

# 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 second quarter of 2017. This was a period in which we saw the best and worst of the UK labour market. On the one hand, compared to a year earlier real pay fell by 0.5 per cent; yet on the other hand the unemployment rate hit a low not seen since 1975, and employment rose to new highs.*

*Below we examine some of the reasons why a supposedly tight labour market is not feeding through into higher nominal wage growth. Our 'Spotlight' article suggests that the inactive population may be providing a bigger boost to effective labour supply than it has historically done, due to changes in who makes up this group.*

*Other clues come from the fact that long-term unemployment remains elevated, particularly for younger people. Similarly underemployment – in spite of recent falls – remains above the lows of the mid-2000s. Of more concern is the fact that other measures of a healthy labour market continue to disappoint. It looks as though job-to-job moves may have plateaued, after a gradual recovery, at a level 40 per cent below their pre-crisis peak. And productivity growth has flat-lined over the past year.*

*With inflation likely to subside towards the end of 2017 there may be some respite from the pay squeeze. However, healthy earnings growth depends on a higher nominal wage growth. So far – in spite of the many signs of a healthy labour market – there is little evidence of this occurring.*

Our earnings breakdown shows that real pay growth started to fall in Q1 2017 and has continued to fall in the latest quarter. The compositional boost to pay provided by a changing workforce has also fallen. More positively the pay squeeze is less severe at the bottom and this has contributed to continued falls in pay inequality, partly as a result of the National Living Wage.

Our analysis of pay pressures and slack shows that unemployment and net underemployment have continued to fall, the latter declining 14 per cent over the past year. Less positively job-to-job moves appear to have plateaued significantly below their pre-crisis high.

Our review of longer-term labour market health and efficiency has welcome news, stagnant productivity aside. Participation continues to rise, the decline in off-the-job training appears to have bottomed-out and the rise in graduates in non-grad jobs has also plateaued.

## Analysis from Stephen Clarke:

*"The two-faced nature of the UK labour market continues. In Q2 2017 real pay continued to fall, meaning that we have experienced almost 6 months of falling wages. Yet over the same period the labour market has added around a quarter of a million jobs and continues to break records.*

*"Look below the surface though and – in terms of pay pressure – the labour market looks less healthy. Job-to-job moves have plateaued, long-term unemployment remains elevated and underemployment has not yet fallen to the lows of the mid-2000s.*

*"The outlook for the future is that the UK is likely to continue to perform strongly in terms of jobs growth, yet this may do little to raise productivity, growth in which continues to be anaemic. Unless this changes any respite from the pay squeeze due to lower inflation over the next six months is likely to be short-lived."*

