National Institute
Monthly Wage Tracker

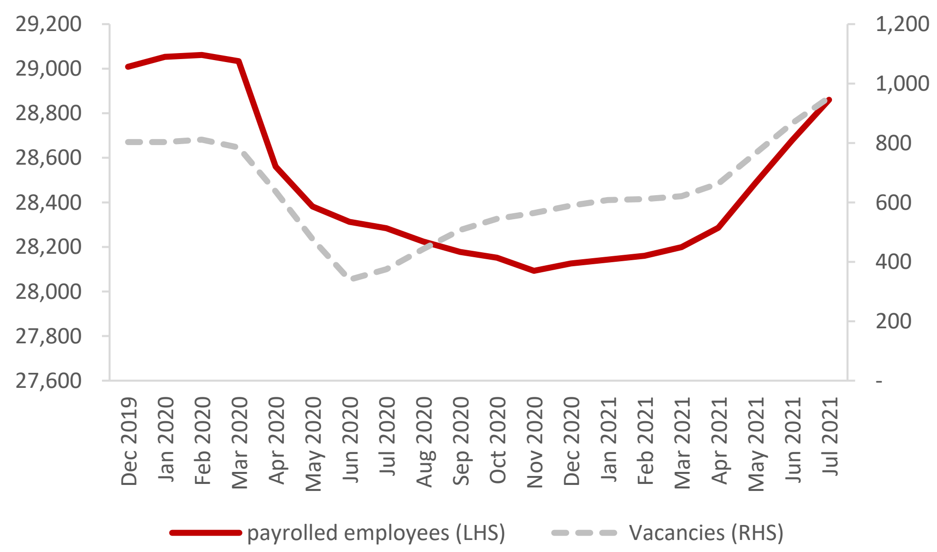
Tuesday 17 August 2021

The U-shape recovery of the labour market

Main points

- The labour market recovery is in a U shape, with the number of payrolled employees higher than in April 2020 and the number of vacancies at a record high of 953,000.
- A robust growth of labour demand and limited candidate availability are creating temporary labour shortages in some industries like health and social work, finance and insurance, and public administration.
- Employment fell during the pandemic because people dropped out of the labour force.
- Average weekly earnings should ease from 8.8 per cent in the second quarter to 5.5 per cent in the third quarter as base effect dissipates.
- Underlying wage growth which excludes base and compositional effects increased to 4.0 per cent in the three months to June, up from 3.8 per cent in the three months to May.

Figure 1: The U-shape recovery in the labour market



Source: HMRC and ONS. In Thousands

"The U-shaped recovery in the labour market is causing labour shortages in some industries like health and social work and wage inflation. Underlying wage growth increased to 4 per cent in the three months to June. With consumer price inflation rising and expected to reach also 4 per cent at the beginning of next year, there is a risk that price inflation feeds into wage inflation. The Bank of England should monitor the situation carefully to prevent in a wage-price spiral."

Cyrille Lenoël
Principal Economist, NIESR

Employment

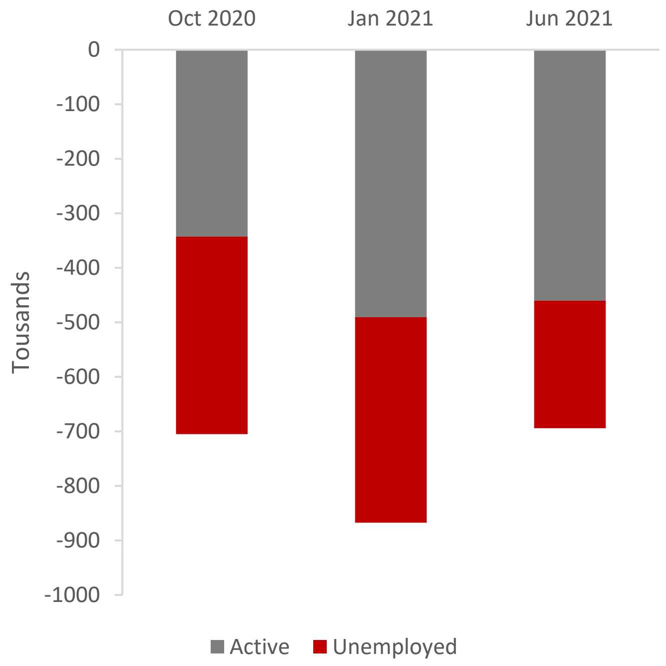
The latest data from the Labour Force Survey show that the labour market is continuing to recover from the pandemic, with employment, vacancies and wages all increasing. The recovery, driven by improved confidence and the reopening of sectors of the economy, is broad-based across age groups, industries and regions. **The labour market recovery now displays a U shape, with the number of payrolled employees higher than in April 2020 and the number of vacancies at a record high** (see Figure 1).

