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

This Earnings Outlook looks at the final quarter of labour market data for 2016. Most importantly, inflation has risen rapidly in recent months, weighing heavily on real pay growth – though published pay statistics will take some time to fully reflect this.

Indeed, our 'Spotlight' article notes that real pay in the public sector has likely now begun a fall that could well last for several years. Conversely, private sector pay growth will continue to outpace the headline average earnings figures.

More positively, inequality between low and high earners has notably declined, helping to cushion low earners from price increases. The continued rise in labour market participation in 2016 was also very welcome. However, a range of persistent regional inequalities – including productivity and long-term unemployment - are concerning.

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

Our **earnings breakdown** shows relatively strong pay growth in 2016 as a whole, and very notable continued falls in pay inequality, largely related to the introduction of the National Living Wage. But with rapidly rising inflation, it appears that this pay growth is now coming to an end and that real pay in some sectors is already in decline.

Analysis from Adam Corlett:

"The outlook for average real pay is worrying. A return to pay stagnation or decline looks likely, even with the previous recovery still incomplete. Looking beneath the headlines, the outlook for public sector pay appears particularly weak, with real earnings likely to fall until 2019-20 at least.

"Increases in the wage floor have contributed to stronger growth in some lower paying sectors, underpinning a remarkably progressive phase of wage growth.

"Yet while rising inflation looks set to drag on wage growth in the coming months, there is some good news in the forward looking indicators. Productivity growth picked up at the end of last year, unemployment remains low and the training picture has improved. However, it remains far too early at this stage to know whether these positive trends will be sustained long enough to help drive future earnings growth."

Our analysis of **pay pressures and slack** shows that unemployment and underemployment have continued to fall, which might be expected to apply upward pay pressure. However, relatively low levels of job mobility remain a concern for pay growth prospects, particularly for young people. Perhaps surprisingly, the importance of migrant job entry has also continued to grow, which might be expected to dampen the sensitivity of pay growth to headline measures of domestic slack.

Our review of **longer-term labour market health and efficiency** gives some tentative cause for optimism. Participation has risen yet again, as has output per hour – though there have been many false starts on productivity in recent years. Training intensity and the rate of graduates in non-graduate roles have also levelled off, representing a welcome change relative to previous, negative trends.

 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 is available at www.resolutionfoundation.org/earningsoutlook. This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.

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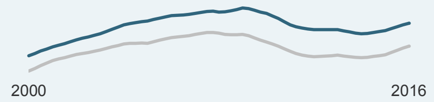
The Scorecard: Q4 2016

What's happened: The earnings breakdown

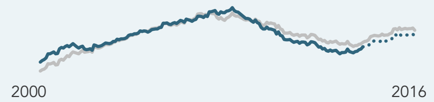
MEDIAN EMPLOYEE EARNINGS



↑ 2.3% on yr (all)
↑ 2.9% on yr (private sector)

Real pay growth was strong in 2016 as a whole though, as our Spotlight (back page) highlights, this period of strong growth may now be coming to an end.

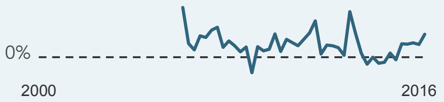
ALL WORKER EARNINGS



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



↑ 0.4ppts on yr

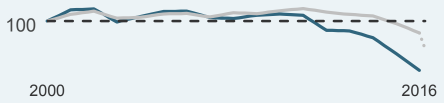
The compositional effect of a changing workforce on average weekly pay has risen, with occupational mix and qualification levels remaining the most important factors.

PAY RISES

↓ 0.1 ppts 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.

EARNINGS INEQUALITY

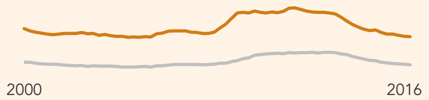


r75:25 ↓ 3.7% on yr
r90:10 ↓ 2.8% on yr

Hourly pay inequality between both the upper- and lower-middle (r75:25) and the top and bottom (r90:10) has fallen sharply, in part reflecting the new National Living Wage.

