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 Q4 2017 the pay squeeze that had affected the UK economy since the beginning of the year was starting to dissipate, leaving people looking forward to a better (at least in terms of pay growth) 2018. However, the extent to which this year will bring relatively robust growth, or the more anaemic variety, remains to be seen.

The background remains one of a tightening labour market. Employment shows little sign of falling from record highs, remaining between 75 and 75.3 per cent for the past 6 months. Similarly despite an uptick in unemployment in the final quarter of the year, the most recent data indicates that the rate continues to hover around 4.3 per cent. Other measures of labour market slack – such as underemployment – continue to improve and a fall in the rate at which migrants are filling vacancies, points to continued tightening.

While falling inflation and an uptick in nominal wages mean real pay growth returned in early 2018, this year is unlikely to be a bumper one for real wages. Furthermore nominal pay growth for those switching jobs fell to 7.3 per cent in 2017, down from 8.9 per cent in 2016. This may reflect the fact that job-to-job moves have been rising, but they it may also suggest that pay pressure is less pronounced than expected given the tightness of the labour market.

Taking a longer view, regardless of quite how significantly pay pressure is building there are still concerns about the potential of the UK economy. While labour productivity picked up in the final two quarters of 2017 it remains to be seen whether this presages a more sustained improvement, or whether forecasters including the OBR and Bank of England are right to be relatively pessimistic about productivity (and therefore pay) growth over the medium-term. Initial data from 2018 suggests that productivity growth was overstated at the end of last year. Until the economy is able to buck this weak productivity trend the outlook for real pay growth is likely to remain subdued.

Analysis from Stephen Clarke:

In Q4 2017 the pay squeeze that had affected the UK economy since the beginning of the year was starting to dissipate, leaving people looking forward to a better 2018. However, the extent to which 2017 signals the end of anaemic pay growth remains to be seen.

This year has certainly started better than the last, the pay squeeze looks likely to have come to an end in February and there is little sign that the jobs market is weakening – the UK could even be approaching 'full employment'.

However, the medium-term outlook for pay remains concerning. Despite an uptick in labour productivity in the second half of 2017, early data from 2018 suggests that this could have been an aberration. Unless the UK economy is able to raise productivity, then our ability to deliver robust real pay growth will be limited.

Our **earnings breakdown** shows that the squeeze on real pay began to dissipate in Q4 2017. However the story for the year as a whole is that returns to those remaining in continuous employment fell from 1.8 per cent in 2016 to 1.3 per cent in 2017. More positively the compositional boost to pay remains below its historic average, suggesting it could rise in future, and the NLW means another year of relatively strong pay growth at the bottom.

Our analysis of **pay pressures and slack** shows that the labour market continues to tighten; Job-to-job moves continue to rise, underemployment is falling and there is also some evidence that the share of job entries accounted for by migrants is shrinking.

Our review of **longer-term labour market health** is less rosy, although the last two quarters of 2017 bought with them an uptick in labour productivity growth, early evidence is that this may not be sustained, while 'off-the-job' training continues to fall and the share of graduates in non-grad jobs continues to rise.

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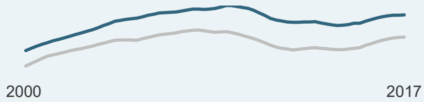
The Scorecard: Q4 2017

What's happened: The earnings breakdown

MEDIAN EMPLOYEE EARNINGS

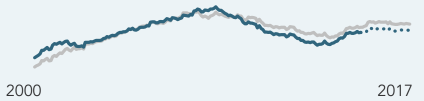


↑ 0.8% on yr (all)

↑ 1.5% on yr (private sector)

Although real pay continued to fall in Q4 2017, the pay squeeze began to ease and averaged over three quarters there was positive (if muted) year-on-year pay growth.

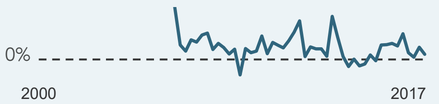
ALL WORKER EARNINGS



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



↓0.9ppts on yr

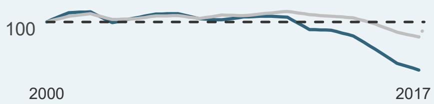
The compositional boost to pay associated with a changing workforce remains low by historical levels and continued to fall this quarter.

PAY RISES

↓ 0.6ppts on yr

Median year-on-year real hourly pay growth for employees in work over a year (both job stayers and changers) remains below the levels of 2015 but above those of the pre-crisis.

EARNINGS INEQUALITY



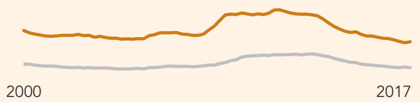
r75:25 ↓ 1.1% on yr

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) continues to fall.

