Slowing UK Wage Growth

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1. Introduction

We have previously examined the path of nominal and real wages in the UK (Blanchflower and Machin, 2014a, 2014b, 2014c). In that work, we expressed the view that in recent years there has been sufficient slack in the labour market to mean there has been little prospect of significant growth in nominal wages. The latest data continue to support that conclusion.

After a short-lived upwards blip last year, there is no evidence that nominal wage growth is picking up as it continues to grow at or around 2%, even though the unemployment rate is approaching 5%. Following what seems to be a temporary boost to wage growth due to the fall in unemployment, wage growth has subsequently weakened and turned back down again.

2. Recent patterns of wage growth

Chart 1 shows the changes in the annual growth rate of wages using single month data for the national statistic, Average Weekly Earnings (AWE). AWE growth rates for total pay averaged 4.3% from January 2001 to December 2007 and 1.8% from January 2008 to December 2015; regular pay growth averaged 4.3% and 1.9% respectively over the same time periods.

It is clear that pay growth on both measures has slowed markedly since the onset of recession. There was some pick-up in the early part of 2015, but that now seems to have fallen back. The latest estimates for annual pay growth are 2.0% for total pay and 2.1% for regular pay.

Table 1 provides monthly data by sector. Manufacturing sector and public sector pay growth have dropped from their peak of just over 2% in early 2015 and now lie at 1.2% and 1.5% respectively. Private sector, service sector and financial sector pay rose to around 5% in March/April 2015 but have now fallen back to around 2%. Pay in both construction and wholesale and retail sector are high at 5.6% and 3.2%, but have also fallen back recently.

Chart 2 shows quarterly wage data from the Office for National Statistics (ONS) on the Labour Force Survey (LFS), the other main source of UK wages data. This confirms that nominal wage growth slowed sharply during 2015: for the third quarter of 2015, wage growth was 1.2%, down from 2.5% in the second quarter of 2015.

Table 2 reports data on pay settlements from the pay firm XpertHR, which shows that they have been stuck at 2% and have not changed over the last year. The pay settlement data are entirely consistent with both the LFS and AWE data: earnings growth is steady at around 2%. There continues to be no sign of any trend wage pick-up.

Chart 3 plots the scores from the REC/KPMG Report on Jobs for January 2016. This confirms that wage growth appears to be slowing. REC/KPMG reports that salaries awarded to staff placed in permanent jobs increased further in December. But the rate of growth was the slowest in over two years. Temporary/contract staff hourly pay rates increased at the weakest pace in 21 months.

The January 2016 report by the Bank of England's agents notes that pay growth is softening, saying '(S)oftening in pay growth had reflected slowing activity in manufacturing and the effects of low inflation, which was mitigating upward pressures in pay for some companies'.

3. Low price inflation

It is the recent decline in price inflation (to below 2% in 2014 and reaching zero in 2015) and not strength in nominal wages that has meant that real wages have started to rise.[1] This rise in real wages has occurred as nominal wage growth has fallen alongside an even steeper fall in CPI (consumer price index) inflation driven by falling oil and commodity prices.

This is shown in Chart 3 with ONS data on real earnings changes since the pre-recession peak, which is set to zero. In July 2014, real wages were 12% below their starting level so they have increased by three percentage points over the last year and a half. Real weekly earnings in 2000 constant prices were £394 in February 2008, £367 in May 2010 and £358 in December 2015. Currently real wages are 9% below their peak level reached in February 2008 and 2.5% below their level when George Osborne became Chancellor of the Exchequer.

4. Employment and unemployment

Despite the fact that unemployment has been falling and employment has been rising, there is a good deal of evidence that this may not continue. Chart 4 reports responses from the survey of expectations of production firms in the UK, conducted by the European Union (EU). Employers were asked for their expectations of employment 'for the months ahead'. Their responses show that these expectations have declined steadily over the last year.

Similarly, service sector employers were asked for their expectations of employment over the next three months. Results are plotted in Chart 5, which also shows a marked decline over the last year. Analogously, individual respondents in the EU's surveys of the UK show a marked pick-up in their expectations of unemployment over the next year.

Consistent with that is the Bank of England's agents' report on employment intentions. Table 3 shows that in all sectors, including manufacturing and services, employment intentions have fallen over the last year or so.

[1] CPI annual inflation rates since 2013 were as follows (%):

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2013	2.7	2.8	2.8	2.4	2.7	2.9	2.8	2.7	2.7	2.2	2.1	2.0
2014	1.9	1.7	1.6	1.8	1.5	1.9	1.6	1.5	1.2	1.3	1.0	0.5
2015	0.3	0.0	0.0	-0.1	0.1	0.0	0.1	0.0	-0.1	-0.1	0.1	0.2

Some commentators have noted that the agents' reports of recruitment difficulties are at historically high levels. But if there were recruitment difficulties we should expect to have seen wage growth, which hasn't occurred. Plausibly firms are saying they can't find an engineer whose market rate is £50,000 for the £20,000 they are offering. There are always recruitment difficulties in a capitalist economy as old firms die and new ones are born.

5. Wage growth forecasts

Interestingly, both the Office for Budget Responsibility (OBR) and the Bank of England's Monetary Policy Committee (MPC) have been forecasting a rapid pick-up in weekly earnings for several years. The OBR's November 2015 Economic and Fiscal Outlook is forecasting average earnings growth of 2014=1.5%; 2015=2.6%; 2016=3.4%; 2017=3.7%; 2018=3.6%; 2019=3.7%: 2020=3.9%.[2]

These forecasts look too high and were raised despite wage growth slowing. In March 2015 they were as follows 2014=2.2%; 2015=2.3%; 2016=3.1%; 2017=3.7%; 2018=4.0%; 2019=4.0.[3]

Table 4 shows the MPC's projections in the last eight Inflation Reports. As time has gone on, they have kept on having to revise down their estimates, which have continually disappointed. This experience does not seem to have generated much learning as longer-term forecasts remain overly optimistic. The MPC continues to forecast relatively high nominal wage growth of 3.7% in 2016; 4% in 2017 and 4.3% in 2018. A move back to these kinds of levels of growth seems overly optimistic and unlikely in the current climate.

6. The state of the economy

In August 2015, at the annual meeting of central bankers organised by the Kansas City Fed at Jackson Hole, Wyoming, the Governor of the Bank of England, said that 'sustained momentum' in the UK economy and rising inflation would 'likely put the decision as to when to start the process of gradual monetary policy normalisation into sharper relief around the turn of this year'.

But the UK economy seems to be slowing – and inflation has not picked up at all. So in a recent speech at Queen Mary, University of London, the Governor once again made an about-turn. 'It is clear to me that since last summer,' Mark Carney said, 'progress has been insufficient along these dimensions to warrant a tightening of monetary policy.' In large part, nominal wage growth failing to pick up has been a major contributor to the no rate rise decision in the last few MPC meetings.

