THE RF EARNINGS OUTLOOK

A look beyond the headline data on the forces behind current developments in pay, how the fruits are shared, and the short- and longer-term drivers of earnings growth

Recent instalments of labour market data have painted a picture of steady but unspectacular growth in nominal wages, combined with zero inflation, producing real average weekly earnings growth above the pre-crisis trend. Labour productivity has started to rise but is essentially unchanged from its 2008 level, fuelling concerns that the pay recovery may prove short-lived once inflation builds, with much ground still to make up. Meanwhile improvements in employment and unemployment appear to have stalled.

In this new regular briefing we use 13 key indicators to take a more detailed look at underlying trends and prospects for the future.

Analysis from Laura Gardiner:

"A look beyond the headline labour market data suggests a solid basis for recent wage growth, which should help maintain the pay catch-up in the near term as inflation returns to more normal territory.

"Particularly encouraging is the fact that the 'drag' effect on pay created by a shift towards lower-paid groups and roles that characterised 2014 has now faded out. Hopefully these shifts can continue into next year and beyond and contribute to productivity increases – the key long-term driver of pay – which are currently muted at best.

"Not everyone is benefitting from recent earnings improvements, however. For example, recovery appears more limited for public sector workers and the self-employed. Ensuring that the fruits of growth are as broadly-shared across the jobs market as possible is an enduring policy challenge."

Our **earnings breakdown** suggests that nominal pay growth has been driven by both a pick-up in pay settlements for employees continuously in work, and a slight shift in the make-up of the workforce towards higher-paid groups and roles. The latter is particularly encouraging given the 'compositional drag' present in the previous year (our 'Spotlight' article explores this change in detail). Private sector employees have benefited most, but it appears the earnings of the self-employed – much harder-hit during the downturn – have not yet bounced back any more quickly.

Our analysis of **pay pressures and slack** paints a relatively positive picture, showing steady improvements (or slower deterioration). Because these indicators tend to lead nominal wage growth, we might expect further pay strengthening in the coming months. This is important given expectations for a relatively swift readjustment of inflation towards its target rate. However our pay pressure and slack measures – which include underemployment and labour mobility – are well short of their tightest levels this century, reminding us that much spare capacity may remain.

Our review of **longer-term labour market health and efficiency** is more mixed. Participation (which will be the key source of further increases in employment as unemployment approaches its pre-crash low) is broadly flat. So is labour productivity – the principal long-term driver of real pay – and the training investment and skills allocation measures that may help to drive productivity increases. The role of these and other factors in boosting productivity remains an area of much uncertainty. Contributing to this ongoing debate, our 'Spotlight' article speculates on the prospects for a continued compositional boost driving productivity increases next year and beyond.

 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator, including data visualisation, is available at www.resolutionfoundation.org/earningsoutlook.

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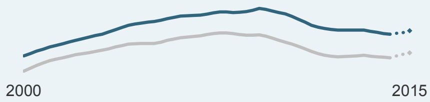
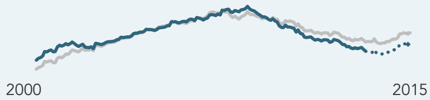
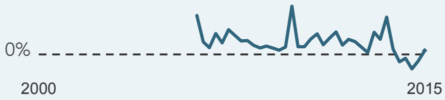
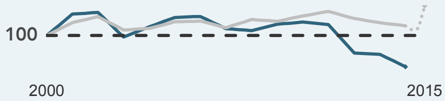
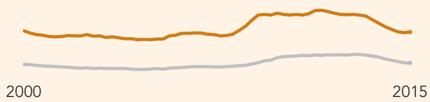
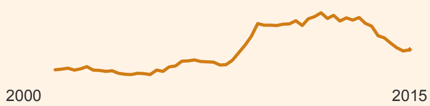
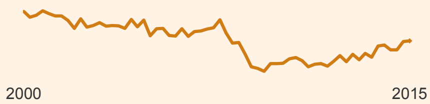
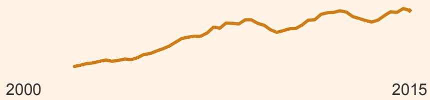
The Scorecard: Q2 2015

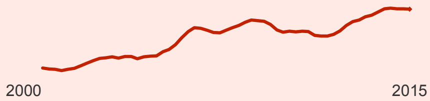
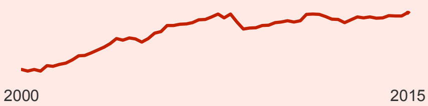
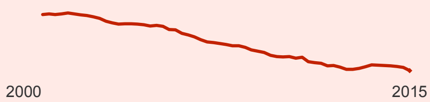
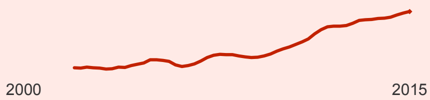
What's happened: The earnings breakdown

