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

The introduction of the National Living Wage (NLW) has dominated recent labour market headlines. With good reason – the higher wage floor will provide a welcome boost to millions of low-paid workers while posing a challenge to businesses in the most-affected sectors. But its effects won't be evident in the wider jobs market data until later this year when we have the statistics for Q2 2016, with the full picture unlikely to be clear until much later given its planned upward trajectory. Monitoring the NLW's impact will therefore be a key theme of future Outlooks.

Meanwhile in terms of measured jobs market performance and the broader earnings picture, the key recent change has been a gloomier view on productivity, due both to poor Q4 outturns and in particular the downward forecast revisions at last month's Budget. The productivity disappointment has been mirrored in more muted real average weekly earnings growth. The latest figure, 2.0%, is the product of stable (well-below-trend) nominal growth offset by inflation slowly rising from zero. Our near-term projection suggests growth tailing off further to below 1.9%, short of the pre-crisis trend of 2.2%.

In this 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:

"The most significant recent development in terms of the outlook for earnings was the downgrading of productivity forecasts at last month's Budget. If the OBR is right, and our growth potential really is lower than thought, then the consequences will be felt in both pay packets and the public finances.

"Subdued job-to-job moves provide further cause for concern. By inhibiting pay progression at the beginning of careers, our new analysis shows that lower mobility may have increased the pay squeeze for young people by as much as one third, and threatens their future earnings potential.

"Other indicators provide better news however, with a shift towards better-paying jobs, unemployment continuing to fall and participation rising. The maintenance or continuation of these trends should provide a good basis for pay increases and shared income growth over this parliament."

Our **earnings breakdown** suggests that steady pay growth has been driven by a combination of further growth in pay settlements for employees continuously in work, and a boosting effect from changes to the make-up of the workforce. The latter, following 18 months of negative or well-below-trend compositional effects and driven largely by positive occupational shifts, is particularly welcome. Our estimates suggest pay inequality has continued falling.

Our analysis of **pay pressures and slack** shows un- and under-employment continuing to fall steadily, but not feeding through to confidence to move between jobs. In addition, migrant job entry has ticked up. Changes in these indicators tend to lead nominal wage growth and they were improving in the main until recently, so we might still expect some upward pressure on pay to come through. As well as its role as an economy-wide slack indicator, our 'Spotlight' article considers how lower job-to-job moves may be constraining young people's pay in particular.

Beyond weak productivity described above, our review of **longer-term labour market health and efficiency** shows a small increase in participation (which will be the key driver of employment growth as unemployment approaches its lower limit), but a further deterioration in the training investment and qualification-job matching measures that help us to understand both the development of productive capacity and the efficiency with which it is put to use.

 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. The views expressed are not necessarily those of the Nuffield Foundation, and any errors are our own.

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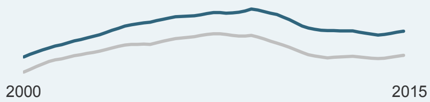
The Scorecard: Q4 2015

What's happened: The earnings breakdown

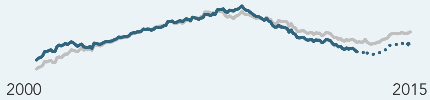
MEDIAN EMPLOYEE EARNINGS



↑ 1.5% on yr (all)
↑ 1.3% on yr (private sector)

Real pay growth has been helped by low inflation. It has also been boosted by a compositional shift, with both the public and private sector rates currently lower than the headline.

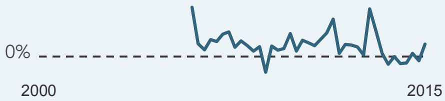
ALL WORKER EARNINGS



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



↑ 0.9ppts on yr

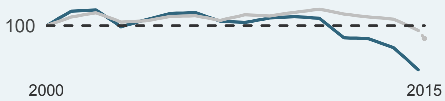
The compositional effect on average weekly pay has risen back above zero. The boosting effect of compositional changes remains slightly below its long-term norm.

PAY RISES

↑ 0.8ppts on yr

The typical real hourly pay change for employees staying in work over a year is 1.3%, marking a continuation of previous improvements.

EARNINGS INEQUALITY

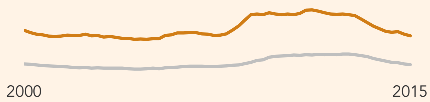


r75:25 ↓ 2.0% on yr
r90:10 ↓ 2.7% on yr

Hourly pay inequality between the upper-middle and lower-middle (r75:25) has been falling, with a sharper decline in inequality between the top and bottom (r90:10).

