National Institute of Economic and Social Research

NIESR Monthly Wage Tracker

Wage Growth in Services Sector Shows No Signs of Cooling

Paula Bejarano Carbo

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"Average weekly earnings, excluding bonuses, grew by 7.3 per cent in the three months to May, equalling the highest growth rate previously seen during the pandemic. Private sector employees saw an average regular pay growth rate of 7.7 per cent, while for the public sector it was 5.8 per cent. When accounting for bonuses, wage growth was 6.9 per cent in the three-month period. Given that the unemployment to vacancy ratio remains low at 1.3, the labour market remains tight, indicating that we will not see a softening in pay growth in the near future. Monetary policymakers will be watching the effect this has on services inflation, which will likely become a driver of headline CPI inflation over the coming months as energy price increases drop out of the CPI basket."

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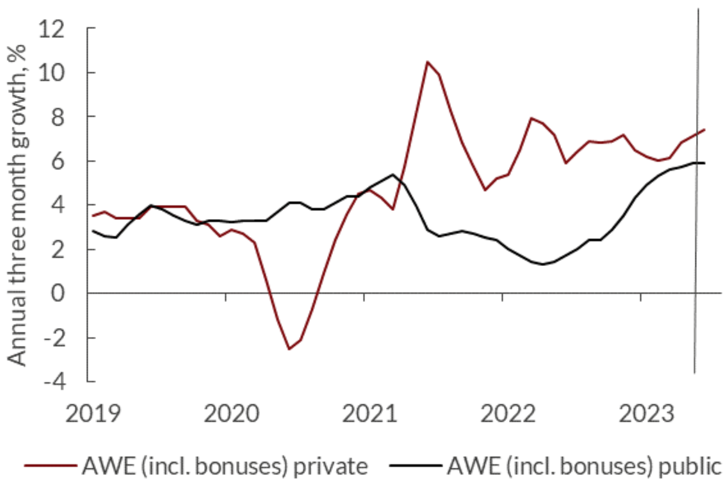
Figure 1 – Average weekly earnings in public and private sectors



Main Points

- The latest ONS estimates suggest that the annual growth rate of average weekly earnings, including bonuses, was 6.9 per cent in the three months to May, while pay growth excluding bonuses was 7.3 per cent - equalling the largest growth rate in regular pay recorded during the pandemic. Our forecast for the second quarter of this year sees both figures at 7.2 per cent.

- Private sector regular pay grew by 7.7 per cent – representing the largest growth rate seen outside of the pandemic period - while regular pay in the public sector grew by 5.8 per cent. Our forecast sees these figures at 7.5 per cent and 5.9 per cent, respectively, in the second quarter of 2023.

- The unemployment rate increased by 0.2 percentage points relative to the previous quarter to 4.0 per cent in the three months to May. This rate has now risen to its pre-pandemic level. The employment rate grew by 0.2 percentage points to 76.0 per cent. Rises in both figures indicate the economic inactivity rate has decreased; the data suggests this rate fell by 0.4 percentage points to 20.8 per cent, driven by those inactive for other reasons, those looking after family or home, and those who were retired. This signals that economic pressures, rather than back-work policies, may be pushing certain workers into work.

- Services sector total AWE annual growth has been on an increasing path since the initial pandemic-related plummet, currently at 7.0 per cent in the three months to May. Seeing that pay in the services sector makes up most of the input costs in this sector, it is the main driver of services inflation. Elevated wage growth in this sector will concern monetary policymakers, who may take this as a sign that services inflation will continue to generate persistence in underlying inflation in the UK, despite monetary tightening.

