The Resolution Foundation Labour Market Outlook

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In the first months of 2022, the labour market continued to tighten, with no sign of weakening in the aftermath of the JRS. Unemployment has fallen further, and stood at an almost-record low of 3.9 per cent in the three months to January 2022 – and although the Bank of England is concerned about unemployment rising in the medium term as price rises dampen demand, the Office for Budget Responsibility expects unemployment to remain low through to the middle of the decade. And with ongoing high levels of vacancies, and strong job-to-job moves as workers gain confidence after the economic reopening, the labour market is tight on multiple measures.

That is not to say that the labour market is without its problems, however. Labour force participation, which fell during the pandemic, has not recovered, with recent rises in inactivity driven by people who are long-term sick. And rising inflation is already causing real wages to fall, with the squeeze set to last until the end of next year. Nominal wage growth is strong, however (albeit not strong enough to offset price rises). In this Outlook's Spotlight, we explore this rise in nominal pay growth – a key driver of both living standards and future unemployment – and how much of it is driven by ongoing data complications from the recently-ended furlough scheme and compositional changes in the workforce. In Lifting the Lid, we look at local differences in the post-pandemic return to the workplace, the types of occupation that have grown and shrunk among employees compared to the self-employed, and how many workers are ineligible for statutory sick pay.

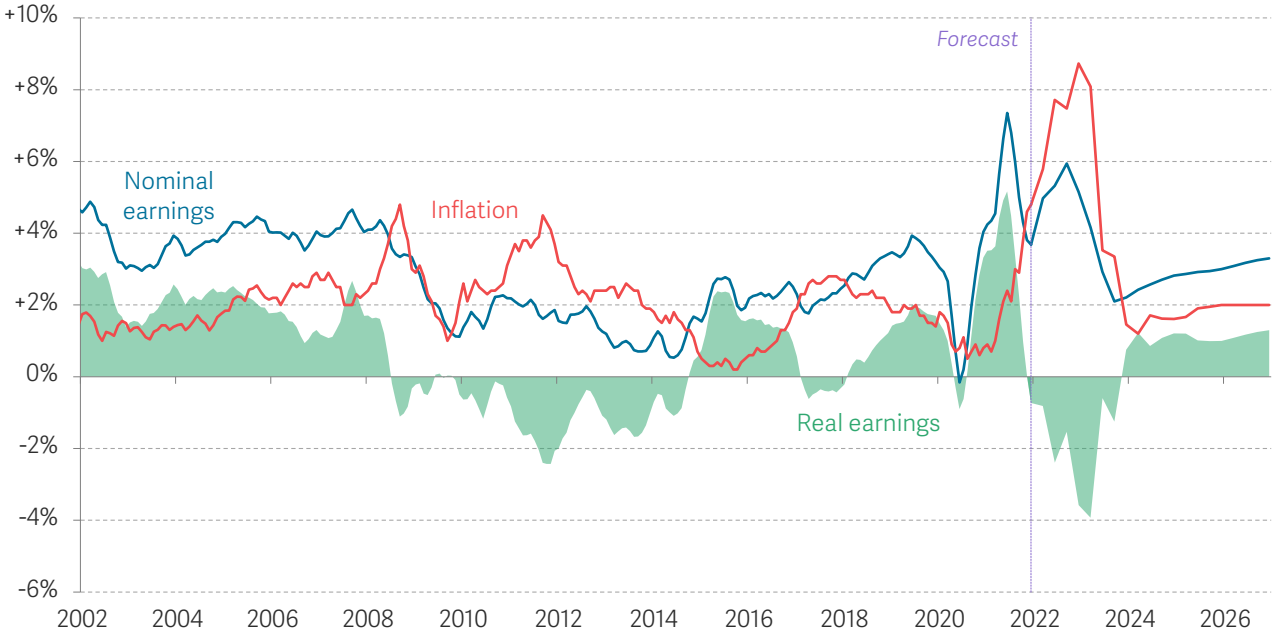
Spotlight | How should we interpret strong nominal earnings growth?

As the UK emerges from the remaining restrictions imposed by the Covid-19 pandemic, it is clear that the long-feared labour market impact coming out of the crisis – a rise in unemployment after the end of the Job Retention Scheme – has not materialised. Instead, attention has turned to wages. But while the main story for living standards has been falling real pay (driven by high inflation), pay is growing relatively quickly in cash terms: nominal earnings grew by 4.1 per cent in the year to January 2022, and the OBR expects year-on-year nominal pay growth to top 5 per cent throughout 2022 (see Figure 1), compared to an average growth rate of just 2 per cent in the decade prior to the pandemic.

Nominal wage growth is not just important for living standards, however: if earnings rise faster than productivity, there is a risk of further inflation down the line if businesses respond to rising wage costs by increasing their prices, and this in turn could lead to higher unemployment in the medium term. This Spotlight explores how we should interpret this strong nominal earnings growth, and the extent to which pay data is still being distorted by both the furlough scheme and the changing make-up of the workforce.