The MPC seems confused as to why its forecasts on wage growth have been so overly optimistic. The November 2015 Inflation Report speculated as follows:

> 'Despite the pickup in wage growth over the past year, it remains some way below its pre-crisis average rate. That in part could be because the impact of the tightening labour market on wages has been slow to come through or has been masked. Job-to-job flows and resignations have remained relatively low which could be limiting the influence of starting salaries on average wage growth. …. As confidence in the job market among existing employees improves further,

[2] http://budgetresponsibility.org.uk/docs/dlm_uploads/EFO_November__2015.pdf
[3] http://budgetresponsibility.org.uk/docs/dlm_uploads/March2015EFO_18-03-webv1.pdf

> those higher starting salaries and the need to retain staff are likely to pull wage growth up further. The Bank's Agents report that some employers are intending to respond to recruitment difficulties by offering increased wages to new recruits and existing staff with key skills.'

The December 2015 MPC minutes a month later show that they remained confused.

> 'Despite lower unemployment, nominal pay growth appears to have flattened off recently. This could reflect short-term volatility in the data. But earnings per worker could be affected by changes in the mix of employment, including a fall in average hours, in which case the impact on unit labour costs would be limited. It could also be that lower headline readings of inflation have acted to limit recent nominal pay growth, despite the tightening labour market.'

7. Labour market slack

A good deal of the explanation of the MPC's overly optimistic predictions on what was going to happen to weekly earnings growth appears to come from their under-estimation of the level of slack in the UK labour market. In part this involves inappropriate downward adjustments, as explained in Bell and Blanchflower (2014).[4]

Chart 7 shows the Bell/Blanchflower underemployment index, which is still markedly higher than the unemployment rate. There is much more slack in the labour market than the MPC calculates. The latest estimate we have is the seasonally adjusted unemployment rate for the second quarter of 2015, which was 5.65% compared with 6.77% for the underemployment rate. This is well above full employment, not least because of the possibility that many more workers from Eastern Europe could potentially show up.

The fear that this might occur tends to keep wage growth down. The latest ONS labour market release shows that there were 982,000 workers employed in the UK from the A8 (Czech Republic; Estonia; Hungary; Latvia; Lithuania; Poland, Slovenia and Slovakia) and 219,000 from the A2 of Bulgaria and Romania.

But according to the Department for Work and Pensions, there have been a total of 2,341,845 National Insurance numbers allocated to nationals from the A8 and 579,791 to those from the A2, making 2,921,636 to the A10.[5] It is plausible that a very high proportion of these individuals had already had a spell of employment in the UK; higher wages and greater labour demand will likely attract them back. This acts to contain wages.

Chart 9 plots a plausible wage curve, which seems to describe well the relationship between labour market slack and wage growth in the UK. The chart plots wage growth against our measure of labour market slack – the underemployment rate. The function is flat at 2% as it has been since the underemployment rate was at its peak of around 11%. Wage growth does not rise, as drawn, until the underemployment rate, which is currently at 6.8% falls below 5%.

[4] This involves adjustments downward to the amount of unemployment due to the share of long-term unemployed, which they assert have less impact than the short-term unemployed. The Bank's own research, as published in Speigner (2104), shows that is mistaken. The MPC have also reduced the amount of underemployment by a half, which Bell and Blanchflower (2104) show is entirely inappropriate. If these adjustments were right they would predict rising wage growth.

[5] https://www.gov.uk/government/statistics/national-insurance-number-allocations-to-adult-overseas-nationals-to-september-2015

8. Conclusions

In historical context, the long and extended period of stagnant or falling real wages experienced by most UK workers since the onset of the financial crisis has been unprecedented. It is becoming increasingly difficult reasonably to envisage an end to this coming soon, in the current economic climate where nominal wage growth remains weak and where only very modest real wage growth has come about because of inflation falling below its 2% target level.

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Speigner, B (2014) 'Long-term Unemployment and Convexity in the Phillips Curve', Bank of England Working Paper No. 519, December.

Table 1. AWE annual growth rates, November 2014-November 2015, seasonally adjusted (%)

	Whole Economy	Private	Public	Services	Finance	Manufacturing	Construction	Wholesale Retail
Nov 14	2.0	2.5	0.7	2.2	2.8	1.2	3.2	2.0
Dec 14	2.5	2.9	0.9	2.5	4.0	2.1	3.4	2.0
Jan 15	1.5	1.7	0.8	1.9	1.0	0.3	-1.7	2.1
Feb 15	1.1	1.2	2.2	1.4	-0.8	0.0	1.4	4.8
Mar 15	4.4	5.7	0.6	4.7	5.2	2.1	6.0	7.1
Apr 15	2.7	3.1	0.9	2.8	5.0	1.7	3.3	3.6
May 15	2.8	3.3	1.1	2.9	3.2	1.0	6.1	4.4
Jun 15	2.3	2.5	1.0	2.4	1.4	1.7	2.2	4.2
Jul 15	3.6	4.3	1.0	3.7	4.4	1.7	6.8	5.6
Aug 15	3.2	3.6	1.2	3.2	3.3	1.7	6.6	4.5
Sep 15	2.1	2.3	1.5	2.1	1.3	1.2	5.1	2.9
Oct 15	1.9	2.1	1.4	1.8	1.3	1.5	6.9	2.9
Nov 15	2.0	2.2	1.5	1.9	1.9	1.2	5.6	3.2

Table 2. Pay settlements from XPertHR

3 months to the end of:	Dec-14	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec-15
Median increase by # reviews	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Median increase by # employees	2.0	6.3	6.3	6.3	2.3	2.3	3.0	3.0	2.7	1.0	2.5	1.0	3.0
Mean increase by # pay reviews	2.2	2.1	2.0	2.1	2.0	2.0	2.0	2.3	2.0	1.9	1.9	1.9	2.1
Upper quartile	3.0	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.4	2.5	2.6	3.0
Lower quartile	1.5	1.6	1.6	1.8	1.4	1.5	1.4	1.3	1.2	1.0	1.0	1.0	1.5
No. of pay reviews	127	380	386	405	599	606	597	149	155	178	142	111	66

12 months to the end of:	Dec-14	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec-15
Median increase	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Mean increase	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Upper quartile	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Lower quartile	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
No. of pay reviews	1385	1398	1405	1396	1386	1382	1360	1353	1323	1307	1270	1258	1246

Source: XPertHR Pay Settlement Report, 21st January 2016.