MEDIAN EMPLOYEE EARNINGS		↑ 1.1% on yr (all) ↑ 1.9% on yr (private sector)	Pay growth has been helped by low inflation. Real median hourly pay is growing faster in the private sector than across the economy. It remains around £1 lower.
ALL WORKER EARNINGS		Employee earnings and all worker earnings gap →	An enduring squeeze on self-employed earnings means the gap between average weekly earnings for all workers and employees has persisted since 2012.
EARNINGS DECOMPOSITION		↑ 0.5ppts on yr	The year-long compositional drag on average weekly pay has ended. The boosting effect of compositional changes remains lower than its long-term norm, however.
PAY RISES		↑ 1.0ppts on yr	The typical real hourly pay change for employees staying in work over a year is 1.1%, marking a continuation of the previous year's improvements.
EARNINGS INEQUALITY		r75:25 ↑ 1.6% on yr r90:10 ↓ 1.0% on yr	Hourly pay inequality between the upper-middle and lower-middle (r75:25) has risen. Inequality between the top and bottom (r90:10) has been falling.

What's round the corner: Pay pressures and slack

UNEMPLOYMENT BY DURATION		↓ 0.7ppts on yr (all) ↓ 0.5ppts on yr (long-term)	Unemployment is falling, but remains 0.9ppts (20%) higher than its post-2000 low-point. The long-term (+6 months) unemployment rate is 0.8ppts higher than its low-point.
UNDER-EMPLOYMENT		↓ 16% on yr	Underemployment (net hours desired by those in work as well as the unemployed) is falling, but remains 67% above its post-2000 low.
JOB-TO-JOB MOVES		↑ 8% on yr	Job-to-job moves, which are a key mechanism of pay progression and can reflect worker confidence, have risen steadily. They remain 35% below their post-2000 peak.
MIGRANT JOB ENTRY		↑ 4% on yr	Employment from abroad expands labour supply, dampening pay's sensitivity to falls in domestic slack. Migrants make up a gently rising share of job entries.

What's in the pipeline: Longer-term labour market health and efficiency

WORKFORCE PARTICIPATION		→ on yr	Boosting participation is key to full employment (although it can constrain pay growth in the short term). The 18-69 rate is flat.
LABOUR PRODUCTIVITY		↑ 1.3% on yr	Labour productivity is the principal long-term driver of real pay. It is rising gently (below trend), having been more-or-less flat in recent years.
TRAINING INTENSITY		↓ 4% on yr	Training can boost individual productivity and may reflect employer confidence. While 'off the job' training rates continue to fall, the rate of decline has slowed.
GRADUATES IN NON-GRADUATE OCCUPATIONS		↑ 1.9% on yr	Grads in non-grad roles can reflect skills mismatch, and may keep individual productivity below potential. The rate of established grads in such roles continues to rise gently.

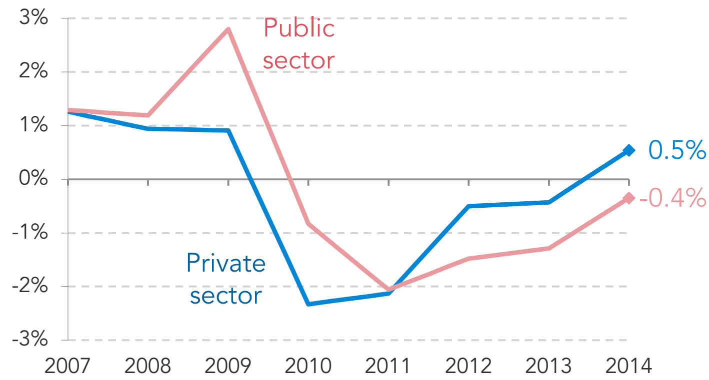
 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator, including data visualisation, is available at www.resolutionfoundation.org/earningsoutlook.

