Markit Economic Research
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United Kingdom

Tightening labour market drives pay growth higher

- **Single-month jobless rate down to 6.9% in January and jobless benefit numbers also fall more than expected**
- **Pay growth picks up to 1.4%, led by inflation-beating growth in manufacturing, construction and retail**
- **Employment at record high**

Unemployment fell further in February, and looks set to decline further in coming months, while pay growth also continues to revive. Pay is now rising well above inflation in manufacturing, construction and retail. The total number in employment meanwhile rose to a record high of 30.2 million and job vacancies hit the highest since late-2008.

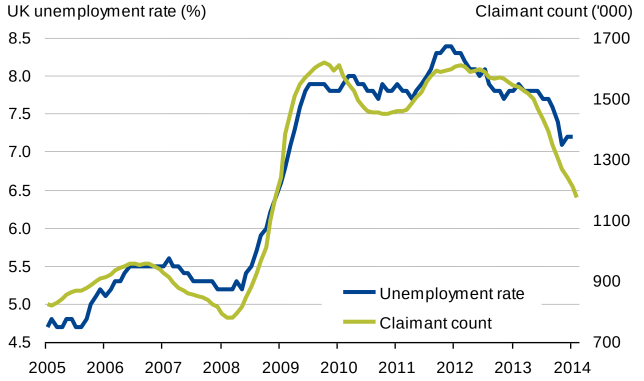
The data, from the Office for National Statistics, add further evidence that the rapid upturn in the labour market is showing no signs of cooling. Companies are taking on extra staff amid improving confidence in the economic outlook and the sustainability of the upturn. Business surveys have been especially buoyant in recent months and companies are reporting that forward guidance by the Bank of England has provided additional encouragement to hire extra staff and boost investment spending.

Rising pay growth and falling unemployment is also feeding through to improvements in household confidence and consumer spending. Today's Markit Household Finance Index showed views on future finances dipping only slightly in February from a post-crisis high at the start of the year, buoyed in recent months by rising income from employment and signs of lower inflation.

Jobless rate set to fall further

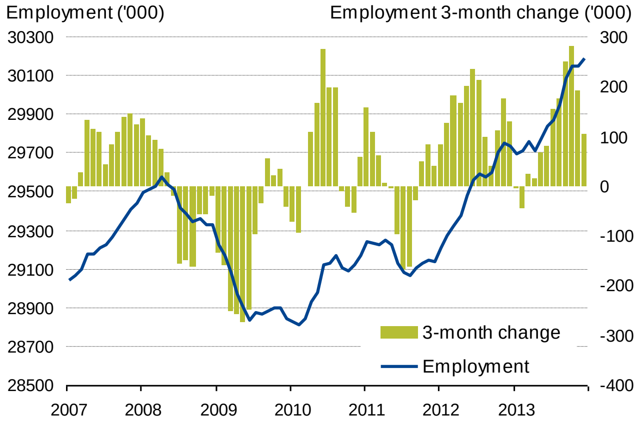
The unemployment rate held steady at 7.2%, as expected in the three months to January, but in January alone the rate fell to 6.9%, the lowest recorded since February 2009. The claimant count meanwhile fell a larger than expected 34,600 in February, taking the total number signing on for jobless benefits to the lowest since November 2008.

Unemployment indicators



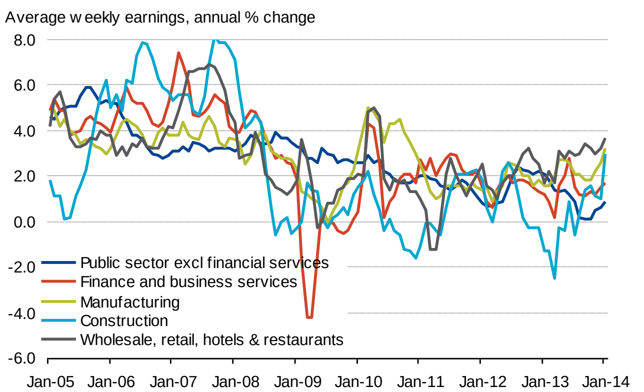
Source: ONS via Ecowin.

Employment



Source: ONS.

Pay growth by sector



Source: ONS.

