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FLASH NOTE – BENIGN ECI WAGES SHOW NO PRESSURE ON INFLATION FROM LABOR MARKET, SUPPORTS FED CUTS

The Employment Cost Index (ECI) –regarded inside the Fed as the gold standard measure of compensation – has printed soft across the board for Q3 with the lowest overall read since mid-2021, underlining that there is to date no sign of upward pressure on inflation from a strong labor market.

Indeed, adjusted for productivity, ECI-based unit labor costs for Q3 looks likely to print below 2 per cent, putting downward pressure on inflation relative to the Fed's target.

ECI can be noisy from quarter to quarter, and the benign print comes against a backdrop of continued upside surprises on activity, with monthly core PCE for September printing at its highest level since April with mild upward revisions to prior months.

But while the inflation data is less spotless than it appeared prior to the first releases for September, allowing for the usual month-to-month volatility we think the overall trajectory remains very consistent with inflation heading back to target without the need for the economy to weaken further, assuming that housing services related inflation is lagging and will abate.

Core PCE inflation on three, six and twelve month annualized horizons is running at a modest 2.35, 2.30 and 2.65 per cent respectively – fractionally higher than expected a month or two ago but only modestly so, and consistent with the idea that underlying inflation is already down to the mid-2s.

We view the data overall as suggesting that upside inflation risks from a strong economy and labor market remain to date muted, and while the Fed and investors will need to keep this under ongoing review given the strength in the data, it is fundamentally constructive for risk and for the soft landing.

ECI in particular in our view will reassure the Fed that its basic story in which inflation is heading back towards target with bumps along the way has not been thrown off track by the strong recent data.

This reinforces our confidence that cuts in both November and December remain the right base case, with November a lock, and December still materially odds-on.

The Q3 2024 employment cost index (ECI) came in below expectations, with whole economy total compensation (wages plus benefits) increasing by 0.8 per cent quarter-on-quarter vs consensus of 0.9 per cent. This increase translates into an annualized rate of 3.2 per cent, a significant fall from the 3.7 per cent recorded in Q2 2024.

ECl whole economy wages and salaries also slowed down from 3.7 per cent q/q saar in Q2 to 3.2 per cent q/q saar in Q3. The magnitude of the deceleration was very similar in the private (0.3p.p.) and government (0.6p.p.) sectors, pointing to a widespread cooldown in workers compensation.

ECl private sector wages and salaries decreased to 3.1 per cent q/q saar from 3.4 per cent q/q saar, still 0.8p.p. below the growth rate of wages and salaries in the government sector. Given the recently strong productivity growth – which could extend into Q3 in light of the strong GDP print – wages appear consistent with inflation at target, plausibly in a spot sense below target, supporting the Fed's view that the labor market is not a source of inflationary pressure anymore.

The softening in private sector wage growth primarily came from services sectors, with wages and salaries in services providing industries declining by 1.0p.p. to 2.9 per cent q/q saar. In contrast, wage growth in goods producing sectors increased by 3.5p.p. to 4.5 per cent saar, largely reflecting a strong acceleration in construction wages. Union workers saw their wages and salaries decelerate from 5.8 per cent to 4.1 per cent on a quarter-on-quarter annualized rate, after seasonal adjustment.

The growth in employment costs for private industry workers excluding incentive-paid occupations – another measure closely tracked by the Fed – also further declined in Q3. In particular, after seasonal adjustment the wages and salaries component dropped to 3.7 per cent q/q annualized from 4.2 per cent in Q2.

September PCE inflation was broadly in line with expectations. Headline inflation came in at 0.18 per cent month-on-month, while core printed at 0.25 per cent, both in line with consensus. Year-on-year core inflation was slightly above market consensus, printing 0.1p.p. higher than expected at 2.7 per cent.

Compared to the expectations based on yesterday's release of Q3 data, core PCE came in slightly lower mostly due to upward revisions to the July (1bp m/m) and August prints (3bp m/m). The revisions were mostly concentrated in services, as the upward revisions to monthly core services ex-housing (CSEH) inflation were larger in both July and August.

With core printing slightly above 0.2 per cent on a monthly basis, 3-month annualized core increased from 2.2 per cent to 2.3 per cent, while 6-month annualized core continued to decline, falling to 2.3 per cent from 2.5 per cent in August.

