Economic Viewpoint

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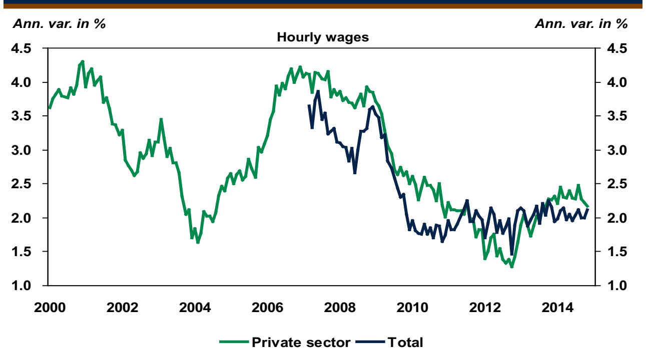
Can we expect wages to accelerate in the United States?

A key factor for the Federal Reserve in 2015

Several economic indicators have improved significantly in the United States, and real GDP growth and employment are increasingly robust. Growth by wages remains neutral, though, despite the better job market performance. Luckily, some indicators are beginning to raise hopes that hourly wages will grow faster. As the Federal Reserve (Fed) is also worried by weak wage gains, an acceleration could be a decisive factor in starting to raise key rates during 2015.

The 2008 and 2009 recessions were hard on the job market and economy as a whole. The consequences were also negative for wage growth. The annual change to hourly wages in the private sector averaged 3.9% between 2006 and 2007. In the 24 months covering 2010 and 2011, the average fell by half to 1.8%, belatedly reflecting the many layoffs that occurred during the crisis. It even bottomed out at 1.3% in October 2012 (graph 1). The private sector has posted slightly more robust growth for several quarters recently, but the public sector's weakness is offsetting these gains. Other surveys providing information on wage growth, including the employment costs index, show a trend similar to that of the average hourly wage.

Graph 1 – Wage growth remains weak



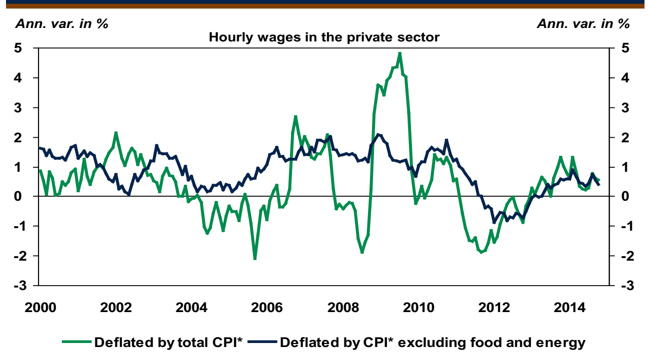
Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

WHY IS WAGE GROWTH SO WEAK?

Clearly, the problems in the job market and surplus capacity that settled in during the crisis are the main sources of weak wages. We can therefore expect the improved job market to cause wages to advance more quickly. However, other factors, often related to the consequences of the crisis, are also limiting their movement.

Weak growth by prices overall in the U.S. economy has affected wage pressures. Core inflation, which excludes food and energy, stayed at an average 2.4% from 2006–2007. Over the 24 months covering 2010 and 2011, growth was 1.3%. Core inflation has since risen to 1.7%. If we look at wages in real terms, inflation's weakness improves the picture compared with the historic average, without completely erasing the problem (graph 2).

Graph 2 – Growth by real wages is a bit stronger relatively



* Consumer price index.
Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

Workers' worries mean that wage demands have not been very strong. What's more, household views of the job market are even bleaker than reality. A survey conducted

