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

In Q3 2017 labour market observers were looking for signs that nominal pay growth could finally be picking up or that the British job creation machine was running out of steam. There was evidence of both, and the big question for 2018 is whether they're sustained.

The employment rate fell to 75 per cent, from 75.3 per cent in July. Despite the fact that the number of people in work still grew by 0.9 per cent over the past year, this is down from 1.5 per cent growth in Q3 2016. A definite slowdown appears to have arrived.

A belief that more buoyant nominal pay growth could be round the corner was (though far from the most important reason) partly behind the Bank of England's decision to raise rates in November. The Bank's Inflation Report suggested that compositional changes to the workforce (a rise in employment in lower paying occupations and industries) that had been weighing down on pay and productivity growth could unwind soon. Unfortunately, looking at private sector pay growth (the area of the economy where wage pressure is most likely to be evident), there was signs that far from accelerating in September, it could be slowing slightly from its August 6-month high.

The result is that we come to the end of the year with a sense that so far 2017 has echoes of 2016 albeit in the context of much higher inflation. Like last year the strength of the UK's jobs market has continued to surprise, and as with 2016 an (apparently) tight labour market has failed to feed into stronger nominal wage growth. With the OBR downgrading the country's productivity prospects, the big question is whether this is the new norm or is an uplift around the corner?

Analysis from Torsten Bell:

2017 was a tough year as the pay squeeze returned. The good news is that things will get better next year. The bad news is that they may only go from backwards to standing still, with prospects for a meaningful pay recovery still out of sight.

The public have famously defied recent gloomy economic predictions and continued to spend, but their expectations now appear to be moving in line with experts' pessimistic predictions. Over half expect no pay rise next year and households are just as likely to expect their financial situation to get worse as improve.

Of course predictions are almost always wrong. But it matters a lot in what way they are wrong. Ongoing pay rises for the lowest earners, record employment levels and potentially stronger productivity growth in recent months provide grounds for optimism. On the other hand, the OBR's main pay forecasting problem has actually been excessive perkiness.

Our **earnings breakdown** shows that real pay growth continued to fall in Q3 2017. The compositional boost to pay remains below its historic average, with the improved qualification level of the workforce having the smallest boost since late 2015. Another year of relatively strong pay growth at the bottom due to the NLW, and sluggish growth for mid and high-earners, means that pay inequality continues to fall.

Our analysis of **pay pressures and slack** shows that the labour market continues to tighten, and there is some evidence that the rise in job-to-job moves since the recession may have not fizzled out yet. However, moves remain well below their pre-crisis level. There is also some evidence that the share of job entries accounted for by migrants may have plateaued.

Our review of **longer-term labour market health** is concerning. Productivity growth continues to flat-line and there is little evidence of a pick-up in training. The one bright spot is that labour force participation 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 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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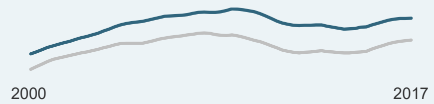
The Scorecard: Q3 2017

What's happened: The earnings breakdown

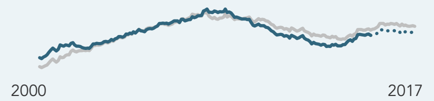
MEDIAN EMPLOYEE EARNINGS



↑ 0.6% on yr (all)
↑ 1.2% on yr (private sector)

Real pay continued to fall in Q3 2017. The pay squeeze looks likely to ease up in early 2018 when inflation moves closer to the Bank's target of 2 per cent.

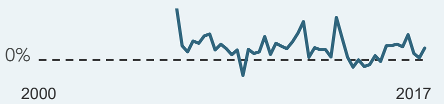
ALL WORKER EARNINGS



Employee earnings and all worker earnings gap →

Following strong self-employed earnings growth in 2015-16 the difference between the employee average and the all worker measure has remained relatively constant.

EARNINGS DECOMPOSITION



↓0.1ppts on yr

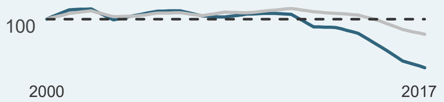
The compositional boost to pay associated with a changing workforce remains positive, with little change. Improved qualifications are providing the smallest boost since 2015.

PAY RISES

↓ 1.2ppts 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 sluggish pay growth.