What's round the corner: Pay pressures and slack

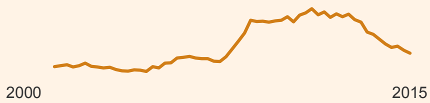
UNEMPLOYMENT BY DURATION



↓ 0.6ppts on yr (all)
↓ 0.5ppts on yr (long-term)

The unemployment rate continues to fall, and is now only 9% above its post-2000 low-point. Long-term (+6 months) unemployment is falling but still well above its low-point.

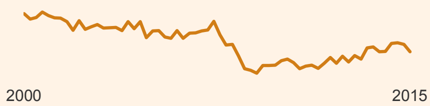
UNDER-EMPLOYMENT



↓ 14% 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 49% above its post-2000 low.

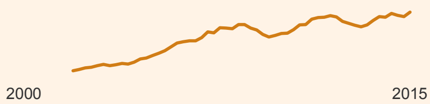
JOB-TO-JOB MOVES



→ on yr

Job-to-job moves, which are a key mechanism of pay progression and can reflect worker confidence, have flattened. They are 45% below their post-2000 peak.

MIGRANT JOB ENTRY

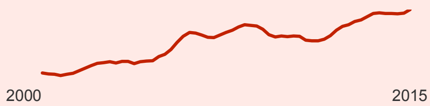


↑ 4% on yr

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

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

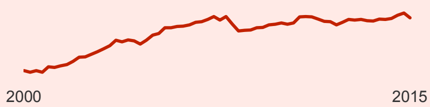
WORKFORCE PARTICIPATION



↑ 0.2% 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 very slightly to a new high-point.

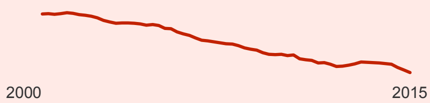
LABOUR PRODUCTIVITY



↑ 0.4% on yr

Labour productivity is the main long-term driver of real pay. Growth has stagnated after modest (below trend) increases, due to weak output and an uptick in hours worked in Q4.

TRAINING INTENSITY



↓ 7% on yr

Training can boost individual productivity and may reflect employer confidence. 'Off-the-job' training rates are again falling steadily, continuing a long-term downward trajectory.

GRADUATES IN NON-GRADUATE OCCUPATIONS

↑ 2% on yr

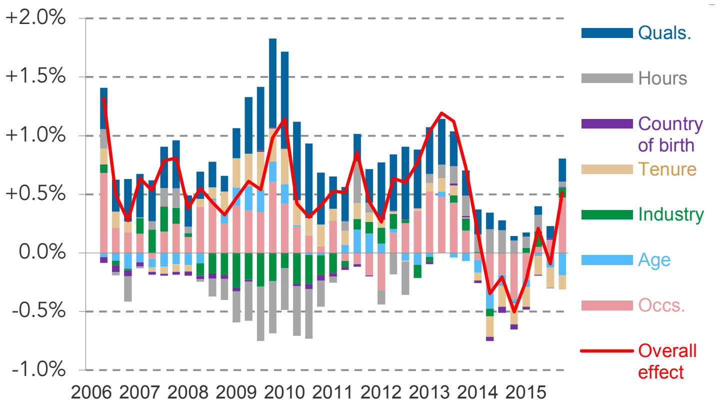
Grads in non-grad roles reflect mismatches between qualifications and jobs, and may constrain productivity. The rate of established grads in such roles continues to rise.

 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. The views expressed are not necessarily those of the Nuffield Foundation, and any errors are our own.

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: 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

Shift towards higher-paying occupations boosting earnings

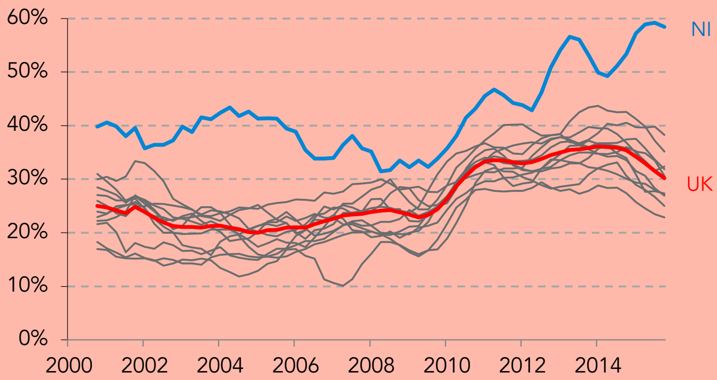
After 18 months in which the changing make-up of the workforce had a negative or well-below-trend impact on average pay, the 'compositional effect' turned positive again in Q4 2015. In other words, our economy shifted towards better-paid people and jobs.