Core goods inflation posted a positive growth on the month (0.1 per cent), but remained in negative territory across other horizons, with 3-month and 6-month annualized rates essentially unchanged at -0.7 per cent and -0.3 per cent respectively while the 12-month rate ticked up a bit to -0.4 per cent (vs -0.5 per cent prior).

PCE CSEH – the Fed's preferred measure for domestically-generated inflation – saw a re-acceleration to 0.3 per cent month on month, after stabilizing at around 0.2 per cent over the past two months. The stronger monthly print pulled the 3-month annualized rate higher to 2.9 per cent (vs 2.7 per cent prior). But inflation rates on 6-month and 12-month horizons continued to decelerate to 2.7 per cent and 3.2 per cent, respectively.

Looking at the underlying components that drove the firmer CSEH print, transportation services was among the categories that witnessed a substantial surge, increasing by 1.3 per cent month on month vs 0.2 per cent prior. In particular, airfares spiked 2.7 per cent on the month vs 0.4 per

cent prior. Healthcare services and auto insurance were also a bit stronger, both accelerating by around 0.2p.p. on the month to 0.4 per cent and 0.2 per cent, respectively.

Given the earlier release of the September CPI data, the deceleration in housing services inflation to 0.3 per cent month on month (vs 0.5 per cent prior) was expected. The deceleration can be observed across both primary rent (0.3 per cent vs 0.4 per cent prior) and owners' equivalent rent (OER, 0.3 per cent vs 0.5 per cent prior).

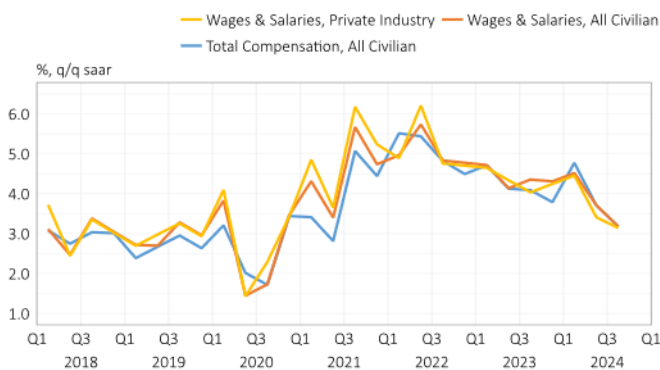
Employment Cost Index Growth

Percent, q/q

	2023 Q4	2024 Q1	2024 Q2	2024 Q3
All civilian				
Total comp	0.93	1.17	0.91	0.79
Wages & salaries	1.06	1.11	0.92	0.79
Private sector				
Total comp	0.94	1.11	0.86	0.73
Wages & salaries	1.04	1.09	0.84	0.78
Government				
Total comp	0.99	1.35	1.21	1.08
Wages & salaries	1.06	1.38	1.10	0.96

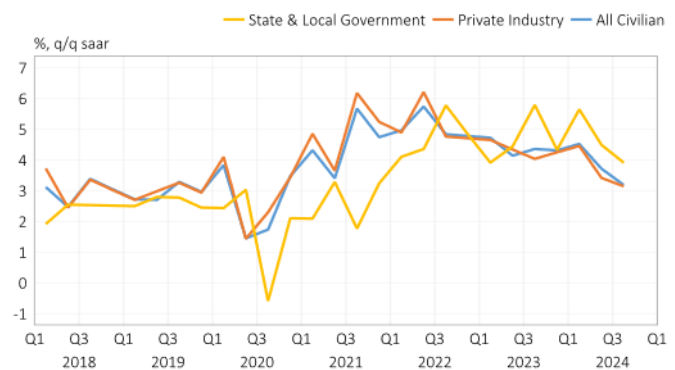
Source: BLS, Evercore ISI

Employment Cost Index



Source: Evercore ISI, U.S. Bureau of Labor Statistics (BLS)

Employment Cost Index – Wages & Salaries



Source: Evercore ISI, U.S. Bureau of Labor Statistics (BLS)

