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## WHY SOME ECONOMISTS SEE FASTER WAGE GROWTH AROUND THE CORNER

Looking beneath the headline wage figures offers a bit more hope for U.S. workers

By Lisa Beilfuss  
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Elusive wage growth has frustrated many Americans throughout the seven-year economic expansion. But some economic gauges suggest wages are set to accelerate in the months ahead. Here are some key measures to watch:

### **Backing Out the Baby Boomers**

One measure gaining popularity is the Federal Reserve Bank of Atlanta's wage tracker. Some economists say the indicator, which hit a seven-year high last month, is a better gauge of wage inflation because it adjusts for composition bias. The more familiar average hourly earnings series put out by the Labor Department's Bureau of Labor Statistics is influenced by demographics — namely, the large number of retiring baby boomers who are leaving the workforce with wages that are higher than those of new entrants. "It's masking an underlying gradual increase," said Nariman Behravesh, chief economist at IHS, of the BLS wage data that showed wages rose 2.5% from a year earlier. He favors the Atlanta Fed's measure because it looks at wages of people who have remained in their job for at least a year.

"Under normal labor market conditions, we'd expect the Atlanta numbers to run ahead of the regular hourly earnings series because people who remain in the same job tend to see their wages rise more quickly over time," says Pantheon Macroeconomics chief economist Ian Shepherdson. But the spread is widening, he warns, with the current gap between the Atlanta Fed's tracker (last up 3.4% from a year earlier) and the BLS average hourly earnings measure "much wider than early 2006, when the unemployment rate last slipped below 5%." Back then, the spread between the measures disappeared and hourly earnings briefly ran hotter than the Atlanta measure. While the Atlanta Fed's gauge doesn't always lead the BLS numbers, Mr. Shepherdson says it would be dangerous to ignore it.

### **Job Switchers**

Staying at the same employer and rising up the ladder is one way to secure higher pay. Switching jobs is the other. The recent pickup in median wage growth is being driven more by rapidly rising wages for switchers, a good sign because wage growth for job switchers has historically led pay growth for stayers, according to Paul Ashworth, chief U.S. economist at Capital Economics. Job switching feeds into the rate of voluntary job quits, which has been steadily climbing as Americans grow more confident in the labor market. "That's why [Fed Chairwoman Janet] Yellen puts such a premium on quits," Mr. Ashworth said.

### **Small-Business Signals**

Small businesses have been reporting increasing difficulty filling open jobs, a sign they'll have to raise pay to lure workers. According to the National Federation of Independent Business, a trade group for the small-business sector, more than a quarter of firms surveyed in May said they had positions they couldn't fill. The same share reported raising compensation during the month -- high for this recovery, according to NFIB chief economist Bill Dunkelberg. The problem is especially acute for small businesses seeking highly skilled workers.

"The small-business sector is where all the action is," said Mr. Shepherdson, who notes that the NFIB's jobs-hard-to-fill measure closely tracks the Atlanta Fed's wage gauge. That NFIB indicator leads real wages, he said, adding that "the NFIB numbers now clearly suggest that real wages will rise more quickly over the next year."

Mr. Dunkelberg, for his part, doesn't see the pressure building broadly.

Another possible sign of rising wage pressures coming from small business: Pay for job switchers at firms with fewer than 50 workers has jumped 6.5% over the past year, according to data from payroll provider ADP. While the clip has cooled a bit in recent months, it far outpaces the average wage gain of 1.6% among employees at medium and large businesses.

### **Real Versus Nominal Numbers**

Wages look much different in real, or inflation-adjusted, terms. Familiar measures come in nominal terms, not accounting for the broader inflation picture. While many Americans haven't seen meaningful pay increases in recent years, wage growth adjusted for inflation has been in line with the longer-run trend, said Tom Porcelli, chief U.S. economist at RBC.

Mr. Shepherdson also emphasizes the distinction: The mystery is in nominal terms and disappears in real terms, he said. Behind the gap? As inflation unexpectedly slowed and held lower for a long time, millions of people felt better off and they pushed a little less forcefully for a raise, Mr. Shepherdson said.

As prices pick up and chip away at that growth in real wages -- Mr. Shepherdson expects consumer prices excluding food and energy to rise 2.4% this year and 2.6% next year (after rising 2% last year and 1.7% in 2014) — employers may come under more pressure to lift pay.

Add it all up, and some economists say wage inflation is upon us, whether or not familiar measures show it. Mr. Shepherdson expects average hourly earnings, as measured by the BLS, to rise 3.3% this year (up from 2.5% in 2015) and 4% next year. Mr. Ashworth also predicts a pickup, but at a bit more gradual one. He expects wages to rise 3% by the end of this year and by 3% to 3.5% next year.

To be sure, many economists agree wage growth will be contained by a productivity rate that still is in the doldrums. "There's no way we're going back to a world where wage growth is running at 5%," Mr. Ashworth said. "There's definitely a lower ceiling for wage growth. It's like we have a new normal."

Even so, some indicators suggest there's room to go before hitting that ceiling. "More wage pressure is in the offing," Mr. Porcelli said. The signs "are all pointing up."

Corrections & Amplifications

Ian Shepherdson of Pantheon Macroeconomics expects average hourly earnings, as measured by the Labor Department, to rise 3.3% this year. An earlier version said 2.3%.  
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