FIGURE 1: **Nominal wage growth is set to be strong in the short term, though will be outpaced by inflation**

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



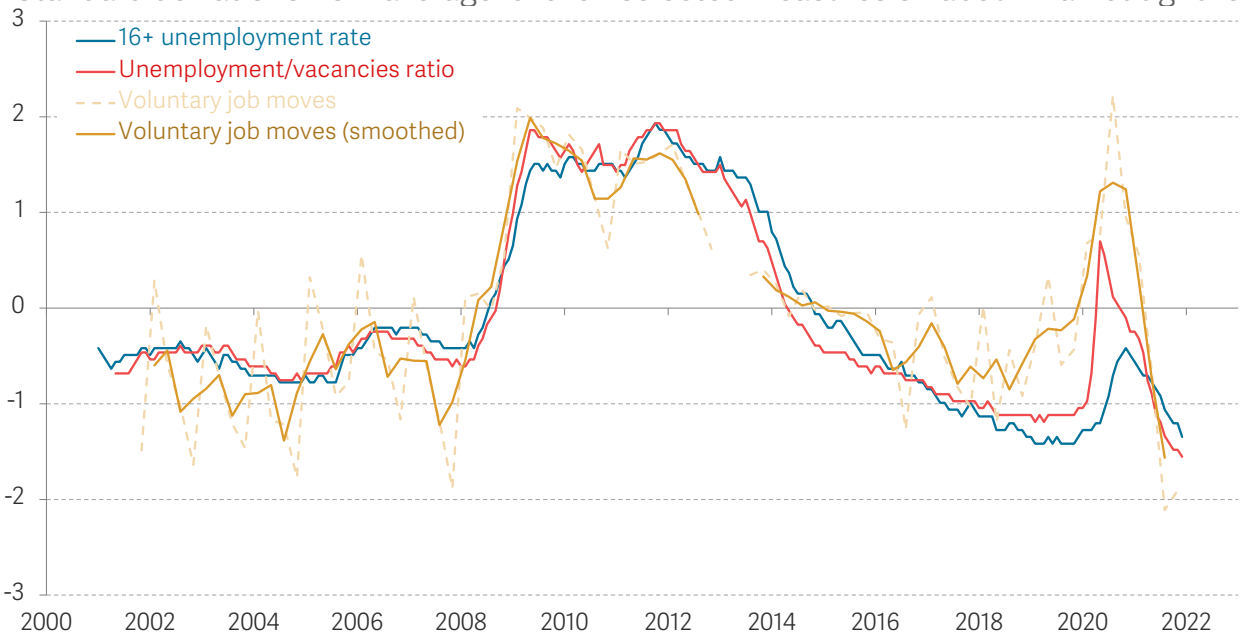
NOTES: Average weekly earnings growth is year-on-year change in quarterly whole economy average, regular pay (i.e. excludes bonuses), and inflation outturn is the CPIH measure. Projections apply the OBR's forecast of average earnings and CPI inflation. Earnings outturn data covers Great Britain; earnings growth forecast and all inflation data covers the UK. This chart first appeared in: T Bell et al., Inflation Nation: Putting Spring Statement 2022 in context, Resolution Foundation, March 2022.
SOURCE: RF analysis of ONS, Labour market statistics; OBR, Economic and fiscal outlook, March 2022; ONS, Consumer price inflation.

A tight labour market is one key driver of nominal wage growth

One key driver of nominal wage growth is a tight labour market. Since the summer, the labour market has tightened on all three of the headline measures shown in Figure 2. The unemployment rate is close to record lows, the unemployment-to-vacancies ratio is the lowest on record, and workers are moving jobs voluntarily at record-high rates. (Figure 2 shows the *inverse* of the trend in voluntary job moves, since a high rate of job moves is associated with a tighter labour market.)

FIGURE 2: **The labour market is tight on a number of measures**

Standard deviations from average level on selected measures of labour market tightness



