National Institute of Economic and Social Research

NIESR Monthly Wage Tracker

Spring Budget Should Include a Public Sector Wage Rise

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"Today's figures suggest that economy-wide average weekly earnings, excluding bonuses, grew by 6.5 per cent in the three months to January, 0.2 percentage points lower than last month. This fall in AWE growth - after a year of sustained rises - can be attributed to a larger-than-expected decrease in private-sector regular AWE growth, which fell from 7.3 per cent in the fourth quarter of 2022 to 7.0 per cent in the three months to January. At the same time, we observed a larger-than-expected rise in public-sector regular AWE growth, which rose from 4.2 per cent in Q4 to 4.8 per cent in the three months to January. Ahead of the Chancellor's Spring Budget tomorrow, it is important to note that public-sector wages need to 'catch-up' with private-sector wages as the gap between the two remains wide. If this gap cannot be closed, the government risks incurring further losses from prolonged industrial action or an outflow of skilled public sector workers."

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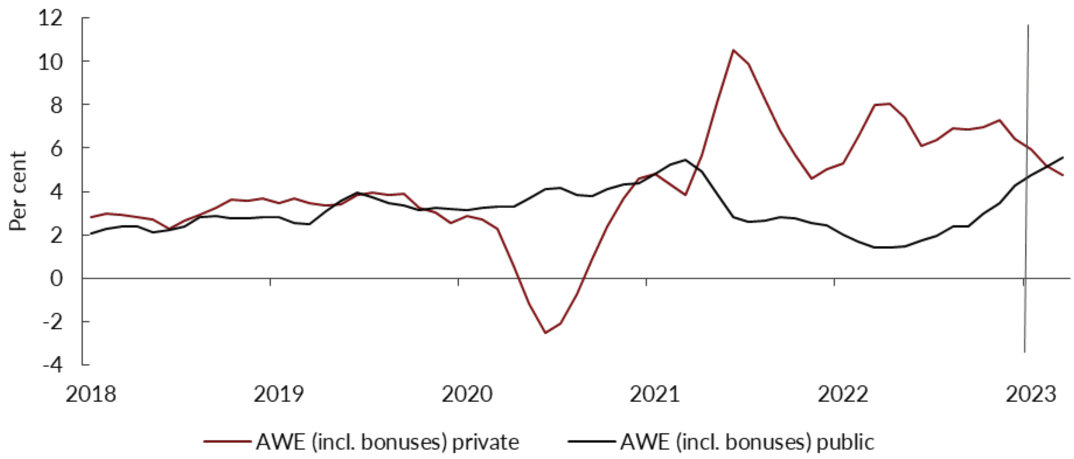
Figure 1 – Average weekly earnings in public and private sectors



Per cent change 3 month average year on year

Main Points

- The latest ONS estimates suggest the annual growth rate of average weekly earnings, including bonuses, was 5.7 per cent in the three months to January, while pay growth excluding bonuses was 6.5 per cent. NIESR's wage tracker estimates that regular (excluding bonuses) and total average weekly earnings will have grown at 6.3 and 4.9 per cent, respectively, in the year to the first quarter of 2023.

- The disparity in public- and private-sector wage growth has fallen for a fourth consecutive month, though it remains high, with private sector regular pay growing by 7.0 per cent while regular pay in the public sector grew by 4.8 per cent.

- Real total pay in the United Kingdom fell by 3.2 per cent on the year in the three months to January, remaining among the largest falls in growth since comparable records began. Public-sector workers experienced an average fall of 4.0 per cent.

- Public-sector wage increases ought to feature in tomorrow's Budget as the public-private wage gap remains wide. While such increases may have some adverse macroeconomic consequences in the short-run (increasing the government's wage bill and contributing to the persistence of domestic inflationary pressures), these effects need to be considered against the potential output losses across both sectors that would be incurred if industrial action were to be prolonged or if there were to be a significant outflow of skilled public-sector workers.

- NIESR research suggests that public-sector wages gradually adjust to the equilibrium determined by private-sector wages in the long run. On the other hand, in the long run, private sector wages are determined independently by factors like productivity or demographic characteristics – so concerns about a private-public wage spiral are unlikely to materialise.