Table 3. Bank of England agents' scores for employment intentions

	Manufacturing	Business Services	Consumer Services	Total
Sep-14	0.8	1.9	1.0	1.5
Oct-14	0.8	1.5	0.9	1.2
Nov-14	0.6	1.5	0.9	1.2
Dec-14	0.3	1.7	0.9	1.3
Jan-15	0.2	1.5	0.9	1.2
Feb-15	0.2	1.2	0.9	1.1
Mar-15	0.2	1.4	0.9	1.2
Apr-15	0.3	1.5	1.0	1.3
May-15	0.4	1.5	1.1	1.3
Jun-15	0.5	1.5	1.3	1.4
Jul-15	0.4	1.4	1.3	1.3
Aug-15	0.4	1.4	1.0	1.2
Sep-15	0.3	1.2	0.8	1.0
Oct-15	-0.3	1.2	0.6	0.9
Nov-15	-0.5	1.1	0.6	0.9
Dec-15	-1.0	1.0	0.7	0.9

Table 4. Indicative projections of weekly earnings consistent with the MPC's modal projections (%).

	February 2014	May 2014	August 2014	November 2014	February 2015	May 2015	August 2015	November 2015
2014	2.75	2.50	1.25	1.25	1.75			
2015	3.75	3.50	3.25	3.25	3.50	2.50	3.00	2.50
2016	3.75	3.75	4.00	4.00	4.00	4.00	3.75	3.75
2017					4.00	4.00	4.25	4.00
2018								4.25

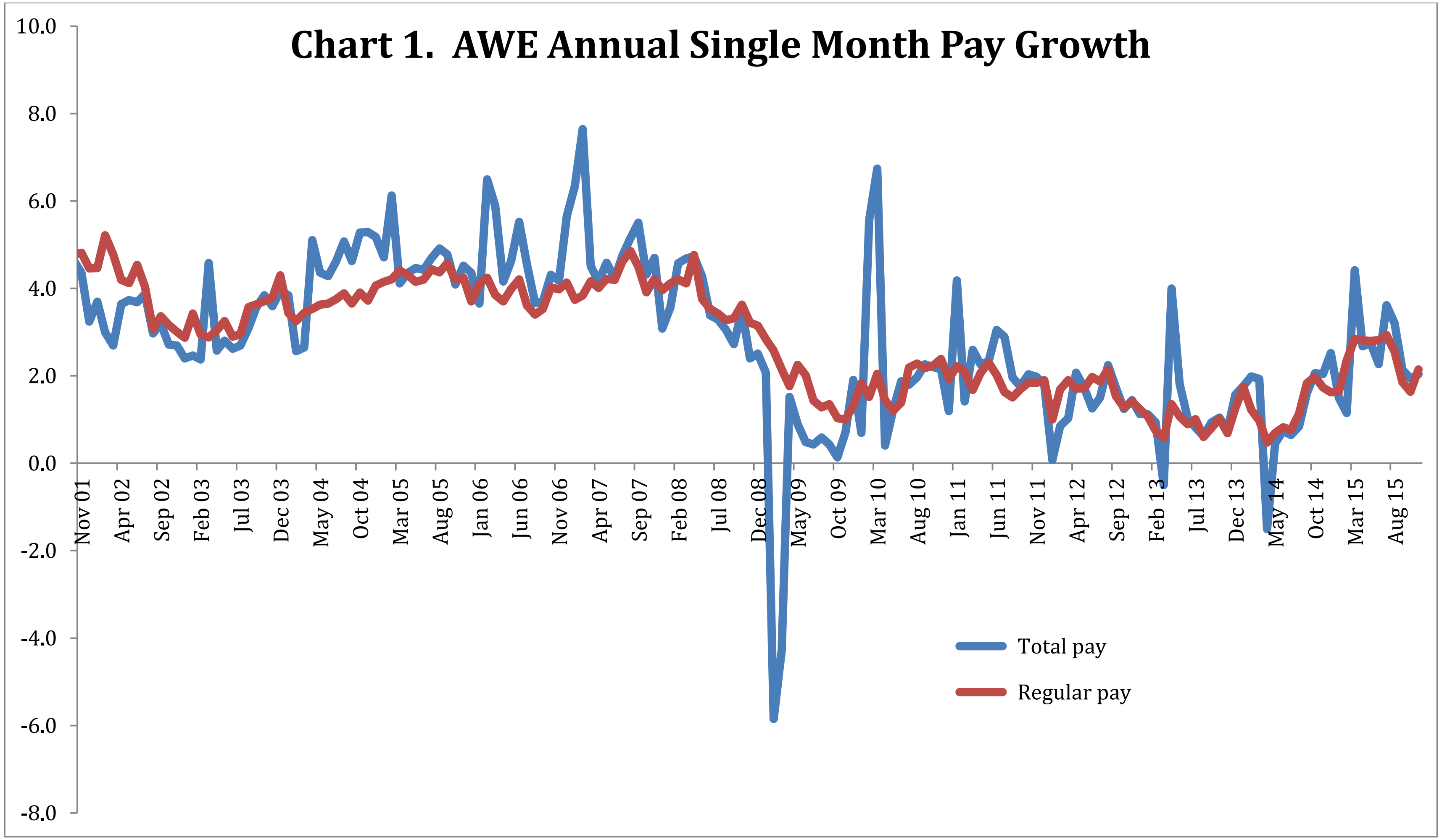

Chart 1. AWE Annual Single Month Pay Growth
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
-8.0
Nov 01
Apr 02
Sep 02
Feb 03
Jul 03
Dec 03
May 04
Oct 04
Mar 05
Aug 05
Jan 06
Jun 06
Nov 06
Apr 07
Sep 07
Feb 08
Jul 08
Dec 08
May 09
Oct 09
Mar 10
Aug 10
Jan 11
Jun 11
Nov 11
Apr 12
Sep 12
Feb 13
Jul 13
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May 14
Oct 14
Mar 15
Aug 15
Total pay
Regular pay