THE RF EARNINGS OUTLOOK

Lifting the lid: The picture across different groups and areas

Here we explore a few of the most interesting developments for different groups of workers and different parts of the country. But there's plenty more: a comprehensive breakdown of each indicator is available on the RF Earnings Outlook website: www.resolutionfoundation.org/earningsoutlook

Figure 1: Median real pay change for employees remaining in work



Notes: See notes on Indicator 4: Pay rises at www.resolutionfoundation.org/data/sources-and-methods

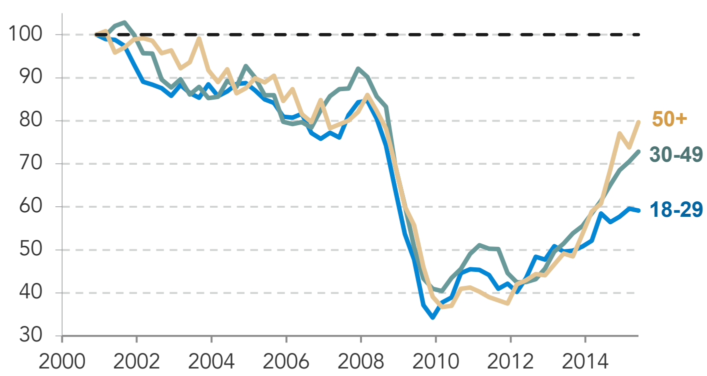
Public-private tide has turned on pay rises

The divergent path of average wages in the public and private sectors is seen clearly in the changing pay rise experience of employees remaining in work in each year.

Post-crisis, wage rises in the public sector were initially protected. But the advent of wage restraint means that since 2012 pay rises in the public sector have tracked around one percentage point below those elsewhere in the economy.

The persistence of public wage restraint and signs of diminishing slack that may create further wage pressure in the private sector mean that we might expect this gap to widen in coming years, raising potential questions over recruitment and retention in the public sector.

Figure 2: Job-to-job moves by age (Index: 2000=100)



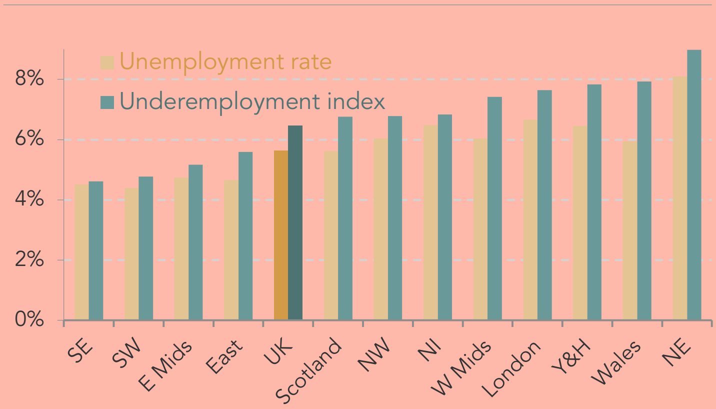
Notes: See notes on Indicator 8: Job-to-job moves at www.resolutionfoundation.org/data/sources-and-methods

Labour mobility dampened for the young

Job mobility provides a leading indicator of wage growth across the workforce: moves are usually to higher-paid jobs, they can reflect worker confidence, and they may prompt employers to raise pay for remaining staff. It is also an important consideration for individuals: moving between jobs enables career advancement, particularly for young people. Therefore it is unsurprising that the rate of job-to-job moves is always much higher for young people (1.4% for 18-29 year olds compared to 0.7% for all workers in Q2 2015). Equally, it is concerning that the mobility rate for younger workers remains further away from its peak. This may have longer-term implications for the younger cohort's career prospects.

The regional perspective

Figure 3: Unemployment and underemployment by region, Q2 2015



Notes: See notes on Indicator 6: Unemployment by duration and Indicator 7: Underemployment at www.resolutionfoundation.org/data/sources-and-methods

Underemployment highest in the North East and Wales

We use the underemployment index developed by Bell & Blanchflower, capturing both the work desired by the unemployed and the net desired hours of existing workers. This is higher than the unemployment rate nationally and in each region, suggesting slack within the employed population that headline unemployment misses.

Under- and un-employment display similar variation across regions; however the under-to-unemployment ratio is particularly inflated in Wales, Yorkshire & Humber, the West Midlands and Scotland. These regions appear to have the most 'additional' slack among workers, which may continue to dampen wage pressure even if unemployment improves.

