National Institute of Economic and Social Research

NIESR Monthly Wage Tracker

Inflation and Tax Rises Will Erode Record Earnings Growth

Cyrille Lenoël

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"The exceptional real earnings gain of 3.6 per cent in 2021 is unlikely to last into next year because it reflects a combination of statistical effects (compositional and base effects). Unless there is an acceleration in underlying wage growth, rising inflation will reduce any real wage gains next year, and households' income will be further squeezed by the rise in national insurance contributions."

Cyrille Lenoël
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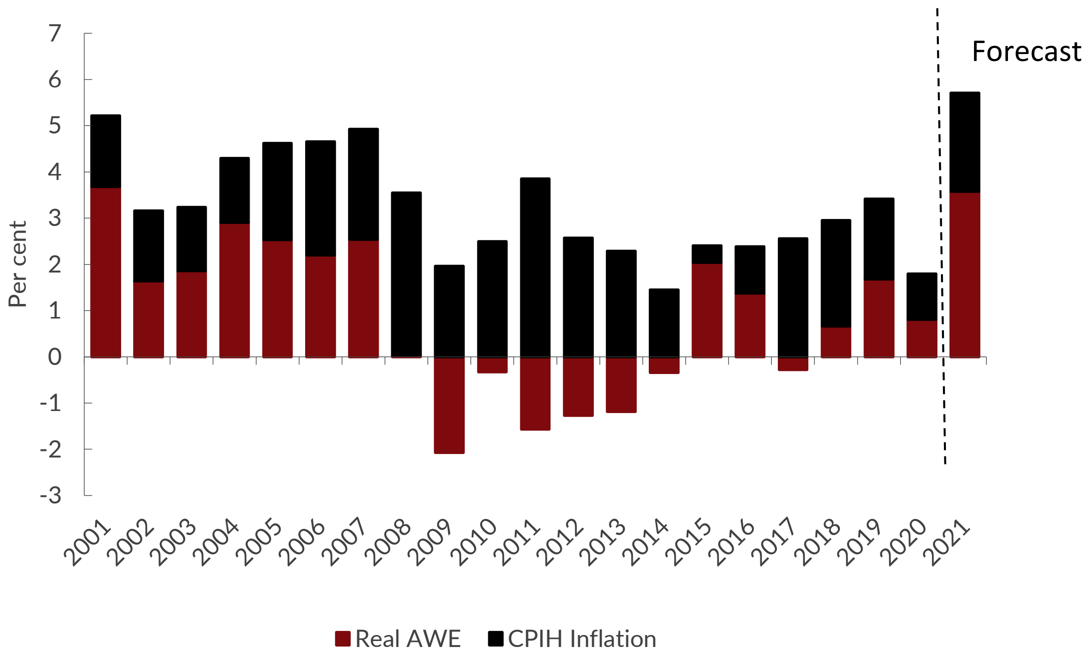
Main Points

- We expect weekly earnings annual growth to average 5.7 per cent in 2021 – the highest in two decades - and 3.6 per cent in real terms, after 1.8 per cent (nominal) and 0.8 per cent (real) in 2020.
- The strength of AWE is explained by high bonuses, robust public sector pay growth and a cyclical recovery exaggerated by compositional effects and increased weekly average hours due to the end of furlough.
- The growth rate in average weekly earnings including bonuses (AWE) in Great Britain decreased in the three months to September to 5.8 per cent compared to a year ago, down from 8.8 per cent in the three months to June. This is in line with what we forecast last month and reflects a smaller impact of base effects.
- We forecast average weekly earnings to decelerate further to 4.1 per cent in the fourth quarter as the base effect fully dissipates.
- The rise in inflation will mean close to zero average real earnings growth next year if there is no significant increase in underlying wage growth.
- 8 out of 10 people who became unemployed during the pandemic have returned to employment, but some of them in temporary or zero-hours contracts.

Figure 1: Average weekly earnings (incl. bonuses), real and inflation components



Source: ONS, NIESR calculations and forecast

Pay

The growth rate in average weekly earnings including bonuses (AWE) in Great Britain decreased in the three months to September to 5.8 per cent compared to a year ago, down from 8.8 per cent in the three months to June. This is in line with our forecast last month and was driven by 6.6 per cent growth in private sector AWE, compared to only 2.5 per cent growth in public sector AWE. We estimate that excluding base effects, underlying earnings growth stands at around 4.2 per cent.

While there is currently **no generalized acceleration in settlement pay** (see Box C by Jack Kennedy in our Autumn UK Economic Outlook), there is evidence of **higher starting salaries for new recruits**, particularly in sectors experiencing labour shortages. The record level of vacancies of 1.2 million suggests a persistent mismatch between labour force skills and the post-pandemic pattern of labour demand. The 12-month rate of consumer price inflation (CPIH) rose from 0.7 per cent in February to 3.0 per cent in August, and is expected to reach 4 per cent by the beginning of 2022 according to NIESR's Autumn UK Economic Outlook. **The combination of a tighter labour market and rising inflation should result in higher wages**. We forecast adjusted AWE to increase from 4.2 per cent in the third quarter to 4.5 per cent in the fourth quarter.