François Dupuis
Vice-President and Chief Economist

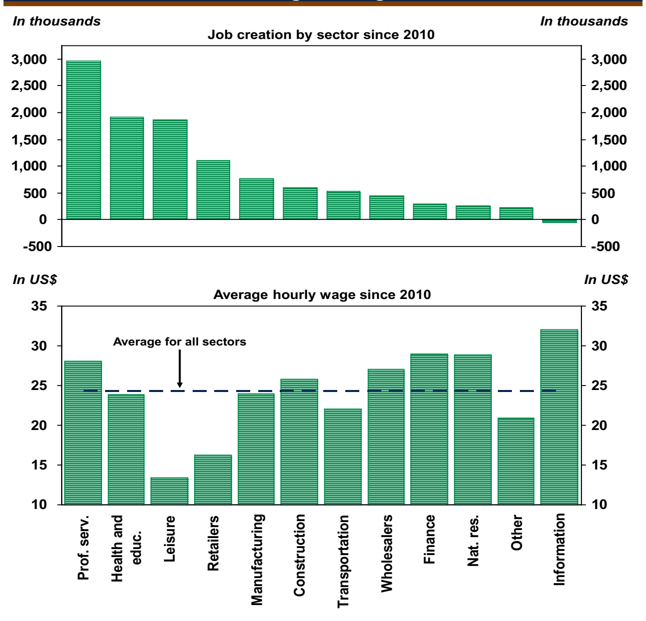
Francis Généreux
Senior Economist

514-281-2336 *or* 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

last August showed that, on average, U.S. respondents believed that the jobless rate was 32%! The latest data available at that time put the jobless rate at just 6.2%. Low consumer confidence, affected by economic difficulties and the various federal budget policy crises that occurred over the last few years, did not help workers strengthen their demands.

The types of jobs created during the recovery may have also affected movement by average wages. Most of the jobs created were not in industries where wages beat this average (graph 3). The exception is the professional services sector, but health and education, leisure (including hospitality and food services) and retail sales are not sectors where compensation is especially attractive.

Graph 3 – Job creation has not occurred in sectors offering the highest wages



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

We can also see a historic trend for **worker disaffiliation**. Unions are increasingly less prevalent in the United States. In 2013, just 6.7% of private sector workers belonged to unions. Twenty years earlier, this rate had been 11.2%. Unions and collective bargaining therefore have little influence on wage pressures.

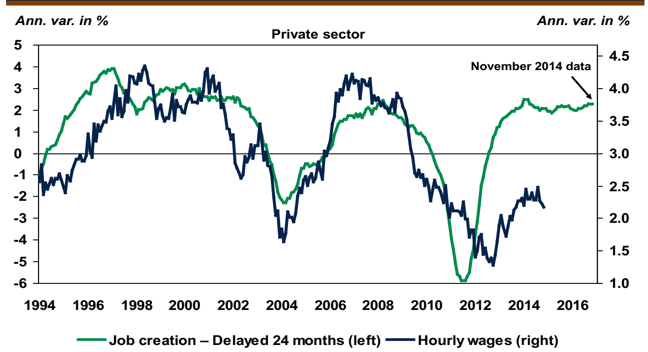
International economic pressure also means that U.S. businesses must limit cost increases, especially in sectors where competition from emerging nations is fierce.

ARE THERE SIGNS THAT WAGES ARE ACCELERATING?

We have started to see signs that wage growth could soon pick up. Already, November posted monthly growth in the average hourly wage of 0.4%, the strongest since June 2013, which is a step in the right direction. However, it follows more modest results (average of 0.1% over the four previous months). Also note that the annual change to private sector wages has stayed between 2.2% and 2.5% for a year, while growth was below 2% in 2012.

The job market's stellar performance in recent quarters should eventually support better growth by worker compensation. The jobless rate fell below 6%, and many indicators of slack in the labour market are also improving. During the fall, initial jobless claims fell to historically very low levels. During previous recoveries, good employment growth led to wage acceleration after a delay of around two years (graph 4). This time, the lag seems much longer, but the positive effect should still occur.

