Resolution Foundation

The Resolution Foundation Labour Market Outlook

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The final three months of 2021 have been a mixed bag for the pandemic and the labour market. At the end of September, the Coronavirus Job Retention Scheme (JRS) came to an end after 18 months – and the feared rise in unemployment does not seem to have come to pass. But the emergence of the Omicron variant means there are clouds looming on the horizon – and with the initial support package announced on 21 December focusing on supporting firms, with nothing to support workers who lose their jobs or see shifts cancelled (and no incentive for firms to keep them in their jobs), there is a risk of rising unemployment in the months ahead.

Despite unemployment remaining (so far) close to pre-crisis levels, there is cause for concern in other areas of the labour market. With year-on-year earnings growth beginning to recede in the headline data, this Outlook's spotlight focuses on the prospects for wages over the next year, and whether pay growth is likely to compensate for expected rises in the cost of living in early 2022. And to prevent longer-term scarring, policy makers will need to turn their attention to the fall in labour force participation since the start of the crisis. The 'Lifting the Lid' section looks at the reasons behind the changes in economic inactivity over the course of the crisis, how real wages have changed in different UK regions and nations, and the sectors where workers were still on furlough at the end of the JRS.

Spotlight | Wages and the cost of living in 2022

2022 has a difficult start in store for us, with the new year set for an Omicron wave peaking at potentially over a million cases a week. This will cause huge disruption for firms and public services as customers and workers alike dry up. Omicron's only saving grace is that the wave should be short lived. But not every challenge that 2022 brings will ease as promptly.

This note focuses on the likely evolution of the pressure on living standards that households are already facing. Far from fading, this is likely to build with further price rises outstripping pay growth, and real wages set to be no higher at the end of 2022 than they were at the start. The spring looks particularly difficult, with April bringing a broad-based cost of living catastrophe affecting the vast majority of households: soaring energy bills and significant tax rises will see an annual income hit to the typical household of over £1,000.

So large, widespread, and government-policy-related is this pain that it's almost impossible that it will go ahead without some form of mitigation. In particular, top of the Government's New Year resolutions should be addressing the increase in the energy price cap that will see gas and electricity bills taking up 12 per cent of lower-income households spending (up from 8.5 per cent last year).

On current trends, this time next year we're likely to look back on a 2022 defined more by a cost of living crunch than the Omicron wave that will dominate its start.

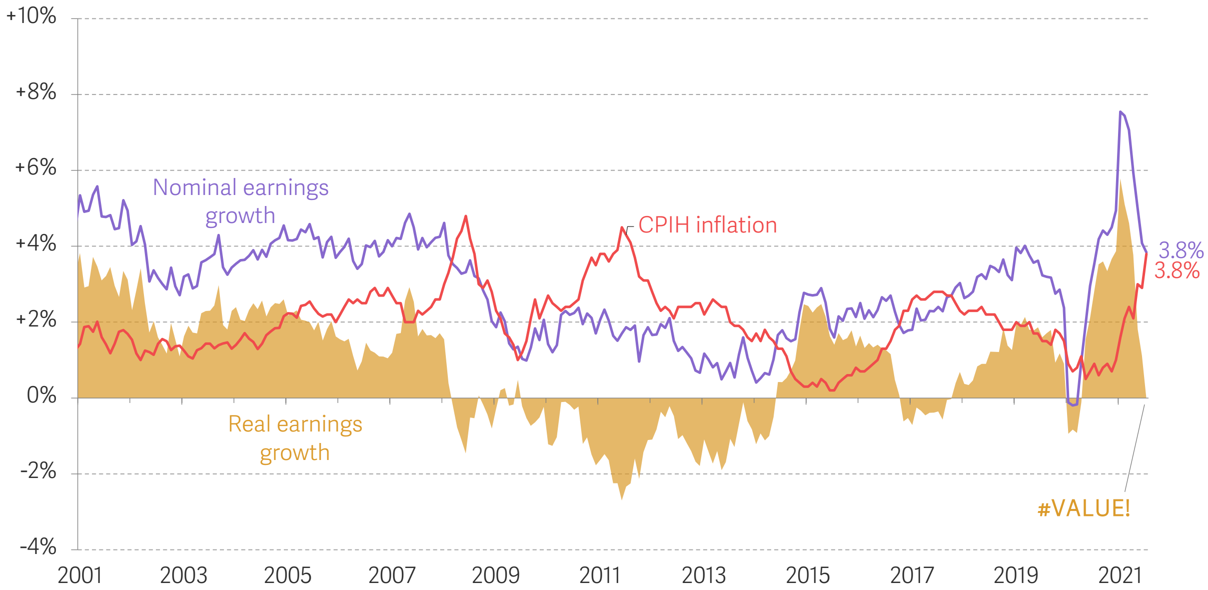
Falling wages

Avoiding a big rise in unemployment has rightly, and successfully, been the labour market priority during the Covid-19 crisis. But as the economy rapidly reopened in the second half of 2021, and unemployment returned to near pre-pandemic levels, the focus has shifted to earnings. Just a few months ago, high headline pay growth led some to worry about wages growing dangerously quickly. Talk of a wage surge was all the rage, despite high growth figures reflecting base effects and the temporary impact of reopening the economy, rather than a new dawn for worker power.