This might be considered a normal state of affairs: as Figure 1 shows, a positive compositional effect was present throughout 2006-2013. That we are moving back into this old territory is welcome.

Welcome, too, is the fact that occupation changes – which we flagged as a cause for concern when they were dragging on earnings – are the biggest driver of the recent turnaround (due in particular to a strong uptick in managerial jobs). If this shift reflects a move towards higher-productivity roles, and if it can be sustained, it builds a solid basis for future pay growth.

The regional perspective

Figure 2: Proportion of unemployment that is long-term (6 months+) unemployment by region, 2015

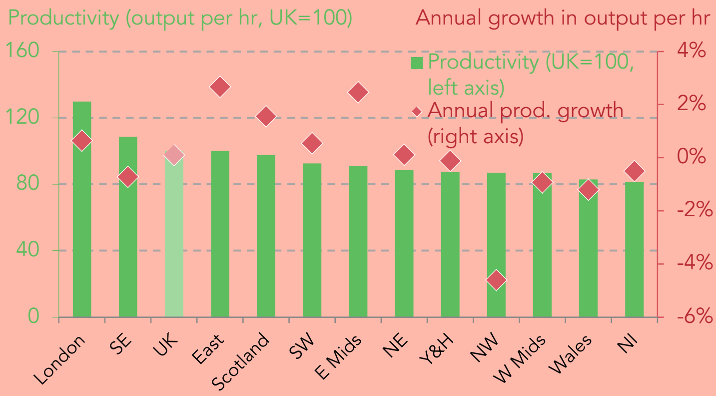


Notes: See notes on Indicator 6: Unemployment by duration at www.resolutionfoundation.org/data/sources-and-methods

Northern Ireland's long-term unemployment problem

Falling unemployment has been felt across the UK, and Figure 2 shows that in most areas, the long-term unemployment (LTU) share has also reduced. Northern Ireland is the big outlier. While it has only the fourth-highest unemp. rate, its LTU rate and share are the highest by far, and have continued to rise as unemp. has fallen. This may reflect different population characteristics and a different welfare regime in NI with less of a focus on 'activation'. Most obviously, this is a worry for those in LTU, because more time out of work damages lifetime job and earnings potential. But it's also worth considering that, because those in LTU are often less well matched to available jobs, there may be more upward pressure on pay in NI (where although wage levels are low, growth is second-fastest of all areas) than the overall unemp. rate implies.

Figure 3: Productivity by region, 2014



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

Growing regional productivity disparities in 2014

The latest picture on regional productivity (which is published with a two-year time-lag) is summarised in Figure 3. The ranking of regions remains relatively stable over time, with London and the South East consistently beating UK average productivity. There is some evidence in this latest data, however, that higher-productivity areas strengthened their position in 2014 relative to lower-productivity ones, meaning an increase in regional disparities. For example, Figure 3 shows that 5 of the 6 areas in the top half of the productivity league table experienced faster growth than the UK average in 2014, while 5 of the 6 in the bottom half had slower growth.

 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. The views expressed are not necessarily those of the Nuffield Foundation, and any errors are our own.

Spotlight: The young and the restless – job mobility and youth earnings

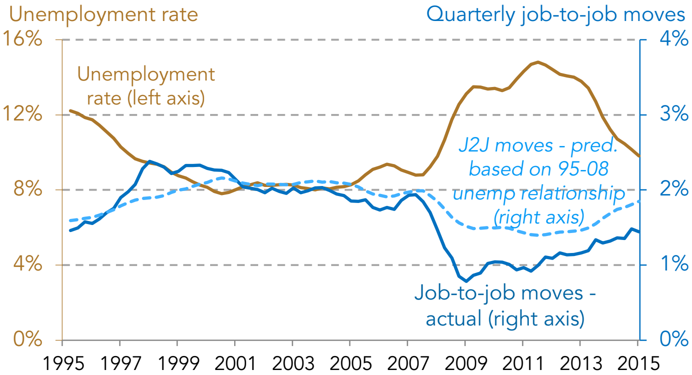
Laura Gardiner, Resolution Foundation

Job mobility has implications for wages and productivity at both the individual and economy-wide levels, and is particularly important for those at the start of careers. Here we estimate the impact that the structural job mobility slowdown has had on youth pay in recent years.

