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

Overshadowing the latest outturn data for the labour market, and our picture of the UK economy more widely, is the UK's decision to leave the EU. It will take some time before the effects of this decision make themselves felt in the hard economic data, but a detailed look at the pre-referendum jobs market can provide clues as to how future adjustments might pan out.

The most important development was easing real average weekly earnings growth, which fell to 1.8% in May and has now been below its pre-crisis average of 2.2% for eight months. This is in the context of still-very-low inflation, which has ticked up since and is expected to rise more rapidly in the coming months due to Brexit-induced currency adjustments.

On the other hand, continued improvements in many of the measures explored in this briefing in Q1 2016 were welcome, particularly in the context of weakening global output and the related downgrading of long-term forecasts for UK productivity growth. It is hoped that these developments will stand us in good stead, as should the introduction of the National Living Wage, providing a pay boost to millions of low-paid workers in April 2016.

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:

"Although overall wage growth remains muted there are things to be positive about in this pre-referendum picture of the UK labour market. In the first quarter of 2016 the jobs market shifted towards better-paying roles, un- and under-employment fell and job mobility picked up slightly.

The decision to leave the EU is likely to disrupt this picture significantly. The Bank of England expects labour market slack to widen, and the balance of independent opinion suggests that downward pressure on nominal pay growth combined with upward pressure on inflation may spell the return of falling real pay next year.

"The key question for the future is how the UK labour market weathers the short-term upheavals and longer-term adjustments associated with Brexit. It is hoped that the underlying signs of health in the early-2016 jobs market will stand us in good stead for any turbulence to come."

Our **earnings breakdown** suggests that steady pay growth continued to be underpinned by a combination of sustained increases in real pay settlements for employees continuously in work (driven by low inflation and large increases for those changing jobs, as our 'Spotlight' article explores) and a boost from changes to the make-up of the workforce.

Our analysis of **pay pressures and slack** gives a positive picture in Q1 2016, with un- and under-employment both falling, job mobility rising again (although still a way off its peak), and migrant job entry flat. By differentiating between the 'dynamic' and 'static' workforces, our 'Spotlight' article considers why recent improvements in these slack indicators may not have fed through to overall nominal wage growth to the extent we might expect.

Our review of **longer-term labour market health and efficiency** continues to present a mixed bag. Rising participation is essential for employment growth towards full employment, but weak productivity growth and declining training intensity remain key long-term challenges.

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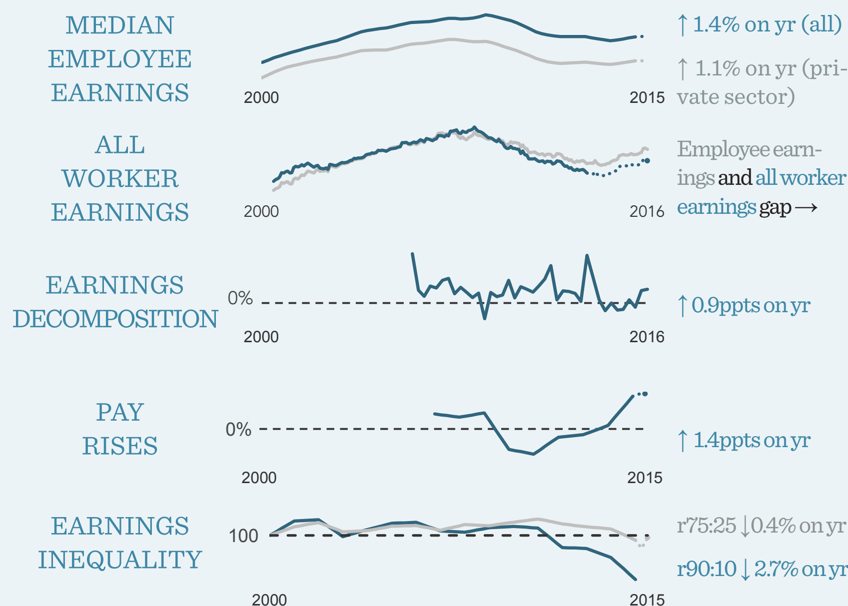
The Scorecard: Q1 2016

What's happened: The earnings breakdown



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 growth rates currently below the headline.

