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 October there was good news on pay: nominal pay grew by 3.1 per cent in the 12 months to August, the fastest growth since the financial crisis (January 2009). The question is whether such (relatively) strong pay growth is likely to be sustained?

Nominal pay growth has been building steadily since early 2017, so this recent data was not a one-off. And it comes after a period in which the labour market has been tightening. The unemployment rate remains at a 40-year low and is still falling, as is underemployment, taking us back to pre-crisis levels of tightness. The number of job-to-job moves is increasing, approaching pre-recession levels. We would expect pay increases in this environment.

Norms play an important role in pay setting and wages are 'sticky' in general. This suggests that labour market pressure might affect wages suddenly, once norms shift, rather than gradually. Perhaps the recent strong data on pay could be a sign that pressure has built sufficiently to shift the post-crisis norm of low pay growth.

Analysis from Nye Cominetti:

October brought good news on pay, with nominal pay growth at its highest point since the recession. This is a sign that the recent tightening in the labour market is now feeding through into pay.

However, the longer-term outlook is poor, because productivity growth, a key driver of pay, remains weak. This was reflected in the OBR's recent pay projections which, if correct, would mean real pay will not recover to its pre-recession peak until 2024. This would amount to a 17 year pay squeeze.

However, despite these positive recent signs, it is unlikely that tightness alone can drive pay growth similar to that which we experienced before the crisis. The Office for Budget Responsibility's (OBR) recent earnings forecasts were not improved on last year's iteration. Their projections suggest that in real terms, pay will not recover to its pre-recession peak until 2024 – which would amount to 17 years of lost pay growth.

The OBR's pay projections are unchanged because they maintain their expectation that productivity growth – the key determinant of long-term real pay growth – will be weak in the coming years. Until this changes we are not likely to see sustained strong real pay growth.

Our **earnings breakdown** shows that the squeeze on real pay ended in 2018, but with real pay growth still low by historical standards. The surprise in the April pay data was the fall in weekly wages at the bottom of the distribution, linked to fewer hours worked.

Our analysis of **pay pressures and slack** shows that the labour market continues to tighten. Unemployment remains at a 40-year low, underemployment is below pre-crisis levels and job-to-job moves are increasing (and are approaching pre-crisis levels).

Our review of **longer-term labour market health** is less rosy. Productivity growth remains very low by historical standards, the share of graduates in non-grad jobs (an indicator of skills under-use) continues to rise, and the amount of off-the-job training (which might improve skills and productivity) has fallen significantly over the last decade or so, and remains low. There are also signs that industrial shifts could be making the UK labour market a less dynamic place (see Spotlight feature). There is some good news in that labour force participation continues to rise, which is likely to benefit those on lower incomes.

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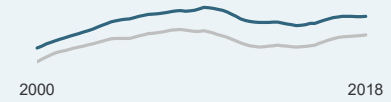
The Scorecard: Q2 2018

What's happened: The earnings breakdown

MEDIAN EMPLOYEE EARNINGS

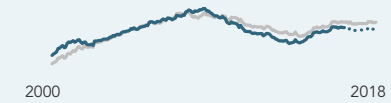


↑ 0.0% on yr (all)

↑ 0.6% on yr (private sector)

The most timely pay data showed median pay growth continued to strengthen into 2018 Q2, but remains subdued compared to 2015-17 and low by historical standards.

ALL WORKER EARNINGS



Employee earnings and all worker earnings gap →

Self-employed earnings fell by more than employee earnings in 2016-17 but the gap (at 1.8 per cent) has been constant since then.

EARNINGS DECOMPOSITION

↑ 0.7 ppts on yr

The compositional boost to pay associated with a changing workforce is moderate by historical standards, but after falling throughout 2017 this has risen in both 2018 quarters so far.

PAY RISES

↑ 0.2 ppts on yr

Median year-on-year real hourly pay growth for employees in work over a year (both job stayers and changers) has risen recently.

