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 first quarter of labour market data for 2017. This was a period when the pay squeeze returned with average weekly earnings falling by 0.4 per cent.

This return is particularly unwelcome as average earnings are still 3.4 per cent below their pre-crisis peak. For Londoners and younger workers in particular – whose pay is still 10 per cent below their peak – getting back to pre-crisis pay levels is still many years away.

In a relatively poor pay landscape the one bright spot is the National Living Wage (NLW) which has substantially boosted pay for low-earners. However, by compressing the pay distribution the NLW also heightens the need to help people progress in work. Our 'Spotlight' article looks at how the NLW has affected pay rises for those that remain in the same job, and those who move jobs.

Away from pay, job creation in the UK labour market continues to surprise; the unemployment rate is at a 40 year low, participation remains at a record high and underemployment continues to fall. In terms of labour supply participation continues to rise and although migration has started to fall this has not yet had a big impact on the labour market. Of concern however is the fact that productivity growth continues to disappoint.

All of this is happening at time of unusually high uncertainty for businesses and employees. With the UK leaving the EU the country's economy and labour market could change significantly over the next few years. In this briefing we use 13 indicators to take a more detailed look at underlying trends and future prospects.

Analysis from Stephen Clarke:

"The pay squeeze is back. In Q1 2017 real pay started to fall, just two years and four months since positive pay growth returned. A squeeze was predicted but inflation has risen more quickly than expected and nominal pay growth has disappointed, so the squeeze might prove deeper than previously thought.

"More positively the NLW continues to boost pay for the lowest earners, reducing pay inequality and supporting living standards. A rising NLW will shield those at the bottom of the labour market from the worst of the pay squeeze.

"The outlook for the future is unusually uncertain. On the one hand the labour market appears to be tightening, and there is some evidence that this is leading to more full-time, and fewer insecure, jobs being created. However, productivity growth and job-to-job moves are plateauing and underemployment remains well-above pre-crisis levels. The next few months will tell us whether jobs growth can translate into wage rises or whether inflation will continue to eat into people's pay packets."

Our **earnings breakdown** shows that real pay growth slowed in Q4 2016 and started to fall in Q1 2017. A return to falling pay has meant that pay rises for those staying in the same job or moving jobs has also fallen. More positively the NLW has led to a continuation of robust wage growth at the bottom and this has contributed to continued falls in pay inequality.

Our analysis of **pay pressures and slack** shows that unemployment and underemployment have continued to fall. It might be expected that this will lead to upward pressure on wages, however job-to-job moves have fallen over the past year and most concerning is that this has been driven by falling moves by young people.

Our review of **longer-term labour market health and efficiency** presents a mixed picture. On the one hand participation continues to rise and training is rising after bottoming out last year. However productivity growth is plateauing, suggesting that the UK has not yet addressed its chronically poor post-crisis performance.

 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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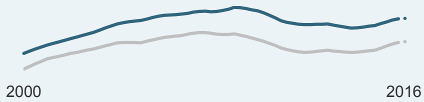
The Scorecard: Q1 2017

What's happened: The earnings breakdown

MEDIAN EMPLOYEE EARNINGS

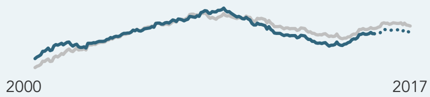


↑ 1.5% on yr (all)

↑ 2.2% on yr (private sector)

Real pay growth slowed significantly in Q4 2016 and data from Q1 shows that real pay is now falling. The squeeze will be felt across sectors, but particularly in the public sector.

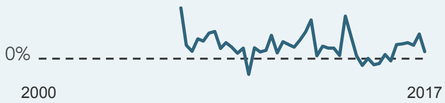
ALL WORKER EARNINGS



Employee earnings and all worker earnings gap →

Strong self-employed earnings growth in 2015-16 narrowed the gap between the employee average and all worker measure, we estimate the gap has stayed the same since then.

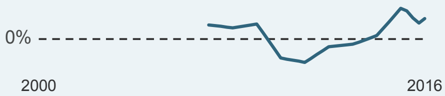
EARNINGS DECOMPOSITION



↓ 0.3ppts on yr

The compositional boost associated with a changing workforce on average weekly pay has fallen. Occupation, qualifications, and now hours explain the fall.

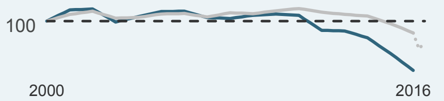
PAY RISES



↓ 0.9ppts on yr

The typical real hourly pay change for employees staying in work over a year (both job stayers and job changers) has fallen over the past year, reflecting falling pay growth.

