

US: FED'S PREFERRED MEASURE OF WAGES IMPROVED ONLY SLIGHTLY IN 2016

**The US Employment Cost Index (ECI), a quarterly measure of wage compensation favored by the Fed, advanced 2.2% in 2016, barely above the 2.1% gain registered in both 2014 and 2015*

**The strong ECI gains were concentrated in mainly low-paying and less-productive jobs*

****The continued modest gains in the ECI support the Fed's perception that it can take its time in normalizing monetary policy. However, anticipate that fiscal policy reforms and stronger economic growth raise the risk that the Fed falls behind the curve***

The ECI, a favored measure that uses fixed weights that control for the effects of interindustry shifts among workers, advanced by 0.5% q/q in Q4, below its recent 0.6% trend. Its 2.2% yr/yr rise in Q4 and 2.2% increase in 2016 was barely above its 2.1% increase in both 2014 and 2015.

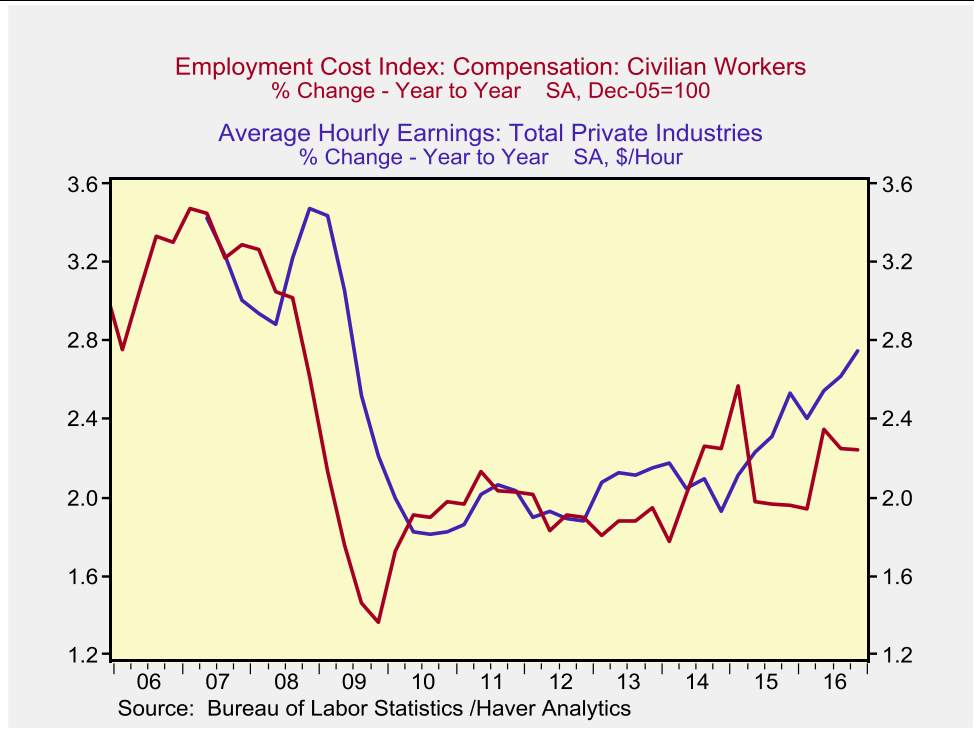
Unlike other measures of wage growth, like the monthly data on average hourly earnings that have picked up since 2015, the ECI has failed to show any notable improvement (see Chart 1). In aggregate, both the goods and service industries have had sluggish growth in employment costs (see Chart 2), with only a few major sectors such as retail trade, transportation and warehousing, information, leisure and hospitality showing any marked acceleration. Most of these sectors are low paying and less-productive jobs.

We have long-maintained, that unless labor productivity increases and structural issues faced by the economy are fixed, wage growth **will remain subdued** (see ["How much can US wages rise"](#), October 26, 2016 and Chart 3). The expected fiscal reform this year is expected to address some of these structural problems, with corporate tax reform and more infrastructure spending (if done smartly) lifting wages and productive capacity.

The continued tepidness in the ECI may give the Fed comfort in thinking it can take its time in normalizing monetary policy. However, with labor markets tightening, anticipated fiscal and economic reforms that are expected to boost economic activity would provide more flexibility to businesses to raise product prices, which raises the risk that the Fed falls behind the curve. The Q1 ECI report will be released in late April, well before the June FOMC meeting when the Fed is expected to next raise rates.