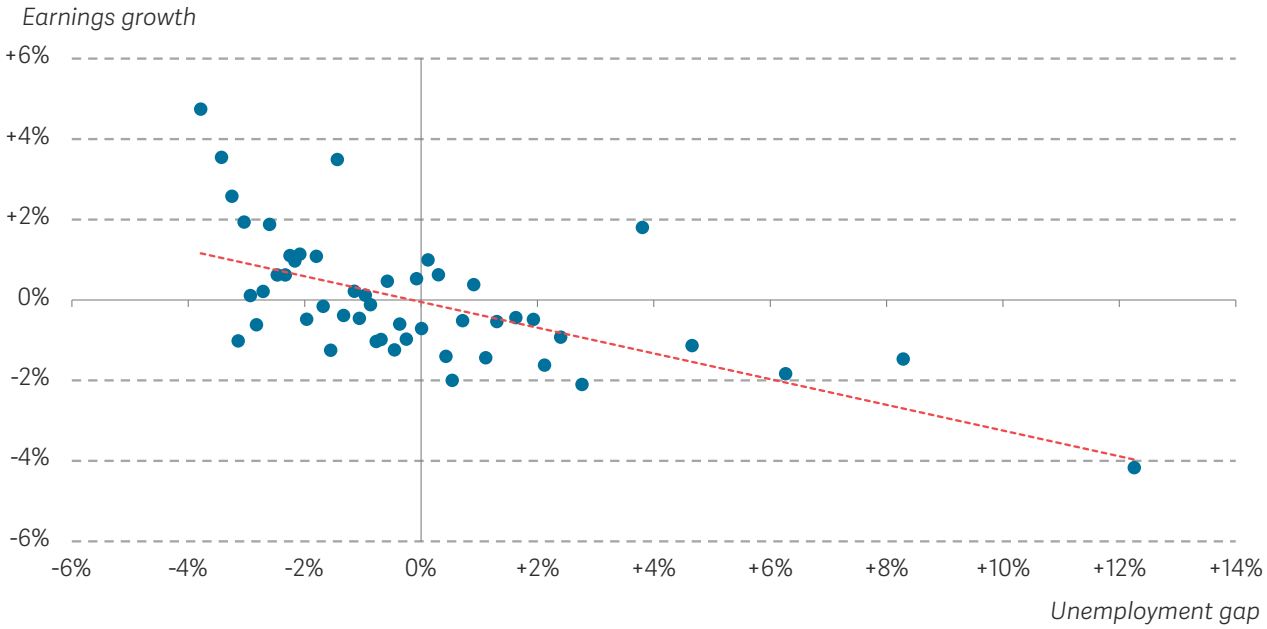
NOTES: Sign of voluntary job moves has been reversed (tighter labour market conditions are associated with higher not lower numbers of voluntary job moves).
SOURCE: ONS, Labour market statistics. Chart idea comes from Jason Furman.

Both the Office for Budget Responsibility (OBR) and the Bank of England have pointed to this tight labour market as a driver of nominal pay growth, as employers raise wages to attract and retain workers. This is backed up by evidence from cross-country data: as Figure 3 shows, across OECD countries there is a clear negative relationship between pay growth and the unemployment gap (the difference between unemployment and its minimum in the past 10 years), after accounting for other characteristics of each economy. As the unemployment gap rises, pay growth tends to fall, all else equal.

In addition, the OBR suggested that high inflation is itself driving some of the nominal wage growth in the short term, as price rises prompt workers to demand higher salaries. But this is set to be a short-term phenomenon – in the longer term, there is no sign in the OBR forecasts of the wage-price spiral feared by some policy makers in recent months.

FIGURE 3: **Across OECD countries, lower unemployment is associated with stronger wage growth**

Binned scatterplot of wage growth and unemployment gap residuals for OECD countries: 1971-2021



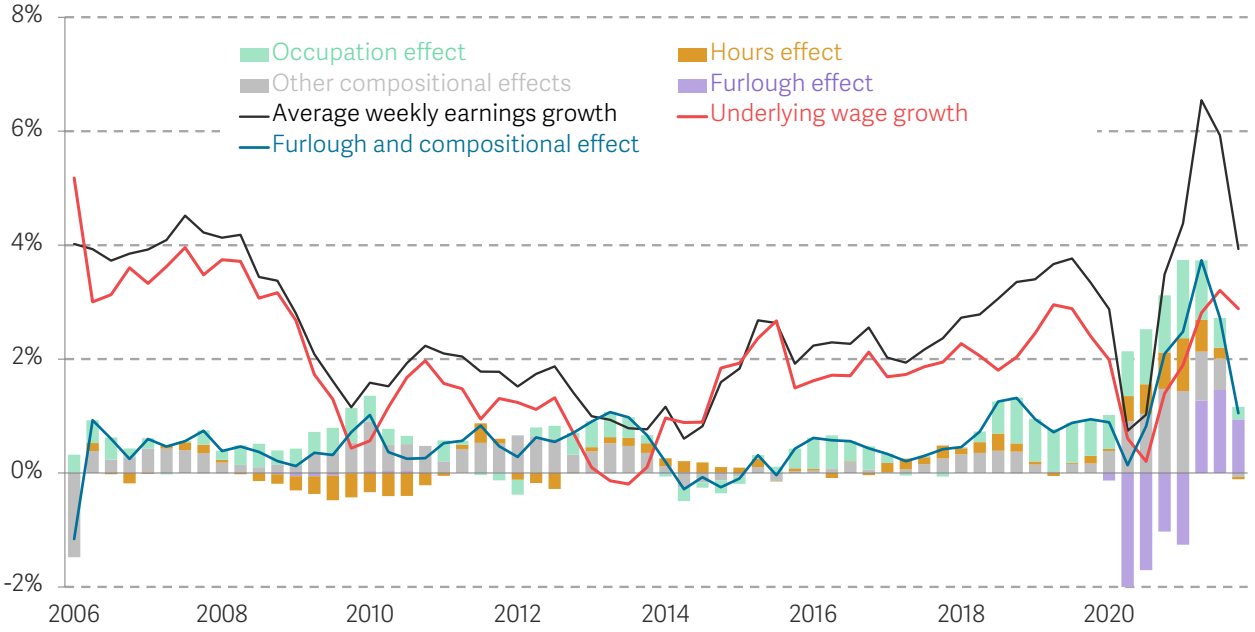
NOTES: This chart uses the Stata 'binscatter' programme, developed by Michael Stepner. It groups observations of the unemployment gap residual into equal-sized bins, computes the mean of the unemployment gap and earnings growth residuals within each bin, then creates a scatterplot of these data points. The unemployment gap is the difference between unemployment and its minimum in the past 10 years. Both variables strip country averages out of them, and wage inflation also strips out lagged price inflation.
SOURCE: RF analysis of OECD statistics.