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The Scorecard: Q2 2017

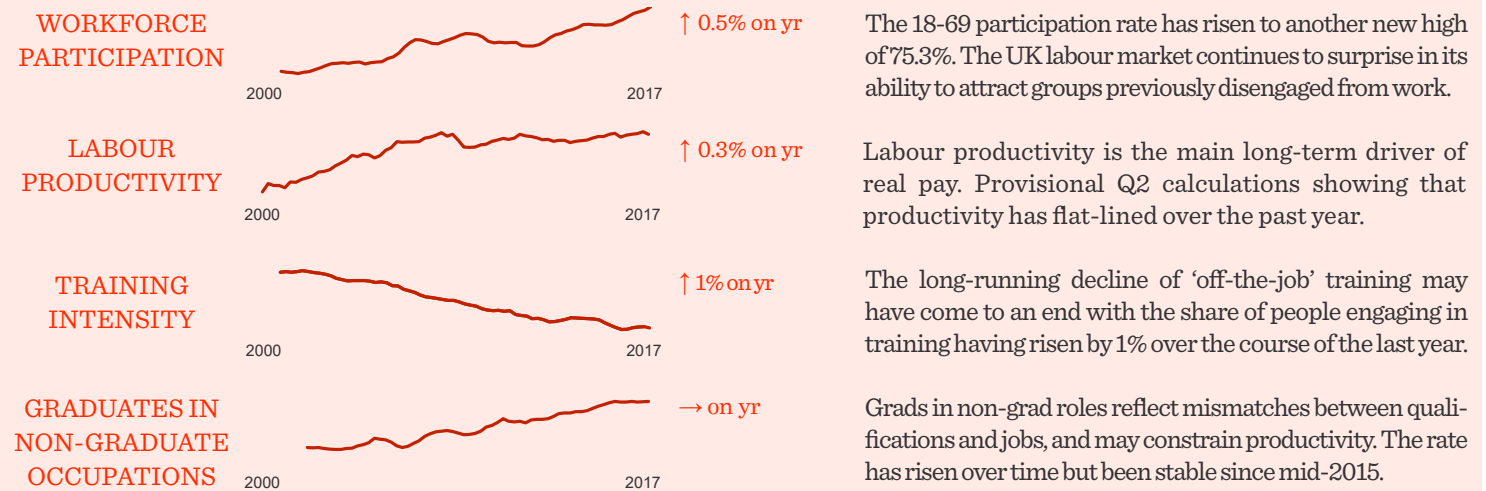
What's happened: The earnings breakdown



What's round the corner: Pay pressures and slack



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



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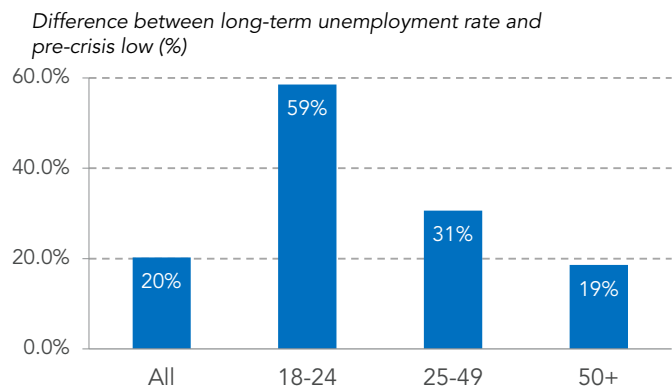
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## Lifting the lid: The picture across different groups and areas

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](http://www.resolutionfoundation.org/earningsoutlook)

**Figure 1: Long-term unemployment by age**

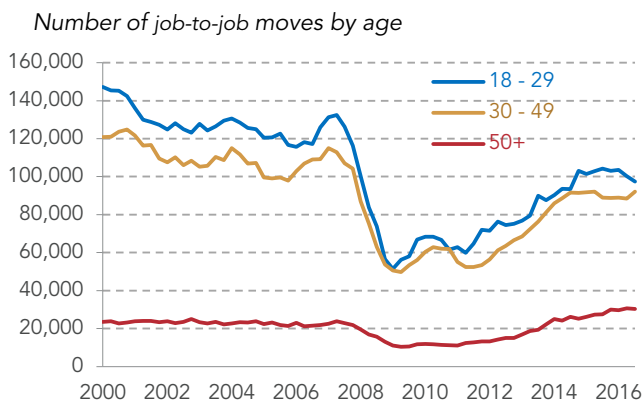


Notes: See notes on Indicator 6: Unemployment by duration at [www.resolutionfoundation.org/data/sources-and-methods](http://www.resolutionfoundation.org/data/sources-and-methods)

### Long-term unemployment remains above pre-crisis lows

In Q2 2017 unemployment fell to 4.3 per cent, a level not seen since 1975. However long-term unemployment is still 20 per cent higher than in the mid-2000s. Furthermore, although it is between 31 per cent and 19 per cent higher for those over 24, long-term unemployment remains significantly elevated for younger workers (aged 18 – 24). This may suggest that there is less effective slack in the labour market than the headline figures suggest, although this doesn't appear to have put more pressure on employers to raise wages. The fact that long-term unemployment is concentrated among the young is concerning, because this is a group for whom time out of the labour market is likely to be particularly damaging. Furthermore declines in long-term unemployment for those aged 18 to 24 have slowed since last summer, suggesting that it could be hard work pushing the rate back to its pre-crisis level.