Mobility, the propensity of workers to voluntarily move between jobs, is an important indicator at the micro and macro levels. It matters for a number of reasons: as a signal of confidence in the jobs market; because job-to-job moves reallocate capacity from lower- to higher-productivity firms; because they can facilitate a better match between workers and jobs; and because turnover spooks firms losing staff to raise pay for those who remain. But most evidently and perhaps importantly, new jobs usually herald a big pay rise for the individual.

This is especially relevant to young people. Frequent moves are key to the steep pay progression trajectory successive cohorts experience as they gain a foothold in the jobs market. As an illustration of this, consider that for 18-29 year olds over 2007-2014, 'job stayers' averaged 4.4% median annual pay growth (nominal), 'job switchers' 11.8%. Unsurprisingly these figures are higher than those for all ages (2.7% and 6.1% respectively), and crucially the 'switching premium' relative to those who stay put is greater when young.

Figure 4: Unemployment and job-to-job moves, 18-29 year olds

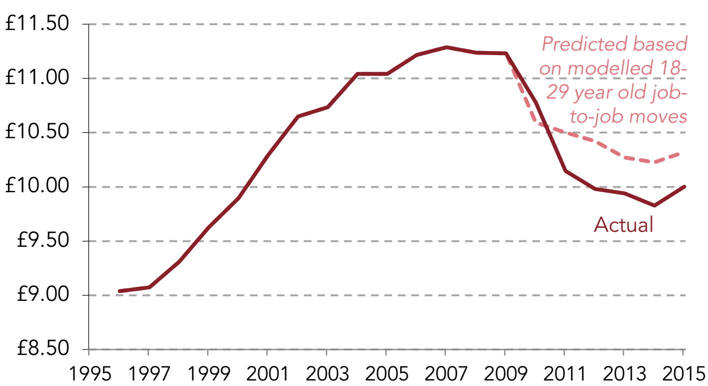


Notes: Predicted moves based on simple OLS regression modelling relationship between job-to-job moves and unemployment. See notes on Indicator 6: Unemployment by duration and Indicator 8: Job-to-job moves at www.resolutionfoundation.org/data/sources-and-methods

This is why we have previously highlighted the decline in mobility that started before the recession (and was accelerated by it, job-to-job moves being strongly pro-cyclical) as a cause for concern. More worrying still is the fact that the young were particularly hard hit – their mobility rate is currently 10% further away from its early-2000s peak than that of older cohorts. A pertinent question is the extent to which this has contributed to the poor performance of young people's earnings in recent years.

To address this question, we conduct a simple (indicative) thought experiment that first considers what youth job-to-job moves since 2008 might have looked like if they had held their previous level relative to the strength of the youth labour market, i.e. no structural mobility slowdown. Figure 4 shows our results: the recession-driven decline in mobility is reduced by around half.

Figure 5: Real median hourly pay (CPI-adjusted to latest prices), 22-29 year olds



Notes: Predicted earnings based on simple OLS regression modelling relationship between earnings and job-to-job moves (with nine month lead), controlling for GDP growth (also with nine month lead), using the job-to-job moves series predicted in Figure 4. The implicit assumption here is that the 'returns' to job switching haven't changed since 2009. Pre-1997, hourly pay (which is drawn from the Annual Survey of Hours and Earnings (ASHE) in the main) is estimated using trends observed in the Labour Force Survey. Hourly pay and job-to-job moves refer to different age ranges due to different definitions in ASHE and our mobility analysis. See notes on Indicator 1: Median employee earnings at www.resolutionfoundation.org/data/sources-and-methods

We know that job mobility is a strong predictor of pay increases, so in the second stage of our experiment we consider what the more benign mobility picture calculated in stage one could have meant for youth earnings. Our results, shown in Figure 5, suggest that young people's hourly pay would be around 30p higher than it is currently, and that their earnings would be around 8% below 2009 levels, rather than 11% (more in line with the figure for all ages).

These calculations are by no means definitive, but provide a general sense of the impact that a lower-mobility labour market might be having. Unpicking what's driven the mobility slowdown is therefore crucial,[1] particularly to understand whether positive job switching can return to its past territory. If it doesn't, a more muted earnings trajectory at the beginning of careers may be part of the new normal, rather than a downturn-related blip. Such a possibility adds weight to concerns about hysteresis in the youth labour market, and raises the question of whether this new inertia could have longer-term 'scarring' effects on current and future young cohorts' lifetime earnings potential.

1 For a discussion of the possibilities see: P Gregg & L Gardiner, *A steady job: The UK's record on labour market security and stability since the millennium*, Resolution Foundation, July 2015

 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. The views expressed are not necessarily those of the Nuffield Foundation, and any errors are our own.