Pay data still includes furlough base effects, but underlying pay growth is similar to pre-pandemic

Pay data during the pandemic has not always been straightforward to interpret, however. One reason is that many workers who were furloughed under the Job Retention Scheme (JRS) received only 80 per cent or less of their usual pay (the amount covered by the Government) unless their employer topped up their wages. As Figure 4 shows, this pushed down wage growth when furlough numbers were higher than the previous year – and the reverse happened as the JRS unwound. Average weekly earnings year-on-year growth was 3.9 per cent in Q4 2021 – but 0.9 percentage points of that was accounted for by furloughed workers moving back onto their full pay as they returned to work. The furlough effect will continue to push up pay growth until the autumn (at which point we will no longer be comparing pay to a point, a year ago, when the furlough scheme was in operation). It will contribute around a percentage point to pay growth in the first quarter of 2022.

FIGURE 4: **In late 2021, earnings were still distorted because of furlough**

Compositional contributions to year-on-year growth in nominal weekly earnings in the Labour Force Survey: UK



NOTES: Furloughed workers were identified as those who either (i) were working fewer hours than usual and gave the reason as being furloughed or (ii) were working fewer hours than usual due to economic conditions. The 'other compositional effects' category includes sex, highest qualification, industry, age, job tenure, region, and whether working in the public or private sector. Underlying wage growth is AWE wage growth minus furlough and composition effects.
SOURCE: RF analysis of ONS, Labour Force Survey, and ONS, Average Weekly Earnings.

Compositional effects have been pushing up on pay growth but are now waning

Figure 4 also shows the impact of changes in the composition of the workforce. As the pandemic struck, job losses were concentrated among lower-paid workers: this pushed up observed pay growth because the average person still in work was higher-paid than a year earlier. As the economy reopened in the middle of 2021, and lower-paying sectors such as hospitality experienced a hiring boom, we might expect this effect to have gone into reverse – that is, the average person in the workforce to become lower-paid than a year earlier, and for compositional effects to push down on year-on-year pay growth.[1]

But as Figure 4 shows, although compositional effects are no longer pushing up whole-economy pay growth, nor do we find a *negative* compositional effect. (Focusing only on the private sector, the Bank of England finds a negative compositional effect emerging in October and November 2021 – of -0.3 and -0.7 percentage points respectively – though this is small relative to the positive compositional effects seen throughout much of the pandemic.)

Overall, Figure 4 suggests that the latest year-on-year pay growth figures are only marginally affected by compositional changes to the workforce. After accounting for this, as well as the impact of furlough, underlying pay growth averaged 2.7 per cent in 2021 and reached 2.9 per cent in Q4 2021,

1 Real-time payroll data for February 2022 shows employee numbers down 0.4 per cent in retail, up 0.7 per cent in hospitality, and down 2.8 per cent in leisure since February 2020, compared to peak falls in these sectors of 3.4 per cent, 16.7 per cent and 20.3 per cent respectively.

down on the 3.2 per cent of Q3 2021 (although bear in mind that these estimates are somewhat volatile). This is relatively healthy pay growth compared to the decade leading up to the crisis, when underlying pay growth averaged 1.5 per cent, but not higher than the eve of the pandemic: underlying pay growth also averaged 2.7 per cent in 2019 when the labour market was tight, as it is again now (see Figure 2).