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Spotlight: How the changing make-up of the workforce affects pay

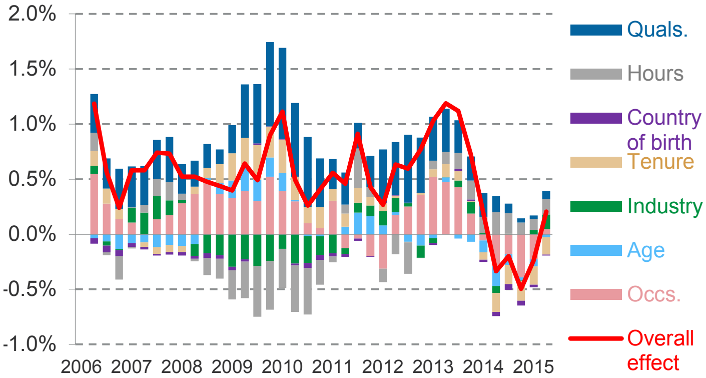
Laura Gardiner, Resolution Foundation

The year-long compositional drag on average weekly earnings came to an end in Q2 2015. Here we discuss the changes in the types of jobs and workers in the economy that have driven this pick-up, and what these developments signal for future pay growth.

This time last year we were scratching our heads. 2014 was supposed to be the year of the pay rise, but half-way through there had been no sign of a let-up in the wage squeeze in the Average Weekly Earnings data (in fact nominal pay growth was trending further downwards). A partial explanation for this puzzle was found in workforce developments: average earnings are affected not just by pay changes within groups of employees, but also by changes in the types of jobs and workers in our economy. In Q2 2014 the shift was towards lower-paying roles and lower-paid people – this was the much-discussed 'compositional drag'.[1]

One year on and the good news is that the drag is over. Four quarters of downward pressure from compositional changes came to an end in Q2 2015, as summarised in Figure 4, which also shows the factors pushing and pulling in each quarter (controlling for the overlap between each).

Figure 4: Compositional effect on annual changes in average weekly pay (nominal)

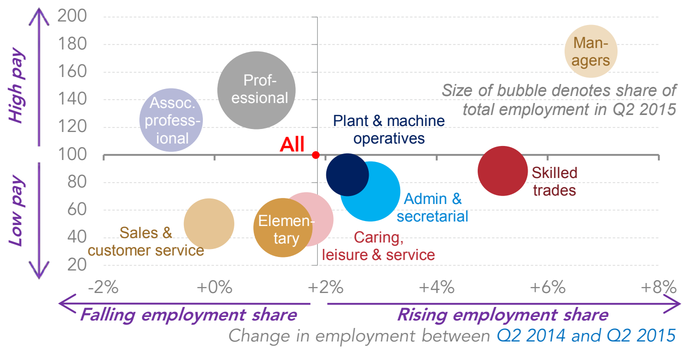


Notes: See notes on Indicator 3: Earnings decomposition at www.resolutionfoundation.org/data/sources-and-methods

The drag effect over most of 2014 and early 2015 was caused in part by the return of younger and less experienced workers (who tend to be lower paid) to the labour market as the jobs recovery gained ground (shown by the downward bars for age and tenure in Figure 4). Although it dragged on pay, this was a welcome development and one that we judged would likely fade as things stabilised: call it the 'growing pains' of recovery.

However, the biggest drag came from a shift to lower-skilled occupations. We viewed this as more concerning as it wasn't clear whether it reflected 'growing pains' or a more permanent phase in which job creation would be focused at the lower end of the labour market.

Figure 5: Q2 2014-Q2 2015 change in employment by occupation



Notes: See notes on Indicator 3: Earnings decomposition at www.resolutionfoundation.org/data/sources-and-methods

In this light it's particularly encouraging that the recent pick-up in the compositional effect has been driven by a change in the impact of occupational shifts (the pink bars in Figure 4 switching from negative to slightly positive). Figure 5 shows that this has been caused in particular by strong growth in managerial roles (which were falling rapidly last year). In addition, the employment share of the three lowest-paid occupations has reduced slightly over the year to Q2 2015. Our concerns about a more permanent downward occupational shift have been allayed somewhat.

However, a watching brief on compositional effects is still needed. An overall boost from compositional changes is the norm in a healthy labour market, and the current effect remains lower than the long-term average. Clearly more progress is required. In addition, because the measure focuses on annual changes it is fairly natural for the picture to improve as the base becomes Q2 2014 when the drag started. Continued progress will rest on an ongoing shift towards higher-skilled occupations stretching into 2016 and beyond, as well as upward shifts in other factors like industrial structure, hours worked and qualifications. Where such shifts reflect a move towards more productive roles or improvements in individual productivity, they will provide a solid basis for sustained wage growth.

1 L Gardiner & M Whittaker, *Why 2014 hasn't been the year of the pay rise*, Resolution Foundation, November 2014