The latest labour market data now suggests the real problem facing the labour market is very different: stagnant wages. In October, earnings growth fell to 3.8 per cent, just as CPIH inflation rose to the same level, meaning that real wages were flat over the previous year (Figure 1). Pay growth over the last few months has been even weaker: looking at month-to-month (rather than annual) changes, average earnings have been falling in real terms since May and, with the cost of living continuing to rise, it looks almost certain that real earnings will have fallen in the year to November.

FIGURE 1: **Real earnings were flat in the year to October**

Annual growth in average weekly earnings (regular pay) and CPIH inflation, single-month figures: GB



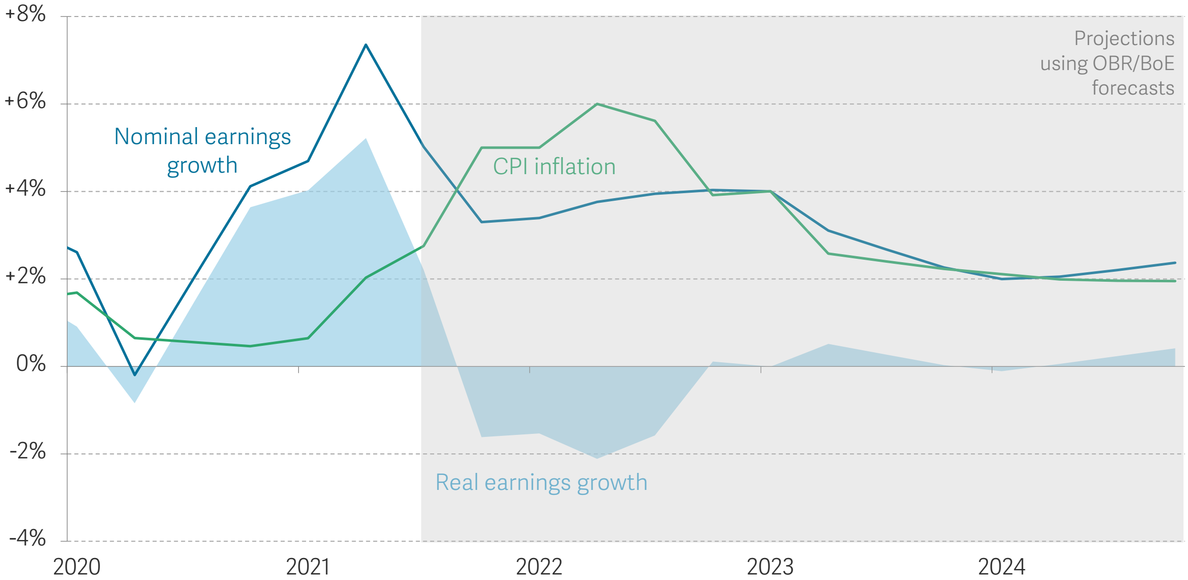
NOTES: Growth is year-on-year change in one-month average. Earnings growth covers regular pay, i.e. excludes bonuses. Earnings data covers Great Britain and inflation data covers the UK.
SOURCE: RF analysis of ONS, Labour Market Statistics; ONS, Consumer Price Inflation.

2021 will end with real wages falling, but what does 2022 have in store? Even if average earnings aren't taking off, signs of future wage pressure might first be visible for new hires with reports of recruitment difficulties and fierce competition for a smaller workforce. Some occupations are seeing wage growth, most famously HGV drivers. But as of November, data from the jobs site Indeed showed such increases in advertised wages for new hires were confined to a handful of occupations.

The medium-term outlook for wages is uncertain but far from rosy. The Bank of England now expects growth in the Consumer Prices Index (CPI) to reach 6 per cent in the spring. Combined with the most recent Office for Budget Responsibility earnings forecasts, this suggests that real earnings will be falling in the first half of next year, before returning to some slow growth if inflation falls back (Figure 2). The result is that we're set to be going into next Christmas with real earnings at almost the same level as during this festive season, with growth of just 0.1 per cent in the year to Q4 2022.[1]

FIGURE 2: **Real wages look set to fall for most of 2022**

Annual growth in average weekly earnings (regular pay) and CPI inflation, outturn and projections: GB/UK



NOTES: Growth is year-on-year change in quarterly average. Earnings growth covers regular pay (i.e. excluding bonuses). The latest outturn data point is Q3 2021 and latest forecast data point is Q4 2024. See footnote 1 for further details. Earnings outturn data covers Great Britain; earnings growth forecast and all inflation data covers the UK.
SOURCE: RF analysis of ONS, Labour Market Statistics; ONS, Consumer Price Inflation; OBR, Economic and Fiscal Outlook, October 2021; Bank of England, Monetary Policy Report, November 2021; Bank of England, Monetary Policy Summary, December 2021.