EARNINGS INEQUALITY

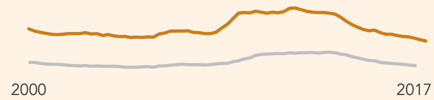


r75:25 ↓1% on yr
r90:10 ↓1.4% on yr

The NLW and poor pay growth at the top means that hourly pay inequality between the upper- and lower-middle (r75:25) and the top and bottom (r90:10) has again fallen.

What's round the corner: Pay pressures and slack

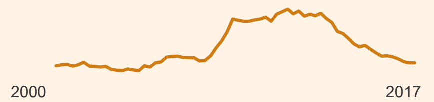
UNEMPLOYMENT BY DURATION



↓ 0.6ppts on yr (all)
↓ 0.1ppts on yr (long-term)

The unemployment rate has fallen to 4.3%, a new low. Falls in long-term unemployment (6 months+) have stalled and it remains above the lows of the early-2000s.

UNDER-EMPLOYMENT



↓ 12% on yr

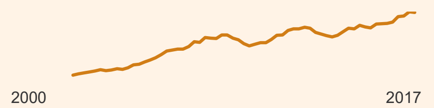
There have been further falls in underemployment (net hours desired by those in work as well as the unemployed) but it remains elevated above mid-2000s.

JOB-TO-JOB MOVES

↑ 15% on yr

After signs that the post-crisis uptick in job-to-job moves had stalled there is now some evidence that they continue to rise, albeit still well below pre-crises highs levels.

MIGRANT JOB ENTRY

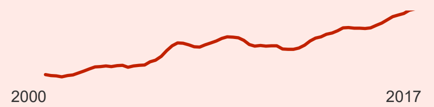


↑ 9% on yr

With net migration down by a third in the past year there are some signs that the growth in share of job entries accounted for by migrants is beginning to slow.

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

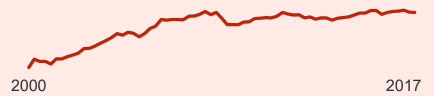
WORKFORCE PARTICIPATION



↑ 0.4% on yr

The 18-69 participation rate has risen to another new high of 75.4%. Year-on-year growth has slowed slightly, perhaps suggesting the beginning of a slowdown.

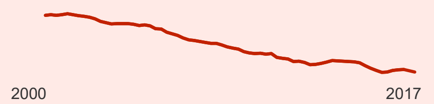
LABOUR PRODUCTIVITY



↓ 0.2% on yr

Labour productivity is the main long-term driver of real pay. There is little evidence that growth is picking up following years of post-crisis stagnation.

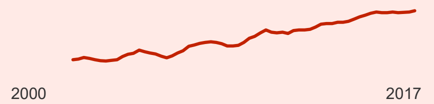
TRAINING INTENSITY



↓ 1% on yr

There has been a slight decline in 'off-the-job' training over the past year, but the significant fall that occurred in the 2000s appears to have halted somewhat.

GRADUATES IN NON-GRADUATE OCCUPATIONS



↑ 1.9% on yr

Grads in non-grad roles can reflect skills mismatch, and may keep individual productivity below potential. The rate of established grads in such roles continues to rise gently.

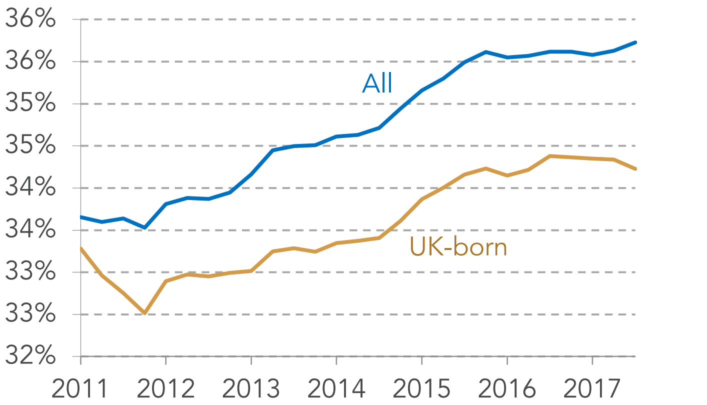
 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator is available at www.resolutionfoundation.org/earningsoutlook. This project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

THE RF EARNINGS OUTLOOK

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: 'Established' graduates in non-graduate jobs