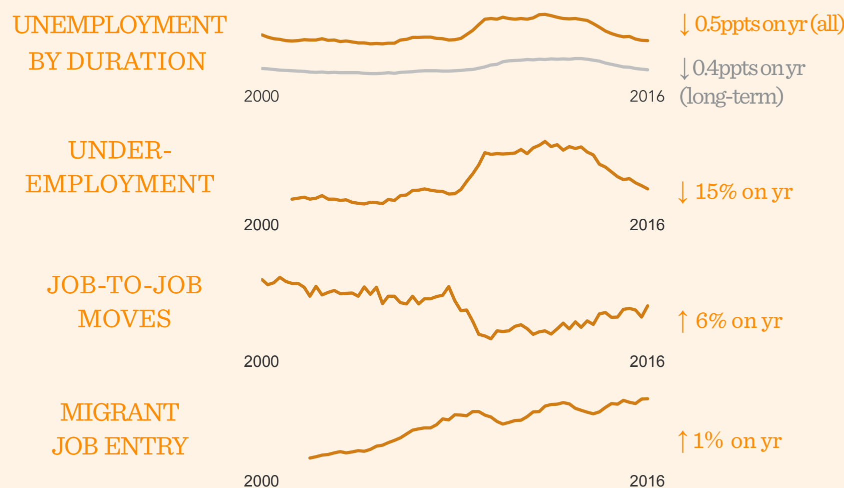
An enduring squeeze on self-employed earnings means the gap between average weekly earnings for all workers and employees has persisted since 2012.

The compositional effect on average weekly pay has risen again. The boosting effect of compositional changes is now close to its long-term average.

The typical real hourly pay change for employees staying in work over a year (both job stayers and job changers) has risen strongly to 3.0%.

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



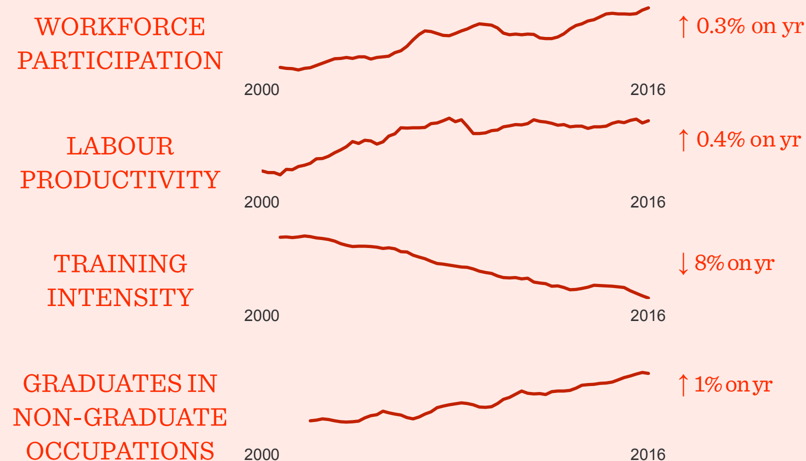
The unemployment rate continues to fall, and is now only 7% above its post-2000 low-point. Long-term (+6 months) unemployment is falling but still well above its low-point.

Underemployment (net hours desired by those in work as well as the unemployed) has been falling steadily for more than two years. It remains 40% above its post-2000 low.

Job-to-job moves, which are a key mechanism of pay progression and can reflect worker confidence, have picked up slightly. They remain 33% below their post-2000 peak.

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 flattened.

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



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 is the main long-term driver of real pay. Growth has stagnated after modest (below trend) increases, due to weak output over the winter months.

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.

Grads in non-grad roles reflect mismatches between qualifications and jobs, and may constrain productivity. The rate of established grads in such jobs is rising, but has slowed.

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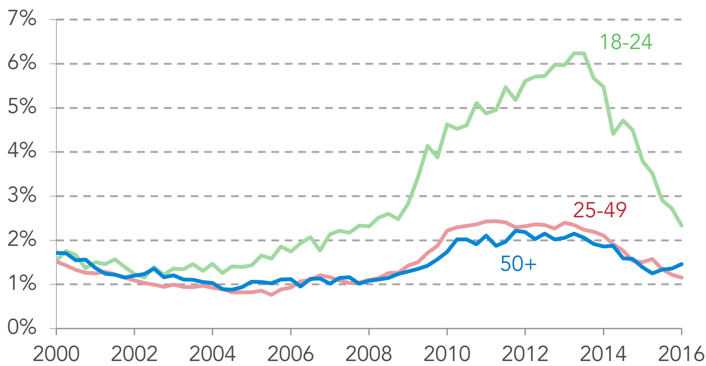
Lifting the lid: The picture across different groups and areas

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: Long-term (6 months+) unemployment rate by age