For all the talk of the pandemic (somehow) boosting worker power, it looks more likely to deliver the third real wage squeeze in a decade and to leave workers substantially worse off than they would have been otherwise. By the end of 2024, average earnings are set to be £740 a year lower than they would have been if even the sluggish wage growth prior to the pandemic had continued.[2]

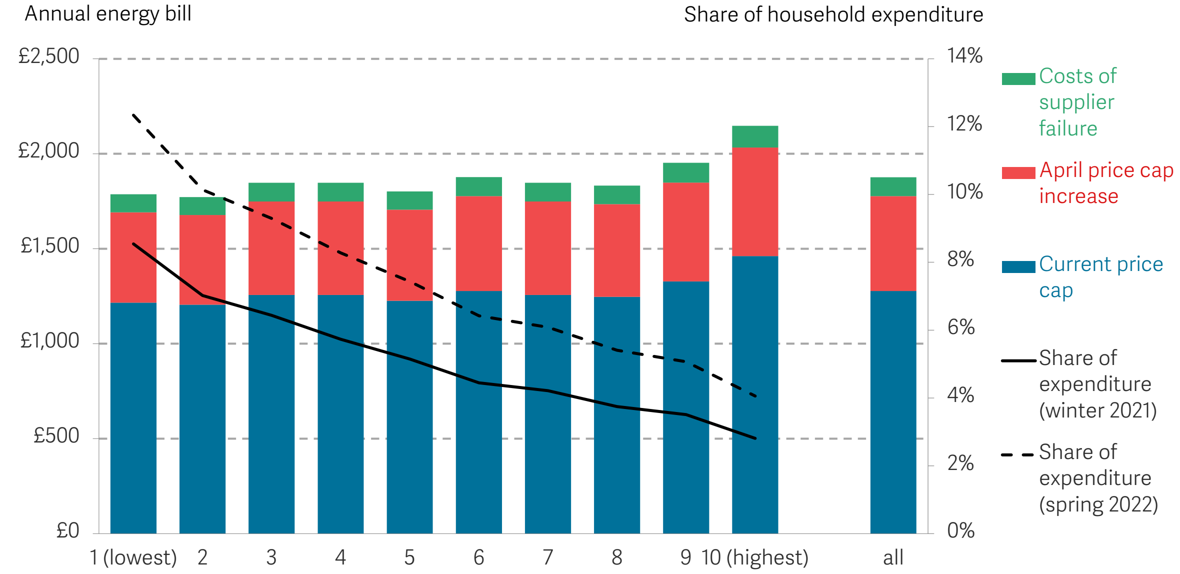
While inflation and wage developments will generally evolve throughout 2022, the month of April deserves specific attention, as it will bring about some major changes to families' living standards. The welcome 6.6 per cent uprating of the National Living Wage (which will now apply to those aged 23 and over) due that month looks set to (just) protect the lowest earners from a fall in real earnings. But wider changes that will affect a much broader swathe of the population could amount to a cost of living catastrophe, as energy prices and taxes rise.

Energy bills

A key driver of the high inflation predicted by the Bank of England during 2022 is energy prices. Wholesale spot gas and electricity prices have increased by more than eight-fold and five-fold, respectively over the past 12 months.[3] The main effect to date (as of 22 December) has been the failure of 28 energy suppliers, but households are next in line, as the higher wholesale prices will feed through into a very large rise in the energy price cap in April: current estimates are that this will amount to a rise of around £500 for a typical household bill, on top of October's £139 increase. Households will also face an additional charge of around £100 as the costs associated with those firm failures are recouped. As Figure 3 shows, £600 is a huge increase for households of all incomes, but will be felt most acutely by poorer families: households in the bottom income decile will see their energy spend rise from 8.5 to 12 per cent of their total household budget – three times the proportion for those in the top decile. Many of those coming off fixed tariffs onto a price cap tariff will even bigger rises.

FIGURE 3: **Higher energy costs will put a squeeze on household budgets**

Current and forecast annual household expenditure, and proportion of expenditure, on energy bills, by equivalised income decile: UK



NOTES: Current expenditure based on the winter price cap, set at £1,277 for a household with standard energy use. Assumed up-rating of the price cap in line with recent forecasts from Cornwall Energy, and costs of £100 per household for the cost of supplier failures, in line with forecasts produced by Citizens Advice (£94) and Investec (£120). Share of expenditure calculations based on household budgets increased in line with OBR forecasts.
SOURCE: RF analysis of BEIS energy price statistics, Ofgem price cap data, ONS Living Costs and Food Survey, OBR EFO.

