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

Two big 2016 events dominate our view of the labour market and likely developments in the coming years: the introduction of the National Living Wage (NLW) in April, and the result of the EU referendum in June.

This final Earnings Outlook of the year – capturing data up to Q3 – provides an opportunity to take stock of these developments. In particular, we now have a full picture of how earnings were performing just after the NLW's introduction, and new forecasts from the Office for Budget Responsibility (OBR) that provide a view on how the post-referendum economy might develop. The former confirms a positive picture, with fairly strong and very progressive earnings growth into the early part of 2016. However, the latter suggests this risks being as good as it gets: new analysis in our 'Spotlight' article points to an earnings growth freefall setting in from the very beginning of 2017.

In terms of the period between these two phases – from around May to now – our measures add to the headlines on the flattening of employment growth, providing further evidence that the labour market has entered a 'holding pattern' in which not much at all has changed.

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

Analysis from Laura Gardiner:

"The end of each year is a time to take stock of the past 12 months and consider what next year might bring. From a labour market perspective, our analysis shows three clear phases.

"First, we had continued employment improvements and fairly strong and progressive pay growth in early 2016 – helped in a large part by the introduction of the National Living Wage. After this, our labour market entered a 'holding pattern' through the summer and autumn of this year, during which headline employment and pay measures – and a range of underlying indicators – stabilised.

"Our forward-looking analysis suggests the third phase – an earnings growth freefall and a return to wage stagnation – is just around the corner. Near-certain expectations for fast-rising inflation are a big driver of this immediate change of direction. But looking further ahead, addressing our poor productivity performance will be key to changing course."

Our **earnings breakdown** shows relatively strong pay growth in April – particularly in the private sector – and falling pay inequality largely thanks to the introduction of the NLW. More recently there is evidence of stabilisation in both individual pay rises and compositional effects on wages.

Our analysis of **pay pressures and slack** gives a flat picture, with the stalling of job mobility well below its historic peak a particular concern. Migrant job entry continues to expand slowly, which can dampen the sensitivity of pay growth to headline measures of domestic slack. Changes to migration policy may alter this trajectory in coming years.

Our review of **longer-term labour market health and efficiency** shows that participation continues to rise, although the recent uptick in inactivity – not fully feeding through to our annual average measure yet – raises concerns for the future. Productivity growth remains very weak, and the OBR has further downgraded forecasts. However training intensity and the rate of graduates in non-graduate roles both show signs of levelling after at least a decade of going in the wrong direction. Persistence in these trends could provide a catalyst for productivity improvements in future.

 This work uses research datasets which may not exactly reproduce National Statistics aggregates. 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. We would like to thank the Nuffield Foundation for supporting this work.

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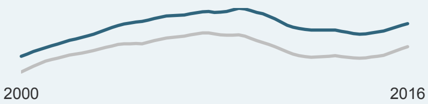
The Scorecard: Q3 2016

What's happened: The earnings breakdown

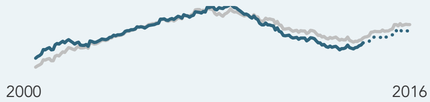
MEDIAN EMPLOYEE EARNINGS



↑ 2.9% on yr (all)
↑ 3.6% on yr (private sector)

Real pay growth has been fairly strong, driven by low inflation. Private sector growth is now outperforming the overall figure, due in part to public sector pay restraint.

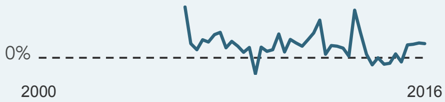
ALL WORKER EARNINGS



Employee earnings and all worker earnings gap ↓

Strong self-employed earnings growth in 2014-15 narrowed the gap between the employee average and the all worker measure, with the estimated gap staying the same since then.

EARNINGS DECOMPOSITION



↑ 0.8ppts on yr

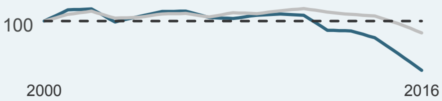
The compositional effect of a changing workforce on average weekly pay has risen on the year, but has been flat – around its long-term average – over the past 9 months.

PAY RISES

↓ 0.1ppts on yr

The typical real hourly pay change for employees staying in work over a year (both job stayers and job changers) has remained stable over the past year. It is currently 2.7%.

EARNINGS INEQUALITY

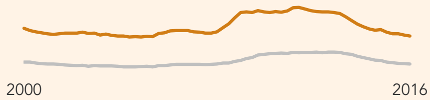


r75:25 ↓ 1.5% on yr
r90:10 ↓ 2.8% on yr

Hourly pay inequality between the upper- and lower-middle (r75:25) has fallen. There was a sharper fall between top and bottom (r90:10), largely due to the National Living Wage.