What's round the corner: Pay pressures and slack

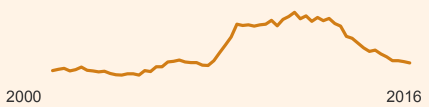
UNEMPLOYMENT BY DURATION



↓ 0.3ppts 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



↓ 11% on yr

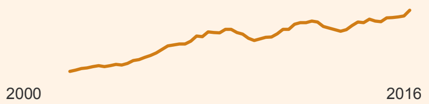
Underemployment (net hours desired by those in work as well as the unemployed) has continued to fall but remains 33% above its post-2000 low.

JOB-TO-JOB MOVES

↑ 2% on yr

Job-to-job moves, which are a key mechanism of pay progression and can reflect worker confidence, have flattened. They remain 44% below their post-2000 peak.

MIGRANT JOB ENTRY



↑ 7% 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 continued to grow.

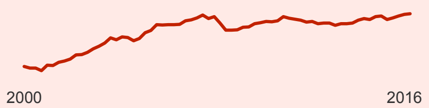
What's in the pipeline: Longer-term labour market health and efficiency

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 another new high of 75.2%.

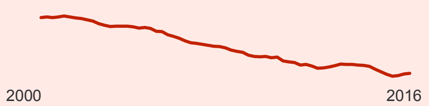
LABOUR PRODUCTIVITY



↑ 1.4% on yr

Labour productivity is the main long-term driver of real pay. Provisional Q4 calculations show a much needed rise in year-on-year growth, but still well below the pre-crisis norm.

TRAINING INTENSITY



↑ 1% 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 stabilised in 2016.

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.

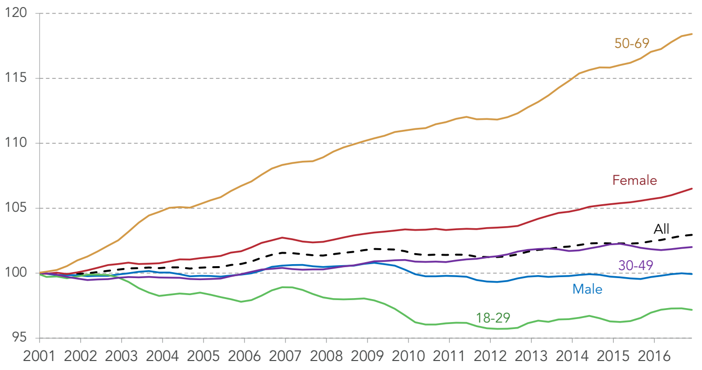
 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator is available at www.resolutionfoundation.org/earningsoutlook. This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.

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: Labour market participation (Dec-00 = 100)

Participation rate, annual rolling average (18-69 unless otherwise stated)



Notes: See Indicator 10: Workforce participation at www.resolutionfoundation.org/data/sources-and-methods

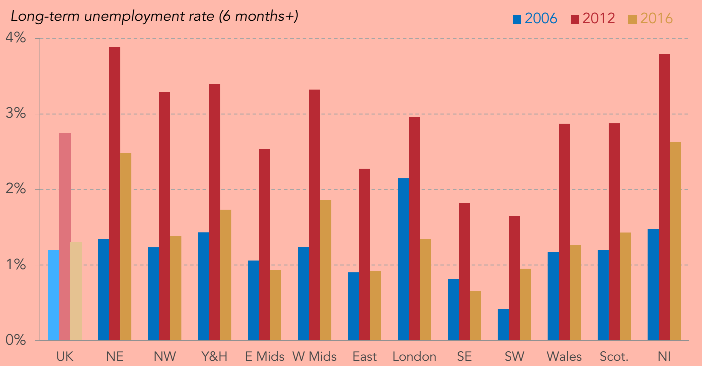
Women and older people drive increase in workforce participation

The participation rate – the proportion of the population who are in work or looking for work – hit a record high of 75.2 per cent in 2016 (using ages 18-69). But this headline hides some divergent trends related to age and gender. The female participation rate has grown almost continuously since 2000 – though there was a levelling off post-crisis (when the rate fell for men). In contrast, the male participation rate is no higher than in 2000.