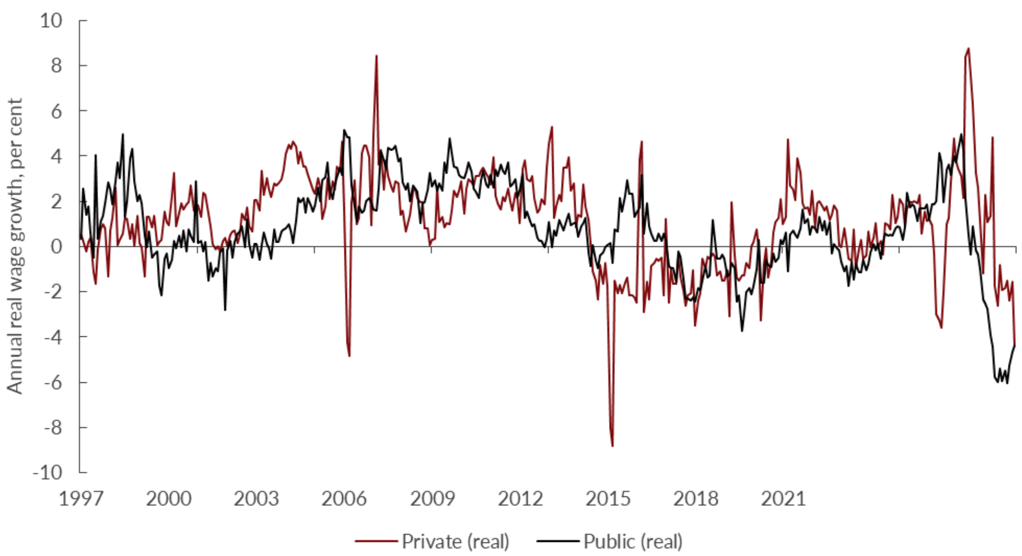
Employment

The latest data suggest that the employment rate increased by 0.1 percentage points compared with the previous three months, rising to 75.7 per cent in the three months to January. The unemployment rate remained unchanged at 3.7 per cent. The ONS attributes the rise in the employment rate to increases in part-time and self-employed workers, and men in employment.

The economic inactivity rate for people aged 16-64 was estimated at 21.3 per cent, a decrease of 0.2 percentage points in the three months to January compared to the previous three months. This was driven by those inactive because they are students or retired.

High Frequency Indicators: The latest KPMG and REC report on Jobs suggests that February 2023 saw a fifth consecutive fall in permanent staff hires due to high economic uncertainty and cost pressures from elevated starting pay inflation. At the same time, temporary vacancies continue to grow, and overall vacancy growth grew at a four-month high – both clear signs that the labour market has yet to cool. Furter, the most recent report by Hiring Lab - the economic research branch owned by and utilising the proprietary data of job-posting site Indeed – notes that more job postings are offering a four-day work week (though still only representing 0.7 per cent of all vacancies posted), which they attribute to employers looking to attract workers in a still-tight UK labour market.

Figure 2 – Real average weekly earnings in public and private sectors



Source: ONS and NIESR calculations. ONS experimental data is used for the period 1990-2000.

Pay

The annual growth rate in average weekly earnings including bonuses (AWE) in Great Britain was 5.7 per cent in the three months to January and 6.5 per cent if we exclude bonuses. These elevated economy-wide growth rates are driven by a record (outside of the pandemic period) increase in private-sector regular pay growth. The Bank of England's February Monetary Policy Report attributes the rise in private-sector wage inflation to elevated short-term inflation expectations (which the Bank estimates to have been 4 per cent in the fourth quarter of 2022), as opposed to recruitment and retention difficulties in the previous year.

In real terms, total pay fell by 3.2 per cent in three months to January 2023 compared to the three months to January 2022. As figure 2 above shows, workers in different sectors have felt this real squeeze asymmetrically.

Private-sector regular AWE annual growth was 7.0 per cent in the three months to January and 5.9 per cent if we include bonuses. The lower figure for total AWE growth is a result of extraordinarily high bonuses observed in December 2021. Our estimate for the first quarter of 2023 sees these figures at 6.5 and 4.7 per cent, respectively, with the latter being a product of expected stagnating bonus growth.

Public-sector total AWE annual growth has been on an increasing path since a low in the three months to April 2022 of 1.5 per cent and is currently sitting at 4.8 per cent in the three months to January. We estimate public sector total pay growth of 5.6 per cent in the first quarter of 2023, still below the record growth of 6.4 per cent observed in September 2001.

Public-sector wages and the Spring Budget

In January, 220,000 working ways were lost due to labour disputes, down from 822,000 in December. The latest ONS Business Insights and Impacts Survey suggests that 10.3 per cent of firms across the United Kingdom saw their business affected by industrial action in January, both directly and indirectly, down from 15.8 per cent in December. Though January was less affected by industrial action than December, the unrest experienced over the course of the last eight months undoubtedly sets a delicate scene ahead of the Chancellor's Spring Budget tomorrow, which many hope will unveil a pay settlement for public-sector workers.

As we noted in our recent pre-Budget analysis, though public-sector wage increases may have some adverse macroeconomic consequences in the short run (such as increasing the government's wage bill and contributing to the persistence of domestic inflationary pressures), public-sector wages need to catch up with the private sector as the public-private wage gap remains wide. **This gap represents a deviation from the equilibrium wage relationship between the sectors – entailing a need to return to a more stable pattern**.