**Figure 2: Job-to-job moves by age (Index: 2000=100)**



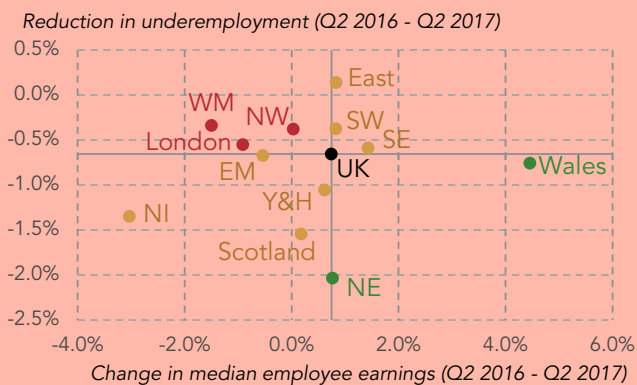
Notes: See notes on Indicator 8: Job-to-job moves at [www.resolutionfoundation.org/data/sources-and-methods](http://www.resolutionfoundation.org/data/sources-and-methods)

### Job-to-job moves have now plateaued

Job-to-job moves declined dramatically as the country felt the impact of the financial crisis. However from a low in 2010 there has been a cyclical recovery, rising to around 220,000 in the first quarter of 2016. Unfortunately moves have now plateaued, though the picture differs by age. Moves have continued to rise for the over 50s (and are now above their pre-crisis level); they have flat-lined for 30 to 49 year olds and they may be starting to fall for those under 30. Job moves help boost pay: people who move typically earn annual pay rises around five times as large as those who remain with the same employer. Therefore an end to the rise in job-to-job moves bodes badly for pay growth, particularly for the young who have experienced the deepest pay squeeze.

## The regional perspective

**Figure 3: Underemployment and pay**



Notes: See notes on Indicator 7: Underemployment at [www.resolutionfoundation.org/data/sources-and-methods](http://www.resolutionfoundation.org/data/sources-and-methods)

### Falling underemployment doesn't necessarily lead to rising pay

If there is more slack in the labour market than the headline figures suggest then once this 'underemployment' starts to fall pay growth may pick up. The evidence so far is that relatively large falls in underemployment (down 14 per cent this year) has not yet had an impact on wages. Furthermore the relationship between the two – at least across the regions and nations of the UK – is currently weak. Underemployment fell sharply in Northern Ireland and the East Midlands last year, but so did real pay. On the other hand there was strong pay growth in Wales with relatively small declines in underemployment, and the North East saw the largest decrease in underemployment, but wages rose by less than 1 per cent.

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**Spotlight: What has happened to the inactive population over time?**

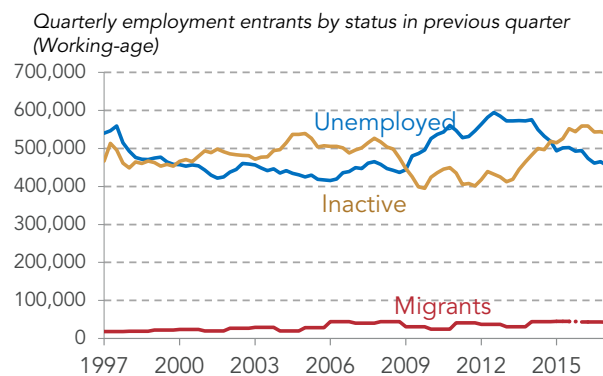
*Stephen Clarke, Resolution Foundation*

We tend to think of people entering work as coming from the ranks of the unemployed. However outside of recessions most people move into work from a period of inactivity; last year around 80,000 more entered work from inactivity than unemployment. Given this, discussion about the level of slack in the labour market needs to pay more attention to the inactive. The evidence is that there are large variations in the probability that different people within the inactive group will enter work, but over time changes in the composition of the inactive population appears to have made it more 'active'. Given this it is possible that there is more effective slack in the UK labour market than the headline employment and unemployment figures suggest.