What's round the corner: Pay pressures and slack

UNEMPLOYMENT BY DURATION

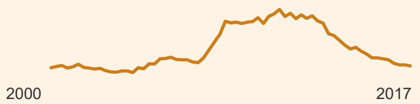


↓ 0.4ppts on yr (all)

↓ 0.1ppts on yr (long-term)

The unemployment rate ticked up in Q4 but continues to fall compared to a year ago. Long-term unemployment also continues to fall, but with signs that levels are plateauing.

UNDER-EMPLOYMENT



↓ 12% on yr

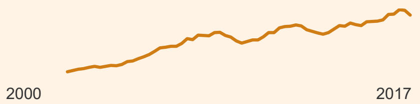
There have been further falls in underemployment (net hours desired by those in work as well as the unemployed) and is back at pre-crisis levels.

JOB-TO-JOB MOVES

↑ 24% on yr

Voluntary job-to-job moves continue to rise, although they are still 14 per cent below the average levels from the pre-crisis (2000-07) period.

MIGRANT JOB ENTRY

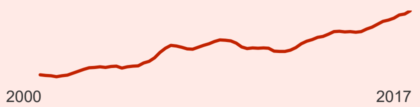


↓ 1% on yr

With net migration down by nearly 100 thousand since mid-2016, this may be starting to be felt in the rate at which migrants fill vacancies, with the first drop since 2013.

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

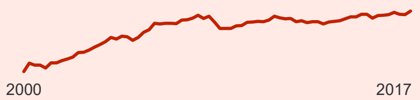
WORKFORCE PARTICIPATION



↑ 0.5% on yr

The 18-69 participation rate has risen to another new high of 75.5%, and although signs of a slowdown are evident, participation does not appear to be plateauing yet.

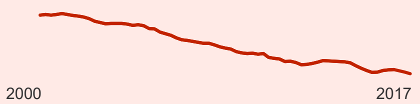
LABOUR PRODUCTIVITY



↑ 0.9% on yr

The end of 2017 bought the first successive two quarters of relatively strong growth in labour productivity since the financial crisis.

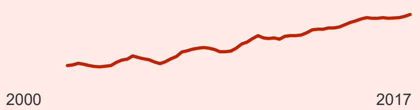
TRAINING INTENSITY



↓ 3% on yr

'Off-the-job' training continues to decline, albeit at a slower rate than in the mid-2000s.

GRADUATES IN NON-GRADUATE OCCUPATIONS



↑ 1% on yr

Grads in non-grad roles reflect mismatches between qualifications and jobs, and may constrain productivity. It has risen over time and ticked up again over the past year.

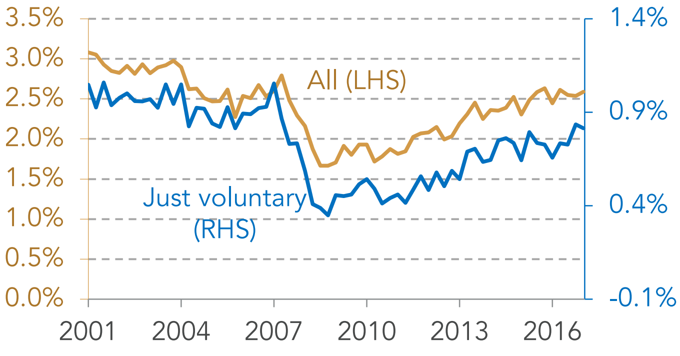
 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator is available at www.resolutionfoundation.org/earningsoutlook. This project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

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: Job-to-job moves (Seasonally adjusted, three-month average to date shown)

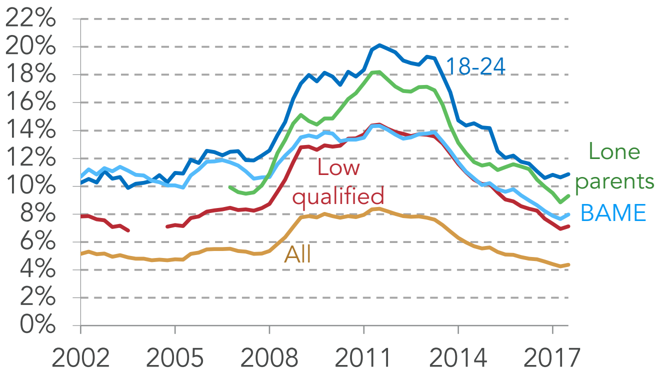


Notes: See notes on Indicator 8: Job-to-job moves at www.resolutionfoundation.org/data/sources-and-methods