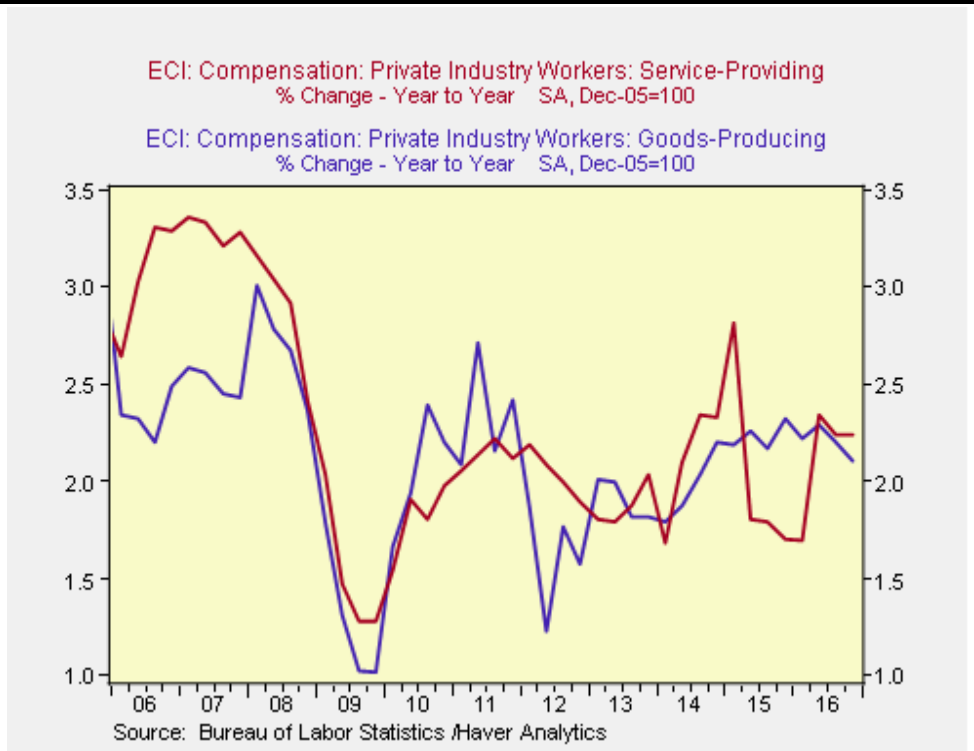
31 January 2017

Chart 1: The Employment Cost Index vs Average Hourly Earnings (Year-Over-Year, %)



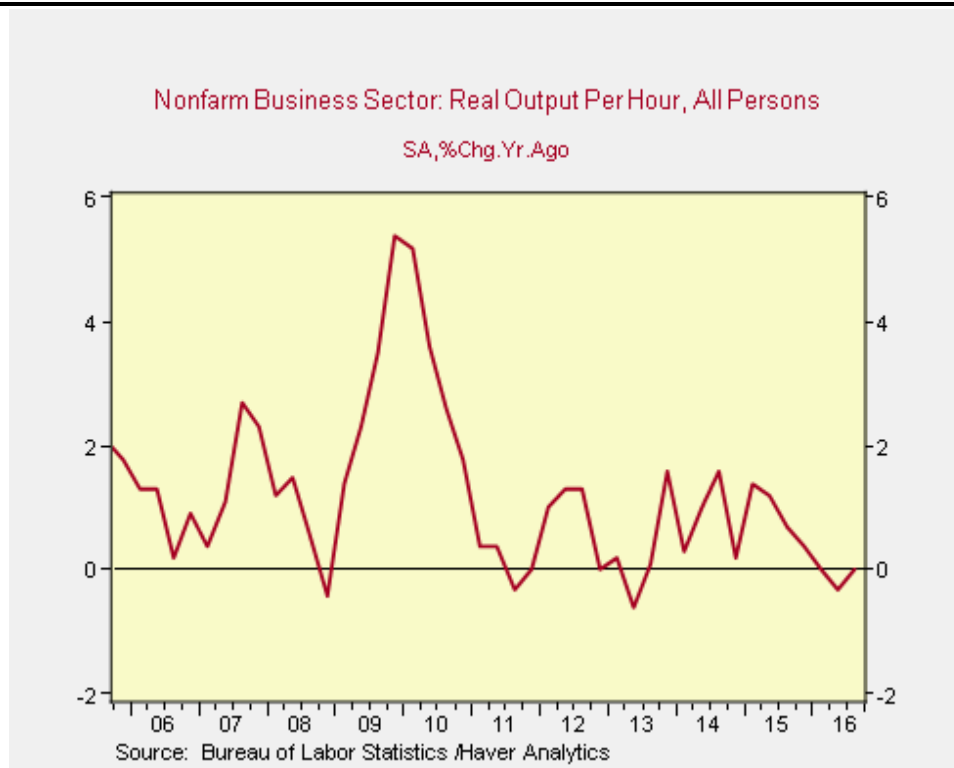
Source: Quarterly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: The Employment Cost Index for Service vs Goods Sectors (Year-Over-Year, %)



Source: Quarterly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: Real Output Per Hour of All Persons in the Nonfarm Business Sector (Year-Over-Year, %)



Source: Quarterly data. Source: Bureau of Labor Statistics and Haver Analytics

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