EARNINGS INEQUALITY



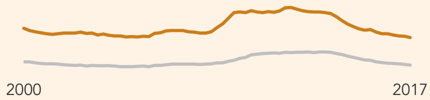
r75:25 ↓ 2.3% on yr

r90:10 ↓ 2.8% on yr

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

What's round the corner: Pay pressures and slack

UNEMPLOYMENT BY DURATION

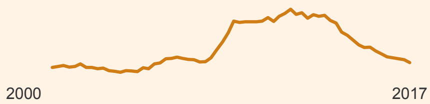


↓ 0.5ppts on yr (all)

↓ 0.3ppts on yr (long-term)

The unemployment rate has fallen to 4.6%, a 40 year low. Long-term unemployment (6 months+) is back to pre-crisis levels but above its mid-2000s low point.

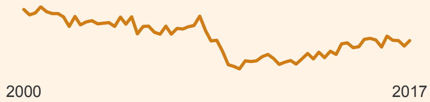
UNDER-EMPLOYMENT



↓ 10% on yr

Underemployment (net hours desired by those in work as well as the unemployed) is down 10% but remains 27% above its mid-2000s low.

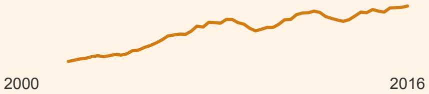
JOB-TO-JOB MOVES



↓ 8% on yr

Job-to-job moves, which are a key mechanism of pay progression and can reflect worker confidence, have flattened since late 2015.

MIGRANT JOB ENTRY

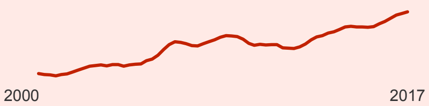


↑ 6% on yr

Although net migration has fallen since the EU referendum, this hasn't yet had an effect on migrant labour supply. The share of job entries made up by migrants continues to grow.

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

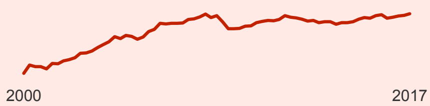
WORKFORCE PARTICIPATION



↑ 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%.

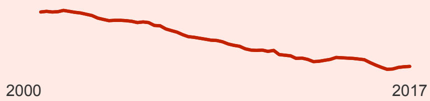
LABOUR PRODUCTIVITY



↑ 1.2% on yr

Labour productivity is the main long-term driver of real pay. Provisional Q1 calculations show productivity growth slowing and still well below the pre-crisis norm.

TRAINING INTENSITY



↑ 3% on yr

Training can boost individual productivity and may reflect employer confidence. 'Off-the-job' training rates had been on a downward trend but have risen 3% over the past year.

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.

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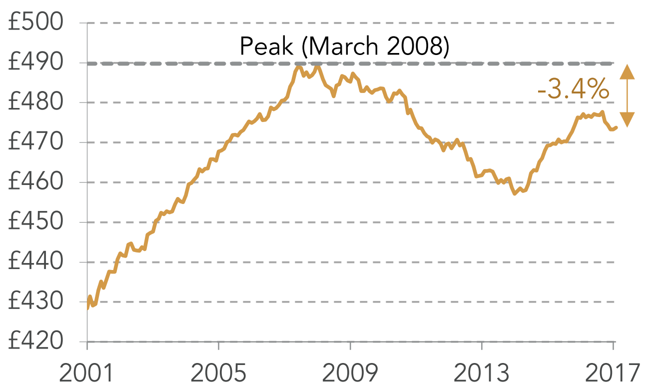
Lifting the lid: The picture across different groups and areas

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: Real average weekly earnings



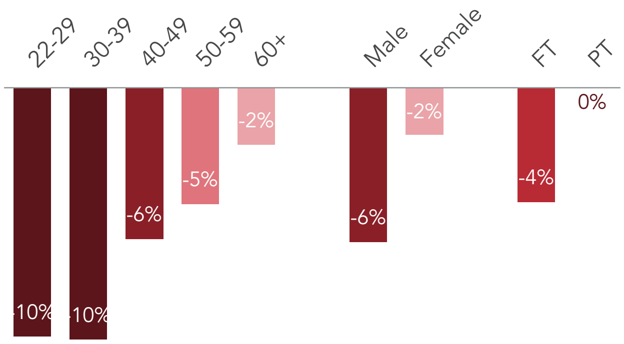
Notes: ONS, *Average Weekly Earnings*

The pay squeeze

In Q1 2017 the pay squeeze returned. Real average weekly earnings fell 0.4 per cent in Q1 2017 and data from April 2017 shows that it has now fallen by 0.6 per cent. The upshot is that pay is still 3.4 per cent below its pre-crisis peak and is likely to fall further over the rest of the year.