Voluntary versus involuntary job-to-job moves

Job-to-job moves are an important sign of a healthy labour market, particularly when they are voluntary. Moving jobs voluntarily usually comes with a pay rise and allows others to move as well. It is therefore encouraging that moves have risen since a dramatic post-crisis fall. However voluntary moves (the blue line) fell more during the crash than involuntary ones (63 per cent compared to 39 per cent). Furthermore such moves are further from their pre-crisis (2000-07) average (14 per cent compared to 5 per cent). Therefore while the involuntary moves figures may suggest the labour market is as dynamic now as it was before the crash, voluntary moves (which are more associated with pay growth) tells a slightly less positive story and should be the focus of policy makers. More encouragingly voluntary moves appear to be rising faster than involuntary ones and this could presage faster pay growth in the near future.

Figure 2: Unemployment rate (Seasonally adjusted, three-month average to date shown, 16+)



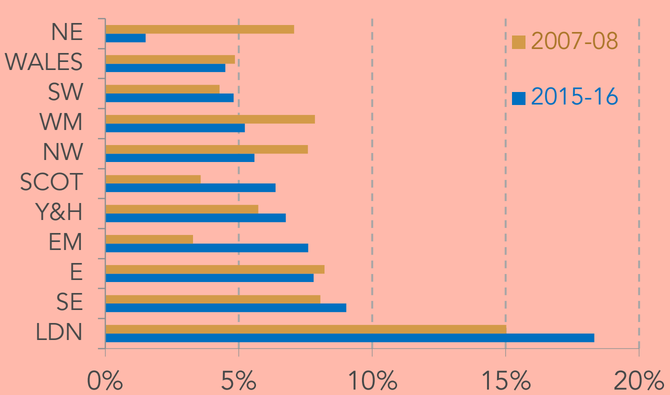
Notes: See notes on Indicator 6: Unemployment & Indicator 10: Workforce participation at www.resolutionfoundation.org/data/sources-and-methods

Are there signs that the long decline in unemployment could be reversing?

After nearly 7 years of almost continuously-falling unemployment are there any signs that this could be reversing? Any indication that unemployment was on the rise would first be apparent in data on groups more likely to find themselves out of work in a downturn. Figure 2 charts the unemployment rates for those aged 18-24, ethnic minorities, single parents and those with low qualifications. The evidence is that most groups continued to experience sustained falls in unemployment until the latest quarter (when unemployment overall ticked up). However the unemployment rate for younger workers has plateaued, or risen, since Q1 2017. This group, and the others, are worth keeping an eye on for an early sign of any future labour market trouble.

The regional perspective

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



Notes: RF analysis of ONS, *ASHE panel*

Where to move to get the highest pay rise?

The evidence (see Spotlight feature) is that those that move region and employer earn the highest pay rises, although the returns differ by region. Interestingly the variation in returns and the difference between the average return earned and the return to moving to London have both risen in the post-crisis period. By contrast, excluding London, the typical pay rise earned when moving to another part of the country was lower in 2016-17 than in 2007-08. The result is a more polarised picture; the relative reward for moving region has fallen but this is not the case for those moving to the highest-paying parts of the country. This has occurred at the same time as regional job-to-job moves have fallen, perhaps reflecting the fact that once housing costs are taken into account, incomes in London are lower than in the South West.

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Spotlight: Is wage pressure building?

Stephen Clarke, Resolution Foundation

To what extent is wage growth picking up? This is an important question, not just for people's pay packets but also for monetary policy makers in the Bank of England who are weighing up when to raise interest rates further.

While nominal pay growth has been rising recently (up to 2.6 per cent in year to January), this is still some way short of the rates at which pay was rising before the crisis. To get a sense if stronger pay rises are in the offing we need to take a look behind the headline figures. Doing so reveals a number of points that could be seized upon by labour market bulls or bears.

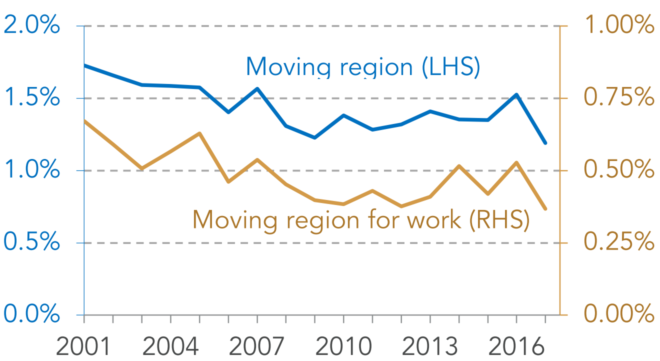
First, those who are bullish about future pay rises can take heart from the fact that, while the annual pay growth figures are unexceptional, the annualised six month figures look a lot perkier. Over the past six months annualised pay growth has been around 3 per cent, and above this in the private sector, levels we haven't seen for eighteen months. Similarly the ONS' index of labour costs grew at an annualised rate of 4.9 per cent in the last six months of 2017, the highest since late 2007.

