ECONOMIC UPDATE

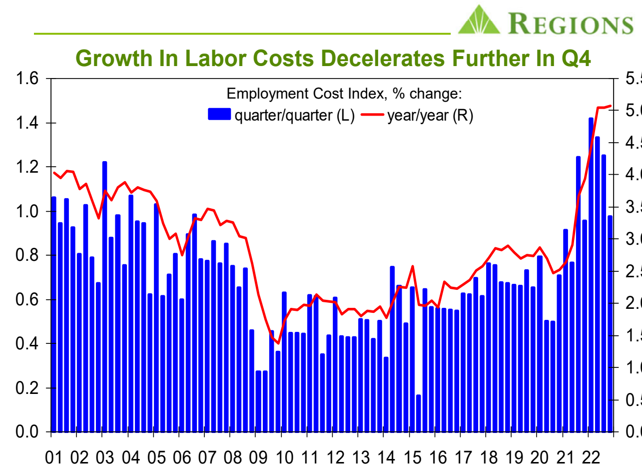
REGIONS

January 31, 2023

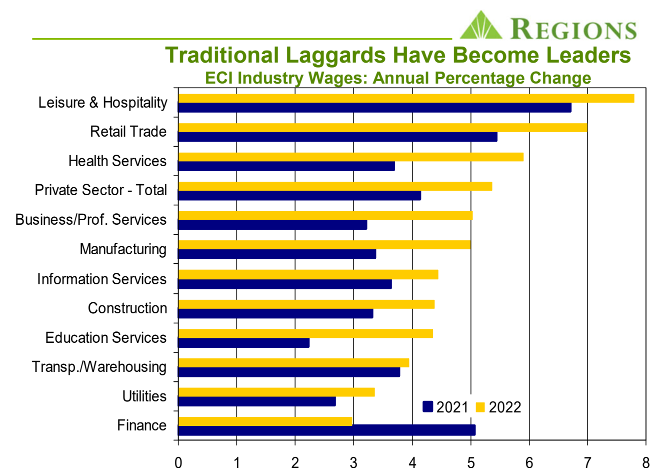
Q4 2022 Employment Cost Index: Growth In Labor Costs Decelerates Further

- The total ECI was up 1.0 percent in Q4 2022, with the wages/salaries component up 1.0 percent and the benefits component up 0.8 percent.
- For full-year 2022, the total ECI was up by 4.9 percent, with wage costs up 5.0 percent and benefit costs up 4.7 percent.

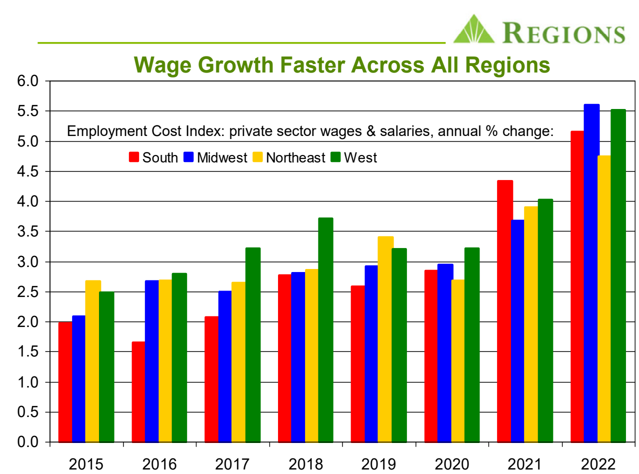
Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 1.0 percent in Q4 2022, matching our below-consensus forecast, with wage costs up 1.0 percent and benefit costs up 0.8 percent. Quarterly growth in total labor costs decelerated in each of the final three quarters of 2022 and our expectation is that growth will continue to slow as we move through 2023, which will soon be reflected in smaller over-the-year increases in the ECI. For full-year 2022, total labor compensation costs rose by 4.9 percent, with wage costs up 5.0 percent and benefit costs up 4.7 percent. That growth in labor comp costs has slowed is consistent with other measures, such as aggregate private sector wage and salary earnings as measured in the personal income data and in the earnings detail from the monthly employment reports. Not only has the pace of private sector hiring slowed over the past several months, but aggregate hours worked have also been falling of late with shorter average workweeks being used by firms reluctant to let workers go in the face of slowing demand as a means of managing total labor input. It should be noted that wage growth has slowed across industry groups, including across service providing industries, which is relevant in that some point to wage growth in the service providing industries as a prime source of broader inflation pressures.



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.



With the exception of financial activities, wage growth was faster in each of the broad industry groups in 2022 than was the case in 2021, as we illustrate in our middle chart. What stands out is that for the second year in a row leisure and hospitality services and retail trade logged the fastest wage growth across the broad industry groups. That wage growth in leisure and hospitality services has been so rapid is not surprising in light of employment levels in this industry group remaining far below pre-pandemic norms and job vacancies remaining significantly elevated. Still, looking at the quarterly data shows slowing wage growth in most industry groups over the final quarter of 2022, and this includes retail trade and leisure and hospitality services.



As our bottom chart shows, wage growth accelerated across each of the broad regions in 2022 with the Midwest (5.6 percent) seeing the fastest growth. It is interesting to note that the South Atlantic and Mountain sub-regions have seen faster growth in labor comp costs over the past several quarters. The former includes Florida and the Carolinas, while the latter includes Colorado, Nevada, and Utah, all states in which rapid population growth has likely been at least in part due to the increased incidence of remote work since the onset of the pandemic, which could be one factor driving the geographic splits in the ECI data.

As do we, the FOMC sees the ECI as the most reliable gauge of trends in labor costs. While we have not agreed with some FOMC members having characterized the labor market as being "tight to an unhealthy degree," those inclined to do so will have to take notice of the clear deceleration in the growth of labor costs as measured by the ECI, even those who see the pace of wage growth as still being uncomfortably high. Wage growth will surely continue to slow as labor demand cools and the broader economy slows further.

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