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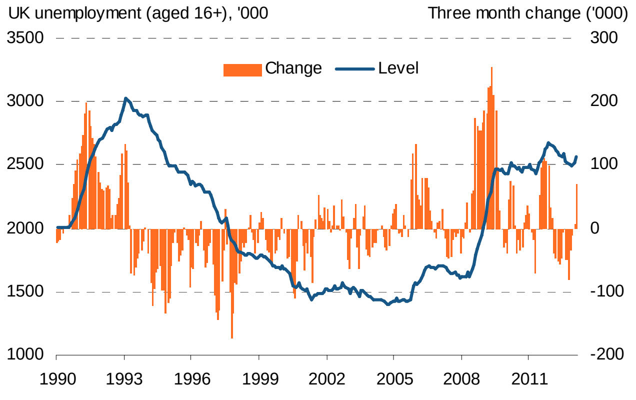
United Kingdom

Pay growth drops to record low as employers withdraw from job market

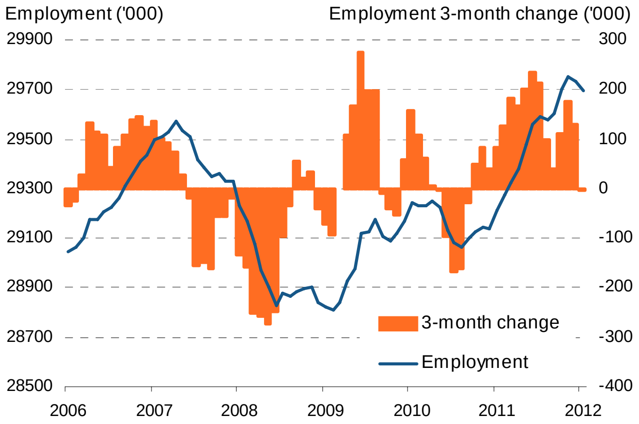
- **Unemployment shows largest jump for 15 months**
- **Employment falls slightly**
- **Pay growth hits record low**

UK unemployment



Source: ONS via Ecowin.

UK employment



Sources: ONS.

Bleak looking labour market data raise the prospect of the Bank of England stepping up its asset buying programme in May. Employment fell, unemployment rose and pay growth slipped to a record low.

UK unemployment showed the largest quarterly rise in 15 months in the three months to February, jumping 70,000 to reach 2.56 million. The unemployment rate rose to 7.9%, a six-month high.

The Office for National Statistics attributed much of the deterioration in the unemployment rate to more people being eligible for work, and in particular an inflow of women on to the job market who had previously been looking after family homes. However, in addition, and more worryingly, the actual number of people employed fell by 2,000 to 29.70 million people in the three months to February. Although only small, the decline was notable in being the first since late 2011 and in sharp contrast with the buoyant job growth seen in previous months, and points to an underlying malaise as employers pull back from hiring amid economic uncertainty.

The official data follow surveys which have also brought downbeat news on the labour market. Recruitment agencies reported the slowest growth of demand for seven months in March, while surveys of purchasing managers reported that companies barely took on any additional staff in March.

While the small drop in employment raises concerns about employers' appetite to take on staff, a drop in regular pay growth to a record low of 1.0% rings alarm bells about the fragility of the whole economy. Once earnings are included, total pay rose by just 0.8% in the three months to February, the lowest rate of increase since late 2009.

The weakness of pay growth means, with inflation running at 2.8%, real incomes are falling at an annual rate of 1.8%. The rate of decline had eased to just 0.3% back in September, prompting hopes that the consumer could begin to play a bigger role in the economic recovery, having been squeezed out for much of the post-crisis period. However, the renewed intensification of the pay squeeze suggests that the consumer will continue to act as a dampener on the economy in coming months.

More QE?

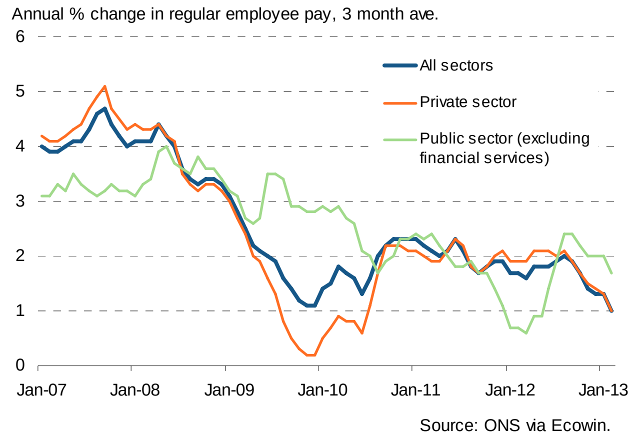
This bleak picture of the labour market will be a concern to the Bank of England. The squeeze on pay and resulting impact on economic growth prospects will be a worry, but more importantly if employers have stopped hiring then policymakers are likely to see an immediate need to reignite the labour market. The chance of further quantitative easing (QE) in May have increased considerably with these disappointing numbers.

The minutes from the latest Monetary Policy Committee (MPC) meeting showed six members voted to keep policy unchanged, while three – including bank governor Sir Mervyn King – voted for an extra £25bn of quantitative easing.

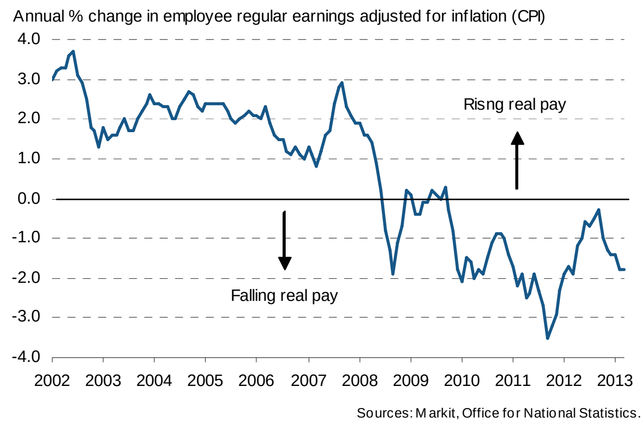
High inflation remains a potential stumbling block to further stimulus. The Bank is permitted to 'look-though' periods of above target inflation to avoid undesirable volatility in the economy, providing that they consider cost and price pressures are "consistent with inflation returning to the target in the medium term". This means that the Bank needs to ensure inflation expectations do not rise too high and risk losing credibility in being able to control inflation.

As noted in the MPC minutes, inflation "was likely to rise further later this year, and was expected to remain elevated for an extended period. Medium-term inflation expectations had drifted upwards in recent months, and a further easing [in policy] might exacerbate this movement and prompt renewed weakness in sterling, with implications for wages and prices".

Annual pay growth



Inflation-adjusted pay growth



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