EARNINGS INEQUALITY

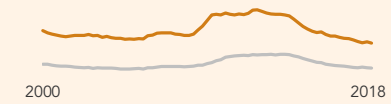
r75:25 ↑ 0.4% on yr

r90:10 ↓ 0.7% on yr

Hourly pay inequality between the upper- and lower-middle (r75:25) rose slightly in 2018, having fallen since 2010. The ratio of high to low high incomes (r90:10) continued to fall.

What's round the corner: Pay pressures and slack

UNEMPLOYMENT BY DURATION



↓ 0.4 ppts on yr (all)

↓ 0.1 ppts on yr (long-term)

The unemployment rate continued to fall in Q2 2018. Long-term unemployment also continues to fall, but with signs that levels are plateauing.

UNDER-EMPLOYMENT

↓ 12% on yr

Underemployment (net hours desired by those in work as well as the unemployed) was stable between Q1 and Q2, but is still very low - almost at the levels of the early 2000s.

JOB-TO-JOB MOVES

↑ 19% on yr

Voluntary job-to-job moves (an indicator of a healthy labour market and worker confidence) continued to rise in Q2 2018, and are now approaching pre-crisis levels.

MIGRANT JOB ENTRY

↓ 5% on yr

Net migration has steadied since the post-referendum fall. The rate at which migrants fill vacancies has been steady in recent quarters, though down on the year.

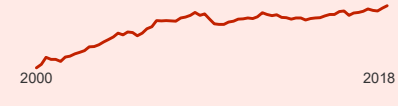
What's in the pipeline: Longer-term labour market health and efficiency

WORKFORCE PARTICIPATION

↑ 0.5% on yr

Labour force participation continues to rise, as it has for the past 12 quarters. However, the rate of growth is now small (less than 0.1 percentage points on the quarter).

LABOUR PRODUCTIVITY



↑ 0.9% on yr

Labour productivity was up on the quarter and year. There have been four consecutive quarters of growth. However, growth is very low compared to pre-recession.

TRAINING INTENSITY

↓ 3% on yr

'Off-the-job' training was unchanged on the previous quarter, but down on the year. It is too early to say whether the long-term fall in training intensity has stopped.

GRADUATES IN NON-GRADUATE OCCUPATIONS

↑ 2% 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 over the past year.

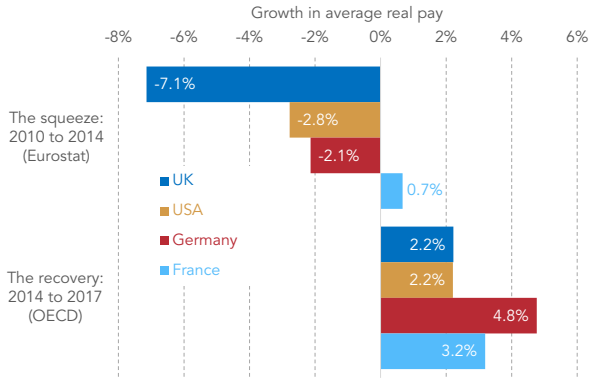
 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator is available at www.resolutionfoundation.org/earningsoutlook. This project 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: International earnings growth – squeeze and recovery

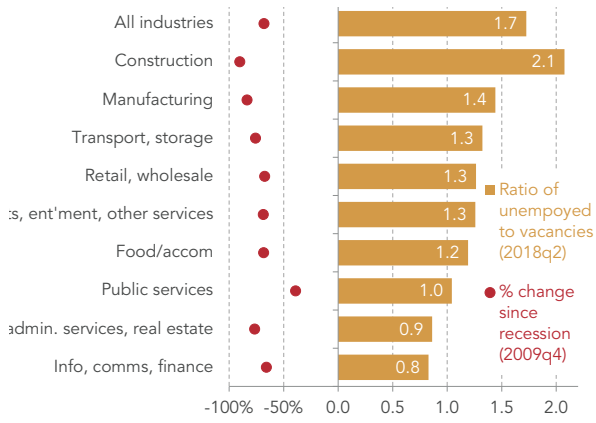


Source: Eurostat (median real wages) and OECD ('average wages': national accounts based method, measured in 2016 USD using PPP).