There is also significant variation in energy usage within income deciles that will see some households facing bill increases of far more than £600. Around one-in-six (15 per cent) of households in the poorest two deciles have energy bills at least 25 per cent above the typical household,[4] meaning they could see an increase of £750 or more in April thanks to having larger families, outdated boilers[5] or poorly-insulated properties.[6]

The April cap increase will also affect far more households than past changes, thanks to the near-absence of fixed tariffs for the second half of 2021 and the fact that customers moving from failed suppliers are being moved onto standard tariffs (85 per cent of Avro Energy's 580,000 customers were on fixed deals, for example). Proceeding with such a large, overnight bill rise without mitigating measures at a time when real wages are likely to be falling looks completely untenable.

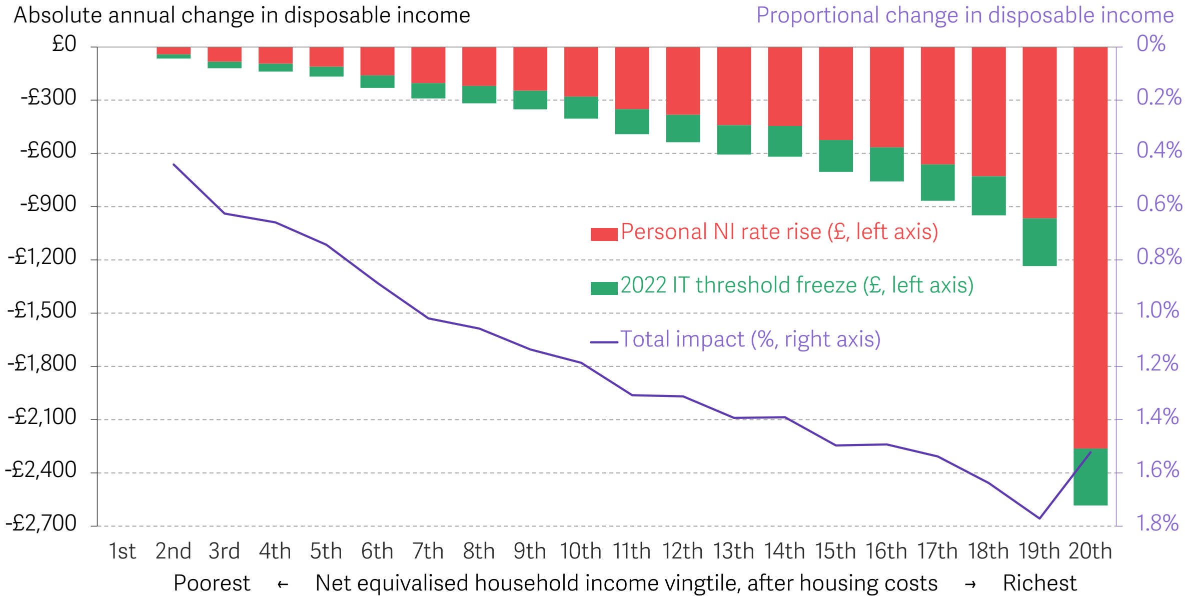
Taxes

If that wasn't enough, April will also see significant tax rises. As well as the usual Council Tax rise, the VAT rate for hospitality and accommodation is set to return to the standard 20 per cent rate on 1 April, and dividend tax rates are also set to rise. Most significantly, National Insurance (NI) rates will rise by 1.25 percentage points (as a precursor to the proper Health and Social Care Levy which will exist from 2023). For the lowest earners, this will be slightly offset by the normal inflationary increase in the starting point for NI. But April also marks the start of a four-year Income Tax threshold freeze, meaning a further tax rise – albeit one that does not result in a month-to-month loss of cash.

The scale of the NI and Income Tax changes are significant, though the former is more important, as Figure 3 shows. Across all households, the average combined impact on household incomes is £600, or 1.4 per cent of disposable income. But – unlike the impact of rising energy prices – these losses are tilted towards higher-income households. For example, the NI rate rise (excluding the impact of the threshold rise) will lower the average income of households in the bottom half of the distribution by around £140 (0.6 per cent), but those in the top half will lose £730 (1.2 per cent).

FIGURE 4: **For higher-income households, the National Insurance rate rise will likely be the most important income hit in April**

Annual impact on average disposable household incomes in 2022-23, by equivalised income vingtile after housing costs: UK



NOTES: Figures are relative to a scenario without either tax rise. We exclude the bottom 5 per cent, due to concerns about the reliability of data for this group.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit Model.

There is a broad consensus that taxes will generally be rising in the years ahead, given the long-term impact of the pandemic as well as pre-existing, structural fiscal pressures. But it is fair to assume that the Treasury did not envision these tax rises taking place at exactly the same time as a new coronavirus wave, falling real wages and huge energy price rises.

