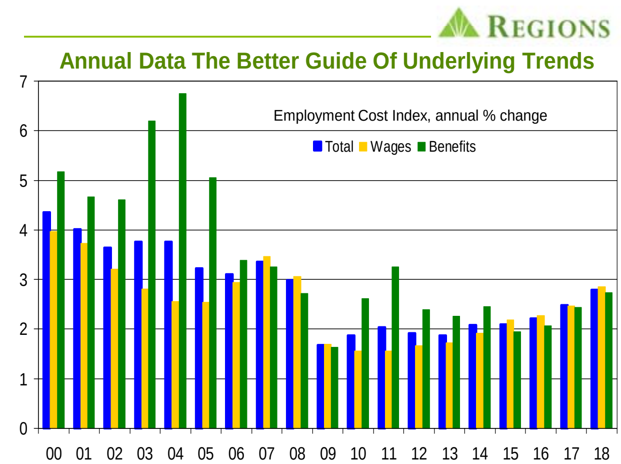
Q4 2018 Employment Cost Index: Growth In Labor Costs Accelerating Steadily

- The total ECI was <u>up</u> 0.7 percent in Q4 2018, with the wages/salaries component <u>up</u> 0.6 percent and the benefits component <u>up</u> 0.7 percent.
- Year-on-year, the total ECI was <u>up</u> by 2.9 percent in Q4 with wage costs <u>up</u> 3.1 percent and benefit costs <u>up</u> 2.8 percent.

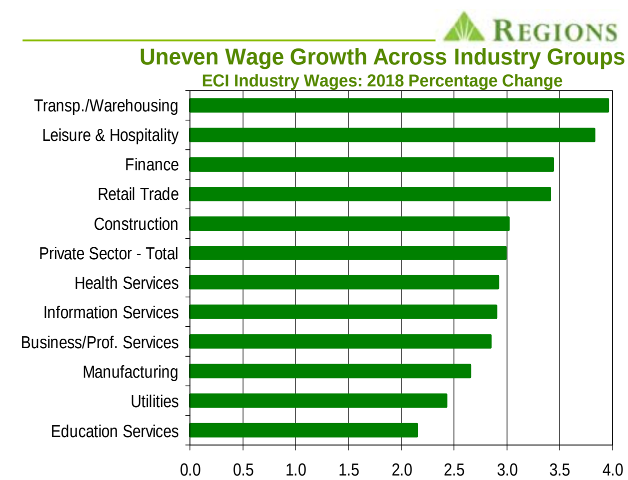
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.7 percent in Q4, below the 0.8 percent increase we and the consensus expected. Wage costs as measured in the ECI were up 0.6 percent in Q4, down from the 0.9 percent increase seen in Q3, while benefit costs were up 0.7 percent. Our forecast anticipated a 0.8 percent increase in wages and a 0.7 percent increase in benefit costs. As of Q4, the total ECI is up 2.9 percent year-on-year, with wage costs up 3.1 percent and benefit costs up 2.8 percent. As can be seen in our top chart, the quarter-to-quarter changes can be somewhat volatile, so the annual data are more reflective of the underlying trends in labor compensation costs. For 2018 as a whole, the total ECI increased by 2.8 percent, with wages up 2.9 percent and benefit costs up 2.7 percent. Regardless of how you look at the data, the conclusion is the same – while the ECI data show growth in labor costs is steadily accelerating, the ECI data do not paint the picture of a labor market on the boil despite an unemployment rate having pushed below 4.0 percent and likely to go even lower.



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 earnings differentials across industry groups. These differences aside, the alternative series are showing faster, but not full employment fast, wage growth.



One advantage of the ECI is that it gives us detailed data on compensation costs across the major industry groups, which is a more informative way to look at growth in labor costs than the broad average hourly earnings metric. It will come as no surprise that wage growth varies across industry groups, but the ranking of wage growth across industry groups may be surprising. For 2018 as a whole, wages in the transportation/warehousing industry group rose by 3.96 percent, topping all industry groups and displacing leisure & hospitality services from the top spot this industry group held in 2017. Even so, wages in leisure & hospitality services rose by 3.83 percent in 2018, followed by growth of 3.44 percent in finance and 3.41 percent in retail trade. To some extent, wage growth in retail trade and in leisure & hospitality services has been helped along by mandated hikes in minimum wages and also by many national chains having voluntarily raised entry level wages – increases which tend to filter up through the seniority chain. Growth in wages in transportation/warehousing reflects what has been rapid job growth in this industry group, in large measure fueled by shifting consumer shopping patterns, and we expect wages in this industry group to post another solid increase in 2019. Given the persistent complaints of labor shortages in construction, it may seem as though wage growth in this industry group would be faster – the 3.02 percent increase in wages in 2018 ranks fifth amongst the major industry groups. Wage growth in construction has actually been accelerating – 2018 saw the fastest annual growth in construction wages since 2008 – but started from such a slow pace that even with faster growth, construction still lags other industry groups. On the whole, however, there is no single industry group in which wage growth suggests labor supply constraints are fueling intense wage pressures.



The ECI data are in line with other measures showing moderately accelerating labor costs. We expect to see this pattern continue as the labor market tightens further in 2019.

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