The UK employment rate increased to 75.1 per cent in the three months to June, 0.3 percentage points higher than the previous quarter, but still 1.5 percentage points lower than before the pandemic (December 2019 to February 2020). Before the latest pick-up, the employment rate had steadily declined from 76.6 per cent in the three months to February 2020 to 74.6 per cent in the three months to January 2021. Early estimates suggest that **the good momentum in the labour market continued in July,** with payrolled employment increasing in July by 182,000 to 28.9 million (Figure 1), and vacancies reaching a new record high.

The number of unemployed people declined moderately by 57,000 in the three months to June compared to the previous three-month period, bringing total unemployment to 1,564,000 and the unemployment rate to 4.8 per cent. Thanks to supportive labour market policies – in particular the furlough scheme - the unemployment rate has only moderately increased during the pandemic, from 4.0 per cent at its onset to a peak of 5.3 per cent in the fourth quarter of 2020, declining since then.

Employment fell during the pandemic because people dropped out of the labour force. Since the beginning of the pandemic, employment has declined by 694,000. Most of this decline can be attributed to people dropping out of the labour force, rather than a rise in unemployment: Figure 2 decomposes the decline in employment since February 2020. In June, the number of economically active people was 460,000 fewer than in February 2020, while the number of unemployed increased by only 234,000 over the same period.

Figure 2: The fall in employment since February 2020 is explained largely by a reduction in the economically active, rather than a rise in unemployment



Source: ONS, NIESR calculations

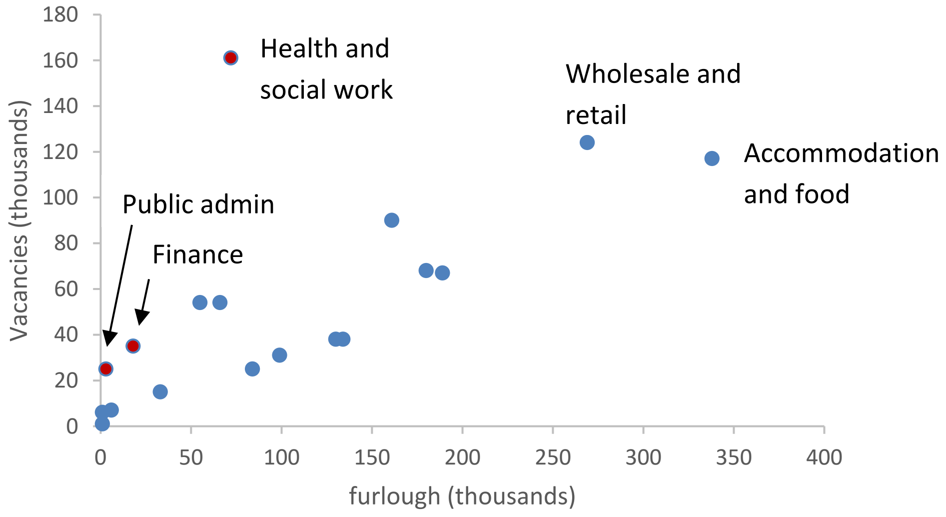
Consistent with a rise in employment, **the number of workers on furlough is fast decreasing.** It is estimated to have decreased from 5.1 million in January to 1.9 million at the end of June thanks to the progressive lifting of restrictions. As explained in NIESR's UK Summer Economic Outlook, we expect that about 150,000 people will move from furlough to unemployed when the furlough scheme expires in September.

