Economic Analysis

Employment Cost Index up 0.6% in 4Q14

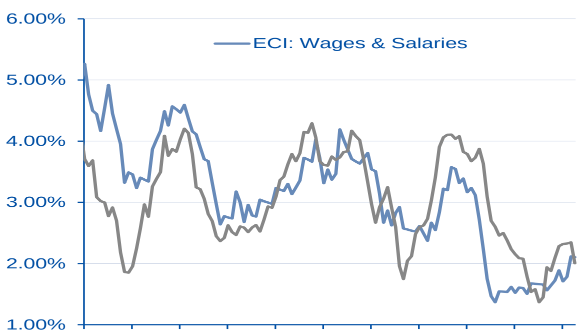
Kim Fraser Chase

- **Wages and salaries rose 0.5% in 4Q14, benefits increased 0.6%**
- **Increasing inconsistencies between ECI and average hourly earnings growth**
- **Despite strength in ECI, wage inflation is expected to remain subdued in 2015**

The employment cost index (ECI) is coming under close watch as policymakers await signs of higher inflation, and more notably, higher wages. In the fourth quarter, the ECI increased 0.6% on a QoQ seasonally-adjusted basis following a 0.7% pace in both 2Q and 3Q, marking 2014 as the strongest year of the recovery thus far. By component, wages and salaries increased 0.5% while benefits rose 0.6% for the quarter. On a YoY basis, the ECI accelerated throughout all of 2014, finishing the year off at 2.3% growth. In real terms, the ECI increased 1.5% YoY, the fastest pace since 3Q09.

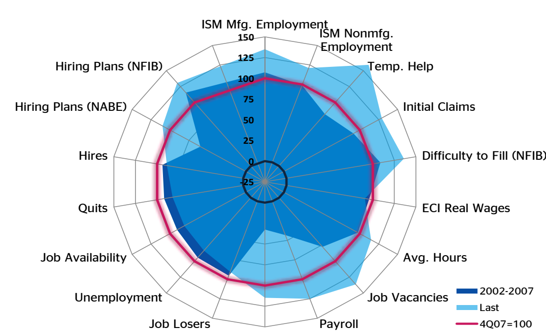
Taken at face value, strength in the ECI is welcomed with open arms. However, there seem to be some inconsistencies with other measures of wage inflation. Most notably, average hourly earnings reported in the establishment survey were flat and/or decelerated throughout 2014, with YoY growth in 4Q14 hitting the slowest pace since 2Q13. The relationship between the two measures, particularly when considering the wages and salaries component of the ECI, appears to have fallen apart compared to pre-recession trends. This brings up the question of which indicator is more relevant and reflective of the true underlying movement in the labor market. Furthermore, it remains unclear whether one can be a leading indicator of the other as we move forward in monitoring wage inflation. As other labor market indicators have shown significant improvement throughout the past year, wage growth is still lagging behind. Even with the latest strength in the ECI and the diminishing slack in the labor market, we are not convinced that wage growth will pick up significantly in 2015. Hiring tends to be skewed toward the low-skilled lower-wage positions, and with such a large pool of workers to fill those spots, it is unlikely that business will feel the pressure to increase wages. Still, we will continue to monitor the ECI particularly as it relates to the Fed's policy accommodation as it is one of the indicators that Yellen has brought up on multiple occasions.

Chart 1
ECI & Average Hourly Earnings (YoY % Change)



Source: Bureau of Labor Statistics & BBVA Research

Chart 2
Labor Market Outlook (%)



Source: BLS, DoL, NABE, ISM, & BBVA Research

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