Conclusion

Real wages are already falling, and look likely to continue doing so through the majority of 2022. Against that backdrop, the Government's current intention is for taxes and energy bills combined to rise overnight by an average of £1,200 per household in April. While the Omicron wave means this fact is yet to move centre stage, that moment will come, and the scale of the living standards catastrophe that it would cause means it's hard to believe that steps to mitigate it won't be taken.

It is possible that the combination of Conservative MPs opposed to any tax rises, and a Labour Party that thinks NI rises are unfair, could together cause the NI rise to be delayed, given the wider cost of living pressures in 2022. But top of the Government's new year resolutions should be addressing the increase in the energy price cap that will be felt very keenly by low-income households, and especially by out-of-work households whose income has already been cut back by £1,000 this autumn when the £20/week uplift to Universal Credit was removed.

Of course, the longer-term answers to insulate ourselves better from volatile commodity markets are to accelerate the rollout of renewable energy,[7] crack on with long-overdue reform of the power system architecture to accommodate more variable generation sources at low cost,[8] and to insulate the nation's homes. But households feeling the squeeze today will be looking for more immediate action.

The Government does not have straightforward policy options to mitigate this huge price rise, the causes of which largely lie outside its control. But it can take action in one of two broad categories:

- providing some relief via the tax or benefit system; or,
- directly limiting the increase in electricity bills on a temporary basis.

Options for delivering relief include:

- Raising the basic generosity of Universal Credit. This is the most efficient and targeted means of supporting lower income households, but seems unlikely, given that the £20 uplift has recently been ended.
- Extending and increasing the Warm Homes Discount, which currently provides a £140 discount on energy bills for households on Pension Credit and some lower-income working-age households. This is currently funded by a levy on bills, so any increase in eligibility or generosity would require a reform so that any increase was state funded. Furthermore, the annual discount is currently applied to bills between October and March, so this would need changing if it were to offer relief from April.

The level of energy bills themselves could be reduced, ideally with some targeting of the reduction, by:

- Temporarily removing VAT on electricity bills, reducing the typical bill by around £45 at a cost of more than £1 billion per year. Doing so for gas bills as well would roughly double the savings (to households) and cost (to the Government) but run directly against the Government's net zero ambitions.
- Moving environmental and social levies currently added to electricity bills into general taxation. This would save households £160 per year (and would improve the economics of shifting to clean heat sources) but at a cost approaching £4.5 billion per year.[9] Options for only removing levies from bills of lower-income households could be explored.
- Extending the time period over which the costs of supplier failures are recouped. The £100 bill rise reflects a policy of recouping costs over a single year; extending that period could materially reduce that rise.

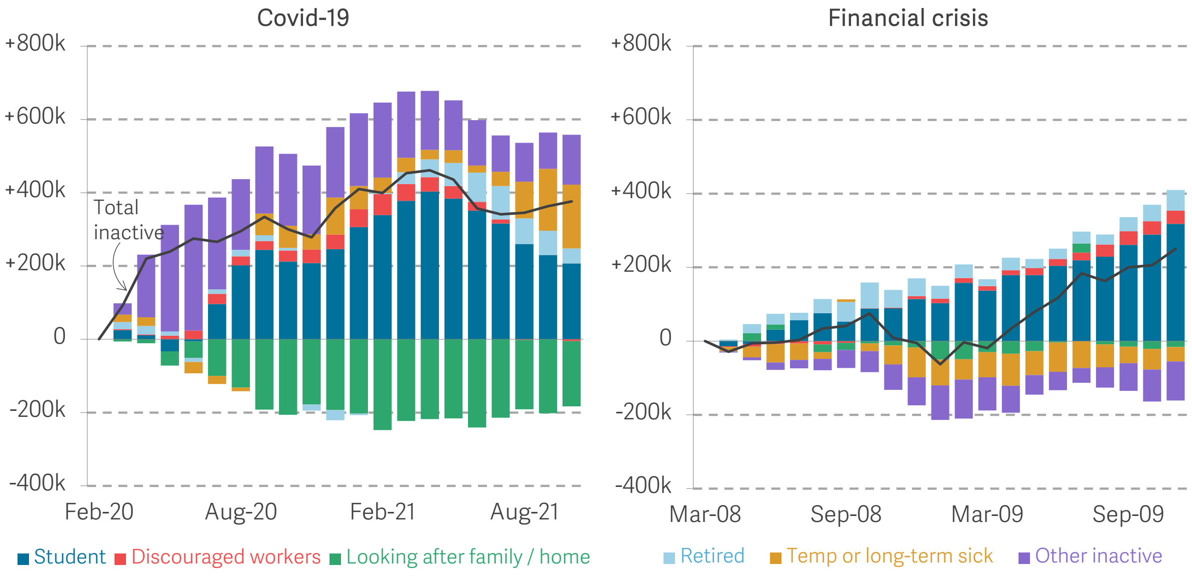
Directly reducing the size of the price cap increase, potentially requiring both legislative change and compensation for suppliers. A £200 reduction, for example, would cost around £2.7 billion for six months. These significant costs could be reduced, albeit with administrative pain, to £450 million by limiting the cap increase only for those households in receipt of Universal Credit. Public subsidies cannot be the permanent answer to higher energy prices, so any move should be temporary, for example until the next price cap reset in October 2022. Given the future path of wholesale prices is far from certain, this would either smooth household bills through the current spike or merely offer households time to adjust.