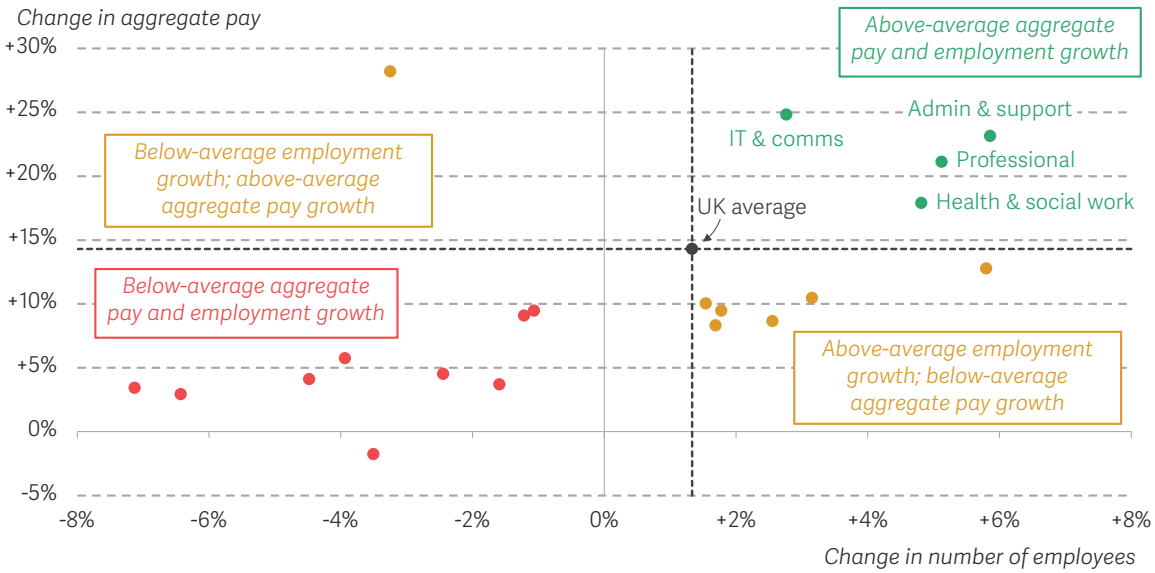
We can compare these results to The Bank of England's recent calculations. They estimated that underlying private sector pay growth is somewhat higher than pre-crisis levels, partly driven by higher inflation expectations. But the difference is not large. They estimate underlying private sector pay growth in the private sector was 4.0 per cent in November 2021, compared to an average of 3.6 per cent across 2019. Taking these results with ours, the shared message is that underlying pay growth, once furlough effects are removed, is likely to be similar to or at best only slightly stronger than pre-crisis pay growth. There is no evidence yet of accelerating pay growth to match fast-rising prices.

But the level of pay remains elevated compared to pre-pandemic

If pay growth in the early stages of the pandemic stemmed partly from changes in the composition of the workforce, and these effects have not gone into reverse, this suggests that the *level* of average earnings remains elevated compared to pre-pandemic. Figure 5 shows that four industries stand out as having above-average growth in the number of employees since the start of the pandemic, as well as above-average growth in average pay: IT and communications, admin and support, professional services, and health and social work.[2] Together, these four sectors have accounted for more than half (53 per cent) of the growth in aggregate pay since the start of the pandemic.

FIGURE 5: **Office jobs and the healthcare sector have grown since the start of the pandemic**

Change in number of employees and change in sector's aggregate employee pay, by industry: UK, February 2020-January 2021



SOURCE: RF analysis of ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted.

2 One complication in using employee jobs data is that the IR35 tax change in April 2021 is likely to have shifted some private-sector workers from self-employment to employment, bringing them into scope of HMRC's payrolled employee numbers but not representing growth in overall employment. However, we find very similar changes in employment levels by industry when we use data from the ONS Workforce Jobs series, which includes self-employed workers. We use HMRC RTI data in Figure 5 for consistency and because none of our main sources of earnings data include the self-employed.

It is not surprising that the relative size of different sectors has changed in response to Covid-19: many employers in industries where people could work from home faced little impact from the pandemic. In addition, some of the growth in employee jobs has been driven not by growth in overall employment, but by self-employed workers becoming payrolled employees in response to the IR35 tax change – and as this Outlook's 'Lifting the Lid' section shows, those who have moved out of self-employment and entered employee jobs are disproportionately in higher-paying occupations, pushing up average employee pay. (The growing sectors highlighted in Figure 5 also stand out if we use workforce jobs data that includes the self-employed, however.)

But the fact that these sectors remain bigger than before the pandemic could have implications for pay in the months ahead: while some of these sectoral changes may signal permanent shifts, some are likely to reflect temporary changes in economic activity that may unwind in the future. (Examples across the public and private sector include operating vaccination centres, meeting additional NHS demand, and providing PCR tests for international travel.) As pandemic demand continues to unwind, employment in these sectors may yet fall back closer to pre-crisis levels – and if workers move into lower-paying jobs elsewhere, this could exert downward pressure on average pay and so push down pay growth.[3]

It is difficult to know how much employment is being supported in different sectors by pandemic demand – and how much of this will reverse. But it is clear that these sectors' disproportionate expansion has contributed to labour market growth. If the four sectors in the right-hand quadrant of Figure 5 had grown at the same rate as other sectors (in terms of both pay and employment), average pay would be 1.9 per cent lower than it is now and there would be 1.4 per cent fewer employee jobs.

Strong nominal wage growth is not enough to prevent falls in living standards

Overall, then, nominal wage growth is healthy (although not quite as strong as headline figures suggest). But as well as possible headwinds over the next few months as the composition of the workforce continues to adjust in the aftermath of the pandemic, nominal wages are still not growing fast enough to keep pace with price rises. As Figure 1 showed, earnings are set to fall in real terms for the rest of this year and most of next – and wages will fall even for those who benefit from the 6.6 per cent rise in the NMW on 1 April, thanks to inflation which is set to top 8 per cent this spring. In the face of falling real wages, it is crucial not only to ensure that the labour market remains strong enough to deliver decent pay rises to workers, but also for the Government to provide targeted support to those at the sharp end of the cost of living crisis.

