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Job switching: a prelude to wage growth?

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Workers may want to switch jobs for a multitude of reasons. Whether to improve the quality of work life or to garner higher wages, they typically switch jobs by quitting their existing job rather than by becoming unemployed or leaving the labor force and then pursuing a new job. During economic expansions, the number of available jobs exceeds the number of workers seeking employment. The tighter labor market makes it more likely that employers offer higher wages to prospective employees, thereby creating an incentive for workers to switch jobs.

In "Job switching and wage growth," authors R. Jason Faberman and Alejandro Justiniano (*Chicago Fed Letter*, Federal Reserve Bank of Chicago, April 2015) argue that, because quits are procyclical—meaning they rise during economic expansions and fall during recessions—the worker quit rate, measured as a ratio of total quits to employment for a specific period, can be used to predict nominal wage growth and inflation pressures.

The authors argue that the procyclicality of quits implies that wages are also procyclical. Under the assumption that people typically switch jobs during an economic expansion to pursue higher paying jobs, Faberman and Justiniano assert that aggregate wages rise in concert with the quit rate. In contrast, wage growth would be lower during periods of economic contraction, when the quit rate declines. As evidence of a strong correlation between wage growth and the quit rate, the authors cite correlations between the quit rate and the wage component of the Employment Compensation Index (ECI) as well as the growth in average hourly earnings of production and nonsupervisory workers. The quit rate tends to move two quarters ahead of the ECI and four quarters ahead of average hourly earnings, indicating that changes in the quit rate anticipate changes in wage growth by 6 months to a year. The authors note that the relationship of the quit rate to wages is similar to that of the quit rate to unemployment. Low unemployment makes it more likely that job seekers will hold out for higher wages, while higher unemployment makes it more likely that workers will accept the prevailing wage.

How does the quit rate help predict the cyclical component of inflation known as the inflation gap—that is, the difference between actual and long-run expected inflation? Citing the association between changes in prices and wages, the authors indicate that "the strong predictive relationship between quits and wage growth should, in theory, translate to inflation." Considering current economic conditions, the authors suggest that inflation remains below expectations because of modest increases in the quit rate despite growth in the labor market and a declining unemployment rate. Assuming the quit rate returns to where it was prior to the Great Recession, the authors suggest that the quit rate may be a precursor to increased wage growth and future inflation.