

Economics Group

John E. Silvia, Chief Economist

john.silvia@wellsfargo.com • (704) 410-3275

Sarah House, Economist

sarah.house@wellsfargo.com • (704) 410-3282

Michael Pugliese, Economic Analyst

michael.d.pugliese@wellsfargo.com • (704) 410-3156

What Does Wage Growth Tell Us About Full Employment?

After increasing at 2 percent for most of this expansion, wage growth has strengthened over the past year. With low inflation and weak productivity continuing to weigh on wage growth, the recent pickup is telling.

Rising Wages as a Sign of Labor Scarcity

As we have discussed in prior notes, structural changes in the labor market, including declining participation rates and a shift to more part-time employment, can make it difficult to determine whether the economy is at full employment. Wage growth, therefore, can be a useful input into determining the state of the labor market. When labor is plentiful, businesses have little need to boost wages on a widespread basis. Yet, when labor becomes scarce, employers need to offer more compensation to attract and retain workers, leading to a pickup in wage growth.

For most of this expansion, wage growth was absent among the list of labor market indicators making steady, albeit painfully slow, improvement. More recently, however, wage growth has strengthened across a range of measures. Average hourly earnings have increased 2.8 percent over the past year after rising around 2 percent from 2010 to 2015. Growth has been even more pronounced when looking only at the wages of workers who have been employed in the current and prior year, as evidenced by the Atlanta Fed's Wage Tracker (top chart). The Employment Cost Index, which includes both wages and benefits, has also picked up recently.

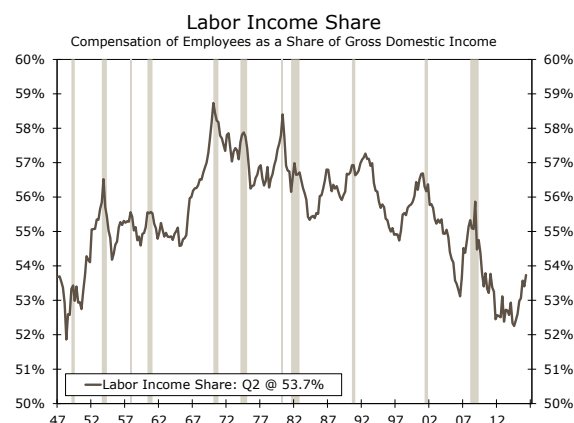
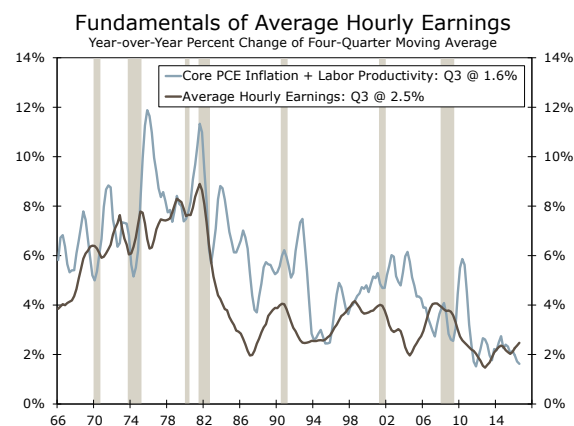
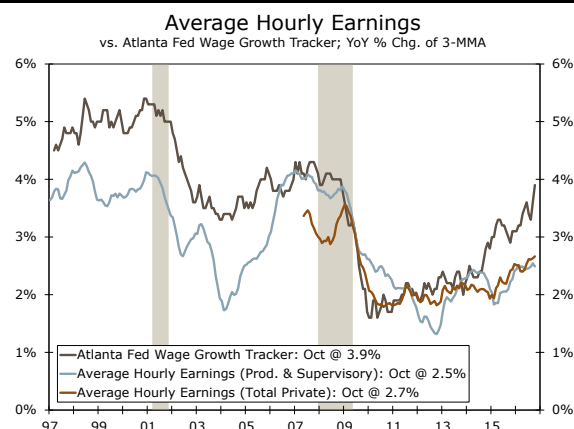
Still, Why So Low? Fundamentals Matter

Despite strengthening over the past year, by all measures wage growth remains weak relative to previous cycles. Is this a sign the labor market has further room to run, or are there other factors holding back wage growth?

One factor in recent years holding back average hourly earnings and employment costs—both reported in nominal terms—has been the low inflation environment. With prices rising only moderately, most workers have felt little need to push for higher wages.

Nominal wages may also still be held down in part due to the inability of firms to cut real wages in the short run. Researchers at the Federal Reserve Bank of San Francisco show there is still an elevated share of job-stayers who have not received a pay increase over the past year, which likely reflects ongoing real-wage adjustment after the deep recession and sluggish pace of expansion.

Low productivity has been another key holdup to stronger wage growth in this expansion. Over time, real wage gains are driven by the ability of workers to produce more per hour. Given weak productivity growth and low inflation, wage growth does not look as inconsistent with full employment (middle chart). As illustrated in the bottom chart, labor's share of income has risen since 2014, consistent with a tightening labor market. Therefore, while wage growth remains low relative to the past two expansions, the pickup in growth over the past year is telling.



Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(212) 214-8543	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Analyst	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC, is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC, and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2016 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE