WAGE GROWTH A MISSING PIECE OF THE FULL EMPLOYMENT PUZZLE

"We have increased hourly wages at least once since the recession.... What we have also done is maintain good individual health insurance 100 percent at our expense."

LARKIN MARTIN, owner, Martin Farms, Courtland, Alabama; employs 15 people, 12 full-time, on a 7,000-acre farm

During 2014, employment growth turned in its best year since 2000. The official unemployment rate fell to 5.6 percent, from its high of 10 percent five years earlier. Nevertheless, that strength in the labor market did not translate to bigger paychecks for most workers, and evidence on wages remained mixed in 2014.

Average private-sector wages rose by just 1.7 percent during the year, barely outpacing inflation, according to the U.S. Bureau of Labor Statistics (BLS) Payroll Survey. A different measure of wage growth, the Employment Cost Index, which adjusts for the changing composition of jobs over time and measures labor costs beyond just wages, ticked slightly higher later in the year. Still, all measures of wage growth remained well below historical norms through 2014.

Subdued wage increases are not characteristic of a tight labor market. As the labor market strengthened considerably, broad-based wage growth was a missing ingredient that would bolster policymakers' confidence that full employment is at hand.

Economists were unable to identify a single, underlying reason for sluggish wage growth. But Atlanta Fed analysis suggested that among many factors, two were especially significant.

Still-high numbers working PTER weighed on wages

Start with the simplest explanation economists often cite for weak wage growth: an imbalance in labor supply and demand. A still relatively large supply of unemployed and underemployed workers—including people working part-time who wanted full-time work (part-time for economic reasons, or PTER)—could be restraining wage growth. That is, there is intense competition among job seekers for available job opportunities. And within many jobs, the demand for more hours has been greater than the supply of hours offered by employers. Atlanta Fed economist Patrick Higgins found that, in addition to unemployment, the effect of the elevated share of PTER workers helps explain weak wage growth and some of the sluggish inflation since the recession (see the Median Year-over-Year Wage Growth chart).

A secondary factor that could have slowed wage growth is related to the composition of employment. For example, for full-time workers, year-over-year median wage growth was just under 2 percent in 2009; it steadily climbed to nearly 3 percent in the third quarter of 2014. Part-timers found the going much tougher. Their median wage growth was about half as much as that of full-time workers from 2011 through 2013, according to Atlanta Fed researchers who analyzed data from the U.S. Census Bureau Survey of Income and Program Participation. An elevated share of employment in part-time jobs may have depressed overall hourly wage growth to some extent.

More recent data from the U.S. Census Bureau's Current Population Survey suggest that overall wage growth picked up during 2014 and that the gap between part-time and full-time wage growth began to close. These are encouraging findings. But the wage growth of part-time workers as a group continued to lag well behind that of full-time workers, Atlanta Fed analysis showed. The good news is that the number of people working part-time for economic reasons declined by almost a million during 2014, to roughly 6.8 million, or 4.6 percent of all workers, according to the BLS. That was four times the decrease in 2013.

PTER rolls shrank as many employers increased workers' hours, BLS data indicate. By the end of 2014, average weekly work hours for private-sector production and nonsupervisory employees had returned to prerecession levels and were up substantially from their nadir of 2009, according to the BLS. The combination of continued strong growth in full-time employment and further reduction in the PTER rolls would bode well for a return to more normal wage growth trends going forward, Atlanta Fed analysis suggested.

Recession took big toll on wages

Low wage growth since the Great Recession is a product of compound forces. What is clear is that the economic downturn battered Americans' paychecks. The recession displaced millions of U.S. workers and left them with the largest earnings reductions

Pay raises for part-time workers continued to lag those of full-time employees.

Note: Shaded areas indicate recession. Lines represent median year-over-year wage growth, quarterly average.
Sources: Current Population Survey, authors' calculations

Source: U.S. Bureau of Labor Statistics, May 2013 (most recent data available)

since the BLS began the Displaced Worker Survey in 1984, according to the Cleveland Fed working paper "Why Do Earnings Fall with Displacement?"

Wage growth is intertwined with the Fed's dual mandate

Wage growth matters to the Fed. Wages and broader labor costs are crucial to both components of the central bank's dual mandate: price stability and maximum employment. And, of course, healthy wages are critical to the well-being of Americans.

Wage growth is a significant component of broader inflation. So perhaps not surprisingly, given lagging wages, most readings of inflation remained well below the Fed's goal of 2 percent throughout 2014. Fed policymakers seek signs of upward pressure on wages, and in turn wider inflation, to help them decide when to begin raising the federal funds rate.

As Atlanta Fed President Dennis Lockhart pointed out in a July 2014 speech, wage pressures would constitute important evidence that the nation is progressing toward full employment and moving closer to the Federal Open Market Committee's inflation target of 2 percent.