A record level of vacancies illustrates labour shortage in industries like health and social work. The return of business confidence following the lifting of restrictions led to a sharp increase in vacancies reaching 953,000 in the three months to July, having grown by 290,000 compared with the previous quarter, and the highest level since at least 2001. Vacancies increased in all industries, with the largest increase in arts, entertainment and recreation.

The rise in vacancies suggests that the return of workers from furlough has not been enough to accommodate the recovery in labour demand. The stock of nearly two million workers still on furlough suggests that there is room for employers to respond to further increases in business activity by taking back workers that were on furlough, but there may still be a mismatch between the sectors that are hiring and the skills of the people in furlough.

Figure 3 compares vacancies and furlough by sectors. In a balanced labour market, the number of vacancies and furlough would correlate well. The excess labour in accommodation and food that was apparent in June has diminished in July thanks to the reduction of the number of employees on furlough in that sector from 590,000 to 338,000. But there remain clear labour shortages in the industries of Health and Social Work, Finance and Insurance, and Public administration, where the number of vacancies exceed the number of furloughed workers.

Figure 3: The (mis)match between vacancies and furlough by industries



Note: Vacancies from ONS and furlough from HMRC. Vacancies are for July, and furlough for end of June. Red dots are the industries with labour shortages defined as more vacancies than furlough.

Pay

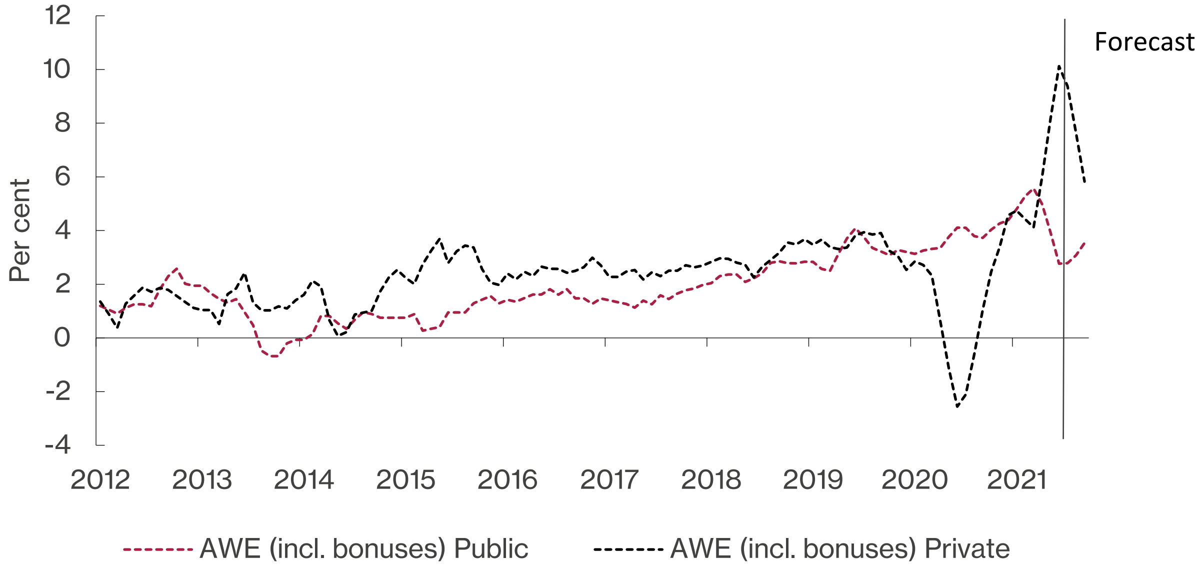
Average weekly earnings including bonuses (AWE) in Great Britain increased sharply in the three months to June to 8.8 per cent compared to a year ago, up from 5.8 per cent in the three months to April. This is slightly higher than the 8.5 per cent that we had forecasted in the July Wage Tracker and was driven by a 10.1 per cent growth in private sector AWE.

