Recession Fears Stoked as Higher U.S. Labor Costs Crimp Profits

The biggest rise in U.S. labor costs in eight years is squeezing company profits and heightening fears of a recession.

Expenses per worker -- so called unit labor costs -- increased 2.4 percent last year, the most since 2007, after a 2 percent gain in 2014, according to data released Thursday by the Labor Department.

The rising wage bill is taking a bite out of companies' bottom lines and prompting concern among some economists that firms will slash spending and hiring in response.

"The outlook for profits is challenging," said Russell Price, a senior economist at Ameriprise Financial Inc. in Detroit. "Hiring was strong but the pace of business activity was weak. It means hiring will decelerate."

Bruce Kasman, chief economist at JPMorgan Chase & Co. in New York, highlighted the danger of a "huge squeeze on earnings" in saying that he had recently raised his odds of a recession in 2016 to 30 percent to 35 percent, from around 25 percent six weeks ago and 20 percent three to four months back.

Behind the jump in labor costs: near stagnant productivity. Employee output per hour worked rose by an annual average 0.5 percent over the past five years, the smallest increase during a similar period in three decades.

Productivity has languished since the end of the last recession as companies remain hesitant to invest in new technologies, relying instead on new hires to meet demand.

Firms have had difficulty offsetting their higher wage bills by raising prices because their ability to do that in a competitive environment has been limited, Kasman said.

S&P Profits

Analysts estimate profit at members of the Standard & Poor's 500 Index dropped 5.6 percent in final three months of 2015, the third consecutive quarterly fall, the longest streak since the end of the last recession in 2009. Excluding energy companies, profit is forecast to have edged up 0.5 percent.

Neil Dutta, head of U.S. economics at Renaissance Macro Research, said the big issue facing companies is how they'll offset the squeeze on margins.

The best outcome from the Federal Reserve's point of view would be a pickup in productivity growth and a modest rise in prices posted by companies, he said in a note to clients. That would keep the economic expansion on track and help raise inflation back up toward the central bank's 2 percent target.

More Claims

In its latest reading on the job market, the Labor Department said Thursday that the number of Americans filing applications for unemployment benefits rose by 8,000 to 285,000 in the week ended Jan. 30.

The four-week moving average, a less volatile measure than the weekly claims numbers, increased to 284,750 last week from 282,750. The last time the average exceeding 280,000 for at least three consecutive weeks was in April.

While the uptick in claims bears watching, it may also represent the week-to-week volatility common to the data around holidays, economists said. Other recent reports show employers are holding on to existing staff and are still adding workers as they anticipate sales will improve.

Payrolls are projected to have increased by 190,000 workers last month after a 292,000 increase in December, according to the median forecast of economists surveyed by Bloomberg. The January jobs numbers, which will be released by the Labor Department Friday, also are expected to show the jobless rate held at a seven-year low of 5 percent.