Graph 4 – Strong job creation has had little influence on wages

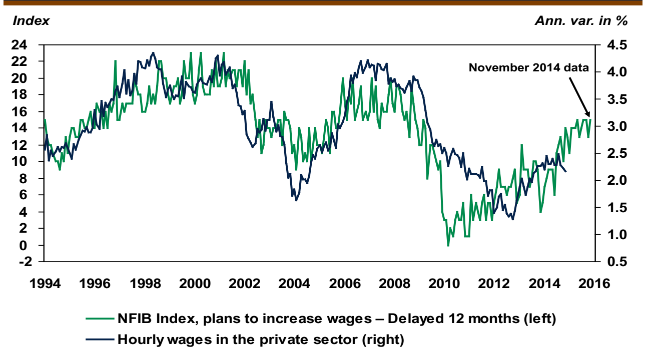


Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

We can see that workers are finding some "courage" for new demands. The number of voluntary terminations of employment have risen in the last few months, reaching levels that haven't been seen since early 2008. Households are also more confident and now expect livelier income growth. According to the University of Michigan consumer confidence survey, median income growth expected for the next year has gone from 0.5% to over 1.75% in just a few months.

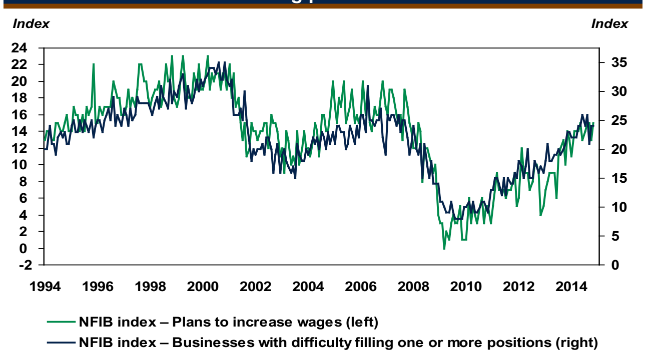
Businesses are also feeling a bit more pressure to increase worker compensation. This is especially true for small businesses. The National Federation of Independent Business survey shows that a growing number of respondent businesses are planning to raise wages (graph 5). This is a direct consequence of the difficulties that businesses have had filling vacancies (graph 6).

Graph 5 – Small businesses are beginning to feel pressure to raise wages



Sources: National Federation of Independent Business, Bureau of Labor Statistics and Desjardins, Economic Studies

Graph 6 – Wage pressures are coming from difficulties filling positions

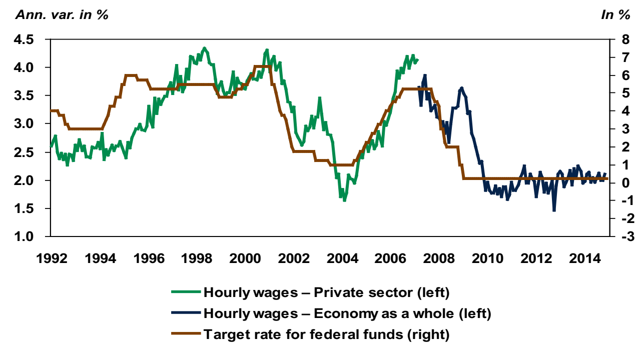


Sources: National Federation of Independent Business and Desjardins, Economic Studies

WAGE INCREASE EXPECTED BY THE FED

Wage growth that is faster than the unusually low rates for this point in the economic cycle will be very welcome. This is especially true as Fed leaders still bemoan the weak price growth in the U.S. economy. While the job market and the jobless rate in particular are relatively satisfactory, inflation remains below Fed targets. An upswing by worker compensation would be an important turning point and reassure Chair Janet Yellen and her colleagues. They would then be more confident that inflation is heading toward their targets, notwithstanding the drop by oil prices which will temporarily bring back a disinflationary trend. It is hard to believe that the Fed could begin to raise key rates without seeing true acceleration by wages. Historically, key rates seem to move in tandem with the latter's movement, since they are very representative of any inflationary pressure on the U.S. economy (graph 7). We can therefore conclude that faster wage growth for the economy as a whole seems to be a prerequisite for key rate increases. Since there are factors suggesting that compensation will soon take a more positive turn, we can expect the Fed to begin normalizing key rates in 2015.

Graph 7 – Stronger wage growth will prompt the Fed to begin raising key rates



Sources: Federal Reserve Board, Bureau of Labor Statistics and Desjardins, Economic Studies

Francis Généreux
Senior Economist