Compensation Growth Running Well Ahead of Pre-Pandemic Pace

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Headlines

- **The employment cost index rose 0.8% in September from June, with wages and salaries also up 0.8%.** The release was delayed by more than one month.
- **On a year-ago basis the ECI was up 3.5% in September, a slight slowing from June.**
- **Annual compensation growth has slowed from 2022 but was below 3% before the pandemic.**
- **Strong compensation growth is one of the reasons for inflation that is above the Federal Reserve's objective.**
- **PNC expects a 25 basis point cut in the fed funds rate this afternoon.**

Details

Total civilian compensation increased 0.8% in September from June, according to the Employment Cost Index (ECI) from the Bureau of Labor Statistics (BLS). Both wages and salaries and benefits were up 0.8% over that period. Compensation in the private sector was up 0.8% in September, with state and local government growth of 0.8% as well. The ECI controls for changes in industries and occupations, and thus is a measure of individual compensation growth over time. The release of the September ECI report was delayed for more than one month because of the government shutdown.

On a year-ago basis total civilian compensation was up 3.5% in September, compared to 3.6% growth in June. Both wages and salaries and benefits were up 3.5% in September from one year earlier. After adjusting for inflation compensation growth was 0.5% year-over-year in September, including a 0.6% increase in wages and salaries.

Total compensation growth for private-sector workers over the past year was strongest in the Northeast and South, at 3.6%, with slower growth in the West (3.5%) and the Midwest (3.4%). Wage growth was strongest in the South, at 3.8%.

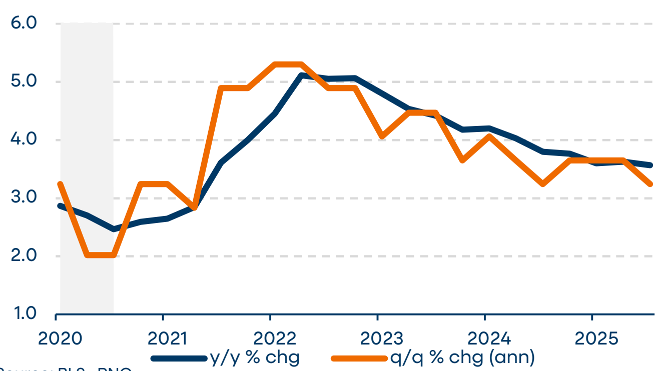
Compensation growth has slowed over the past few years, but is running ahead of its pre-pandemic pace, according to the ECI. Both total compensation and wage and salary growth peaked at above 5% on a year-over-year basis in 2022 as the very tight labor market forced businesses to aggressively raise pay. But as job growth has slowed and the unemployment rate has risen, compensation growth has been running at around 3.6% in 2025.

This is well above the below-3% pace prior to the pandemic, however, suggesting that strong labor cost growth is one of the reasons why inflation is running above the Federal Reserve's 2% objective. And with much weaker labor supply growth in 2025 due to restrictions on immigration and increased deportations, compensation growth is likely to remain elevated over the next few years.

Strong labor compensation growth contributing to inflation suggests that the Federal Open Market Committee may have a limited ability to cut the federal funds rate going forward. PNC expects the FOMC to cut the fed funds rate, their key short-term policy interest rate, by 25 basis points in their monetary policy press release later this afternoon. PNC then expects another 25 basis point rate cut in early 2026, but that will depend on the state of the labor market and inflation readings.

Stronger productivity gains from investment in artificial intelligence, leading to higher output per worker, could allow for stronger compensation growth over time with lower inflation.

Figure 1: Employment Cost Index (SA)



Source: BLS, PNC

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