The compositional affect on earnings that had emerged during the pandemic has now virtually disappeared. The latest ONS estimate gives a compositional effect on AWE of only 0.1 percentage point in the three months to June. The compositional effect is the fact that AWE increases because of a smaller proportion of lower-paid people in the wage sample. During the pandemic, lower-paid people were at greater risk of losing their jobs, and generally received a smaller pay increase.

Our estimate of underlying wage growth which excludes base and compositional effects increased to 4.0 per cent in the three months to June, up from 3.8 per cent in the three months to May. Using the same methodology as described in the June Wage Tracker, we estimate that the base effect accounts for 4.7 percentage points in AWE growth.

The acceleration in underlying wage growth is proof that the labour market is becoming tighter, even if the economy is far from full employment. The KPMG and REC UK Report on Jobs points to a decrease in candidate availability to explain the rise in wages, in particular for new recruits. The end of the furlough scheme in September will increase candidate availability and reduce pressure on wages, but strong wage growth could continue if there is a persistent mismatch between the skills of the labour force and the demand of new jobs. There is also the risk that rising consumer price inflation, which we expect to reach 4 per cent at the beginning of next year, feeds into wage inflation.

Figure 4: public and private sector average weekly earnings (including bonuses)



Source: ONS and NIESR forecast

The base effect should decline from July on, causing AWE to decelerate from 8.8 per cent in the second quarter of 2021 to 5.5 per cent in the third quarter. The split between public and private AWE is displayed in Figure 4 and in Table 1.