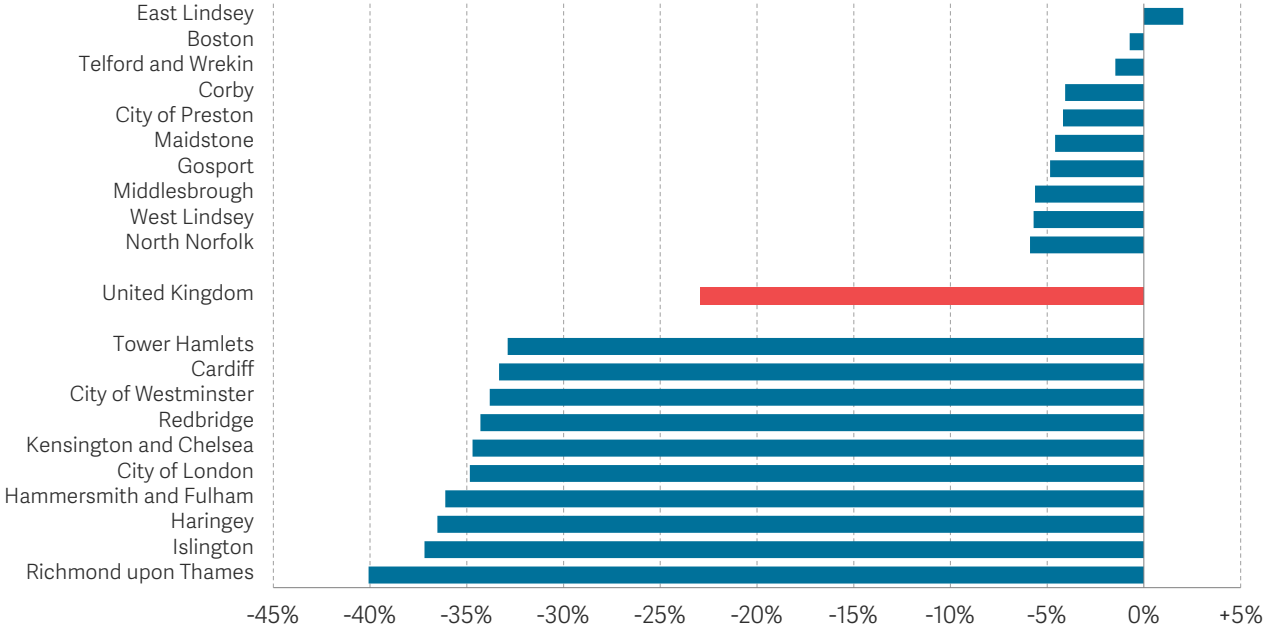
3 It is, of course, possible that any workers who do move out of these sectors maintain their current pay levels or get a pay rise. However, not only are two of the sectors that have grown during the pandemic (IT and professional services) substantially higher-paying than average, but workers who took on work as part of the crisis response may have been offered a pay premium to move jobs or to meet excess demand, which they may not be able to keep.

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 6: **Workplace mobility in many London boroughs is still more than a third down on pre-pandemic**

Change in workplace mobility since the start of the Covid-19 pandemic, local authorities with the smallest and largest changes and UK average: March 2022

