THE RF EARNINGS OUTLOOK | Q2 2019

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

Resolution Foundation

Analysis from Nye Cominetti

"Britain's post-crisis pay downturn has been deeper and longer-lasting than anyone could have predicted, and caused a major squeeze on household incomes across the country. After 12 long years, Britain is finally on the brink of returning to 'peak pay'. This is a big living standards milestone and a relief for households after an unprecedented pay downturn.

"But politicians tempted to use the return of 'peak pay' to claim that Britain 'has never had it so good' should remember that pay for millions of workers is still below pre-crisis levels, and that our pay downturn has left average pay £138 a week off track."

2019 has been a good year for pay so far. Annual growth in real (average weekly, regular) pay increased from 1.5 per cent in January to 2 per cent over the three summer months. In fact, looking back, we can now see that real pay growth has been on a steady upwards path since mid-2017. Nominal earnings growth was 3.8 per cent in the three months to August – within sight of the level we were used to pre-recession.

After a false dawn in 2015 (real earnings growth surged above 2 per cent, but only because inflation fell to almost zero), it looks like it is finally time to talk about a labour market that has returned to full employment after the financial crisis. We almost have the real pay growth of the mid-2000s with an employment rate three percentage points higher.

We can also talk about the return to the pre-crisis position in another sense – in the *level* of pay. In our Spotlight piece, we suggest that, twelve years since pay was last at peak (August 2007 – as measured by regular weekly pay, adjusted for CPIH), we might finally be about break new ground. Our projections suggest this could happen in November or December this year. However, for many groups, including young people, men, and those living outside London, Scotland and the South West, pay is still some way off its previous peak. And returning to pre-crisis levels is very different from making up any of the lost ground in the intervening decade.

What are the prospects for future pay growth? With real pay growth having settled at or just below 2 per cent in the last three months of data (June to August 2019), and with the unemployment and employment rates essentially unchanged in the last few months, the labour market has reached a plateau. Conditions are no longer tightening. The question, therefore, is how long the plateau will last.

Unfortunately there are some negative signs – two of which we highlight in our Lifting the Lid section. One is the number of vacancies employers are advertising, which has been falling throughout 2019. We show that vacancies are a good leading indicator for unemployment, lagged two months. If this relationship continues to hold, we could see an uptick in the unemployment which, in turn, could ease the upwards pressure on pay. The other indicator we look at are voluntary job-to-job moves, which have also softened in the latest data. Of course, the major black spot when it comes to the outlook for pay is labour productivity, which has now fallen for three quarters in a row (as measured by output per hour worked). This places a limit on potential pay growth, which can outpace it for a time but not forever.

- Our **earnings breakdown** shows that real pay growth has plateaued just below pre-crisis levels, with real pay growth of 2 per cent in the latest data.

- Our **analysis of pay pressures and slack** shows that the labour market is tight but has stopped tightening. Employment remains close to its record high, and underemployment is now at its lowest point this century.

- Our **review of longer-term labour market health**, as usual, shows areas of concern. Productivity growth is very low, as is the level of workplace training.

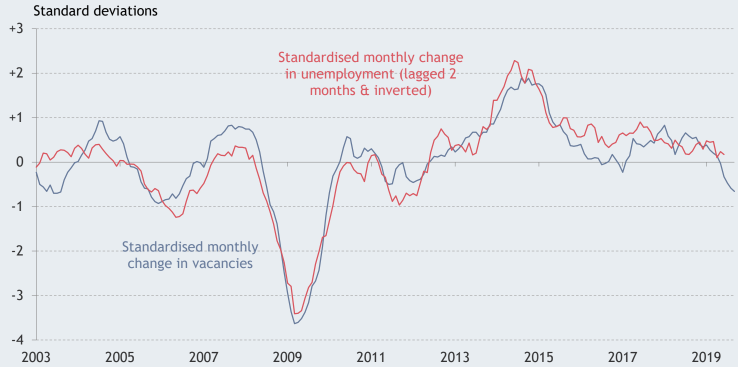
Lifting the lid: The picture across different groups and areas