What's round the corner: Pay pressures and slack

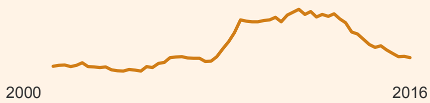
UNEMPLOYMENT BY DURATION



↓ 0.5ppts on yr (all)
↓ 0.3ppts on yr (long-term)

The unemployment rate has fallen to 4.8%, just above its post-2000 low (4.7%). Long-term unemployment (6 months+) is back to pre-crisis levels but above its low-point.

UNDER-EMPLOYMENT



↓ 13% on yr

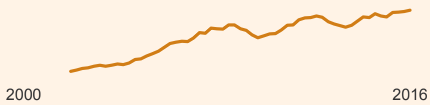
Underemployment (net hours desired by those in work as well as the unemployed) has been falling steadily for more than two years. It remains 36% above its post-2000 low.

JOB-TO-JOB MOVES

↓ 1% on yr

Job-to-job moves, which are a key mechanism of pay progression and can reflect worker confidence, have flattened. They remain 38% below their post-2000 peak.

MIGRANT JOB ENTRY

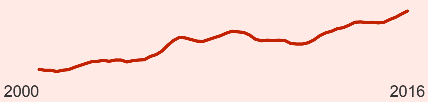


↑ 6% on yr

Employment from abroad expands labour supply, dampening pay's sensitivity to falls in domestic slack. The share of job entries made up by migrants has increased slightly.

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

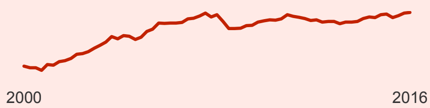
WORKFORCE PARTICIPATION



↑ 0.5% on yr

Boosting participation is key to full employment (although it can constrain pay growth in the short term). The 18-69 participation rate has risen to a new high of 75.1%.

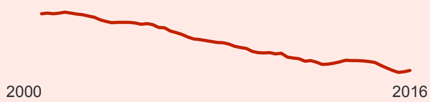
LABOUR PRODUCTIVITY



↑ 0.4% on yr

Labour productivity is the main long-term driver of real pay. Growth has stagnated after modest (below trend) increases, with provisional Q3 calculations showing no sign of change.

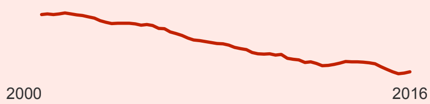
TRAINING INTENSITY



↓ 2% on yr

Training can boost individual productivity and may reflect employer confidence. 'Off-the-job' training rates have been on a long-term downward path, but show signs of stabilising.

GRADUATES IN NON-GRADUATE OCCUPATIONS



→ on yr

Grads in non-grad roles reflect mismatches between qualifications and jobs, and may constrain productivity. The rate has risen over time but been stable over the past year.

 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. We would like to thank the Nuffield Foundation for supporting this work.

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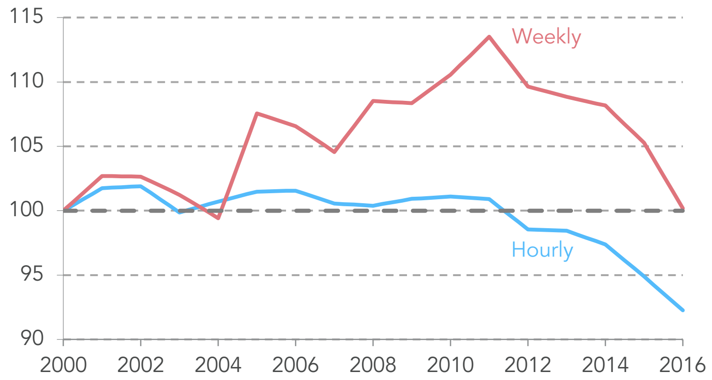
Lifting the lid: The picture across different groups and areas

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: Hourly and weekly earnings inequality: 90:10 ratio (Apr-00 = 100)