In part, the increased female rate reflects a rising state pension age since April 2010. This is also reflected in the sharp rise in the 50-69 participation rate. 18-29 year olds however, are now less likely to be in the labour force than pre-crisis, though insofar as this reflects growth in higher education it is a largely welcome change.

The regional perspective

Figure 2: Long-term unemployment by region



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

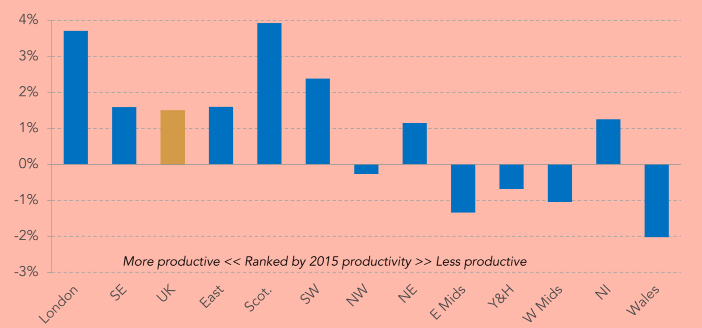
Long-term unemployment down but not evenly spread

Nationwide, 1.3 per cent of the workforce in 2016 had been unemployed for six months or more. This was slightly above pre-crisis levels but less than half the rate that followed the recession.

But the retreat of long-term unemployment has not been even across the country. While in London and the South East long-term unemployment was less common in 2016 than 10 years earlier (though from a very high base in London's case), it remains elevated in some regions – particularly the North East, Northern Ireland and West Midlands. And, while still below the national average, the South West has not retained the very low rates of long-term unemployment it had pre-crisis.

Figure 3: Productivity growth by region, 2013-2015

Growth in real output per hour, 2013 to 2015



Notes: See Indicator 11: Labour productivity at www.resolutionfoundation.org/data/sources-and-methods

Productivity growth continues to be regionally unbalanced

Any improvement in the UK's productivity per hour is to be welcomed given the dismal post-crisis performance. But regional statistics – which come with a two year lag – do suggest that growth has been higher in those parts of the country that already have the highest productivity.

After Scotland (which may be affected by oil production), London recorded the strongest productivity growth between 2013 and 2015, and indeed between 2007 and 2015 – despite the financial crisis. In contrast, in every region except London, Scotland, the South East and the North East, output per hour in 2015 was still lower than in 2007. If pay growth is to be sustained and widespread, productivity must lead the way.

 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 is available at www.resolutionfoundation.org/earningsoutlook. This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.

Spotlight: Public sector pay in decline as spending restraints and inflation bite

Adam Corlett, Resolution Foundation

Growth in average real pay is weakening as inflation rises. But pay in some industries is being squeezed more than in others, with pay growth negative in some and rapid in others. The public sector in particular faces low nominal pay growth as a matter of policy. Together with rising inflation, this means that real public sector pay has likely now started falling – bringing to an end a short-lived recovery from the financial crisis – and that it will continue to fall for some time.

Average real pay grew reasonably fast in 2015 and 2016 – driven more by an inflation slowdown than high productivity or nominal wage growth – but this growth is now slowing rapidly. Adjusting for CPI inflation, ONS figures show annual growth in Q4 2016 of 1.4 per cent, down from 1.9 per cent a year earlier. With inflation expected to rise further, there is every chance of real average pay growth turning negative in the next few months.[1] Any new pay squeeze would be particularly unwelcome given that average earnings are still 4 per cent below their pre-crisis peak.

But sectoral data can paint a richer picture. In some sectors – including retail, finance and higher-end manufacturing – real pay actually surpassed its previous peak in early to mid 2016. In contrast, average pay in "Professional, Scientific & Technical Activities" (including law, accounting, media and consultancy) has not recovered at all – with earnings now little higher than 15 years ago and still falling.