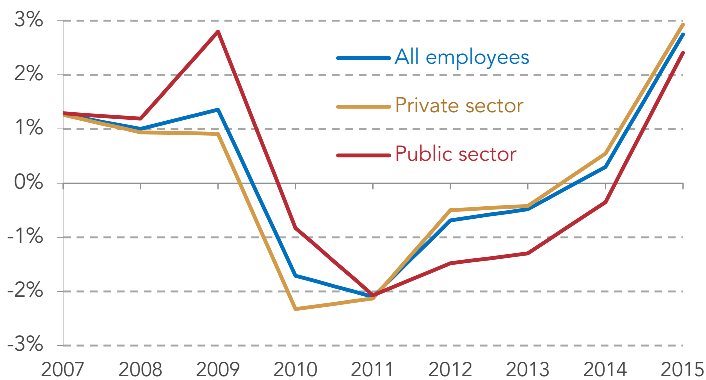
Notes: See notes on Indicator 5: Unemployment by duration at www.resolutionfoundation.org/data/sources-and-methods

Youth long-term unemployment halves in two years

The proportion of the 18-24 year old workforce unemployed for more than 6 months increased rapidly between 2009 and 2013. This reflects the fact that although unemployment rose much less during the financial crisis than it did in the downturns of the 1980s and 1990s, young people bore the brunt of the growth. They also experienced a more marked shift in duration towards longer periods of unemployment than older workers did.

But since 2013 this pattern has reversed rapidly. Long-term unemployment for 18-24 year olds has fallen from 6.2% in Q3 2013 to 2.3% in Q1 2016. Given evidence for scarring effects on future employment and earnings from extended periods of unemployment when young, this is encouraging for the long-term pay outlook for today's younger workers.

Figure 2: Median real pay change for employees remaining in work (CPI-adjusted)



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

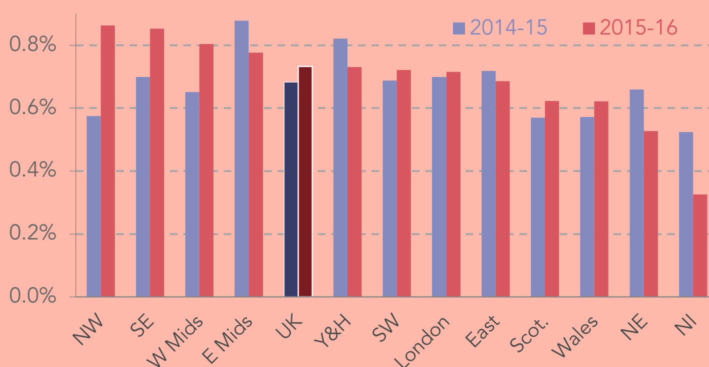
Pay rises in the public sector keeping pace

Figure 2 captures the typical pay rise for employees who have stayed in work from one year to the next. It shows that pay rises in the public sector previously tracked above the economy-wide rate, but fell below 2012, coinciding with the advent of pay restraint.

We noted this three Earnings Outlooks ago and speculated that the public sector rate would remain subdued in 2015, given the continuation of pay restraint policies. In fact, the gap between sectors has narrowed. Very low inflation (CPI was 0.1% in April 2015) will have played a role in minimising the impact of caps on nominal pay uprating, and these medians mask a range of outcomes, with many in the public sector still experiencing flat or falling real pay. But it remains notable that public and private sector settlements appear so similar given the constraints in the former.

The regional perspective

Figure 3: Job-to-job moves by region, Q1 2016



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

Big regional differences in changing job mobility – a harbinger of things to come?

The job mobility rate improved solidly across the UK as a whole between 2014-15 and 2015-16, but there were big differences between regions and nations. Figure 3 shows that in three areas (the North West, South East and West Midlands) the rate increased by more than 20%, pushing them up to the podium positions in the mobility league table. But in the two areas now at the bottom of the table – the North East and Northern Ireland – the rate fell by more than 20%.

Given that job mobility is important for individual pay progression, and is a strong leading indicator of earnings growth, we might expect some downward pressure ahead on wage increases in the North East and Northern Ireland.

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Spotlight: A tale of two labour markets

Laura Gardiner, Resolution Foundation

Stripping out the role played by ultra-low inflation, underlying (nominal) wage growth has remained fairly muted given labour market slack was falling rapidly in 2015. Here we speculate on why this might be the case, by differentiating between what we term the 'dynamic' and 'static' parts of the jobs market.