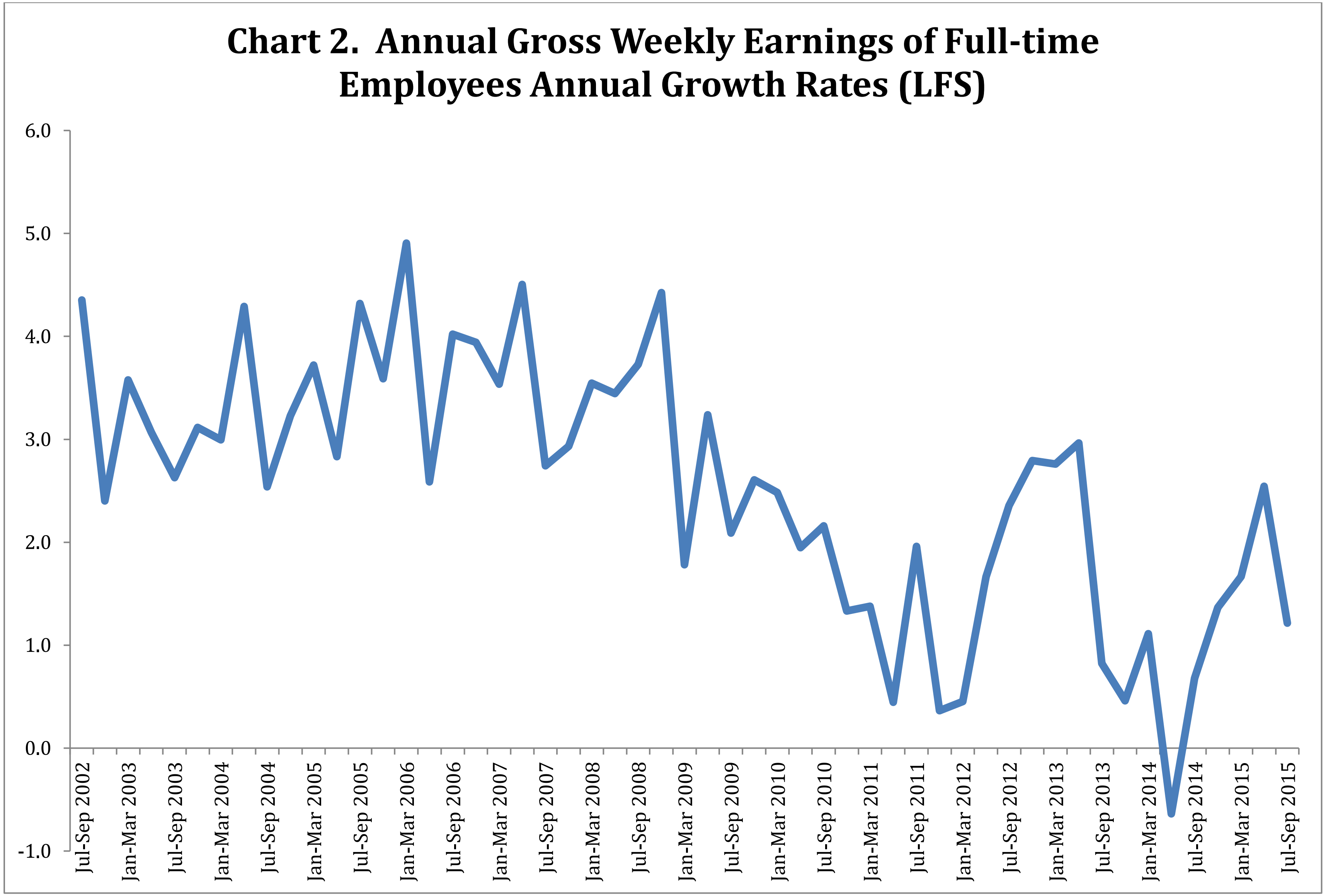
Chart 2. Annual Gross Weekly Earnings of Full-time Employees Annual Growth Rates (LFS)
6.0
5.0
4.0
3.0
2.0
1.0
0.0
-1.0
Jul-Sep 2002
Jan-Mar 2003
Jul-Sep 2003
Jan-Mar 2004
Jul-Sep 2004
Jan-Mar 2005
Jul-Sep 2005
Jan-Mar 2006
Jul-Sep 2006
Jan-Mar 2007
Jul-Sep 2007
Jan-Mar 2008
Jul-Sep 2008
Jan-Mar 2009
Jul-Sep 2009
Jan-Mar 2010
Jul-Sep 2010
Jan-Mar 2011
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Jan-Mar 2013
Jul-Sep 2013
Jan-Mar 2014
Jul-Sep 2014
Jan-Mar 2015
Jul-Sep 2015

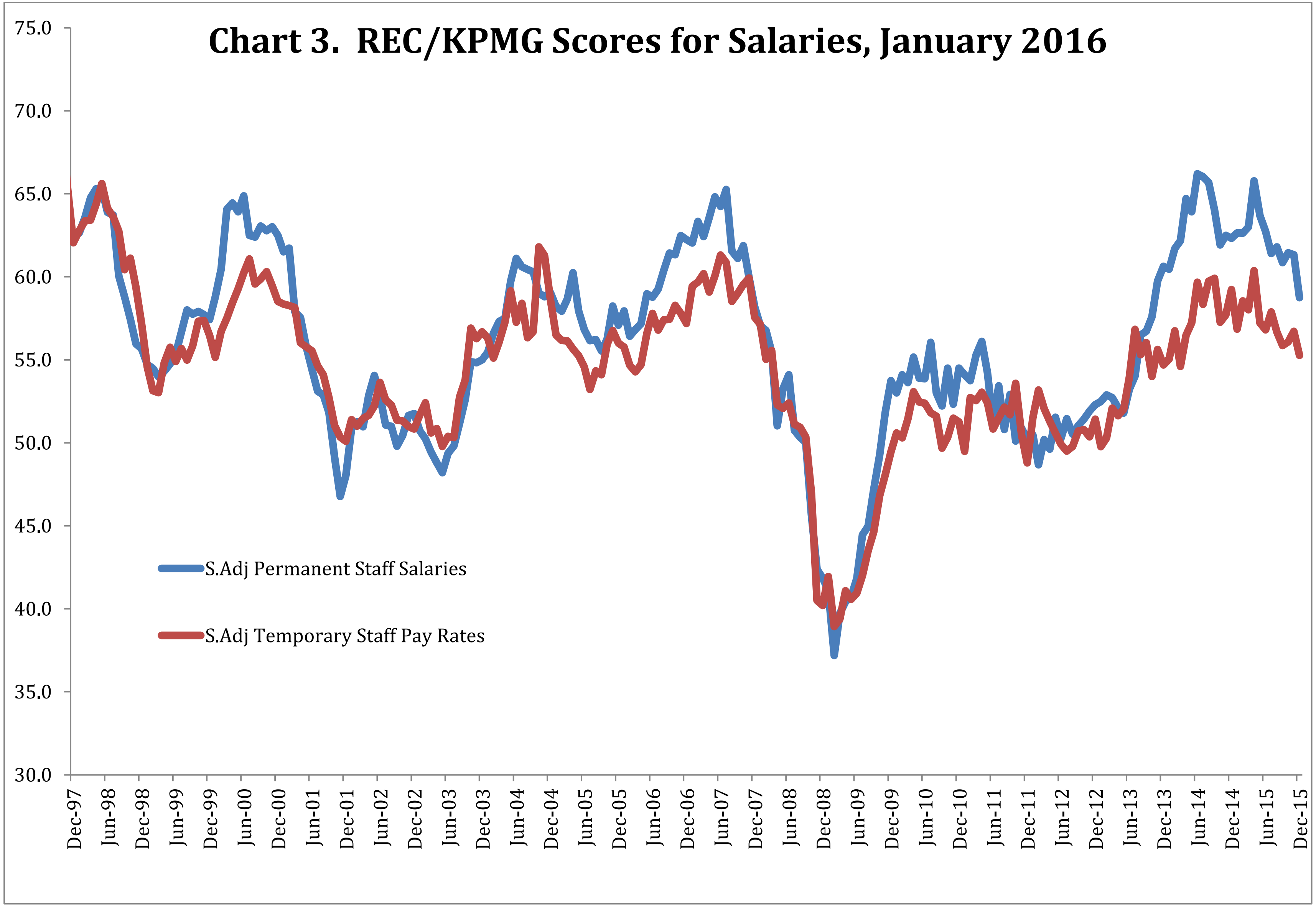
Chart 3. REC/KPMG Scores for Salaries, January 2016
75.0
70.0
65.0
60.0
55.0
50.0
45.0
40.0
35.0
30.0
S.Adj Permanent Staff Salaries
S.Adj Temporary Staff Pay Rates
Dec-97
Jun-98
Dec-98
Jun-99
Dec-99
Jun-00
Dec-00
Jun-01
Dec-01
Jun-02
Dec-02
Jun-03
Dec-03
Jun-04
Dec-04
Jun-05
Dec-05
Jun-06
Dec-06
Jun-07
Dec-07
Jun-08
Dec-08
Jun-09
Dec-09
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Dec-14
Jun-15
Dec-15