None of these is a pain-free solution, but then the months ahead will not be easy for households who see their wages fall back as energy bills and taxes rise. As Omicron hopefully fades in the early months of 2022 we will come to realise the scale of the challenge posed to household finances. At that point, Government is likely to realise it has little choice but to act.

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

FIGURE 5: **Change in the number of economically-inactive 16-64-year-olds since the start of the Covid-19 pandemic and the financial crisis, by reason: UK**

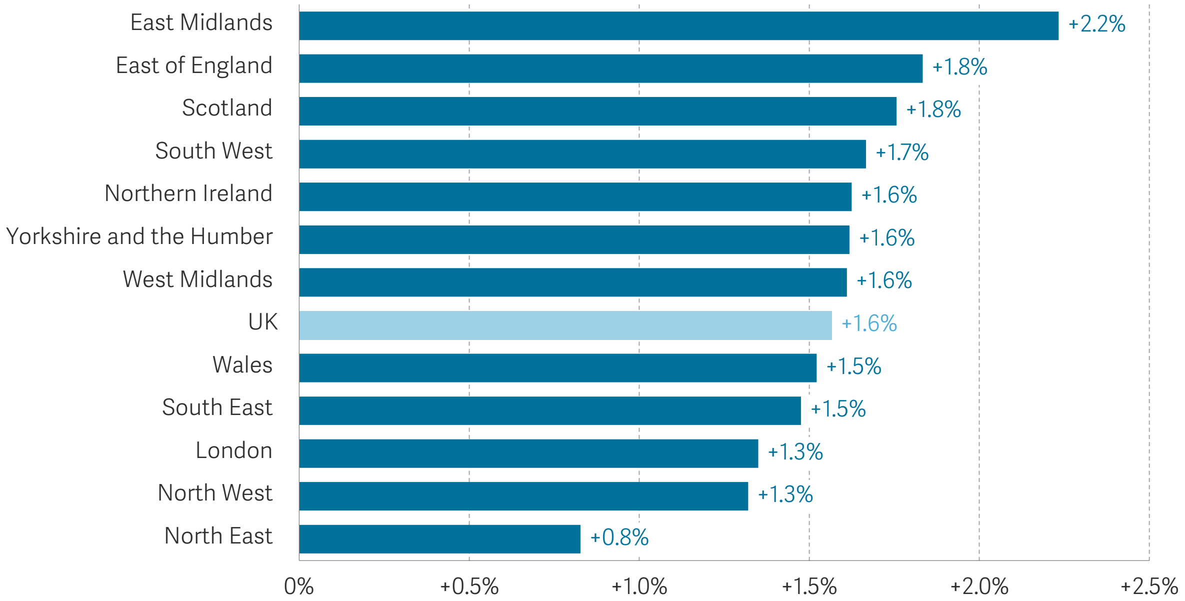


SOURCE: RF analysis of ONS, Labour Market Statistics.

The big labour market fear for most of the Covid-19 pandemic was that unemployment would surge – but our report last month found that the lasting legacy of the Covid-19 pandemic is instead likely to be a rise in economic inactivity. Figure 4 breaks down the rise in economic inactivity by reason since the start of the Covid-19 pandemic, and compares it to the other recession of the 21st century. The rise in inactivity after the financial crisis was almost entirely explained by students, but although the number of students has risen in this crisis too, the pandemic has seen two unique drivers of decreased participation. First, recent months have seen a marked increase in the number of people not working due to illness, which will include those who have long Covid.

Second, at the start of the pandemic, there was a stark rise in people who said they were inactive for 'other reasons' – which might include, for example, those who do not want to work because of the fear of catching the virus. On the other hand, the number of people inactive for family reasons has fallen, as mothers of young children in particular have entered the workforce. We explored these and other trends in labour force participation in our recent report as part of the Economy 2030 Inquiry.