Here we explore a few of the most interesting developments for different groups of workers and different parts of the country. A comprehensive breakdown of each indicator is available online: resolutionfoundation.org/earningsoutlook

Continuing falls in vacancies are a head-wind to wage growth

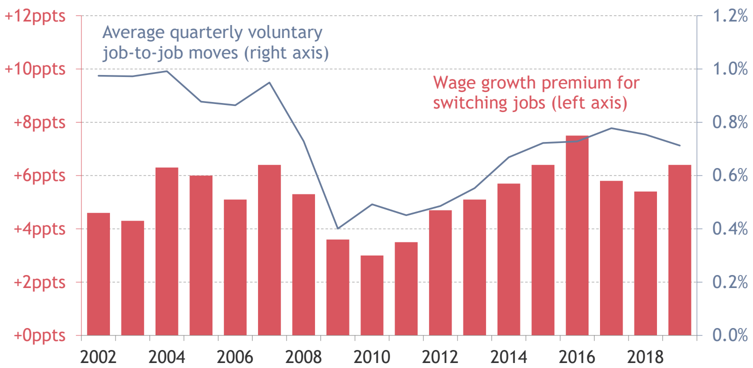
The trend of falling job vacancies has continued, with vacancies in September 6 per cent lower than January. Fewer vacancies suggest less competition for new workers and therefore less direct pressure on wage growth. Vacancy data are also timelier than other labour market figures, so can help to predict how they will move. The drop in vacancies is consistent with a small increase in unemployment over the coming quarters; similar in scale to that seen in 2005-06, when the unemployment rate rose by a little over 0.5 percentage points. Any increase in unemployment would increase slack in the economy, dragging on future wage growth.

FIGURE 1: **Change in unemployment and vacancies, 12-month rolling average**



SOURCE: RF analysis of ONS, *Vacancy Survey; Labour Force Survey*
NOTES: For ease of comparison, series are standardised by subtracting averages and dividing by their standard deviation.

FIGURE 2: **Quarterly voluntary job moves and pay benefit of switching jobs**



SOURCE: RF analysis of ONS, *Vacancy Survey; Labour Force Survey*
NOTES: The pay growth premium is defined as the gap between annual growth in median gross hourly earnings between job movers and job stayers. Quarterly job switches are shown as a proportion of total jobs.

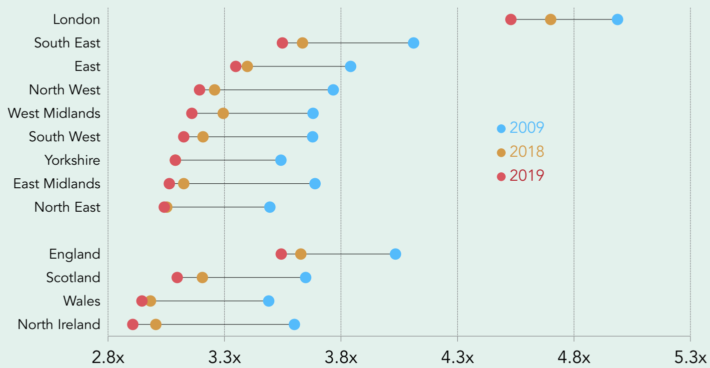
Muted job switching could continue to limit pay growth

The prevalence of 'voluntary' (i.e. driven by resignations rather than redundancies or short contracts) job-switching tends to move with the economic cycle – plentiful job availability means workers will be more likely to seek out better opportunities; and stronger economic conditions may make them more confident to risk trying out something new. There are also clear pay benefits from switching jobs: the average extra pay rise per year for those switching has been more than 5 percentage points since 2002. Therefore, the fact that job switching remains below pre-crisis levels, despite record employment, is continuing to limit overall pay growth. If workers today expect a weaker economy (e.g. due to Brexit uncertainty or slowing global growth) we might expect the pay growth headwind from lower voluntary job-switching to endure.