There are three sources of increased employment: people who are out of work, looking for a job and available to begin one (the unemployed); people who are out of work and not looking for one or unavailable to start one (the inactive); and people who move to the UK for work (migrants). Figure 4 shows how each of these three sources have contributed to employment entries over time. In Q2 2017 around 450,000 unemployed people moved into work, along with 540,000 inactive people and around 50,000 migrants. At present the inactive are the most important source of new entrants. This is perhaps unsurprising as there are over six times (8.7 million compared to 1.4 million) as many inactive than unemployed people. However, they are far less likely to enter work.

It is difficult to speak of the inactive population as a whole. Some tend to resemble the unemployed in their prospects of finding work, while many are more disconnected from the labour market.

**Figure 4: Who's moving into work?**



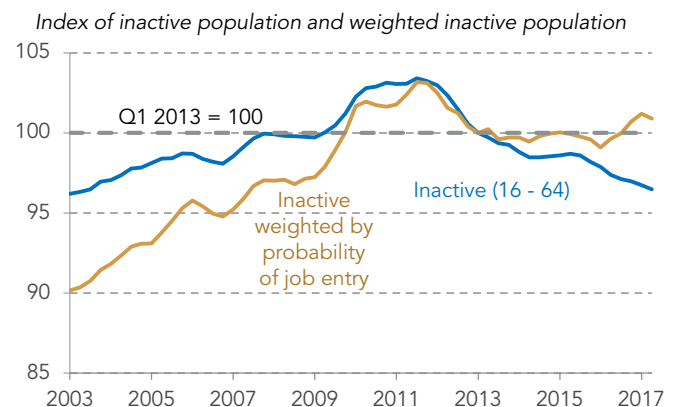
Source: RF analysis of 2 Quarter longitudinal Labour Force Survey

For example around 37 per cent of the inactive population have a disability, and – controlling for a range of other personal and economic characteristics – compared to someone without a disability they are 90 per cent less likely to find work. On the other hand – again controlling for a range of characteristics – someone who has a degree has a much better chance of entering work, but only 16 per cent of the inactive population has a university education.

Failing to take these differences into account can mean that policy makers can over or underestimate the role of the inactive population in determining the UK's effective labour supply. Using information

about the relative probabilities of different groups entering work we can produce a 'weighted' estimate of the size of the inactive population.<sup>1</sup> Because these weights are fixed over time this estimate shows what impact the changing composition of the inactive population has had on effective labour market slack. Figure 5 presents an index of the inactive population and compares this to the weighted estimate. Over time the groups that tend to have a better chance of moving into work have become a larger part of the inactive population. For example in 2013 13 per cent of the inactive population had a degree, this figure is now 16 per cent. Four years ago 90 per cent of the inactive population had been out of work for more than a year, this figure is now 88 per cent. Perhaps most importantly the average age of the inactive population has fallen, which could suggest that the large increase in inactivity that occurred in the early 1980s is starting to unwind. Such compositional changes are distinct from a general improvement in the chance of an inactive person moving into work, with the overall job entry-rate of the inactive population no higher than it was in the mid-2000s.

**Figure 5: The inactive population has remained constant since 2013 once the changing composition is taken into account**



Notes and sources: RF analysis of 2 Quarter longitudinal Labour Force Survey. 4 quarter rolling averages. See footnote for full details.

Figure 5 shows that the weighted measure has remained stable while the raw measure has fallen. What can be learnt from this? First, policy makers need to be aware of the differences that the 'inactive' label masks. A better understanding of who makes up this group – and how it may have changed over time – can help guide active labour market policy. In particular, although there has been a decline in the share of people spending a long time out of the labour market, the share of the inactive population with a disability has remained constant at around 37 per cent. Pushing the employment rate higher will require better support for this latter group. Second the fact that our weighted measure of inactivity has remained constant in recent years suggests that there may be more effective slack in the labour market than declines in the headline inactivity measure indicates. This may be one reason why pay growth has been sluggish.

<sup>1</sup> To do this we split the inactive population into eight groups and look at the probability (assessed over period 2002 to 2017) that people within each group enter work each quarter. We then apply these probabilities to the inactive population. As the probabilities remain constant the only thing driving changes in the weighted population are the sizes of the various groups and the size of the inactive population as a whole.