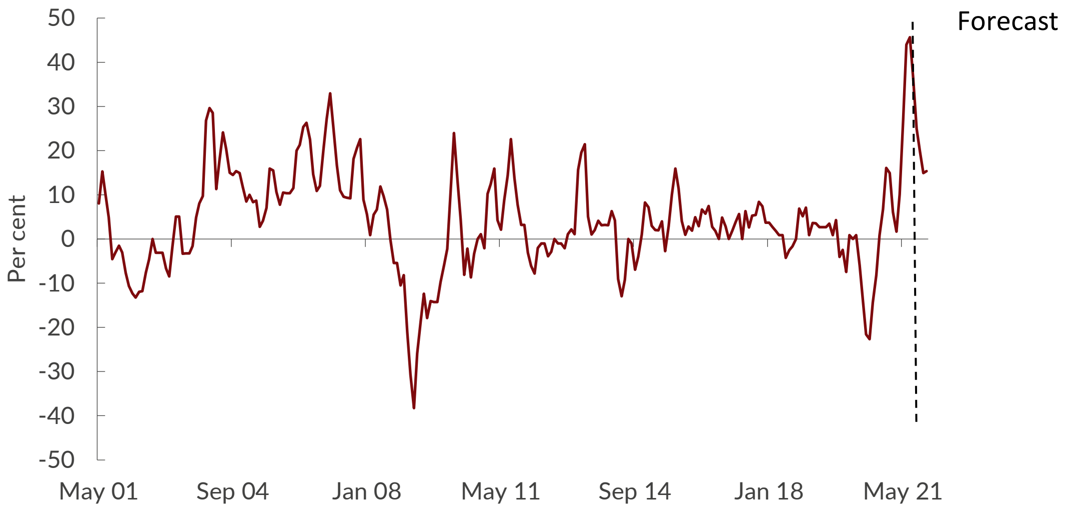
Over the whole year, we expect weekly earnings annual growth to average a record 5.7 per cent in 2021[1] and 3.6 per cent in real terms, after 1.8 (nominal) and 0.8 per cent (real) in 2020 (see Figure 1).

One important contributor to high earnings growth this year is private sector bonuses. While bonuses tend to be volatile because they depend on market conditions, there was a clear increase in bonuses this year (see Figure 2). Higher bonuses partly reflecting buoyant business conditions and reports of signing on bonuses.

Base effect will disappear in October-November. We forecast headline AWE growth to decrease from 5.8 per cent in the third quarter to 4.1 per cent in the fourth quarter (see Table 1).

[1] A record since 2000 when the ONS survey began

Figure 2: Private sector bonuses, 3m on 3m annual growth rate



Source: ONS, NIESR calculations

The exceptional real pay gains of 3.6 per cent in 2021 are unlikely to last into next year because they reflect a combination of statistical effects (compositional and base effects). CPIH inflation is expected to more than double from 2.1 per cent in 2021 to 4.4 per cent in 2022 according to our Autumn UK Economic Outlook. **Unless there is an acceleration in underlying pay growth, rising inflation will reduce any real wage gains next year, and households' income will be further squeezed by the rise in national insurance contributions.**

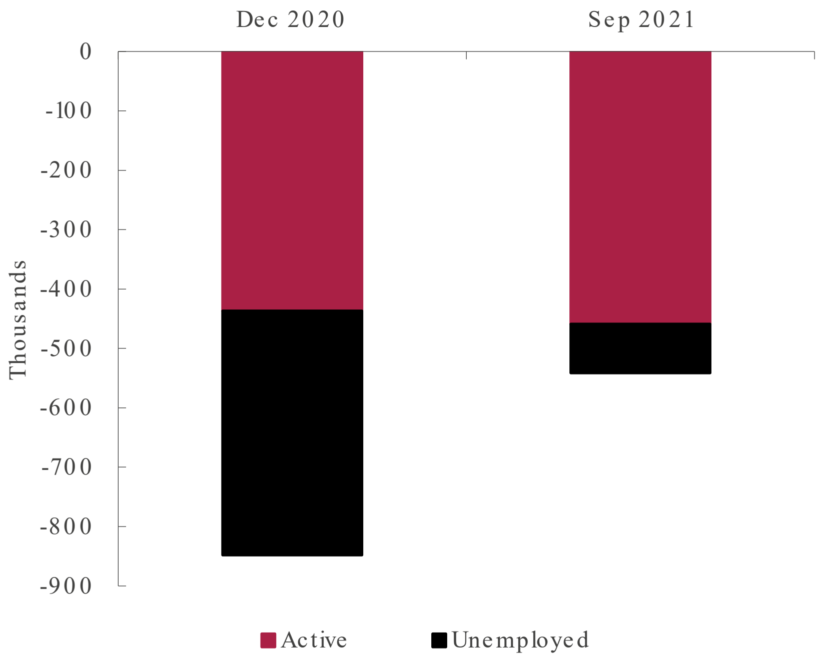
Employment

The latest data from the Labour Force Survey show that the labour market continues 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 is U-shaped, with the number of payrolled employees in September reaching a record 29.3 million and the number of vacancies also at a record high of 1.2 million.** It should be noted that those numbers don't yet reflect the end of the furlough scheme.