The regional perspective

One measure of inequality in earnings is the ratio between pay at the 90th and 10th percentiles. Under this measure, inequality decreased or held steady between 2018 and 2019 in all nations and regions in the UK. But this good news has not altered the fact that inequality varies significantly by region and nation: the 90/10 earnings ratio is 3.5 in England and 2.9 in Northern Ireland. This decade's trend of falling inequality has been driven primarily by faster wage rises for those at the bottom of the distribution, due in no small part to the rising minimum wage. However, the minimum wage does less to reduce inequality in higher earning (and higher inequality) areas like London.

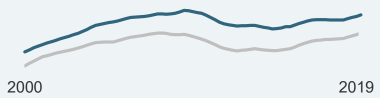
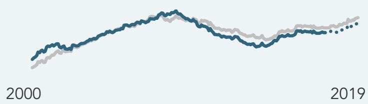
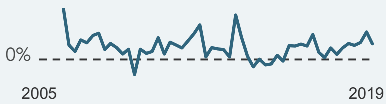
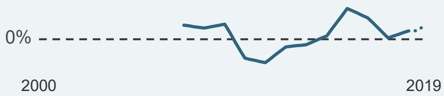
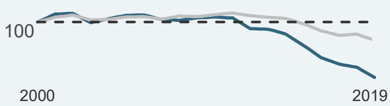
FIGURE 3: **Ratio of gross hourly pay between 90th and 10th percentile**



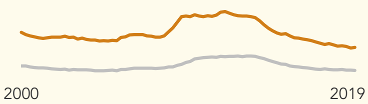
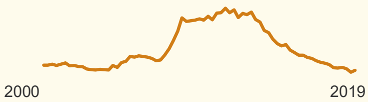
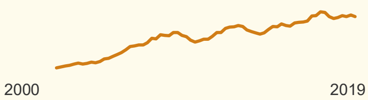
SOURCE: RF analysis of ONS, *Annual Survey of Hours and Earnings*

The scorecard: Q2 2019

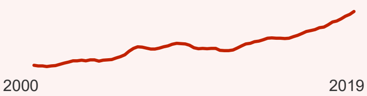
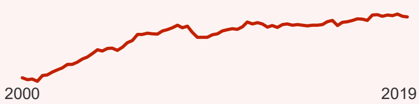
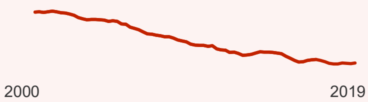
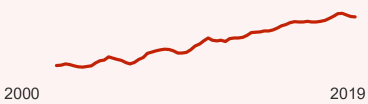
What's happened: *The earnings breakdown*

Median employee earnings		↑ 2.1% on yr (all) ↑ 2.4% on yr (private sector)	In the most recent data, real median pay grew by 2.1%. This reflects both slowing inflation and strengthening nominal pay growth.
All worker earnings		Employee earnings and all worker earnings gap ↑	Employee earnings outstripped self-employed earnings in 2017-18, meaning 'all worker' earnings are falling behind the headline employee series.
Earnings decomposition		→ on yr	Compositional change (e.g. due to high-paying occupations expanding) boosted annual pay growth by 0.7ppts, roughly in line with the average compositional boost this century.
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) stood at 1.2% in January 2019, double the rate in the previous year.
Earnings Inequality		r75:25 ↓ 1.3% on yr r90:10 ↓ 2.4%	Both our headline measures of earnings inequality (r75:25 and r90:10) continue to fall and at an increasingly fast pace (a rate last seen in 2016).

