

Surging labour costs heap pressure on the Fed

The lack of suitable workers at a time of intense demand is prompting firms to pay up for staff. With labour costs surging the most in years this will only increase inflation stresses in the economy and heap more pressure on the Fed to accelerate the process of “normalising” monetary policy



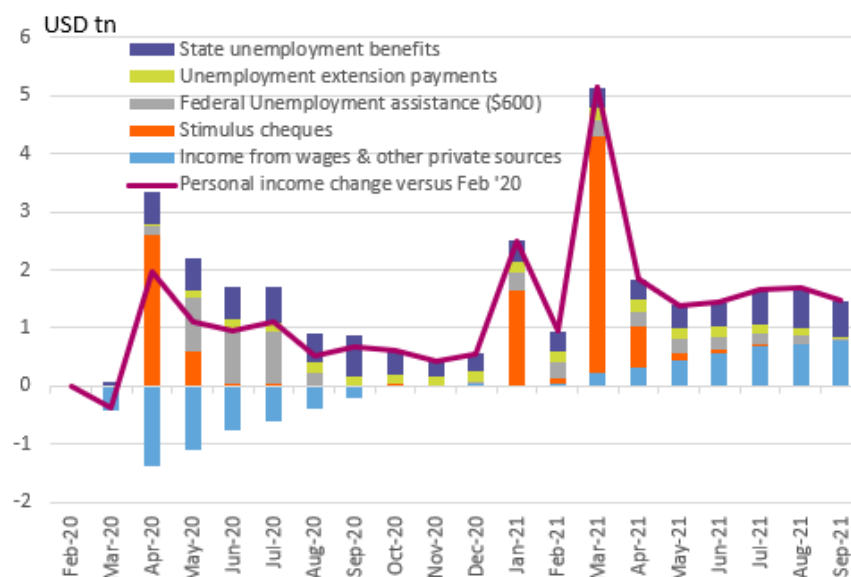
1.3% employment cost increase in 3Q

Benefits end, but households are flush with cash

Personal incomes fell 1% month-on-month in September as the extended unemployment benefits ceased. This was a bigger fall than expected, but the consensus -0.3% forecast had looked a little too upbeat given the situation. Despite today's figure, incomes are an annualised \$1.5tn higher than before the pandemic struck in February 2020 – a remarkable 7.8% increase. This underscores

our view that household finances remain in great shape and with household wealth having increased by \$26tn since 4Q 2019 there is no reason to believe that spending is about to hit the buffers with consumers able to weather a winter storm of higher energy costs.

Compositional change of household incomes versus pre-pandemic levels (\$tn)



Source: Macrobond, ING

Greenspan's favoured measure sets off alarm bells

Moreover, worker compensation increased 0.7% MoM which, given the mediocre payrolls increase in September, suggests pay rates are increasing rapidly. This message was reinforced by the 3Q employment cost index. Former Fed Chair Alan Greenspan was an avid watcher of this report and the fact that it surged 1.3% QoQ, its fastest rate since the series started in its current form in 1996, is going to set alarm bells off amongst both former and current central bankers.

Remember that there are 10.5mn job vacancies in the US (according to the JOLTS report) so the fact only 194,000 jobs were created in September indicates that it is a supply issue and not a demand problem. Given the red-hot competition for workers it is clear that companies are bidding up pay and benefits to not only recruit new staff, but also retain current employees.

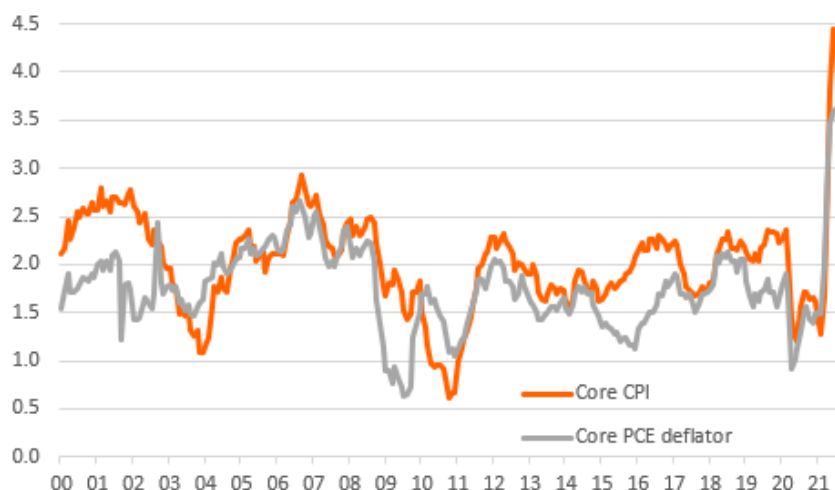
In a strong growth environment there is evidence that companies have got more pricing power than experienced in the past couple of decades with various business surveys suggesting a growing willingness amongst corporate America to pass higher costs on. Given the US is largely a service sector economy and workers are the biggest cost, today's report suggests inflation pressures are likely to build.

Inflation set to climb even higher

The core personal consumer expenditure deflator remained at 3.6% year-on-year, well above the 2% target and we see more upside in coming months. We are already expecting headline CPI to breach 6% and core to break above 5% by December and today's labour cost figures only add to the upside risks. Of course productivity growth can mitigate the impact from higher labour costs,

but given the bottlenecks running throughout the economy we are not confident that will happen imminently. As such the inevitable taper announcement next week may well start off at \$15bn per month, but we expect it to be accelerated early in 2022 with the growing prospect we could see three interest rate increases from the Federal Reserve next year.

Core (ex food and energy) inflation measures (YoY%)



Source: Macrobond, ING

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