Such figures may suggest that the economy is shrugging off the uncertainty that followed the vote to leave the EU and that a tight labour market is (finally) starting to drive robust pay growth. Despite the uptick in unemployment in the third quarter of 2017, the rate fell back to 4.3 per cent in January's figures and shows little sign of rising. Furthermore other measures of labour market slack, such as under-employment, continue to fall and on many indicators the UK labour market is back at pre-crisis (if not yet those in the early 2000s) levels.

Bulls can also point to survey data that suggests that expected pay settlements for 2018 are likely to be higher than the recent past. The Banks Agent's survey forecasts pay settlements of 3.1 per cent in 2018, up from 2.6 per cent in 2017 and research by Incomes Data Research showed that the typical pay award across the whole economy rose to 2.5 per cent in the three months to January 2018, the highest since December 2015.

Yet there are also many reasons to be bearish. First although labour costs have risen recently, rises in unit labour costs (which includes the self-employed) are below those of 2013 not to mention the levels before the crash. Furthermore because unit labour costs move inversely to productivity, they could be being repressed by fast productivity growth, but as this is clearly not the case at the moment, they just reflect limited wage pressure.

Figure 4: Proportion of people moving region and moving region and changing jobs

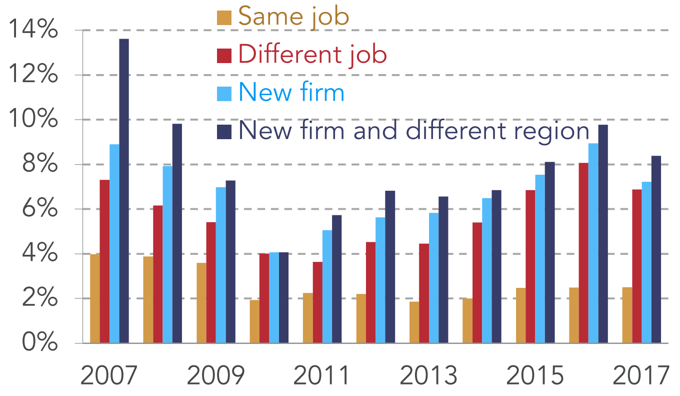


Source: RF analysis of ONS, LFS

More fundamentally – and looking further ahead – although the UK labour market appears tight, measures of labour market dynamism are not as perky. Voluntary job-to-job moves are not back at pre-crisis levels (see Figure 1 above) and regional mobility is below the levels of the early 2000s (Figure 4). While the share of people who move region for work is low (around 0.5 per cent of employees per annum or 100,000 people) it is a broader sign of labour market dynamism and those moving region tend to earn the highest pay rises.

Bears can also point to the fact that historically the pay rises enjoyed by those moving region have been far in excess of other job-movers, however this is increasingly less the case. While the (nominal) pay rise for those moving jobs is back at pre-crisis levels (at around 6-7 per cent), the returns to moving jobs and region are down compared to the pre-crisis period (Figure 5). Furthermore the premium earned by those who move employer (compared to those who just move job) has narrowed in recent years (down from around 1.7 per cent in 2007-08 to 0.6 per cent in 2015-17) as has the premium earned by those moving region (down from 3.3 per cent to 1 per cent).

Figure 5: Median pay rise (nominal) for those remaining in employment



Source: RF analysis of ONS, LFS

Given this the biggest pay rises appear harder to come by. For those of a bearish-persuasion then the impression is of a labour market, which may be experiencing some wage pressure, but this is far from the heady days of the early 2000s when nominal pay growth averaged 4.4 per cent.

Who's right, then? The bulls or the bears? Perhaps one can square the circle by distinguishing between nominal and real pay, and between immediate pressures and the longer term outlook. Falling inflation is certainly bringing the pay falls of 2017 to an end, and there is definitely some evidence that pay pressure is building, suggesting the Bank is right to be concerned about this feeding through into inflation if they, and the OBR, are right that the economy is running at close to (or in excess of) full potential. However there is less evidence that productivity growth is significantly picking up. So while firms may feel the pressure to raise wages in the short term, their ability to deliver longer term high real pay growth may remain limited.

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