Employment

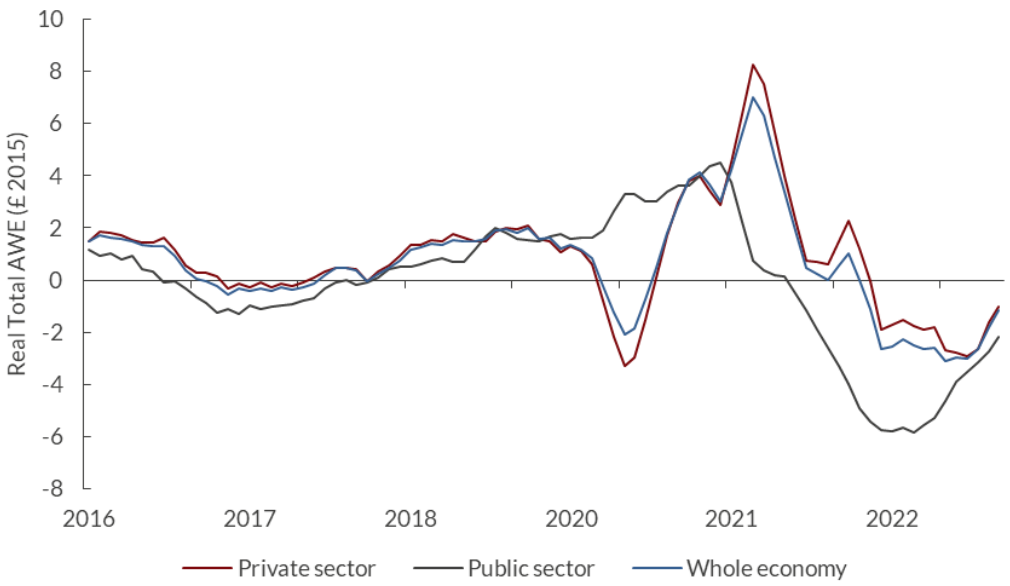
The latest data suggest that the employment rate increased by 0.2 percentage points on the quarter, rising to 76.0 per cent in the three months to May. The unemployment rate increased by 0.2 percentage points on the quarter to 4.0 per cent. Rises in both figures mean the inactivity rate has decreased. Indeed, the economic inactivity rate in three months to May decreased by 0.4 percentage points on the quarter, driven by those inactive for other reasons, those looking after family or home, and those who were retired. With the Spring Budget childcare measures not set to kick-in for some time, the move away from inactivity by the latter group may be a result of increasing economic pressures. The number of people reported to be inactive because of long-term sickness fell marginally from last month's record high of 442,278 to 412,329 in the three months to May. This compares to a pre-pandemic (three months to February 2020) figure of 15,112.

The latest KPMG and REC report on Jobs notes that hiring activity was subdued in June, with economic uncertainty and high starting pay inflation driving a fall in permanent placements and vacancy postings over the course of the second quarter of this year. This gentle slowdown in hiring activity has driven a sustained increase in overall candidate supply; in June, this upturn was the sharpest on record since December 2020. Whether this will be sufficient to reduce labour market tightness and generate a decrease in pay growth is tenuous, however, given that the unemployment to vacancy ratio remains low at 1.3 in the three months to May.

The number of vacancies fell by 85,000 in the three months to May compared to the previous three-month period, caused by high starting pay and economic pressures holding back recruitment. However, we are still far from seeing the UK labour market cool. In fact, a recent report by Hiring Lab - the economic research branch owned by and utilising the proprietary data of job-posting site Indeed – notes that while there has been a sustained slowdown in job postings since the start of the year, postings remained 27 per cent above the 1 February 2020 level as of 28 June (down from the peak of 50 per cent above the pre-pandemic level in December 2022).

128,000 workings days were lost due to industrial action in May 2023, the lowest monthly figure recorded since July 2022. That said, with junior doctors and rail companies announcing more strikes over summer, it is possible that we have yet to see a definite turning point in this wave of labour disputes.

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



Pay

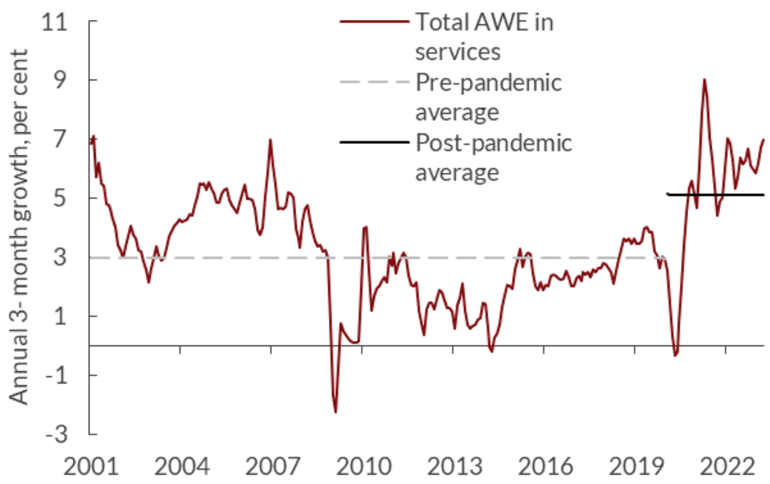
The annual growth rate in average weekly earnings including bonuses (AWE) in Great Britain was 6.9 per cent in the three months to May and 7.3 per cent if we exclude bonuses - equalling the largest growth rate in regular pay recorded during the pandemic period.