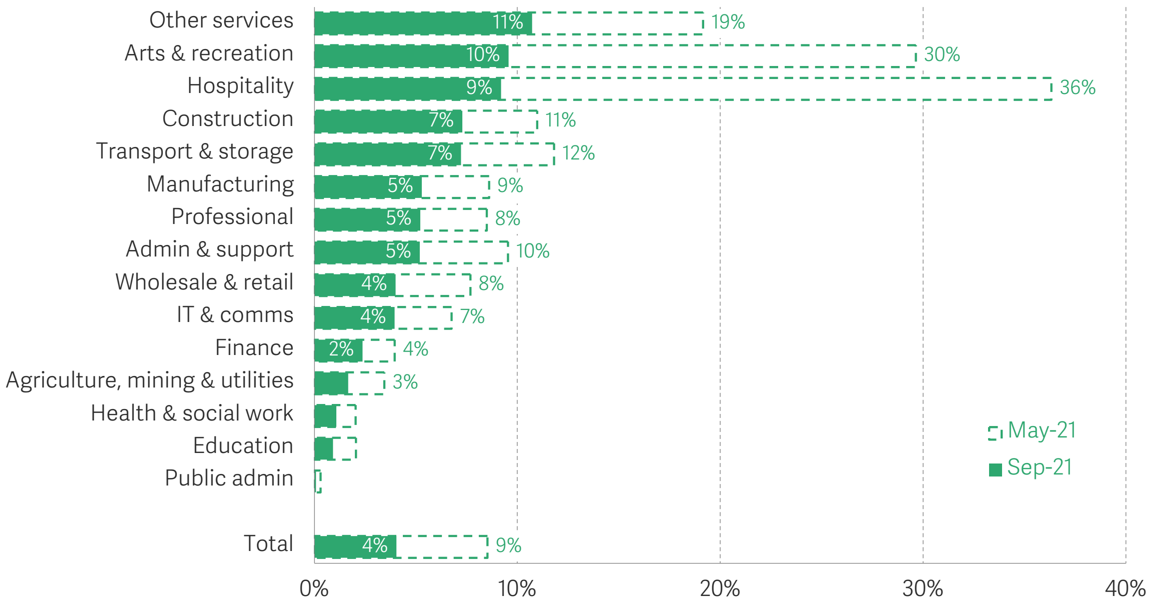
FIGURE 6: **Annualised change in median monthly pay between February 2020 and November 2021, adjusted for CPIH inflation, by UK region and nation**



NOTES: Incomes are allocated to regions and countries according to the residence of the recipient.
SOURCE: RF analysis of ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted.

This Outlook's spotlight focuses on pay growth since the start of the pandemic, and the squeeze on living standards ahead. But as ever, this pay squeeze will not be distributed evenly across the UK. Real-time payroll information from HMRC provides a timely data source that breaks down median earnings in November by UK regions and nations (Figure 5). Across the UK as a whole, median pay has grown by 1.6 per cent a year in real terms since the start of the crisis. Typical earnings have grown slightly faster in the East Midlands (by 2.2 per cent a year) – but in the North East, typical pay during the pandemic grew by just 0.8 per cent a year in real terms. With a tough winter ahead, it is likely that even those areas that have seen above-average earnings growth will see any further pay gains wiped out by rises in energy prices and wider costs of living for much of 2022.

FIGURE 7: **Proportion of eligible employments furloughed, by industry: UK, May 2021 and September 2021**



NOTES: Includes both full and partial furlough.
SOURCE: RF analysis of HMRC, Coronavirus Job Retention Scheme (CJRS) Statistics.

At the end of September, the Coronavirus Job Retention Scheme (JRS) came to an end, having supported more than 11 million jobs over 18 months. Figure 6 shows how furlough take-up changed over the final months of the scheme, as the economy opened up. Between the end of May (just after the return of indoor hospitality) and the end of September (the final day of the scheme), the share of employments furloughed fell by more than half – and in hospitality, furlough rates fell from more than one-third (36 per cent) to less than one-tenth (9 per cent) over that period. At the end of the scheme, around one-in-ten workers in the hospitality, leisure, and 'other services' sectors were still on the scheme. Fortunately, however, the vast majority of furloughed workers returned to their previous jobs when the JRS came to an end.

Endnotes

1 The earnings growth forecasts in Figure 2 are derived from in the Office for Budget Responsibility's (OBR's) latest Economic and Fiscal Outlook. The OBR uses a measure of wages and salaries derived from National Accounts, rather than our usual Average Weekly Earnings (AWE) measure; for consistency, Figure 2 uses the AWE outturn and applies the OBR wages and salaries growth forecast from Q4 2021 onwards. We derive the inflation forecast by applying the quarterly inflation rates implied by the Bank of England's December Monetary Policy Summary to the CPI outturn until Q2 2022, and the rates implied by the November Monetary Policy Report thereafter.

2 This calculation applies the annualised growth in average weekly earnings between Q1 2014 and Q4 2019 from Q1 2020 onwards, and compares the level implied by this trajectory in Q3 2021 with the outturn.

3 Source: Nordpool exchange (electricity), Reuters (gas)

4 RF analysis of English Housing Survey data shows that 40 per cent of the lowest income quintile have fuel costs above the average household, with 15 per cent spending more than 25 per cent more than the median household on domestic energy bills.