What's round the corner: *Pay pressures and slack*

Unemployment by duration		↓ 0.1 ppts on yr (all) → on yr (long-term)	The unemployment rate fell slightly over the year to 2019 Q2, reaching 3.9 per cent. Long-term unemployment stayed broadly flat, as it has for the past two years, at 1 per cent.
Underemployment		↓ 6% on yr	Our measure of under-employment (net hours desired by those in work as well as the unemployed) increased slightly in the last quarter but is still close to its historic low.
Job-to-job moves		↓ 22% on yr	A decline in voluntary job-to-job moves suggests that firm and worker confidence to try new people and roles is falling, with less upward pressure on pay as a result.
Migrant job entry		↑ 1% on yr	The share of jobs going to new migrants has risen slightly over the past year, to slightly under 20%.

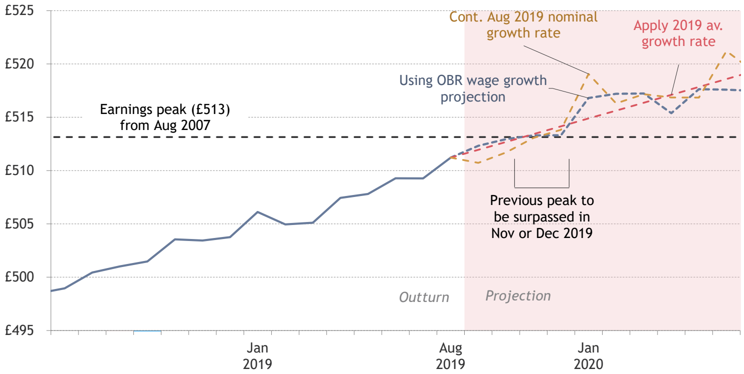
What's in the pipeline: *Longer-term labour market health and efficiency*

Workforce participation		↑ 0.8% on yr	Labour force participation continues to rise and reached 76.3% in 2019 Q2. Women and people aged over 50 have experienced the largest increases.
Labour productivity		↓ 0.5% on yr	Labour productivity continued its post-crisis weakness and fell 0.5% in the year to 2019 Q2. This is the joint-largest 12-month fall since 2012.
Training intensity		↑ 1% on yr	While the proportion of people receiving 'off-the-job' training was slightly up over the past year at 6.7%, the long-term trend still shows a big fall in training intensity over the past 20 years.
Graduates in non-graduate occupations		↓ 1% on yr	The proportion of all graduates in non-graduate roles fell slightly in the last year. While this measure has steadily increased over time, the proportion of 'recent' graduates in non-graduate occupations fell to a post-crisis low.

Spotlight: Almost back to peak pay

The last time pay peaked was in August 2007. Average weekly pay was £513, measured in 2019 prices. Over a decade later, pay is finally set to go higher. In August 2019, the latest month for which we have our most timely earnings data, average weekly pay was £511. With real pay growth at a healthy 2 per cent thanks to the tight labour market, projections (illustrated in Figure 4) suggest we are on course to hit a new peak in November or December this year. That is, we might have hit peak pay already. We won't actually have the data to confirm this until the new year, but it's a cheering thought nonetheless.

FIGURE 4: **Projections of real (CPIH-adjusted) average weekly earnings**



SOURCE: RF analysis of ONS, *Labour Market Statistics*; OBR, *Economic and Fiscal Outlook*

On this narrow measure, Boris Johnson might (just!) be tempted to go into the election repeating Harold MacMillan's claim that people have "never had it so good". He would be the first Prime Minister since Tony Blair to be able to do so.