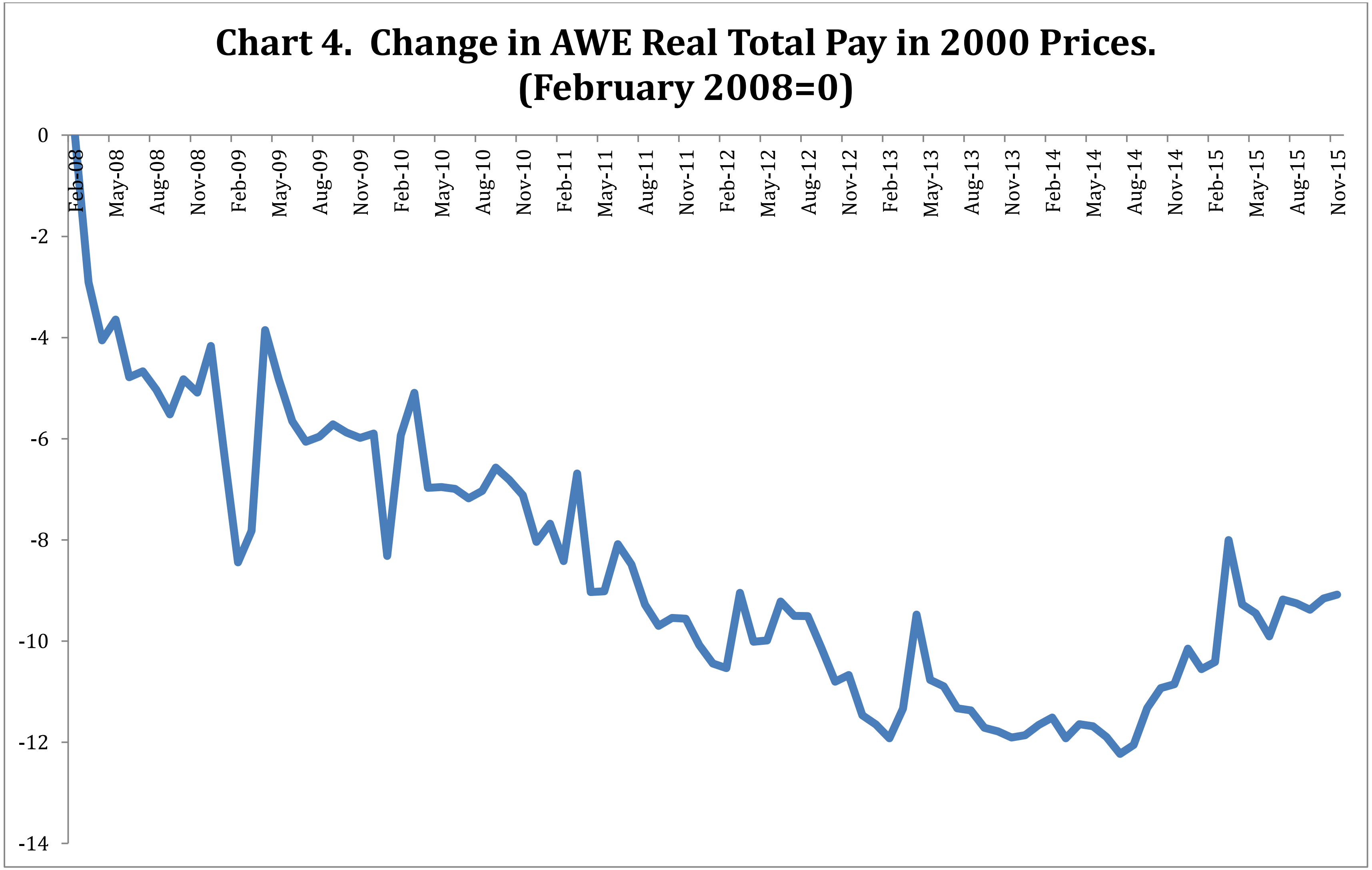
Chart 4. Change in AWE Real Total Pay in 2000 Prices.
(February 2008=0)
0
-2
-4
-6
-8
-10
-12
-14
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
May-12
Aug-12
Nov-12
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Feb-15
May-15
Aug-15
Nov-15