The UK's pay squeeze and recovery were both weak by international standards

The UK and the US are facing similar pay 'puzzles': given the tightness of the labour market, why isn't pay growth higher? Weak productivity growth is likely the main culprit, effectively 'cancelling out' the effects of a tightening labour market in the recovery period (2014-17). However, productivity growth (although subdued by historical standards) remains faster in the US, which may explain why the UK has performed relatively worse. In terms of the squeeze (2010-14) the UK's exceptionally poor performance can be attributed to depreciation and high inflation. These factors were relatively unique to the UK, which is why UK pay was squeezed harder than other countries after the recession, as shown in Figure 1.

Figure 2: Labour market slack by industry – latest and change since recession



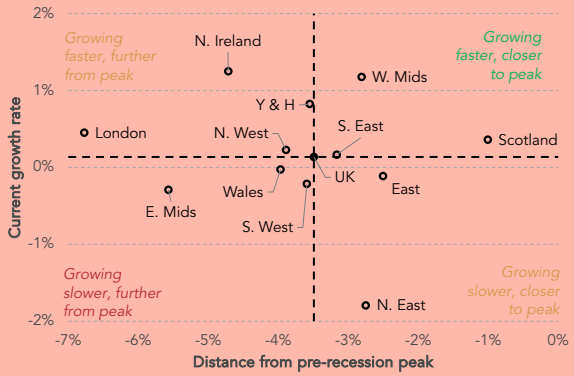
Source: ONS Vacancies Survey and Labour Force Survey. Note: ratio is the number of unemployed whose last job was in industry X divided by number of vacancies in industry X

Different levels of slack across sectors, although all showing tighter conditions than immediately post-recession

One measure of labour market slack is the ratio of unemployment to vacancies, which like other measures shows the labour market tightening. In Figure 2 we replicate this measure by industry, using the ratio of the unemployed who previously worked in an industry to the number of vacancies in that industry. Just as with the overall picture, all sectors show a tightening in the post-recession period (see the red dots on the left). The figure also suggests, however, that there is greater slack in some industries, such as Construction and Manufacturing, than others, such as Information, Communications, and Finance (see the gold bars). Pay pressure may therefore vary across sectors, perhaps influencing where we see pay growth in coming years. However, bear in mind that the presence of migrant workers in some sectors (e.g. Construction) and Brexit uncertainties complicate this picture.

The regional perspective

Figure 3: Real hourly wages - gap from pre-recession peak and latest growth rate



Notes and sources: see notes on Indicator 1, median employee earnings: http://www.resolutionfoundation.org/earningsoutlook/

Earnings below pre-recession peak in all regions but some closer than others

The OBR's projections suggest real pay in the UK will not return to its previous peak until 2024. However, for some regions and countries it is likely to take longer. Figure 3 shows each place's distance from its previous peak and current growth rate. Whereas Scotland is only 1.0% from its previous peak, London (6.8%), East Midlands (5.6%) and Northern Ireland (4.7%) are much further. Particularly worrying are those regions where real pay is still well below its pre-recession peak, and where recent growth rates are low, or negative. These places might have to wait even longer to see a full recovery in real pay. For example, taking the OBR's figure Scotland is on course to reach its pre-recession peak in 2020 but London won't hit its peak until 2030, six years after the UK overall.

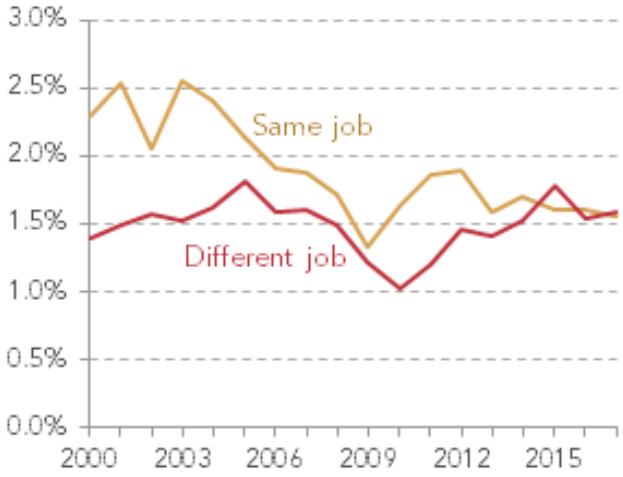
Spotlight: Staying put

Stephen Clarke, Resolution Foundation

Channel 4 (or at least some of it) is off to Leeds. Some staff may be relishing the move, some may have just wanted to stay put. Despite the mixed feelings one thing is undisputed; Channel 4 staff are now part of an increasingly small group. The latest data suggests that the share of people relocating within their firm for work is at the lowest rate recorded since the eve of the financial crisis in 2007.