NIESR research suggests that that **in the long run, UK public-sector wages are determined by private-sector wages**. To elaborate, wages can interact across sectors through a 'wage leader' and 'wage follower' relationship, ie, whereby one sector's wages set wage developments for the whole labour market. This is country dependent: studies have found that the white-collar private-sector determines the wage-setting process in Sweden while in Germany, Belgium and Greece, the public sector sets the economywide wage level. The NIESR researchers estimated a vector error correction model of sectoral wages in the UK to find that **private-sector wages move independently over time whereas public-sector wages gradually adjust to the wage equilibrium determined by the private sector**, explaining the cyclical relationship observed between the two sectors in figure 2. Intuitively, this can be thought of as a consequence of labour market competition between the sectors: if both the private and public sectors compete to hire the same workers, then a rise in private-sector wages will eventually need to be met by a rise in public-sector wages, or else the public sector won't be able to compete.

The above research suggests that**, in the long run, UK private-sector wages are determined independently from public-sector wages** by factors like economy-wide productivity or demographic characteristics **– so concerns about a sustained private-public wage spiral are unlikely to materialise**.

In the short-run, a rise in public-sector wages is likely to lead to wage-increase spillovers in the private sector. The NIESR research suggests that in the United Kingdom, private-sector employers adjust regular and total pay following a positive public-sector wage shock. Despite the public sector making up only 20 per cent of the total labour force, a 1 per cent increase in public-sector pay can lead to an increase of between 0.1 and 0.4 per cent in average nominal pay in the private sector as a whole.

So, public-sector wage increases ought to feature in tomorrow's Budget as the public-private wage gap has deviated from equilibrium. While such increases may have some adverse macroeconomic consequences in the short run, these possible adverse effects need to be considered against the potential output losses across both sectors that would be incurred if industrial action were to be prolonged or if there were to be a significant outflow of skilled public-sector workers.

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 Scores. 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 July 2010 and October 2018. For whole economy earnings, the root mean square error is 0.2 percentage points for the measure excluding bonuses and 0.4 percentage points for the measure including bonuses. 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 actual error bands may be larger or smaller.

Notes for editors:

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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-22	556	598	549	601	586	587
Feb-22	557	601	550	604	589	590
Mar-22	559	614	553	618	589	590
Apr-22	562	604	556	607	589	590
May-22	567	605	562	607	590	591
Jun-22	569	612	564	617	590	594
Jul-22	572	614	568	619	591	594
Aug-22	576	618	571	623	594	598
Sep-22	579	621	575	627	594	598
Oct-22	583	625	578	629	606	608
Nov-22	587	628	582	632	609	611
Dec-22	588	630	583	633	613	614
Jan-23	589	630	583	633	618	619
Feb-23	593	634	587	637	618	622
Mar-23	595	637	589	639	621	625
% change 3 month average year on year						
Jan-22	3.8	4.7	4.1	5.3	2.2	2.0
Feb-22	4.0	5.6	4.5	6.5	1.9	1.7
Mar-22	4.2	6.8	4.9	8.0	1.7	1.4
Apr-22	4.2	6.9	4.8	8.0	1.8	1.4
May-22	4.5	6.4	5.1	7.4	1.8	1.5
Jun-22	4.8	5.2	5.4	6.1	1.8	1.7
Jul-22	5.2	5.5	5.9	6.3	2.0	1.9
Aug-22	5.5	6.1	6.2	6.9	2.1	2.4
Sep-22	5.8	6.0	6.7	6.9	2.2	2.4
Oct-22	6.1	6.2	6.9	6.9	2.8	3.0
Nov-22	6.5	6.4	7.3	7.3	3.4	3.5
Dec-22	6.6	6.0	7.3	6.5	4.3	4.3
Jan-23	6.5	5.7	7.0	5.9	4.8	4.8
Feb-23	6.3	5.2	6.7	5.2	5.1	5.2
Mar-23	6.3	4.9	6.5	4.7	5.2	5.6
% change month on same month of previous year						
Jan-22	4.3	4.9	5.0	5.8	1.6	1.6
Feb-22	4.1	5.8	4.8	6.9	1.7	1.2
Mar-22	4.3	9.8	4.9	11.4	1.9	1.5
Apr-22	4.1	5.0	4.7	5.9	1.7	1.5
May-22	5.0	4.3	5.6	5.0	1.9	1.4
Jun-22	5.2	6.3	5.8	7.3	1.9	2.2
Jul-22	5.5	5.9	6.4	6.7	2.1	2.2
Aug-22	5.9	6.2	6.5	6.7	2.4	2.7
Sep-22	6.0	6.0	7.1	7.2	2.1	2.2
Oct-22	6.4	6.3	7.2	7.0	3.9	3.9
Nov-22	6.9	7.0	7.6	7.7	4.3	4.3
Dec-22	6.5	4.7	7.2	4.8	4.8	4.6
Jan-23	5.9	5.4	6.2	5.3	5.5	5.5
Feb-23	6.4	5.6	6.8	5.5	4.9	5.4
Mar-23	6.4	3.7	6.6	3.5	5.4	5.9