8 out of 10 people that became unemployed during the pandemic have returned to some form of employment. The number of unemployed peaked at 1.7 million in the 3 months to December 2020 and has declined to 1.4 million in the 3 months to September 2021. If we compare to the pre-pandemic level (1.3 million in the 3 months to February 2020), this means that in aggregate only 2 tenth of the extra unemployment remains. Aggregate numbers of course do not tell us about the quality of the jobs returned to, and we know from surveys that a significant part of the jobs returned to are part-time jobs and zero hours contract.

The reduction in participation seems to be persistent. A more worrying side of the labour market recovery is that participation is staying at lower levels compared to pre-pandemic. As Figure 3 shows, while the number of unemployed has decreased, the number of active people has continued to decrease since December 2020. The number of active people is now 460,000 lower than in February. The people who left the active labour force will need to be attracted back by jobs with better wages and working conditions.

Figure 3: Decomposition of the drop in employment since February 2020, between a reduction in economically active and a rise in unemployed



Source: ONS, NIESR calculations

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***
Jul-20	512	540	501	535	562	564
Aug-20	518	550	508	549	563	565
Sep-20	524	559	514	555	568	571
Oct-20	528	563	518	559	567	570
Nov-20	531	567	522	565	570	573
Dec-20	534	569	525	570	571	574
Jan-21	533	568	523	566	577	578
Feb-21	535	567	525	563	580	584
Mar-21	536	568	526	563	579	582
Apr-21	540	572	531	571	579	581
May-21	540	575	532	574	579	582
Jun-21	541	577	533	577	579	581
Jul-21	542	579	534	580	578	580
Aug-21	544	582	536	584	578	581
Sep-21	544	584	537	583	577	581
Oct-21	546	588	539	589	579	581
Nov-21	548	590	541	591	580	585
Dec-21	550	592	543	593	582	585
% change 3 month average year on year						
Jul-20	0.2	-1.0	-0.8	-2.1	4.4	4.2
Aug-20	0.9	0.1	0.1	-0.7	4.1	3.8
Sep-20	2.0	1.4	1.4	0.9	4.1	3.8
Oct-20	2.9	2.7	2.5	2.4	4.0	4.2
Nov-20	3.6	3.6	3.3	3.5	4.2	4.4
Dec-20	4.1	4.6	3.9	4.6	4.1	4.4
Jan-21	4.3	4.7	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	5.9	4.9	5.1
May-21	6.7	7.4	7.2	8.2	3.7	3.9
Jun-21	7.4	8.8	8.4	10.2	2.8	2.8
Jul-21	6.8	8.3	7.8	9.8	2.5	2.5
Aug-21	6.0	7.3	6.8	8.4	2.7	2.6
Sep-21	4.9	5.8	5.5	6.6	2.4	2.5
Oct-21	4.1	4.9	4.7	5.6	2.1	2.1
Nov-21	3.5	4.3	4.1	5.0	1.8	1.9
Dec-21	3.2	4.1	3.7	4.7	1.9	2.0
% change month on same month of previous year						
Jul-20	1.0	-0.2	0.2	-0.9	3.9	3.1
Aug-20	2.0	1.9	1.4	1.5	3.9	3.7
Sep-20	2.9	2.4	2.6	2.2	4.4	4.6
Oct-20	3.7	3.9	3.4	3.5	3.8	4.2
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	4.2	3.8	4.0	5.5	5.3
Feb-21	4.5	3.8	4.2	3.5	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	3.8
May-21	7.4	8.9	8.6	10.4	2.3	2.5
Jun-21	7.1	8.9	8.3	10.5	2.5	2.1
Jul-21	5.9	7.2	6.6	8.4	2.8	2.8
Aug-21	5.0	5.8	5.5	6.4	2.7	2.8
Sep-21	3.8	4.5	4.5	5.0	1.6	1.8
Oct-21	3.4	4.4	4.1	5.4	2.1	1.9
Nov-21	3.2	4.1	3.7	4.6	1.8	2.2
Dec-21	3.0	4.0	3.5	4.1	1.9	1.9

Caveat

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.

Notes for editors: For further information please contact the NIESR Press Office: press@niesr.ac.uk or Luca Pieri on 020 7654 1954 / l.pieri@niesr.ac.uk

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