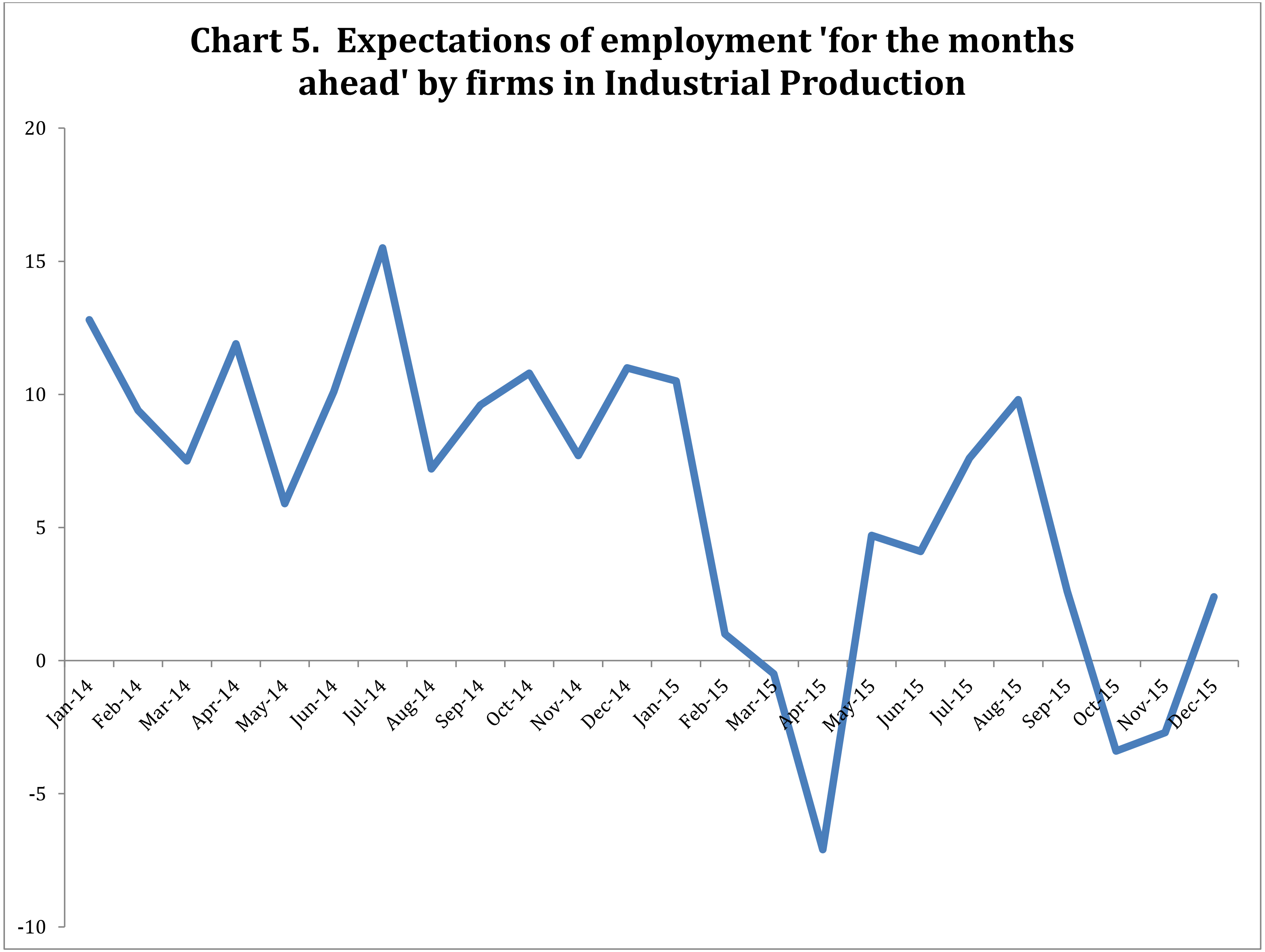
Chart 5. Expectations of employment 'for the months ahead' by firms in Industrial Production
20
15
10
5
0
-5
-10
Jan-14
Feb-14
Mar-14
Apr-14
May-14
Jun-14
Jul-14
Aug-14
Sep-14
Oct-14
Nov-14
Dec-14
Jan-15
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Sep-15
Oct-15
Nov-15
Dec-15

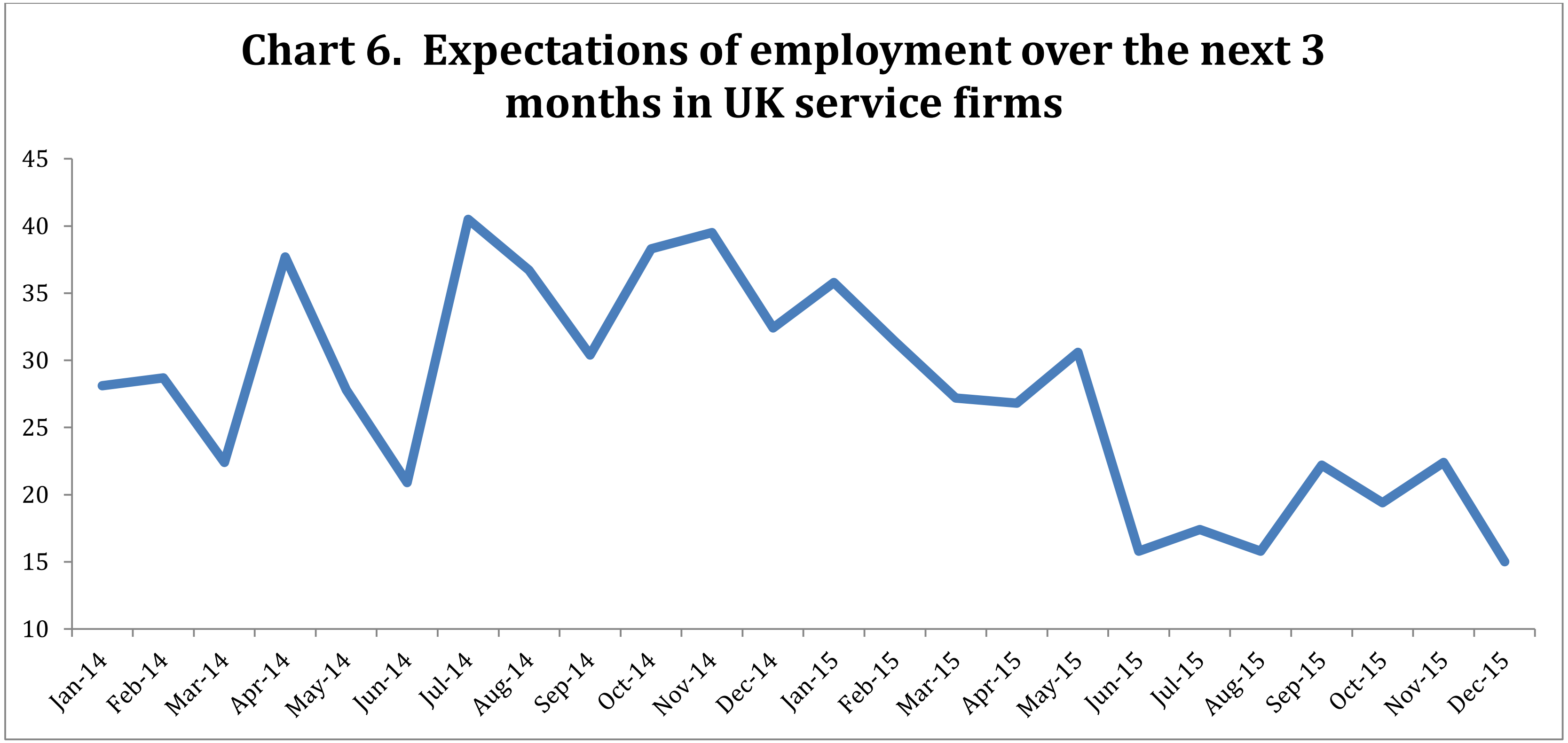
Chart 6. Expectations of employment over the next 3 months in UK service firms
45
40
35
30
25
20
15
10
Jan-14
Feb-14
Mar-14
Apr-14
May-14
Jun-14
Jul-14
Aug-14
Sep-14
Oct-14
Nov-14
Dec-14
Jan-15
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Apr-15
May-15
Jun-15
Jul-15
Aug-15
Sep-15
Oct-15
Nov-15
Dec-15