Even on our preferred inflation-adjusted measures, we've been disappointed by the pay recovery. But take out the effects of very low inflation and look at underlying growth, and the sense that we are a way off the mark is greater still. In our timely data, nominal growth in mean pay averaged 4% and never fell below 3% between 2001 and January 2009. Since then it hasn't risen above 2.8%.

This is surprising given the performance of 'slack' measures that usually lead pay growth, like underemployment and job mobility, which have improved quite a lot in recent years and continued to do so up to Q1 2016. Of course, labour market tightening isn't the only factor influencing pay growth: productivity – which has remained weak – plays the biggest role in the long-term, and inflation can have a feedback effect on the nominal rate of change. But we might still expect slack to do more work than it has. Why isn't the pressure being felt?

For insights to answer this question, we segment employees into three different groups. The first two of these groups – job changers (those who've switched jobs within the past year) and new entrants – we term the 'dynamic' parts of the employee workforce. The remainder – the job stayers (who've been in their current job longer than one year) accounting for around four-fifths of employees – we term the 'static' workforce.

Figure 4 shows the typical nominal pay change for job changers and job stayers (the blue lines), and year-on-year growth in the median pay of new starters (the red line, which captures a different statistic based on movements in an aggregate rather than the typical individual experience).[1]

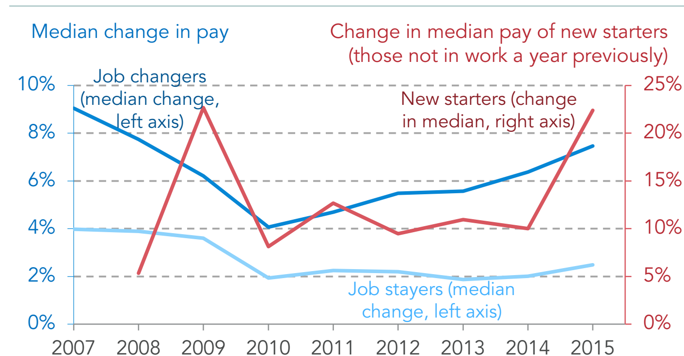
The difference between dynamic and static is clear. We find that nominal pay rises for those staying put fell from 4% to 2% between 2008 and 2010, and have stayed near that level since. In contrast, the typical pay rise for job changers has improved steadily since 2010 (rising to 7.5% in 2015). And median pay for new entrants has soared more recently, up by over one fifth (22.4%) in 2015. Of course, this will partly reflect this group's changing make-up, given we can't compare the same workers year-on-year. Still, the indication is that pay in the dynamic workforce is taking off, while the static part remains on the runway.

Returning to the role of jobs market tightening in driving pressure on overall pay, it's unsurprising that the 'dynamic' workforce feels the effects earliest or most strongly. Reduced slack is exposed when firms take on new staff and when individuals seek a new job. Firms doing little hiring and individuals not looking are unlikely to see it.

But previously we would have expected a knock-on effect on pay settlements for the 'static' workforce, via mechanisms such as firms experiencing resignations raising the pay of those who remain for fear of losing them too. The key questions are therefore why this knock-on effect appears so weak at present, and when it might strengthen?

Speculating on the first question, we can point to the fact that job mobility remains below peak, so fewer firms will be feeling the heat. There may also be some 'path dependence' following the extended trauma of the downturn period. Firms may be complacent about their existing workforce despite their need to pay new joiners relatively handsomely, and risk aversion may be driving employees to make do with whatever pay rise they're offered or crave 'security' in what still feels like a tentative recovery.

Figure 4: Pay growth for job stayers, job changers and new labour market entrants (nominal)



Notes: See notes on Indicator 1: Median employee earnings and Indicator 5: Pay rises at www.resolutionfoundation.org/data/sources-and-methods

On the second question of when this might shake out, the uncertainty in the run up to and following the Brexit vote – with hiring and candidate availability both slowing[2] – is likely to be a brake on any immediate take-off. Longer-term the picture is murkier, but the concern is that any demand slowdown will increase slack before the tightening we've experienced recently has had the chance to work through.

Of course, this is a speculative reading of what's going on and what might happen. Nonetheless, this segmentation between 'dynamic' and 'static' is helpful for understanding how the measures of pay pressure that we track in these publications actually function. And a behavioural perspective reminds us of the importance of the psyche of firms and individuals – for example, juggling the ghosts of the downturn plus Brexit trepidation – in mediating these rules of economic theory.

1 For a full discussion of the differences between 'change in median' and 'median or typical change' measures of pay growth, see: L Gardiner, Who's been getting a pay rise?, Resolution Foundation, March 2015.

2 Markit/REC Report on Jobs, August 2016

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