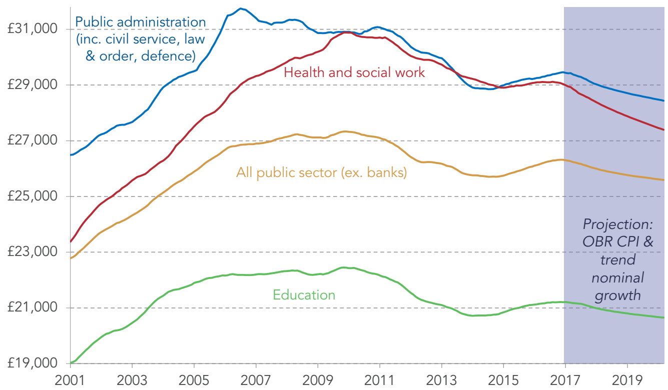
Over the last year (Q4 2015 to Q4 2016), real pay has fallen in several sectors, including professional services and real estate. While these figures can be volatile, there are also sectors that have experienced rapid wage growth, in many cases helped by the introduction of the National Living Wage.

One obvious divide is that between the private and public sectors. While real growth up to the end of 2016 was 1.6 per cent for the private sector, it had fallen to 0.3 per cent for the public sector.[2] With inflation rising further, we expect that annual public sector pay growth turned negative in early 2017 – as ONS figures published in March or April will likely show.

For the one in six workers (over 5 million people) who are in the public sector, overall pay growth has been determined centrally as part of deficit reduction plans. Pay was frozen in 2011-12 and 2012-13 for all but the lowest earners; limited to an average of 1 per cent growth from 2013-14 to 2015-16; and then capped at 1 per cent again for the next four years. While the rising National Living Wage will support the lowest paid (particularly in social care), there are fewer low paid workers in the public sector and so the overall impact will be smaller than in the private sector.[3]

Figure 4: Average public sector pay in 2019-20 may be no higher than in 2004-05

12-month rolling average of public sector real earnings (excluding bonuses and arrears), CPI-adjusted



Source: RF analysis of ONS, Tables A01 and EARN03, based on the Monthly Wages and Salaries Survey. Notes: Average of the past 12 months. Between June 2010 and May 2012, public sector education includes English Further Education Corporations and Sixth Form College Corporations.

Figure 4 shows how public sector real pay has risen and fallen since 2001, and how the next three years may look. This assumes that recent nominal trends continue and that inflation is as predicted by the Office for Budget Responsibility. Having grown in 2015 and 2016, average real public sector pay is now likely to fall for the next few years. On current pay trends, average pay in the public sector would be £1,700 lower in 2019-20 than in 2009-10.

Looking at public sector workers beneath the headline level, the picture is similar in education, health and social work, and public administration (which covers most other roles). Indeed, on these projections average real pay in these sectors in 2019-20 would be lower than in 2004-05, meaning over 15 years of lost pay growth. In public sector education, real pay in 2016 was already lower than in 2003 and is now set to fall further, while health and social work could face a further 6 per cent real fall by 2019-20.

Whatever the other pros and cons of the current public sector pay policy, these wage falls will of course apply a downward pressure to average earnings statistics – increasing the importance of looking beyond the headline average to the public and private split, with the latter expected to perform better. But, in addition to a direct impact on living standards (which for some workers will be part of a double whammy alongside working-age welfare cuts), pay cuts could be expected to make it harder to recruit new workers in the public sector. Where this pressure comes alongside rising demand and uncertainty over migrant worker policy – such as in healthcare – the impact may be compounded.

1 Earnings Outlook Q3 2016
2 Here we use figures for the public sector excluding financial services (i.e. RBS – and previously also Lloyds).
3 Low Pay Britain 2016

 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 is available at www.resolutionfoundation.org/earningsoutlook. This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.