SMBC Group

US Macroeconomics

February 2, 2023

Joseph Lavorgna, Chief US Economist | 212.610.1741 | joseph.lavorgna@smbcnikko-si.com

Don't Look Now, but Labor Costs are Slowing

The percentage change in the employment cost index (ECI) rounded up to 1.0% last quarter, the third quarter in a row in which its growth rate slowed. **The Q4 2022 increase in the ECI was also the smallest gain since Q2 2021** (+0.8%). But the slowdown in labor costs does not stop here.

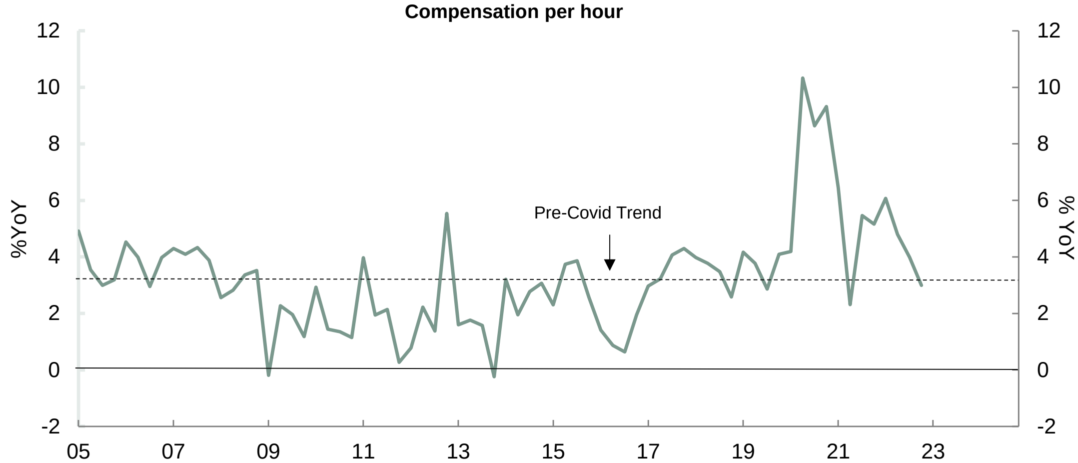
In the Q4 2022 productivity and costs report, total labor compensation also grew a modest 1.0% after a string of sub-1% increases. **Over the last year, compensation per hour has increased only 3%**, which is down from 4% in the previous quarter and down from over 6% at the start of last year.

The sharp downtrend in compensation is illustrated in the graph below. **The current growth rate in compensation is already back in line with its pre-covid trend**. And remember this is with a 3.5% unemployment rate. So, as the economy weakens and unemployment begins to rise, compensation growth — all else being equal — is likely to slow significantly further. This will push compensation growth even lower!

Importantly, the moderation in compensation is dampening growth in unit labor costs, too. They rose just 1.1% last quarter, the smallest gain in nearly two years. **Over the past four quarters, unit labor costs are up 4.5% versus a 7.0% cyclical high**. More moderation can be expected if employment growth continues to slow.

Regarding the next set of labor data, January average hourly earnings are poised to rise 0.3% for the second month in row when new figures are released tomorrow. Recall that last month's lower than expected increase (coupled with a downward revision to November) was the catalyst for the rally in rates and risk markets. Further downward revisions may be forthcoming. Why?

Every year the Bureau of Labor Statistics conducts a benchmark revision that alters previously reported data on jobs, earnings, and hours. **Generally, the pattern in revision reflects the underlying momentum of the economy**. Last year, real GDP increased just 1.0% compared to four quarters earlier. This was down from nearly 6% growth in the previous year. Hence if there are any surprises in tomorrow's report, they are likely to be skewed to the downside.



Source: BLS, Haver, SMBC Nikko

Disclaimer

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation ("SMBC"), SMBC Nikko Securities America, Inc. ("SMBC Nikko"), SMBC Nikko Securities Canada, Ltd. ("Nikko Canada"), SMBC Capital Markets, Inc. ("SMBC-CM"), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading, or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting, and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices, or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation's accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

These materials may contain forward-looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward-looking statements are based upon certain assumptions. All forward-looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward-looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices, or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a U.S. registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered brokerdealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties.