Chart of the Month | October 2022

Wage Inflation Puts Additional Pressure on the Federal Reserve

John Rothe, CMT

Founder & Chief Investment Officer

john.rothe@riverbendinvestments.com

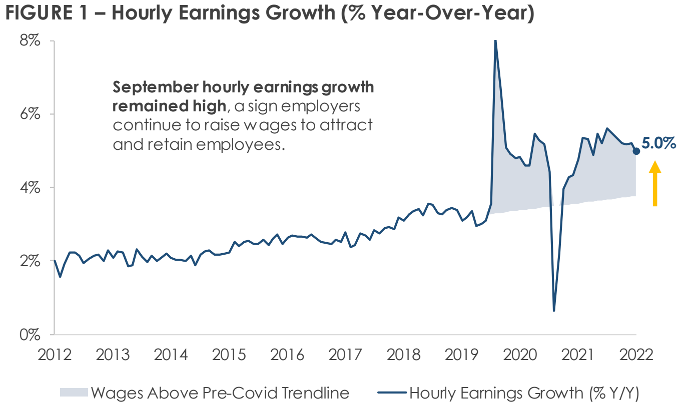
Inflation remains a closely watched topic in financial markets. Core inflation, which excludes volatile food and energy prices, increased +6.6% year-over-year during September. It was the fastest annual pace since August 1982 and signals inflation's persistence. Early inflation pressures were attributed to clogged supply chains and strong demand overwhelming limited supply, but a new source of inflation is gaining attention as supply chains normalize – wage inflation.

Figure 1 shows hourly wages increased +5% year-over-year during September. The growth rate, which is significantly above the pre-pandemic trend, indicates labor demand is outpacing labor supply and employers are paying more to attract and retain workers. What is causing the labor supply / demand imbalance? Data shows millions of workers left the labor market during the pandemic and have not returned.

Figure 2 graphs the number of people not in the labor force, which is defined as persons who are neither employed nor unemployed. This category includes retired persons, students, individuals taking care of children or other family members, and others who are neither working nor seeking work. The chart shows 95 million individuals were not in the labor force at the end of February 2020. The number spiked to 103.5 million at the end of April 2020 as workers left the labor market due to virus and health concerns, childcare responsibilities, and early retirements. While some of those individuals returned to the labor market, there are nearly 5 million more people not in the labor force at the end of September 2022.

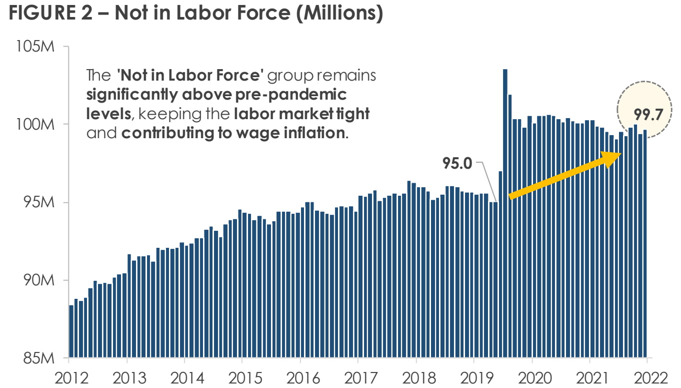
Wage inflation is yet another factor complicating the Federal Reserve's goal to bring under inflation control. Bringing the labor market back into equilibrium could ease wage inflation, but it could also significantly increase unemployment. Despite the near-term employment risk, the Fed views the risk of inflation becoming entrenched as a bigger long-term risk. All eyes will be on the labor market in coming months.

FIGURE 1 – Hourly Earnings Growth (% Year-Over-Year)



Source: Market Desk, Bureau of Labor Statistics

FIGURE 2 – Not in Labor Force (Millions)



Source: Market Desk, Bureau of Labor Statistics. Note: Data is seasonally adjusted.

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