The unemployment rate therefore looks set to fall again in February, given the improvement in the jobless benefit numbers and rising vacancies, and given the sheer pace of hiring that we're seeing at the moment, should continue to fall as we move into the summer. The PMI survey shows companies created jobs at the fastest rate ever seen in the survey history in February, which extends back to 1998. Similarly the number of people placed in permanent jobs by recruitment agencies rose at a rate not surpassed since 1997 last month.

Pay growth reviving

Perhaps the most welcome news was the further upturn in pay growth, which showed average wages and salaries rising 1.4% in the three months to January. That's still below inflation, which is currently running at 1.9%, but the gap is clearly closing and a return to real wages growth is in sight.

There is also a more reassuring picture once you delve deeper into the ONS data. In manufacturing, construction and retail respectively, pay is rising at an annual rate of 3.2%, 3.0% and 3.7% in the three months to January, all well above inflation. Only private services, at 1.7%, and the public sector, at 0.5%, are still below inflation.

Pay growth should also continue to turn up as we go through the year as the labour market tightens. Recruitment agencies are already seeing widespread shortages of suitable candidates to fill vacancies, reporting that the availability of permanent staff deteriorated in February at the sharpest rate since 2004. Employers were forced to increase salaries at the steepest rate since October 2007 as a result.

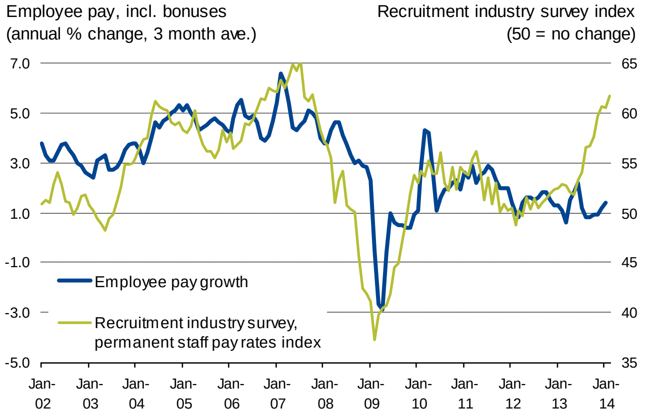
The ONS data similarly showed that the number of job vacancies rose to 588,000, its highest since September 2008. The vacancy ratio (the number of unemployed people per unfilled vacancy) now stands at 4.0, the lowest seen since November 2008, which points to further employment and earnings growth in coming months.

Pay growth to be rate hike trigger

It is a recovery in real pay growth that has been the all-important missing element of the recent improvement of the labour market, and is in turn likely to be one of the most important triggers for higher interest rates.

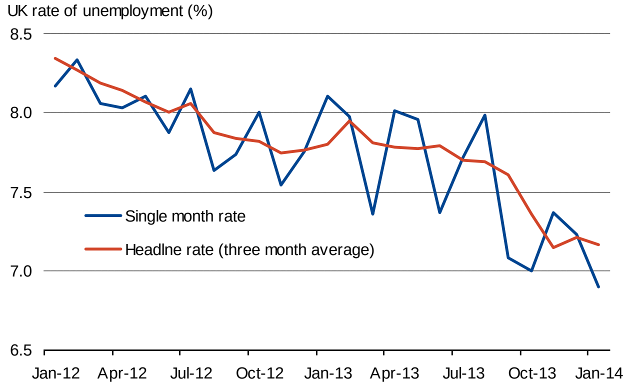
The Bank of England has moved away from focusing on the unemployment rate to watching a broader range of indicators which attempt to measure the amount of 'slack' in the economy or, in other words, the extent to which the economy can grow without hitting constraints (such as skill shortages), which tend to then drive up inflation. The minutes from the March Monetary Policy Committee meeting provide little indication of how views may differ among Bank of England policymakers on which indicators are the most important to be watching, but pay growth is arguably the most important in this respect, as it highlights a tightening labour market. Sustained rising pay growth is also a sign that companies are more confident about the longer-term outlook and that households may be able to withstand gradual increases in interest rates.

Employee pay indicators



Sources: Markit, ONS via Ecowin.

Single month unemployment rate



Source: ONS.

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