May wage growth data may partially reflect public-sector pay deals (such as in the healthcare sector) as well as the 9.7 per cent increase in the National Living Wage announced in April. That said, regular wage growth in the private sector in the three months to May was 7.7 per cent – representing the largest growth rate seen outside of the pandemic period – while for public sector workers this figure was 5.8 per cent. Further, the latest data collected by XpertHR suggest that the median pay settlement in the year to May was 1.2 percentage points higher in the private sector than the public sector. Given that the private sector makes up around 80 per cent of the UK labour market, it is thus high private-sector wage growth and pay settlements (enabled by the tightness of the labour market) that drove UK wage growth in the three months to May.

In real terms, total pay fell by 1.2 per cent in the three-month period. As figure 2 above shows, workers in different sectors have felt this real squeeze asymmetrically: workers in the private sector experienced an average real pay decrease of 1 per cent in this time, while public-sector workers experienced a 2.2 per cent hit to their real incomes.

Private-sector regular AWE annual growth was 7.7 per cent in the three months to April (representing the largest growth rate in private sector regular pay outside of the pandemic period) and 7.1 per cent if we include bonuses. Our forecast for the second quarter of 2023 sees these figures at 7.5 and 7.4 per cent, respectively.

Figure 3 -Total average weekly earnings in the services sector



Public-sector total AWE annual growth has been on an increasing path since a low in the three months to April 2022 of 1.3 per cent and is currently sitting at 5.9 per cent in the three months to May. We forecast public sector total pay growth to remain at 5.9 per cent in the second quarter of 2023, still below the record growth of 6.4 per cent observed in September 2001.

Services sector total AWE annual growth has been on an increasing path since the initial pandemic-related plummet, currently at 7.0 per cent in the three months to May. As Figure 3 above shows, there seems to have been a shift in services sector total AWE growth pre and post-pandemic; the average growth rate in AWE in this sector was 3.0 per cent from January 2001 to February 2020, while from March 2020 onwards this average has increased to 5.1 per cent (even accounting for the initial covid-related plummet). Seeing that pay in the services sector makes up most of the input costs in this sector, it is the main driver of services inflation. As we have been noting in our recent CPI trackers, with energy price inflation 'dropping out' of the CPI basket in recent months, food and core inflation are the main factors keeping CPI inflation elevated. Elevated wage growth in the services sector alongside a low unemployment-to-vacancy ratio of 1.3 will concern monetary policymakers, who may take this as a sign that services inflation will continue to generate persistence in underlying inflation in the United Kingdom, despite monetary tightening efforts. That said, if households reduce services spending over the coming months as higher interest rates and the ongoing cost-of-living crisis squeeze budgets, we may see AWE growth in this sector return to pre-pandemic levels. There are concerns, however, as voiced by Bank of England Chief Economist Huw Pill in the 23 May Treasury Committee oral evidence session, that a behavioural change may have taken place during the pandemic, inducing households to spend more on services than pre-pandemic. Clearly, it will be important to closely monitor services wage growth and services inflation dynamics over the coming months.

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**
May-22	567	606	562	608	590	592
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	589	632	583	635	613	615
Jan-23	591	634	585	637	620	621
Feb-23	596	640	591	645	620	620
Mar-23	599	645	595	651	620	622
Apr-23	604	648	600	653	624	625
May-23	607	651	604	655	623	626
Jun-23	607	651	603	656	626	628
% change 3 month average year on year						
May-22	4.5	6.1	5.1	7.2	1.7	1.4
Jun-22	4.7	5.1	5.3	5.9	1.8	1.7
Jul-22	5.2	5.5	5.9	6.4	2.0	2.0
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	6.7	6.0	7.3	6.5	4.3	4.3
Jan-23	6.6	5.9	7.0	6.1	5.0	4.9
Feb-23	6.7	5.8	6.9	5.9	5.3	5.3
Mar-23	6.8	6.1	7.1	6.1	5.6	5.6
Apr-23	7.2	6.7	7.6	6.9	5.7	5.7
May-23	7.3	6.9	7.7	7.1	5.8	5.9
Jun-23	7.2	7.2	7.5	7.4	5.9	5.9
% change month on same month of previous year						
May-22	5.0	4.5	5.6	5.2	1.9	1.5
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	6.7	4.8	7.0	4.8	4.8	4.8
Jan-23	6.3	6.0	6.6	6.0	5.8	5.8
Feb-23	7.0	6.7	7.3	7.0	5.4	5.3
Mar-23	7.0	5.6	7.4	5.3	5.4	5.6
Apr-23	7.7	7.8	8.1	8.3	6.1	6.1
May-23	7.1	7.4	7.5	7.7	5.6	5.7
Jun-23	6.8	6.4	7.0	6.3	6.1	5.7