5 Despite sales of non-condensing boilers being stopped in 2005, 10 per cent of homes in England and Wales still use standard boilers, which can lead to household heating costs that are £150-570 per year more than using a more efficient system, depending on property size and efficiency.

6 Median energy costs for an EPC E-rated home are more than double that for a C-rated property, ONS data shows.

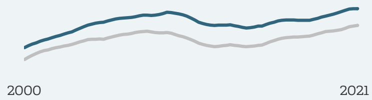
7 Continuing the momentum of the now-underway fourth Contracts for Difference allocation round, which is set to yield upwards of 10 gigawatts of renewable capacity, with annual auctions would be a good start.

8 Modelling by the National Infrastructure Commission showed that a smart electricity system could deliver savings of £8 billion per year.

9 The Government stated its aim to reduce electricity costs by 'shifting or rebalancing' levies on electricity bills 'over a decade' in its Heat and Buildings Strategy, with more clarity expected in the 2022 Affordability and Fairness review.

The Scorecard | Quarter 4 2021

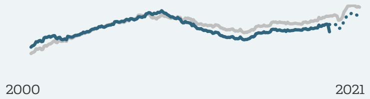
Median employee earnings



↑ 1.4% on yr (all)
↑ 2.0% on yr (private sector)

In the most recent data, real median hourly pay grew by 1.4%. Pay growth picked up in the second half of 2020, largely due to compositional factors, but is now slowing.

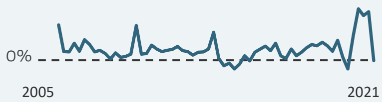
All worker earnings



↓ 4.9% on yr

Our all worker earnings measure is based on pre-pandemic data, so the falling gap does not reflect changes in self-employment earnings since the crisis.

Earnings decomp.



↓ 1.6ppts on yr

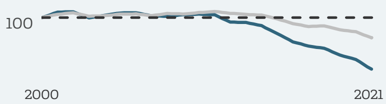
Pay growth was 1.6 ppts lower as a result of compositional effects, as recent entrants to the labour market have tended to work in lower-paid occupations.

Pay rises

↓ 0.7ppts on yr

Median year-on-year real hourly pay growth for employees in work over a year (both job stayers and changers) stood at 1.4% in Q3 2021, 0.7 ppts lower than the previous year.

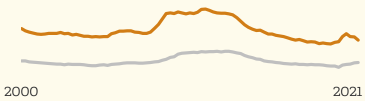
Earnings Inequality



r75:25 ↓ 0.8% on yr
r90:10 ↓ 3.6%

Our headline measures of earnings inequality continue to fall, but low paid workers have been more likely to face reductions to hours and pay or to have lost work during the pandemic.

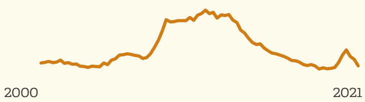
Unemployment by duration



↓ 0.5ppts on yr (all)
↑ 0.3ppts on yr (longterm)

The unemployment rate was 4.2% in the latest data, close to pre-pandemic levels - but long-term unemployment is up 0.3 ppts on the year.

All worker earnings



↓ 23% on yr

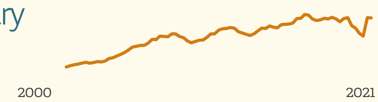
Under-employment rose significantly in the crisis, likely due to employers making hours reductions in the face of weak demand and supply constraints, but has since fallen almost to pre-pandemic levels.

Job-to-job moves

↑ 220% on yr

The proportion of workers voluntarily moving job (an indicator of worker confidence) has returned to pre-pandemic levels after falling sharply in 2020.

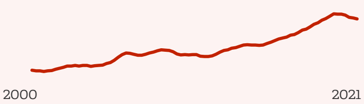
Migrant job entry



↑ 12% on yr

The proportion of jobs going to new migrants fell during the crisis but recovered to pre-pandemic levels in Q2 2021.

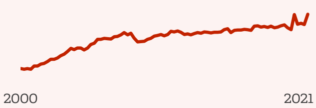
Workforce participation



↓ 0.4% on yr

The labour force participation rate of 18-69-year-olds fell to 76.4% in Q3 2021. The 'Lifting the Lid' section explores the reasons behind rising inactivity.

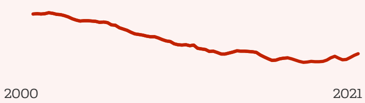
Labour productivity



↑ 0.1% on yr

Hourly productivity rose sharply in Q3 2021, but is at a similar level to a year earlier.

Training intensity



↑ 7% on yr

The long-term trend in falling 'off-the-job' training has flattened out, but the proportion of workers receiving such training remains low – a potential drag on productivity.

Graduates in non-graduate occupations

↑ 1% on yr

The proportion of graduates in non-graduate roles (a measure of mismatched demand and supply of skills) has risen over the past year, but remains below pre-pandemic levels at 35.7%.