Previous Resolution Foundation research has drawn attention to the apparent decline in regional mobility. This article extends this research by drawing upon a different dataset, one that allows us to distinguish moves by people in the same, or different, job. In 2017 just 1.6 per cent of employees moved region of work while remaining in the same job, down from a high of 2.6 per cent in 2003. 2017 was also the first time that the number of people moving region and switching jobs (401,000) exceeded the number remaining in the same position (394,000). What accounts for this decline?

Figure 4: Share of employees changing region of work each year

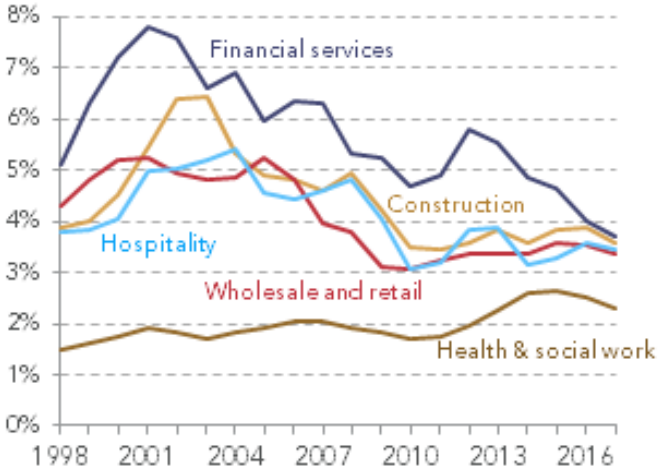


Source: RF analysis of ASHE.

Are fewer firms expanding in London and the South East because of rising costs in and around the capital? No, we find no evidence that London has become a less attractive place to relocate to. Although within-firm regional job moves have declined across the country they have fallen the most outside London, the South and East. More people moved to London in 2016 than in any of the previous 15 years, clearly Channel 4's move to Leeds is the exception rather than the norm.

It could be that younger people today are less willing to relocate with their firm. On the contrary, the sharpest falls in moves have been for older workers remaining in the same job. Around 100,000 fewer workers 35 and over changed their region of work last year compared 2003, despite the fact that that the number of employees

Figure 5: Share of employees moving region by industry



Source: RF analysis of ASHE.

35 and over increased by 200,000. Furthermore this isn't about age; using data on total moves (not just those for employment) mobility rates for this age group are close to where they were before the crisis.

It seems that demographics can't explain the shift, but structural economic trends might. It's far easier to work remotely today than in the early 2000s. On the other hand it could also be driven by the fact that since the early 2000s the share of employees accounted for by the large firms in each sector has declined and so today it may be the case that fewer people work in large firms with multiple sites. Beyond these two broad trends there is also an interesting sectoral dimension; regional job switching has declined most in those sectors that have shrunk (or at least not expanded as fast).

For example the share of employees in finance and insurance moving region for work has fallen from a high of nearly 8 per cent in 2001 to below 4 per cent today. Furthermore financiers and insurers now account for just 3.5 per cent of jobs in the UK economy, down from above 4 per cent before the crisis. We see a similar pattern for wholesale and retail and construction.

On the other hand health and social workers are now more likely to move for work and represent a larger share of total employment than they did in the mid-2000s. It would appear that sectors within which workers have tended to be more mobile have shrunk (or not expanded as rapidly) and workers within these sectors have a lower propensity to move.

This sectoral evidence suggests that the trend towards reduced mobility – at least for those remaining in the same job – could be structural. If so this would have significant ramifications for the UK labour market, though it will come as no solace for those at Channel 4 keener on the big smoke than West Yorkshire.