It is tempting to attribute this to rising inflation, now at 2.7 per cent up from 0.7 per cent a year ago. However that is only part of the story. Even if inflation was at target 2 per cent then real pay would still be falling. This highlights the problem of poor nominal pay growth; in the five years before Q1 2007 nominal pay grew at an annualised rate of 3.8 per cent. In the last five years it has grown by an average of 1.7 per cent, less than half as fast. Inflation may fall back as the effect of the devaluation of sterling dissipates, but unless nominal pay growth picks up, real pay growth will remain stagnant.

Figure 2: Difference between current median hourly wages (Q1 2017) and pre-crisis peak



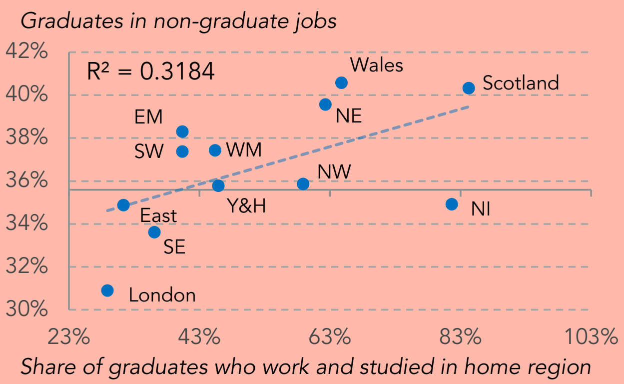
Notes: See notes on Indicator 1: Median employee earnings at www.resolutionfoundation.org/data/sources-and-methods

Younger workers, men and Londoners have been squeezed the most

Although real pay remains 3.4 per cent below peak, some groups and parts of the country were a lot further from reaching their pre-crisis peak before the current squeeze hit. Earnings for workers under 40 were 10 per cent below their pre-crisis peak in Q1 2017, whereas earnings for workers over 60 were only 2 per cent below peak. Earnings for workers in London and Northern Ireland were 11 and 10 per cent, respectively below peak. More positively wages for women were almost back at peak and wages for part-time workers had already recovered before real pay began to fall. Both groups disproportionally benefit from the NLW, which partly explains this (relatively) strong performance.

The regional perspective

Figure 3: Productivity growth by region, 2013-2015



Notes:: See notes on Indicator 13: Graduates in non-graduate occupations at www.resolutionfoundation.org/data/sources-and-methods

Can we make the graduate labour market more efficient?

Although graduates are more likely to move for work than other people, the share doing so has fallen from around 6 per cent in the 1990s to 3 per cent since the crisis. Over the same period the share of graduates in non-graduate jobs has also risen by 5 ppts. Some regions and countries have a far higher share of graduates in non-graduate jobs: Wales, the North East and Scotland stand out. These places also have a far higher share of graduates from the region or country who studied there and then remained to work. Many have also seen larger increases in grads in non-grad jobs than other places since the crisis. Although the relationship between a lack of mobility and rising numbers of graduates in non-graduate jobs is not proven, it could warrant further investigation.

 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: To stick or to twist? Staying and moving jobs under the NLW

Stephen Clarke, Resolution Foundation

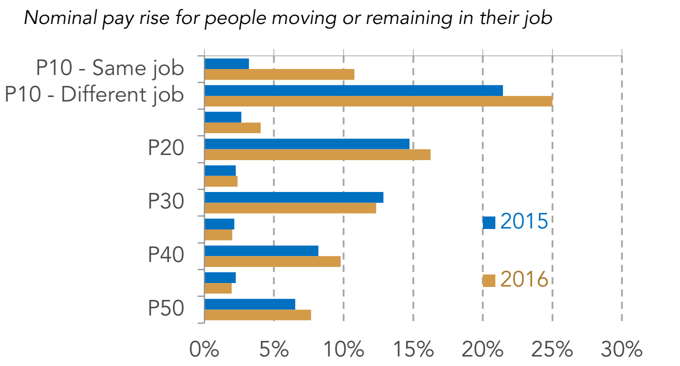
The NLW has provided a welcome pay boost for millions of low paid workers and has been the one bright spot in an otherwise bleak pay growth picture. Introduced in April 2016 it has meant that the minimum wage for those 25 and over has already risen by 12 per cent in two years. But while the NLW brings a pay rise it also brings challenges, particularly how to encourage progression when pay bands are being compressed.