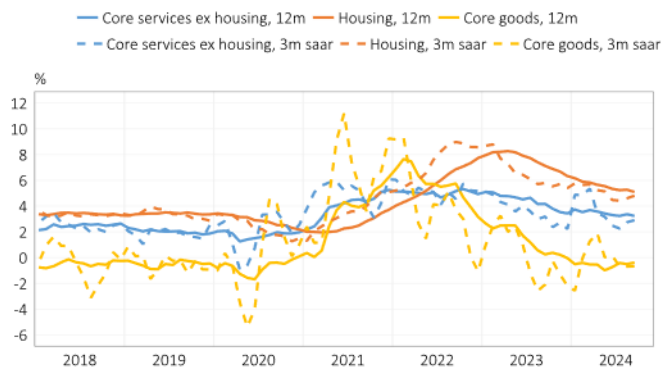
US PCE Inflation

Percent; Sep-24, prior month readings in parenthesis

	Headline	Core	CSEH	Housing	Core goods	Market-based core
1m	0.18 (0.11)	0.25 (0.16)	0.30 (0.20)	0.32 (0.47)	0.11 (-0.17)	0.26 (0.17)
1m saar	2.13 (1.39)	3.09 (1.89)	3.63 (2.46)	3.90 (5.73)	1.28 (-2.07)	3.19 (2.10)
3m saar	1.83 (1.60)	2.35 (2.21)	2.91 (2.74)	4.81 (4.61)	-0.67 (-0.69)	2.45 (2.14)
6m saar	1.66 (2.00)	2.30 (2.47)	2.70 (2.96)	4.64 (4.88)	-0.27 (-0.33)	2.14 (2.21)
12m saar	2.09 (2.27)	2.65 (2.72)	3.24 (3.36)	5.09 (5.27)	-0.38 (-0.51)	2.47 (2.52)

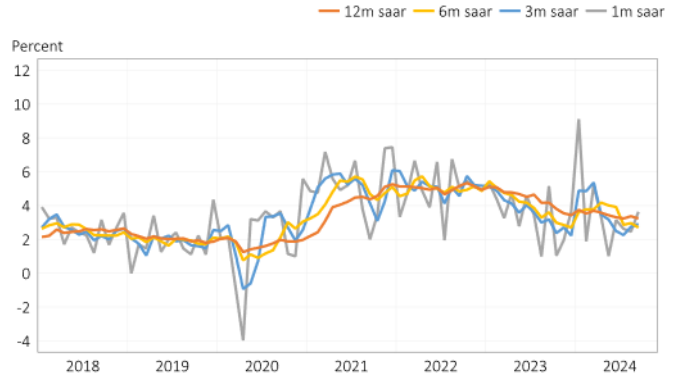
Source: BEA, Evercore ISI

Core PCE Inflation



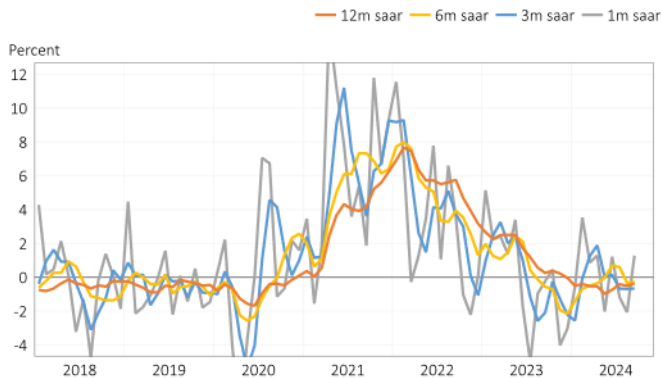
Source: Evercore ISI, U.S. Bureau of Economic Analysis (BEA)

PCE Inflation – Core Services ex Housing



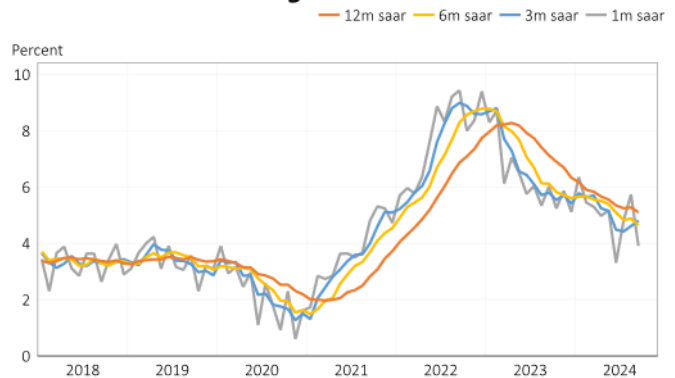
Source: Evercore ISI, BEA, MacroBond

PCE Inflation – Core Goods



Source: Evercore ISI, BEA, MacroBond

PCE Inflation – Housing



Source: Evercore ISI, BEA, MacroBond

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