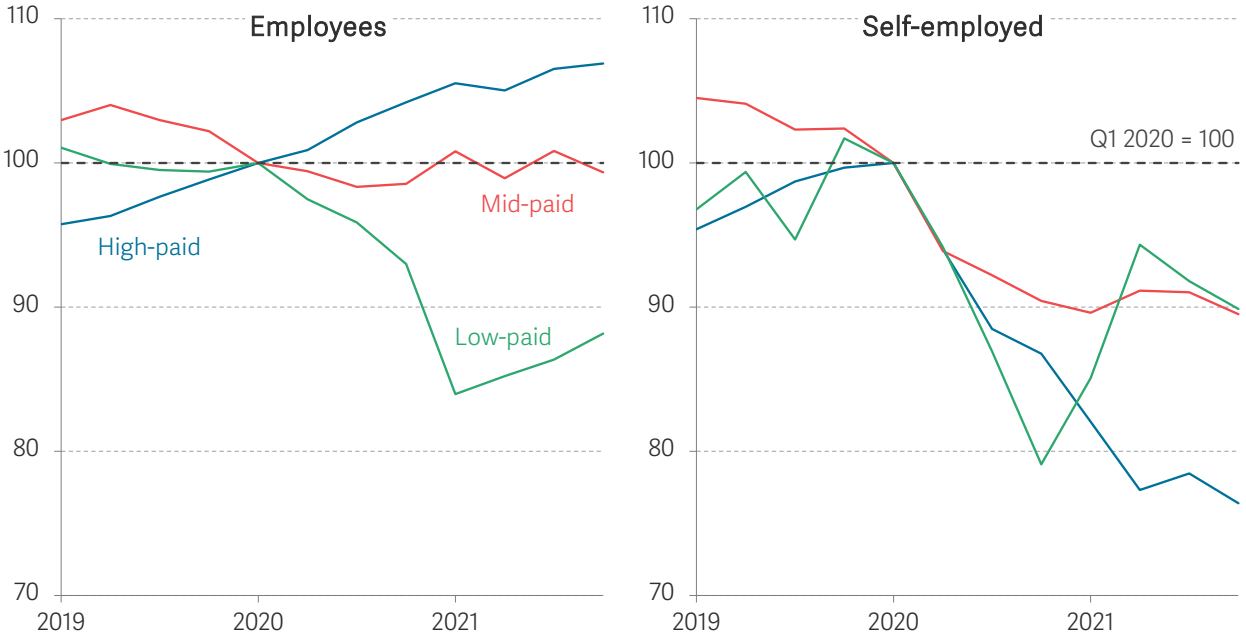


NOTES: The data uses aggregated, anonymised data to chart movement trends over time by geography, across different high-level categories of places such as retail and recreation, groceries and pharmacies, transit stations, workplaces, and residential. The baseline is the median value, for the corresponding day of the week, during the five-week period 3 January-6 February 2020.
SOURCE: Google, COVID-19 Community Mobility Reports.

Following a brief return to working-from-home guidance as the Omicron variant began to circulate in December, the Government has now removed all restrictions and is encouraging workers to return to the office. But Figure 6 shows that according to data from Google, workplace mobility is still almost a quarter (23 per cent) lower than pre-pandemic levels across the UK – and with wide regional variation. Areas such as Boston and Telford & Wrekin are within touching distance of pre-pandemic levels – and in East Lindsey, workplace visits are 2 per cent *higher* than on the eve of the pandemic. But in many areas of London, along with Cardiff, workers appear reluctant to go back to the office, suggesting that, as previous Resolution Foundation research has shown, hybrid working (if not full remote working) is likely to outlast the pandemic. And of course, the regional discrepancies shown here likely reflect, at least in part, the disparities in who is able to work from home – in many (particularly lower-paid) jobs, remote working is simply not an option.

FIGURE 7: **Self-employment has fallen most among the high paid**

Indices of employee and self-employed numbers (Q1 2020 = 100), by occupational pay categories: UK

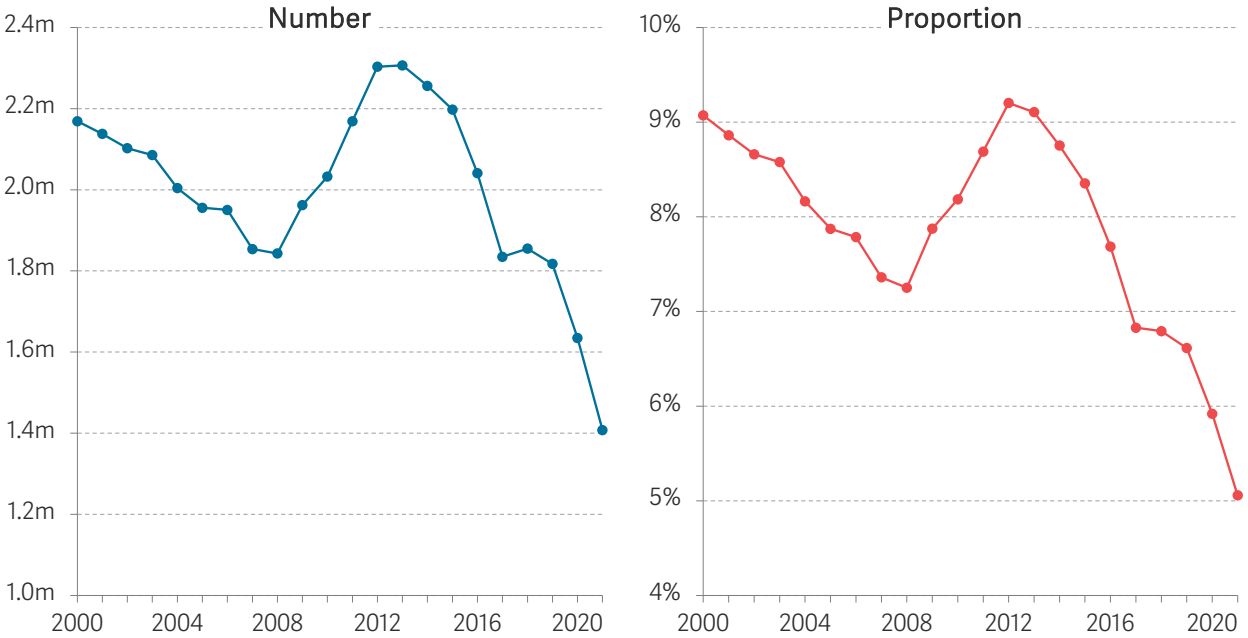


NOTES: High-, mid- and low-paid occupations are proxied using the major groups in the Standard Occupation Classification (SOC) according to their median employee pay in the Annual Survey of Hours and Earnings. 'High' refers to major SOC groups 1-3, 'Mid' to major SOC groups 4, 5 and 8, and 'Low' to major SOC groups 6, 7 and 9.
SOURCE: RF analysis of ONS, Labour Force Survey.