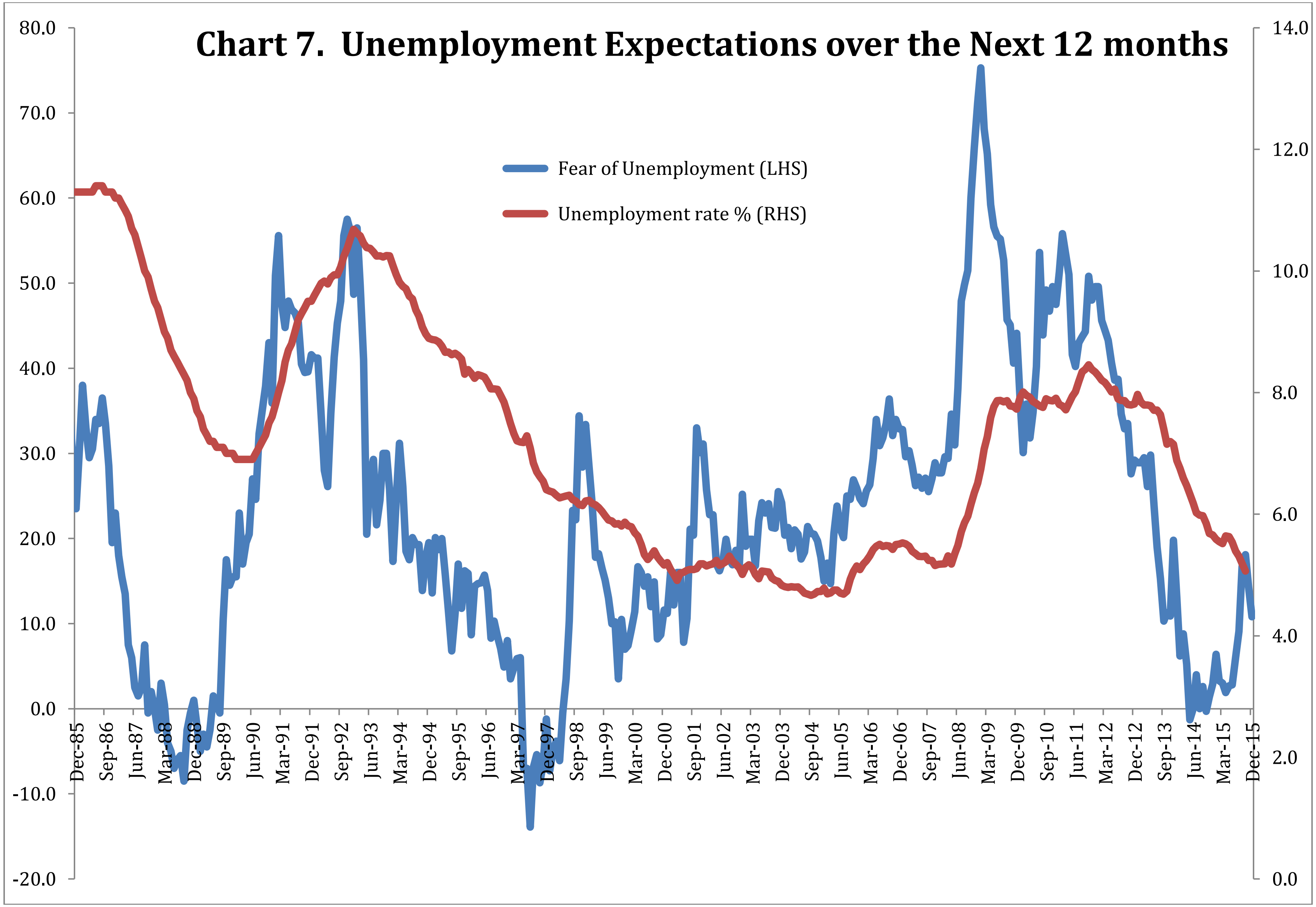
Chart 7. Unemployment Expectations over the Next 12 months
Fear of Unemployment (LHS)
Unemployment rate % (RHS)
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
-10.0
-20.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Dec-85
Sep-86
Jun-87
Mar-88
Dec-88
Sep-89
Jun-90
Mar-91
Dec-91
Sep-92
Jun-93
Mar-94
Dec-94
Sep-95
Jun-96
Mar-97
Dec-97
Sep-98
Jun-99
Mar-00
Dec-00
Sep-01
Jun-02
Mar-03
Dec-03
Sep-04
Jun-05
Mar-06
Dec-06
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Jun-14
Mar-15
Dec-15

