Economics Group

How Worrisome Is the Recent Slowdown in Wage Growth?

Average hourly earnings growth has weakened over the past year, but the ECI suggests a more modest pullback. Compensation plans point to some firming, but wage growth looks set to remain historically weak.

The ECI Suggests Wage Growth Is Not Slowing Sharply

Wage growth has remained historically weak despite the labor market clearly tightening in recent years. Low inflation along with lackluster productivity growth is in part to blame; the need to push for higher nominal wages has lessened and the case for real wage increases is harder if workers are not producing much more while on the job. At the same time, a greater share of workers are at the later stage of their career when earnings tend to increase more incrementally, making composition a factor (workers aged 55+ account for 24% of the labor force, compared to 18% in 2007). Yet these dynamics have not changed to any meaningful extent over the past year, and average hourly earnings (AHE) growth has rolled over (top chart).

As we noted last fall, some weakening in labor demand—evidenced by both job openings and small business hiring plans—suggested businesses were likely to ease up on wage hikes. Plans to increase compensation, which lead average hourly earnings growth, were also reined in as the boost from 2018’s stimulus began to fade and the trade war flared. That said, the few industries that have not seen wage growth slow over the past year have been those hardest hit by the trade war and slower global growth more generally—manufacturing, mining and transportation (middle chart). However, that appears due to fewer new hires in each industry, which are typically brought in at lower pay points and hold down the industry average.

The fourth quarter reading of the Employment Cost Index (ECI), which adjusts for the mix of jobs, corroborates the slowdown in private wages, but suggests it has been more modest than the latest AHE numbers. Where worker compensation has slowed more notably has been in terms of benefits (bottom chart). A detailed breakdown is available only through the third quarter, but shows a sharp pullback in nonproduction bonuses (up 10% yr/yr in Q3-18 to down 22% in Q3-19), after many companies announced bonuses tied to 2018’s tax cuts. Therefore we think that the slowdown in wage growth and compensation more generally over the past year is tied partly to the tough base comparisons brought about by 2018’s buoyant growth environment and does not reflect significant weakening in the labor market.

Onward and Upward

Looking ahead, we expect wage growth to resume its upward trend. Although the economy is not expected to grow as fast as it did a year or two ago, businesses directly threatened by the trade war are likely to be more willing to raise pay as the threat to the bottom line posed by tariffs has eased. Plans to increase compensation have already perked back up. Moreover, scarcity still matters. While wage growth may not be as strong as many expected, it has nonetheless strengthened over the cycle. As the labor market tightens up a bit more this year, we expect to see wage growth rebound as well. That said, we expect only a modest pickup, which, along with slower job growth and higher inflation, will keep a lid on real income growth this year.

Source: U.S. Department of Labor, National Federation of Independent Businesses and Wells Fargo Securities