Self-employed workers were hit hard by the Covid-19 pandemic: many lost substantial amounts of business or stopped working altogether, and support through the Self-Employment Income Support Scheme (SEISS) was poorly targeted. Data issues, however, mean it is difficult to tell how large the fall in self-employed workers has been: as well as measurement issues in the Labour Force Survey, which relies on workers to classify themselves as employees or self-employed, IR35 tax changes that came into force for the private sector in April 2021 have likely led many self-employed contractors to become payrolled employees. Figure 7 shows that the biggest fall in the number of self-employed workers has been among those in higher-paying occupations – by contrast, the number of higher-paid employees has risen. While it is not possible to attribute this change directly to IR35, it is likely that at least some of the fall in high-paid self-employment reflects people moving into high-paid employee jobs.

FIGURE 8: **The number of workers ineligible for statutory sick pay is declining, but still well over 1 million**

Number and proportion of employees who are not eligible for Statutory Sick Pay: UK

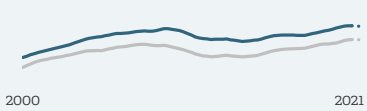


NOTES: Being ineligible for Statutory Sick Pay is equivalent to earning below the National Insurance Lower Earnings Limit.
SOURCE: RF analysis of ONS, Labour Force Survey.

It is now over two years since the start of the pandemic – but Covid-19 is still with us. Although vaccines and the Omicron variant mean that the virus is less harmful than in previous waves, and despite the Government lifting requirements to self-isolate, high case rates still translate into workers having to take time off work. And not only is the UK's level of statutory sick pay (SSP) very low, but many workers are not eligible at all. Figure 8 updates previous Resolution Foundation analysis and finds that the number of workers ineligible for SSP has fallen over the past two years, from 1.8 million to 1.4 million. This decline is very welcome (though well over a million, or one-in-twenty, workers with no financial protection if they fall ill is little cause for celebration). The expansion in eligibility is thanks to the National Insurance lower earnings limit (LEL) falling relative to median pay: since SSP is available to all those earning above the LEL, this has brought more workers into scope.

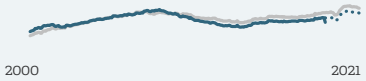
The Scorecard | Q1 2022

Median employee earnings



↓ 0.1% on yr (all)
↑ 0.5% on yr (private sector)

All worker earnings

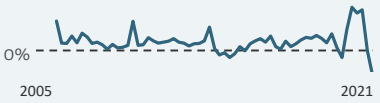


Employee earnings and all worker earnings gap ↓ 4.6%

In the most recent data, real median hourly pay fell by 0.1% as inflation outpaced wages. Pay growth was stronger in the private sector as the public sector pay freeze held down wage growth.

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.



↓ 5.1 ppts on yr

The compositional effect on earnings fell by 5.1 ppts compared to a year earlier, from a positive effect to a negative effect. (Note that this measure does not account for furlough, unlike the decomposition in this Outlook's spotlight.)

Pay rises

↓ 0.7 ppts on yr

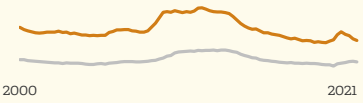
Median year-on-year real hourly pay growth for employees in work over a year (both job stayers and changers) stood at 1.4% in Q3 2021, 0.7 ppts lower than the previous year.

Earnings Inequality

r75:25 ↓ 0.7% 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



↓1.2 ppts on yr (all)
↑ 0.1 ppts on yr (long-term)

The unemployment rate was 4.1% in the latest data, almost back to pre-pandemic levels - but long-term unemployment is up slightly on the year.

All worker earnings

↑ 37% 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

↑ 40% on yr

The proportion of workers voluntarily moving job (an indicator of worker confidence) has returned to its pre-pandemic levels after reaching a record low in 2020.

Migrant job entry

↑ 24% 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 76.3% in Q4 2021. The latest rises in inactivity have been driven by long-term sickness.

Labour productivity

↑ 5.5% on yr

Hourly productivity rose in both Q3 and Q4 2021, and is 5.5% higher than a year earlier.

Training intensity

↑ 5% on yr

'Off-the-job' training has risen over the past two years, but this follows two decades of falls in such training – a potential drag on productivity.

Graduates in non-graduate occupations

↑ 3% 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 36.0%.

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged.

We do this by undertaking research and analysis to understand the challenges facing people on a low to middle income, developing practical and effective policy proposals; and engaging with policy makers and stakeholders to influence decision-making and bring about change.

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