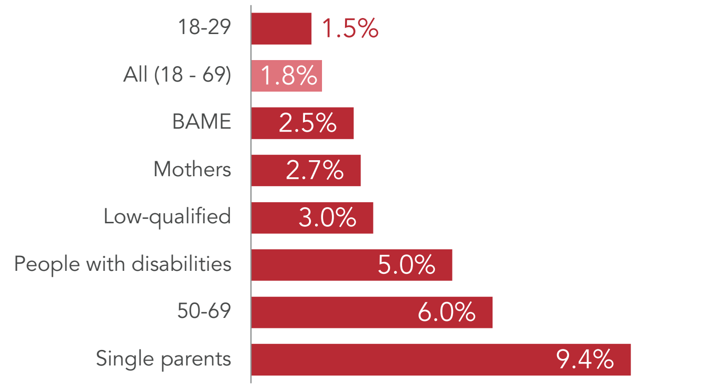


Notes: See notes on Indicator 13: Graduates in non-graduate occupations at www.resolutionfoundation.org/data/sources-and-methods

There are fewer graduates in non-grad jobs once migrants are excluded, but this is not the whole story

The UK has seen an increase in graduates in non-graduate occupations (GRINGOs) over the past two decades. There are many possible reasons for this, not least the significant increase in graduates. However, some have suggested that the increase in the number of migrants in the labour force could be responsible, given they are more likely to be working in roles for which they are overqualified for. Looking at the growth in GRINGOs since 2011 (when migrant qualifications began to be properly recorded in the official survey) shows that there has been a less dramatic increase when migrants are excluded. However, migrants do not account for all the growth, looking at just those born in the UK the share of graduates in non-graduate jobs has still increase from around 32.5 per cent in Q1 2012 to 34.2 per cent in Q3 2017.

Figure 2: Increase in participation rates: Q3 2012-Q3 2017 (annual average)



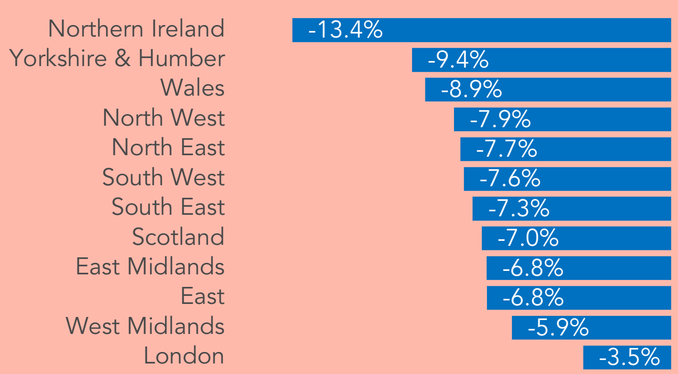
Notes: See notes on Indicator 10: Workforce participation at www.resolutionfoundation.org/data/sources-and-methods

To what extent has a tight labour market benefitted disadvantaged groups?

We would expect that a tight labour market would increase participation by people that struggle to access the labour market in less buoyant times. This has happened, however the varying performance of differing groups highlights the role that wider policy changes have played. Single parents have seen the sharpest increase, reflecting the fact that over time the barriers to participating have fallen, and the benefits of doing so have risen, for this group. Participation rates have also significantly increased for older workers, partly reflecting the rising state pension age for women. The success of these groups and the fact that there has been less progress for others suggest that more than just a tighter labour market is needed to boost engagement.

The regional perspective

Figure 3: Percentage change in 90/10 earnings ratio: 2015 - 2017



Notes: See notes on Indicator 7: Underemployment at www.resolutionfoundation.org/data/sources-and-methods

The NLW is reducing inequality, but not in the capital

The introduction of the NLW has had a significant impact on earnings inequality. Overall the ratio of earnings for those at the 90th percentile to the 10th percentile has fallen by 4 per cent. However this masks wide variation by region. In London – the region in which the NLW has the lowest 'bite' and affects the smallest proportion of people – the 90/10 ratio hasn't fallen at all, whereas in Northern Ireland the ratio has fallen by over 10 per cent. Indeed the parts of the UK where the ratio has fallen the most – Northern Ireland, Yorkshire, and Wales – all have relatively low levels of pay and a high proportion of workers on the NLW.

 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.