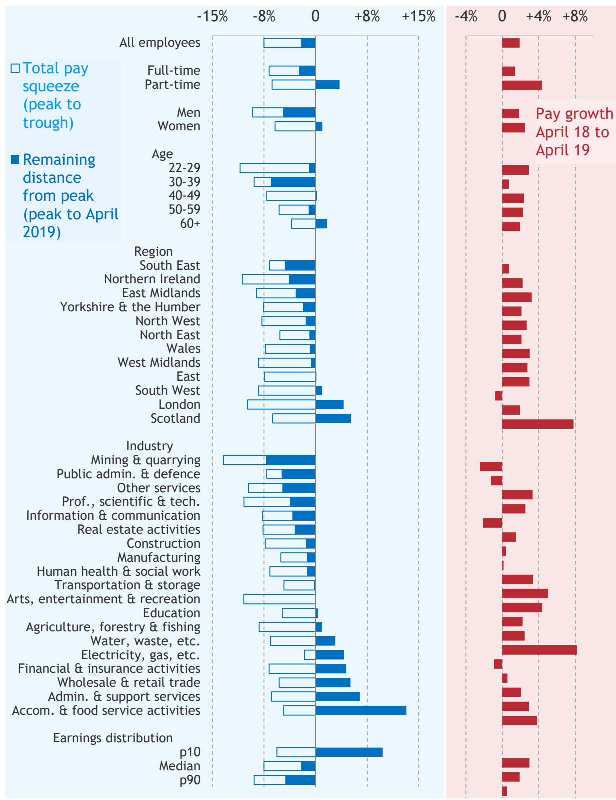
But of course, any crowing would be ill-advised. For one, returning to peak is not the same as making up the lost ground. If real pay growth had continued at 2 per cent since August 2007 average weekly earnings today would be £138 (27 per cent) higher, in 2019 prices. That is a huge gap that we are unlikely to ever make up.

Second, MacMillan said his claim applied across the board, that the listener could "go around the country, go to the industrial towns, go to the farms..." and find unprecedented prosperity. Johnson could not do that today. This is demonstrated by Figure 5, which switches to our slightly-less-timely but much-more-comprehensive earnings data, and shows the real-terms squeeze and the remaining gap to peak across different groups. The first thing to note is that when we switch from weekly pay to hourly, and the mean to the median (which better reflects the typical experience), pay for all employees was still 1.9 per cent away from its peak in April this year. Given real annual growth rates are around 2 per cent, hourly pay for the typical employee is therefore very unlikely to be the best it's ever been when we head to the polls in five weeks' time.

Beyond this fact, one group that stands out is young people. The wages of 20-somethings were squeezed in the immediate post-recession years, with median wages for this group falling 11 per cent in real terms. 20-something wages have now mostly recovered to their previous peak, but 30-something wages have not. This suggests the 20-somethings whose wages were hit hard in the recession have carried wage 'scars' into their 30s.

In terms of region, median wages in London are already well (4 per cent) above their previous peak, despite having experienced the biggest recession squeeze. Wages are also above peak in Scotland and the South West. Other regions are still experiencing the squeeze. None more so than the South East, where wages in April 2019 were will 4 per cent below their previous peak.

FIGURE 5: **Real (CPIH-adjusted) median hourly pay squeeze, gap to peak, and latest growth**



Source: RF analysis of ONS, *Annual Survey of Hours and Earnings*

Looking across sectors, it is the lower-paying sectors that have enjoyed the strongest recoveries. Pay in hospitality in April 2019 was 13 per cent above its previous peak. On the other hand, pay in mining, public administration, and personal services, and several other sectors is some way off.

This sectoral pattern largely reflects the distributional picture. Earnings for the lowest earners (here represented by the 10th percentile) are 10 per cent higher than their previous peak in real terms, while pay in the middle and upper end of the distribution is still lagging. This, of course, is the impact of the minimum wage, which has protected pay for the lowest earners through a difficult decade.

So, have we "never had it so good"? Well, on (one kind of) average, possibly yes. And that is something to celebrate – the pay recovery has been a long time coming. But given the depth of the squeeze, and the many groups still waiting for their recovery, the focus now should be on keeping current healthy pay growth going into 2020 and beyond so that all groups can enjoy a proper pay recovery.

- Explore our interactive data dashboard
- Read past Earnings Outlook briefings