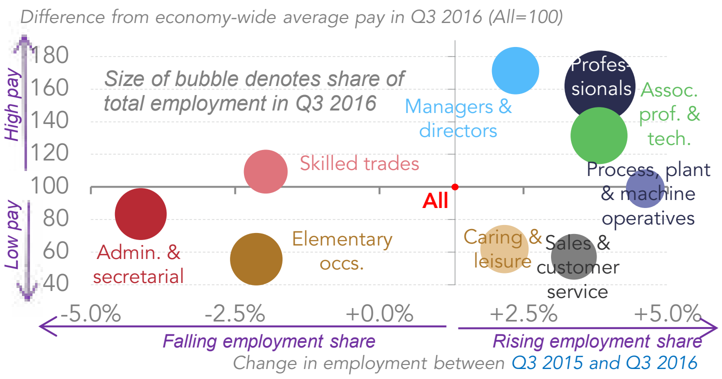
Notes: See notes on Indicator 5: Earnings inequality at www.resolutionfoundation.org/data/sources-and-meth-

Inequality in weekly earnings falling even faster than hourly

We now know that earnings growth in April 2016 was the most pro-low-paid in the past two decades, due largely to the introduction of the National Living Wage (NLW). The NLW's impact is clearly seen in our headline measure of pay inequality – the ratio of hourly pay at the 90th percentile to that at the 10th – which fell by 2.8%.

Looking beyond this headline, it's worth noting that 90:10 weekly earnings inequality fell even faster: by 4.8% (driven by faster growth in weekly pay than hourly at p10 – rates were the same at p90). The impact of the NLW is more dissipated here, as wage floor earners will be spread across the weekly distribution according to their working hours. But what we can infer from this is that at the macro level, the NLW's introduction doesn't appear to have hit low earners' hours. In addition, its effects seem to have fed through (and then some) to pay measures more closely linked to living standards.

Figure 2: Q3 2015-Q3 2016 change in employment by occupation



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

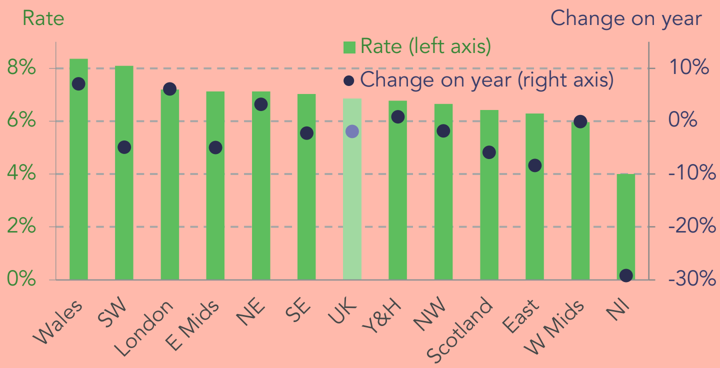
Occupational change continues to boost pay growth

Following 18 months of 'compositional drag', the changing make-up of the workforce has supported pay growth for the past year. A compositional boost is welcome, although it should be considered the norm given the workforce gradually becomes more skilled and our economy has tended to shift to more productive sectors.

As has been the case for the past four quarters, the biggest factor in the compositional boost has been the changing occupational structure, which is shown for the latest year in Figure 2. Strong growth in higher-paying professional and managerial occupations and relative declines in lower-paid administrative and elementary occupations have driven this positive trend, partially offset by growth in lower-paying caring and customer service roles.

The regional perspective

Figure 3: Off the job' training intensity by region, Oct 2015-Sep 2016



Notes: See notes on Indicator 12:: Training intensity at www.resolutionfoundation.org/data/sources-and-methods

Growing regional divide in employee training – Wales forges ahead, Northern Ireland falls further behind

'Off the job' training intensity reflects employers' investment in upskilling staff, which over time should contribute to workforce productivity and therefore pay growth. Figure 3 shows the latest pattern across UK regions and nations, with some evidence of geographic divergence. In particular, the strongest growth occurred in the most training-intensive region, Wales. And at the other end of the spectrum, the least-training-intensive region – Northern Ireland – saw the steepest decline. The long-term fall in training intensity at the national level suggests improvements are needed everywhere. In this light, the relative decline of the worst-performing areas is a particular concern.

 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. We would like to thank the Nuffield Foundation for supporting this work.

Spotlight: 2016 deserves a better press on living standards – we'll miss it when it's gone

Torsten Bell, Resolution Foundation

2016 is getting a bad press. The reasons are many and varied, crossing from the tragic to the frivolous. Syria, Berlin, Zika, Prince/Bowie, Trump, and (for some) Brexit – all get included in the charge sheet. But on living standards at least we may well come to look back at 2016 with fond nostalgia – not least given what 2017 looks set to have to offer. The issue is not that last year was awful, more that it risks being as good as it gets.