Pay progression is obviously important for living standards. But it is also important for productivity with workers moving into roles that better match their talents. Higher pay often entices workers to move jobs, but while there are rewards for moving there are also risks, the new job may not be as secure, or enjoyable as the last one. Weighing up the pros and cons is something most people will be familiar with.

The NLW risks reducing the incentive to change jobs or move to a new employer because it may shrink the pay differentials between jobs towards the bottom of the labour market. By 2020 we expect that 1.7 million of the 25-plus employees will earning £8.75 an hour (the expected NLW rate) and around 2.4 million workers will be earning between £8.75 and £9.45. Historically moving up the pay scale for an employee on the wage floor would have led to a significant pay increase. Unless firms retain pay differentials this may be less true in the future.

The NLW has been in place for over a year now so we can start to estimate what impact it may have had on the incentives to progress. The best way to do this is to see how the NLW has affected pay rises for those moving jobs and those staying put (Figure 4). Two things stand out. First, it pays to move, although only between 10 and 20 per cent of the workforce move jobs or employers each year. Across the pay distribution those who move jobs receive a larger pay rise than those who remain and the returns to moving job are greatest at the bottom.

Figure 4: It pays not to stay

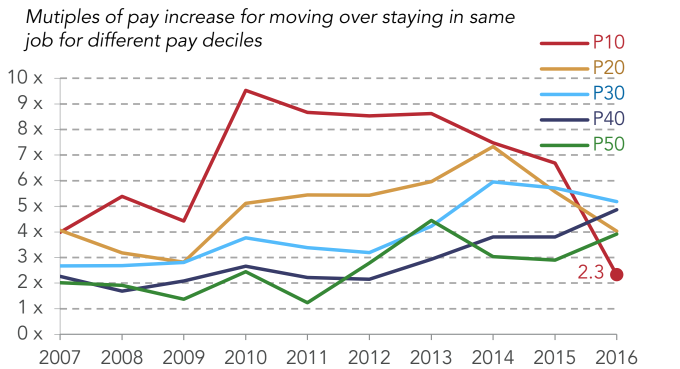


Notes: See notes on Indicator 4: Pay rises at at www.resolutionfoundation.org/data/sources-and-methods

Second, 2016 was the first year since the 2007 when anyone in the bottom half of the pay distribution who remained in the same job got a nominal pay rise above 3.5 per cent. The typical pay rise for earners in the bottom 10 per cent that stuck with their employer was 10.8 per cent and it was 4 per cent for earners in the second decile. As a result of the NLW the pay rise for staying in the same job for those in the bottom 10 per cent of the earnings distribution has never been higher.

Although the returns for remaining in the same job have risen for low earners, moving job would still earn someone double the pay rise. However, although the absolute pay rise is important when weighing up the pros and cons of moving jobs the relative return also matters. Figure 5 shows that in 2016 someone in the bottom 10 per cent of earners moving jobs could expect a pay rise 2.3 times that of someone remaining in the same job. However, in 2015 they could have expected a pay rise 6.7 times higher for moving.

Figure 5: Moving jobs could be more of a gamble than before



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

Although only for the lowest earners, the NLW seems to have reduced the relative returns to moving job. Businesses and policy makers need to recognise that this makes it even more important to encourage progression. Firms can justify the necessary pay rises by investing in staff and capital, and ultimately raising productivity. The hope is that the NLW, and other changes to the labour market, will encourage firms to do this.[1]

The government can encourage progression by improving financial incentives for those in receipt of means tested benefits. With this in mind, it is all the more worrying that current welfare reforms are in danger of reducing incentives for single parents and second earners. There should also be practical support to help people progress. In the past active labour market policy has concentrated on getting people into work, the challenge going forward will be getting people moving up the pay scale.

All in all then the NLW does not change the fact that it pays to move jobs, however it does appear to change the incentives that low earners face. Over the next few years when faced with the uncertainty of moving jobs it will be more of a gamble to do so. Businesses and policy makers therefore need to ensure that for many it is a gamble they're still prepared to take.

1 T Bell & S Clarke "End of an era? The supply of low-wage labour is set to fall and its price is set to rise" in S Clarke (eds) *Work in Brexit Britain*, Resolution Foundation, June 2017