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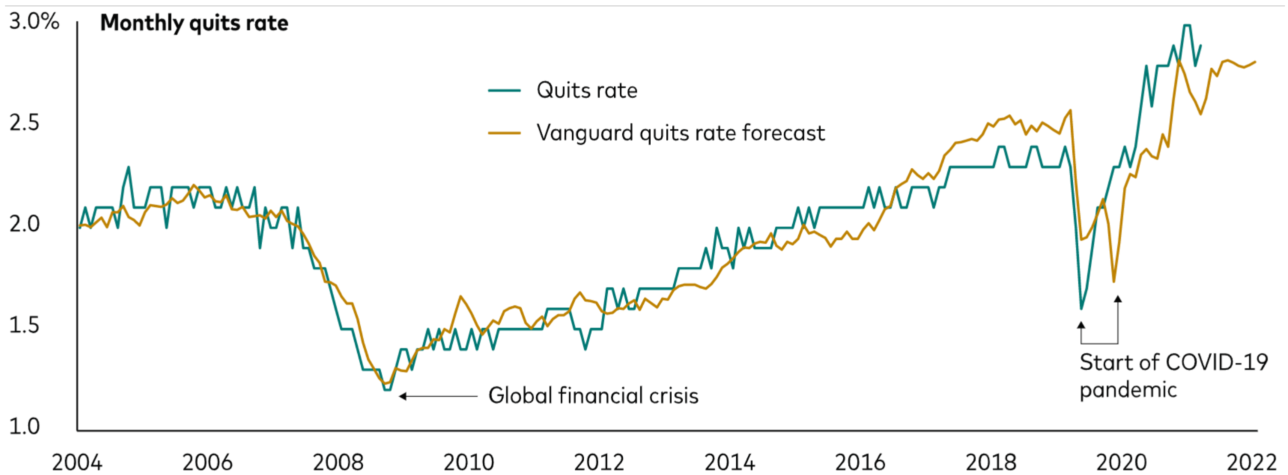
Introduction

The Federal Reserve plans, perhaps as early as its May 4 policy announcement, to start releasing back into the market some of the more than $4 trillion in U.S. government securities it has added to its balance sheet since the start of the pandemic.

The Fed will use this tool, known as quantitative tightening, alongside anticipated interest rate hikes throughout 2022 to rein in inflation, which is at a 40-year high. Vanguard expects the Fed to keep an especially watchful eye on wages during this period. Higher pay takes longer to establish itself in an economy than broader price increases, but when it does, it can precipitate further inflation, which can lead to even higher pay in a cycle that threatens to repeat itself.

A new analysis by Adam Schickling, a U.S.-based Vanguard economist, underscores the significance of compensation metrics today. Using a Vanguard model, Schickling forecasts that the U.S. "quits rate"—the Bureau of Labor Statistics' measure of employee-initiated job separations—is likely to remain elevated for the rest of the year, as is highly correlated wage growth.

Resignations are on the rise in a strong economy



Notes: The quits rate, taken from the U.S. Bureau of Labor Statistics' monthly Job Openings and Labor Turnover Summary, is depicted from December 31, 2004, through February 28, 2022. Vanguard's quits rate forecast is through December 31, 2022.
Sources: Vanguard calculations, based on U.S. Bureau of Labor Statistics data.

As the chart above shows, quits rates have been low when economies have been weak, such as during the global financial crisis and the start of the COVID-19 pandemic. People typically don't leave jobs if they don't already have another lined up or are pessimistic about the economy, Schickling noted. Quits rates have been correspondingly higher in stronger economies.

The pandemic sent millions of older workers into an earlier-than-anticipated retirement, one of several reasons for the labor shortage that is adding to inflationary concerns. Schickling expects only around 20% of those early retirees to return to the workforce this year and only around 40% ever to return, exacerbating labor market tightness that creates the conditions for what has become known as the Big Quit, or the Great Resignation. Many of these retirees have realized they don't need to return to work immediately, because they have accumulated savings (benefiting from elevated asset prices), their spouses still work, or they're eligible for pensions or government benefits, he said.

As job turnover has increased, so has compensation

Notes: Each dot represents a reading of the quits rate, taken from the U.S. Bureau of Labor Statistics' monthly Job Openings and Labor Turnover Summary, plotted against the corresponding month's wages and salaries reading from the bureau's Employment Cost Index. The five circled dots represent the most recent readings.
Sources: Vanguard calculations, based on U.S. Bureau of Labor Statistics data through February 28, 2022.

This chart shows the strong relationship between the quits rate and compensation. "It's very logical that higher rates of quitting are generally going to mean higher wage growth," Schickling said. "Quitting is going to happen when the economy is strong. And when the economy is strong, employers are competing for labor."

So the Federal Reserve, which is on record saying that a healthy labor market is contingent on price stability, may find its calculus governed by wage growth. "If quits rates stay elevated throughout the rest of the year," Schickling said, "we would expect nominal wage growth to stay around 5%, and that poses some challenge to breaking the dynamic of a wage-price spiral."

Notes:

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