THE RF EARNINGS OUTLOOK

Spotlight: 2018 risks being a standstill year on pay

Torsten Bell, Resolution Foundation

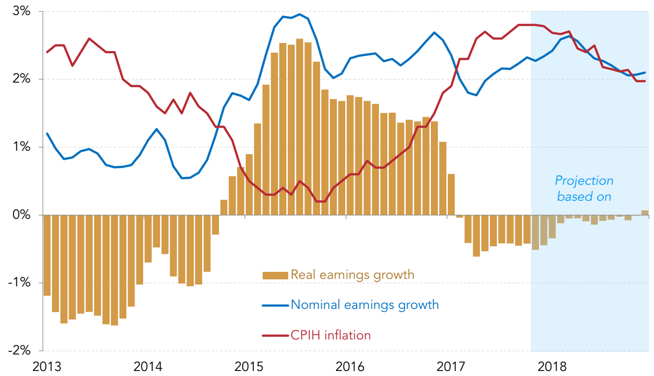
2018 looks set to be a standstill year. On the biggest political issue of our time we will spend all 365 days of it leaving, but not out, of the EU. It also looks set to be a standstill year for our economy as most people experience it – on pay and employment we may well end it pretty much where we began.

That flat pay may be seen as good news shows quite how far we've come as a country. The recent catastrophe of wages in Britain has well and truly managed our expectations. The living standards story of 2017 was the return of shrinking pay packets – still £15 a week below their pre-crisis peak and not forecast to fully recover until 2025. Far from catching back up, we've started digging again.

So zero pay growth is better, but hardly great. It would make 2018 worse than every single year in the three decades running up to the crisis, but a better than average year for post-crisis Britain. Indeed our own projection is that the pay squeeze may well get deeper before it eases during 2018 as inflation recedes. A noticeable year on year rise in real pay isn't forecast to take place until December 2018. Happy Christmas for next year.

Figure 4: Earnings growth and inflation 2013-18

Annual growth in average weekly earnings (regular pay) and CPIH inflation



Source: Resolution Foundation analysis, ONS and OBR

The reason pay growth not returning in 2018 matters is that without it, it's very hard to see how incomes can make much progress. While wage led income growth was the norm pre-crisis, occurring in 9 of the 10 years running up to 2008, we've only experienced 2 years of wage-led growth since then.

Continuing this post-crisis pattern is unlikely to work in 2018 for two reasons. First, our post-2012 jobs boom that has been the major driver of income growth may have finally come to a close in recent months. Second, the scale of social security cuts biting in 2018 are very significant, especially the benefits freeze set for April 2018.

That's what the experts think – but as we know Britain's had quite enough of them. So what about the punters? Very unfashionably they largely agree with the experts, according to recently released Bank of England data.

Over half expect their pay to stay the same or fall if they remain in the same job. Only one in seven expect an increase. More broadly an almost identical proportion (just over a quarter) of families expect their financial situation to get worse next year as expect it to get better.

We can also get an insight into why workers may not be feeling particularly pushy on pay. Nearly 40 per cent think the chances of the economy suffering a "severe" downturn in the next 12 months is higher than normal (only 12 per cent say it's less likely). That pessimism is shared right across the income spectrum. More worryingly, while most people don't expect to lose their job (unsurprisingly with unemployment at a 40 year low), one in five think they will 'almost definitely' or 'quite likely' lose their job. Business isn't much perkier. Pessimistic workers and anxious businesses aren't a good recipe for strong wage growth.

But it's good to end the year on some optimism – after all Philip Hammond told us it was our job to ensure forecasts are 'proved wrong', and there is a decent chance they will be. Here's three reasons for some post-Christmas cheer.

First a good chunk of people will get a pay rise next year – the lowest paid. The National Living Wage will increase to £7.83 in April 2018 – a 4.4 per cent rise that will almost certainly reduce earnings inequality in 2018.

Second, there is a glimmer of hope on productivity. We estimate that a surprisingly large fall in hours worked this Autumn might imply growth in productivity of 1.2% in the three months to October – stronger growth than seen in any quarter since the end of 2005.

Third, the Bank of England is noticeably more optimistic on pay rises next year than the OBR. A tight labour market could deliver the increase in nominal pay growth that economic theory has promised. There is plenty of evidence of firms facing increased difficulties recruiting and workers being able to bargain for more secure jobs.

So there's some grounds for optimism amongst the gloom from the forecasts and the public. The case for pessimism? The experts have been consistently wrong on pay and productivity over the past decade – consistently too optimistic that is...

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