Let's start with some simple facts to encourage a reappraisal of 2016, especially the first half of the year. Average household income may have grown at the fastest rate since 2001 in the year to April 2016.[1] This wasn't just about pensioners either, non-retired household income grew by around 3%. These growth rates were pretty evenly shared too. Forthcoming Resolution Foundation research shows that all parts of the income distribution saw income growth of over 2 per cent. And this wasn't a one off – 2014-15 was similarly strong. Very rapid employment growth coupled with near zero inflation created a solid living standards recovery over the past few years, with the added bonus for low earners of the National Living Wage more recently.

These are good results, but obviously no one expects dancing in the streets as this income recovery has come off the back of an unprecedented income squeeze in the crisis years. Indeed non-retired incomes have only just returned to pre-crisis levels. But in some ways more concerning than the past, which we can do very little about, is the future.

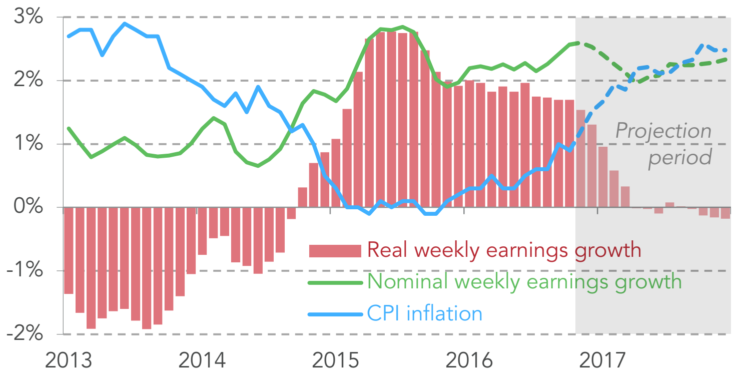
People may not have loved 2016 but we may come to miss the income rises it saw. So why the anxiety about 2017?

Firstly because the scale of employment growth we have recently seen cannot be sustained indefinitely. In fact it has already slowed to a trickle as the labour market has entered a holding pattern since May. The good news is that employment remains close to record highs at over 75 per cent and firms are by and large not planning on shrinking their workforces.[2] The bad news is that without further employment growth in 2017 one of the big boosts to household incomes of recent years (more people working and earning) will weaken. That leaves other determinants of income growth to pick up the slack. Unfortunately they look set to do the opposite.

On pay, our living standards anxiety for 2017 has more to do with the supermarket than the labour market – or to put it another way, rising prices are the big New Year threat to how far our pay packets can stretch. Ultra-low inflation in recent years has boosted real pay rises, with real pay growth nearing 3 per cent in late 2015, hovering around 2 per cent for much of 2016 and now standing at 1.7 per cent annual growth over the three months to October.

But new Resolution Foundation analysis of official forecasts for pay and inflation shows that we are on course for fast, significant and repeated falls in real earnings growth early in the New Year. This earnings freefall means we expect wage growth to fall to around 1 per cent in the three months to January (figures which will be released in mid-March) – the slowest real wage rise in over two years. With inflation forecast to continue rising we project real earnings growth hovering around, or even below, zero for the second half of the year. A return to the pay squeeze we thought we had left behind in 2014 is a real risk.

Figure 4: Average weekly earnings and inflation, outturn and projection



Notes: Analysis applies quarterly forecasts for earnings growth and inflation from OBR, *Economic and Fiscal Outlook*, November 2016 to monthly outturns from ONS, *Average Weekly Earnings*

This is not about changes in actual pay rises being awarded – almost all of this drop is driven by rising inflation, as the impact of sterling's post-referendum depreciation feeds through into higher import prices and filling up your car gets more expensive following recent oil price rises.

Now of course there is a lot of uncertainty about month-to-month movements in both inflation and earnings figures, leaving aside uncertainty about the impact of Brexit. Supermarket competition may continue to hold down food prices, or it may not. But what there is almost total consensus on is that the direction of travel for price rises is up – and there is little sign of wage rises following suit.

Similarly you don't need to know much about the government's plans to cut billions of pounds from in-work benefits to realise that, just as with pay growth, the welfare state is not going to be taking up the slack in boosting incomes in 2017.

You might not have got everything you wanted in 2016 – but when it comes to family incomes, you'll miss it when it's gone.

1 Office for National Statistics, *Nowcasting household income in the UK: financial year ending 2016*, August 2016
2 S O'Connor, 'Company hiring plans for 2017 hold up despite Brexit', *Financial Times*, 19 December 2016

 We would like to thank the Nuffield Foundation for supporting this work.