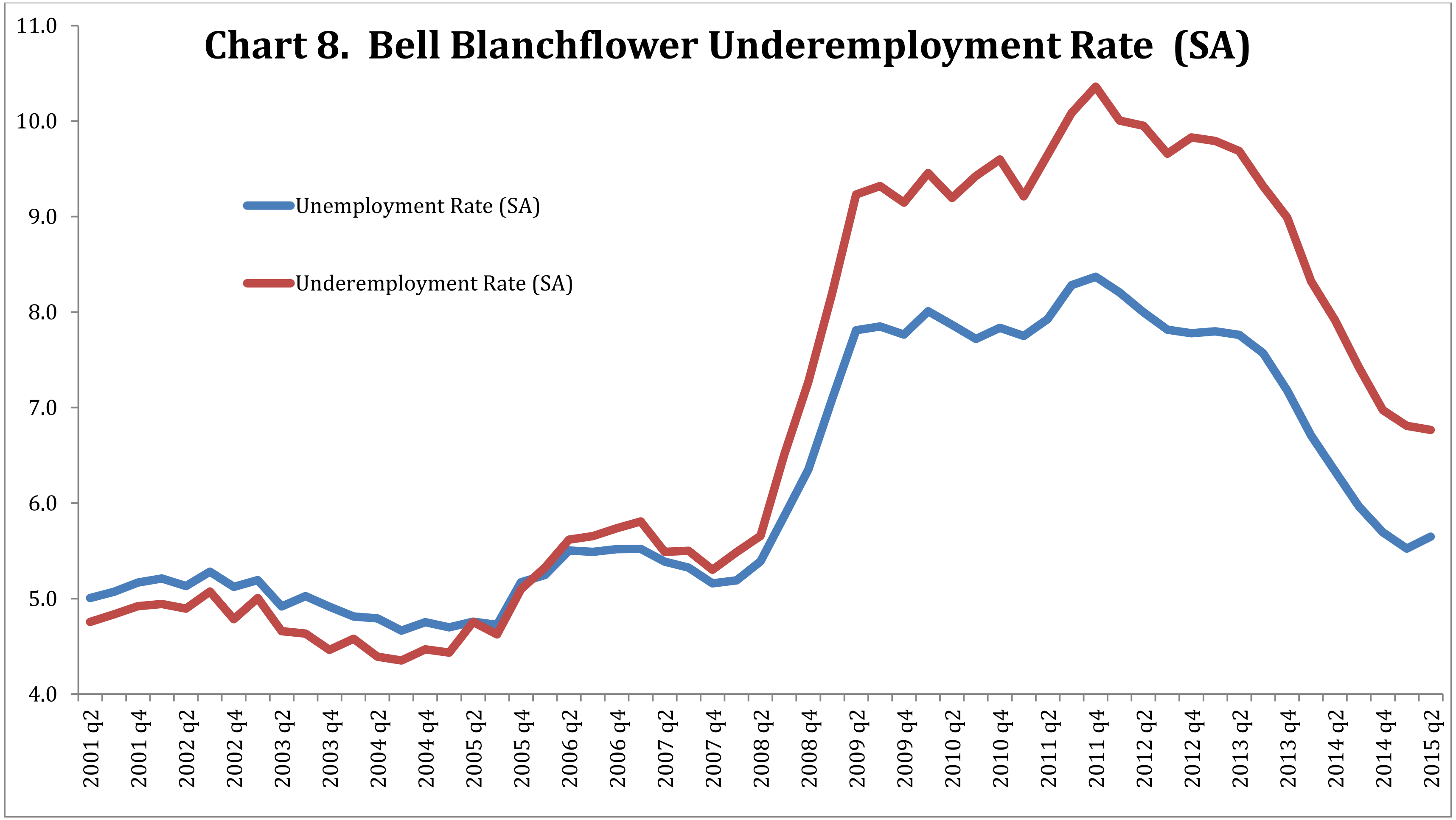

Chart 8. Bell Blanchflower Underemployment Rate (SA)
Unemployment Rate (SA)
Underemployment Rate (SA)
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
2001 q2
2001 q4
2002 q2
2002 q4
2003 q2
2003 q4
2004 q2
2004 q4
2005 q2
2005 q4
2006 q2
2006 q4
2007 q2
2007 q4
2008 q2
2008 q4
2009 q2
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2011 q2
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2012 q2
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2013 q2
2013 q4
2014 q2
2014 q4
2015 q2

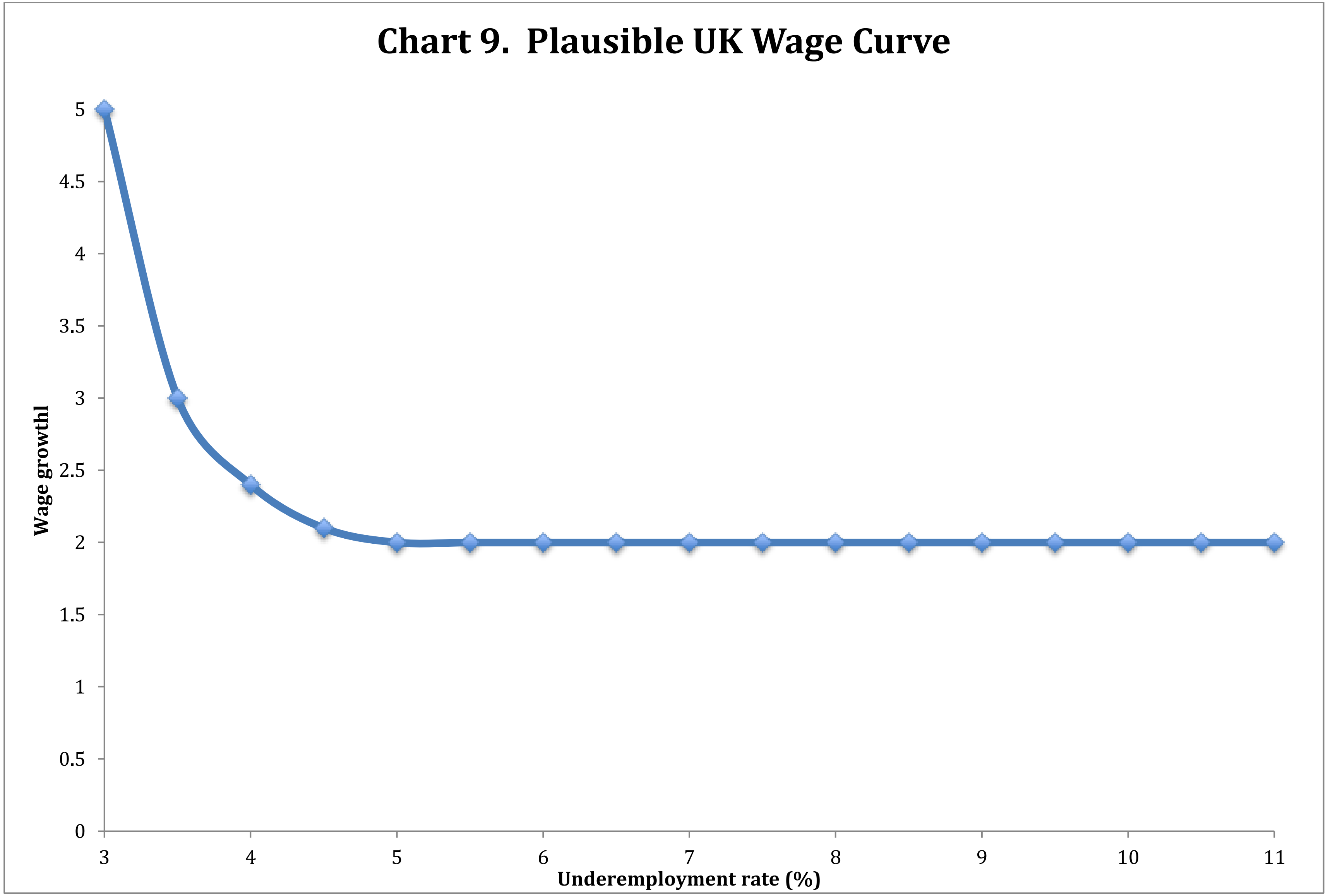
Chart 9. Plausible UK Wage Curve
Wage growthl
5
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
3
4
5
6
7
8
9
10
11
Underemployment rate (%)