Table 1 - Summary table of earnings growth

	Average Weekly Earnings					
	Whole economy		*Private sector*		*Public sector*	
Latest weights	*100*		*82*		*18*	
	Regular	*Total*	*Regular*	*Total*	*Regular*	*Total*
Jan-20	511	545	504	544	547	549
Feb-20	512	546	504	544	548	551
Mar-20	510	542	502	538	550	552
Apr-20	502	527	490	520	559	562
May-20	503	528	490	520	566	569
Jun-20	505	530	492	521	566	568
Jul-20	512	539	501	536	563	563
Aug-20	518	551	508	551	563	565
Sep-20	524	560	514	554	568	569
Oct-20	528	563	518	559	567	569
Nov-20	531	567	522	565	570	573
Dec-20	534	569	525	570	571	574
Jan-21	533	569	523	566	577	578
Feb-21	535	567	525	564	580	584
Mar-21	536	568	526	563	579	582
Apr-21	540	572	531	571	579	582
May-21	540	575	532	573	579	585
Jun-21	541	576	533	575	579	579
Jul-21	543	578	535	577	581	583
Aug-21	545	580	537	579	584	586
Sep-21	546	582	538	581	586	588
% change 3 month average year on year						
Jan-20	3.1	3.1	3.0	2.8	3.2	3.1
Feb-20	2.9	2.8	2.8	2.7	3.2	3.3
Mar-20	2.5	2.5	2.4	2.3	3.3	3.3
Apr-20	1.6	1.1	1.3	0.6	3.4	3.4
May-20	0.6	-0.2	0.0	-1.1	3.8	3.8
Jun-20	-0.2	-1.3	-1.1	-2.6	4.2	4.1
Jul-20	0.2	-1.1	-0.8	-2.1	4.5	4.1
Aug-20	0.9	0.1	0.1	-0.6	4.2	3.8
Sep-20	2.0	1.4	1.4	1.0	4.1	3.7
Oct-20	2.9	2.8	2.5	2.5	4.0	4.0
Nov-20	3.6	3.7	3.3	3.4	4.2	4.3
Dec-20	4.1	4.6	3.9	4.6	4.1	4.4
Jan-21	4.3	4.8	4.0	4.7	4.7	4.8
Feb-21	4.4	4.5	4.1	4.4	5.2	5.3
Mar-21	4.6	4.3	4.2	4.1	5.5	5.6
Apr-21	5.7	5.7	5.7	6.0	4.9	5.0
May-21	6.7	7.4	7.2	8.2	3.7	3.9
Jun-21	7.4	8.7	8.4	10.1	2.7	2.8
Jul-21	6.8	8.3	7.9	9.4	2.6	2.8
Aug-21	6.1	7.0	6.9	7.6	3.1	3.1
Sep-21	5.1	5.5	5.7	5.8	3.4	3.5
% change month on same month of previous year						
Jan-20	2.6	3.0	2.6	3.0	3.0	3.0
Feb-20	2.8	2.8	2.6	2.6	3.4	3.6
Mar-20	2.2	1.7	2.0	1.3	3.6	3.4
Apr-20	-0.2	-1.1	-0.8	-2.1	3.1	3.1
May-20	-0.2	-1.3	-1.2	-2.6	4.8	4.8
Jun-20	-0.2	-1.5	-1.4	-3.0	4.6	4.4
Jul-20	1.0	-0.4	0.2	-0.7	4.1	3.1
Aug-20	2.0	2.0	1.4	1.8	3.9	3.9
Sep-20	2.9	2.6	2.6	2.0	4.4	4.2
Oct-20	3.7	3.9	3.4	3.5	3.8	4.0
Nov-20	4.1	4.6	4.0	4.6	4.2	4.6
Dec-20	4.5	5.4	4.4	5.6	4.4	4.6
Jan-21	4.3	4.4	3.8	4.0	5.5	5.3
Feb-21	4.5	3.8	4.2	3.7	5.8	6.0
Mar-21	5.1	4.8	4.8	4.6	5.3	5.4
Apr-21	7.6	8.5	8.4	9.8	3.6	3.6
May-21	7.4	8.9	8.6	10.2	2.3	2.8
Jun-21	7.1	8.7	8.3	10.4	2.3	1.9
Jul-21	6.0	7.3	6.7	7.6	3.3	3.6
Aug-21	5.1	5.3	5.6	5.1	3.7	3.7
Sep-21	4.3	3.9	4.7	4.8	3.1	3.3

Health warning

NIESR's Wage Tracker includes predictions for regular pay and bonus payments for the whole economy, as well as forecasts for private and public sector wages. The Wage Tracker exploits information from key macroeconomic indicators, including labour market trends, building also on information from monthly GDP nowcasts produced by NIESR's GDP Tracker and survey evidence, such as labour costs in the manufacturing and service sectors from the Bank of England Agents Score. The wage models also capture the interaction between private and public pay, shown to be relevant in work done by NIESR.

To check how our methodology would work in real time we have produced judgement-free forecasts of earnings growth for the period between 2010M07 and 2018M10. For whole economy earnings, the root mean square error is 0.2 per cent points for the measure excluding bonuses and 0.4 per cent points for the measure including bonuses. So, on average, our projections are likely to have an error of 0.2/0.4 percentage points above or below the forecasts we publish. These numbers indicate the degree of uncertainty around the point forecasts produced by the models at each point in time. The errors are greater for the measure of earnings including bonuses because bonus payments, particularly in the private sector, are subject to short-term volatility. In practice, we add residuals reflecting our judgement so the error bands may be larger or smaller.

Forecast schedule

The NIESR Wage Tracker provides a rolling monthly forecast for earnings growth. The ONS produces an estimate of Average Weekly Earnings (AWE) for any particular quarter some 40 days after the end of the quarter. The NIESR Wage Tracker will publish AWE forecasts 5 months ahead of the ONS release for the reference quarter, updating that forecast four times before the official data is out, similar to the monthly GDP Tracker schedule.

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