Markit Economic Research
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United Kingdom

Pay growth reviving as skill shortages rise at fastest rate since 1997

- **Recruiters report marked upward pressure on pay rates as skill shortages intensify**
- **Demand for staff surges at near-record pace again s**
- **Rising pay adds to risk of interest rate hike**

Surging demand for staff and near-record skill shortages meant pay rates offered by companies to attract suitable workers continued to rise at a rapid pace in May. The data add to signs that the UK's economic recovery is increasingly filtering through to improved wage growth, flashing inflationary warning lights at the Bank of England. Wage growth is likely to be a key determinant of when interest rates are likely to start rising.

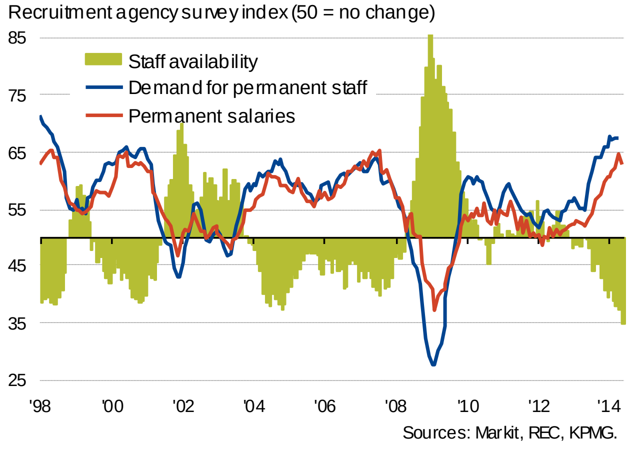
Near-record rise in skill shortages

Recruitments consultants, ranging from some of the largest employment agencies to small head-hunting firms, reported that the availability of candidates to fill permanent vacancies deteriorated to the greatest extent since late-1997, according to Markit survey data collected on behalf of REC and KPMG. The availability of temporary and contract staff meanwhile continued to fall at a rate similar to April, which saw staff shortages rising at the fastest rate since 2000.

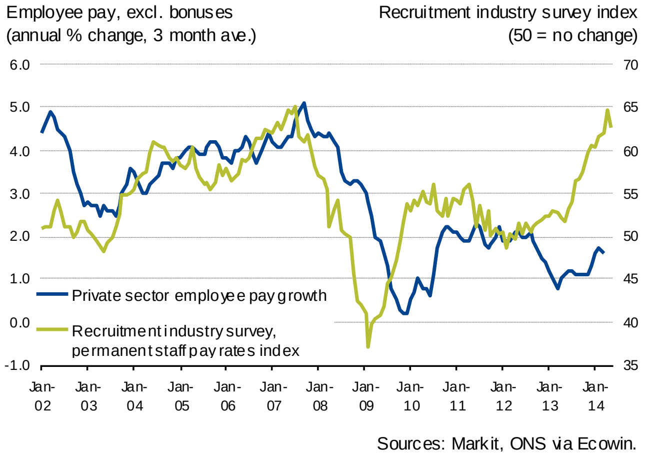
The deterioration in candidate availability follows a sustained period of surging employment amid rising demand for staff from employers. The number of people placed in permanent positions by recruitment firms has so far this year shown the strongest spell of growth in the survey's near 17-year history, albeit with the rate of growth easing slightly in May.

With demand for staff exceeding supply, wages rose sharply again in May, with the survey signalling a rate of increase for permanent staff salaries only slightly lower than Aprils' seven-year peak. The survey also showed the steepest rise for temporary and contract staff pay rates since late-2007.

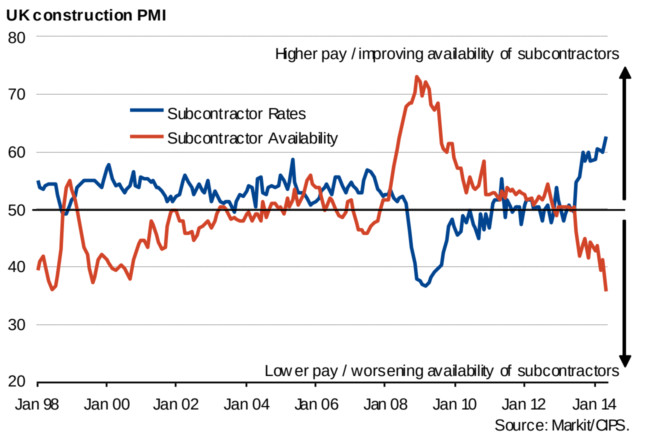
Employee pay pressures



Survey and official wage growth



Construction PMI: subcontractor pay rates



The official data on employee pay remain subdued compared to the recruitment survey signal, at least at the headline level. Regular pay rose just 1.3% in the first quarter compared to a year ago, while including bonuses the rate was 1.7%. With the exchange rate also helping to keep import costs down, the low wage pressures signal a weak inflationary environment which in turn provides the Bank of England with an extended window to keep interest rates at their historical low while the economy recovers.

Pay pressures on the rise

However, this window may be closing, as it is not just the recruitment survey that is suggesting that official pay data may soon start to show an upturn.

Companies responding to the services PMI survey reported a marked increased incidence of rising pay rates in May, which contributed to an overall upturn in cost pressures in the sector.

Construction companies meanwhile reported that the rates that they had to pay sub-contractors rose at the steepest rate since the PMI survey began in 1997 as the availability of sub-contractors also fell to the greatest extent seen in the survey history.

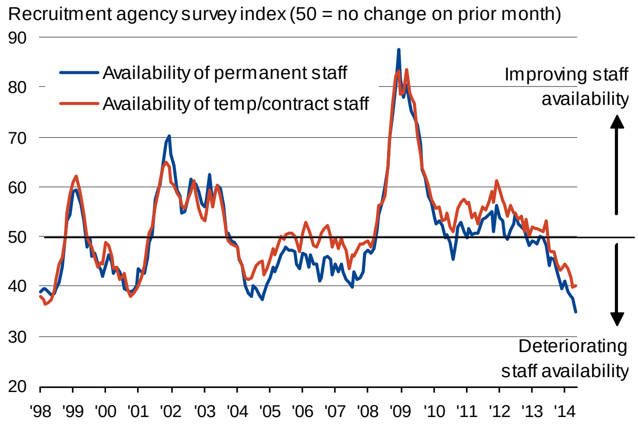
Also, respondents to Markit's Household Finance Index survey reported that income from employment is rising again. Albeit modest, the upturns in incomes so far this year are sitting in marked contrast to the steep falls seen in previous years.

Part of the sustained weakness in the official data is also likely to be due the delay in publication of official data. While the latest survey data reflect the situation in May, the most recent official headline data relate only to the three months to March.

We note, however, that digging into the official data already reveals some upward creep in pay rates. Private sector pay rose by 1.8% on a year ago in the three months to March, rising to 2.9% in manufacturing and construction and 3.2% in retail, hotels and restaurants, all well above inflation.

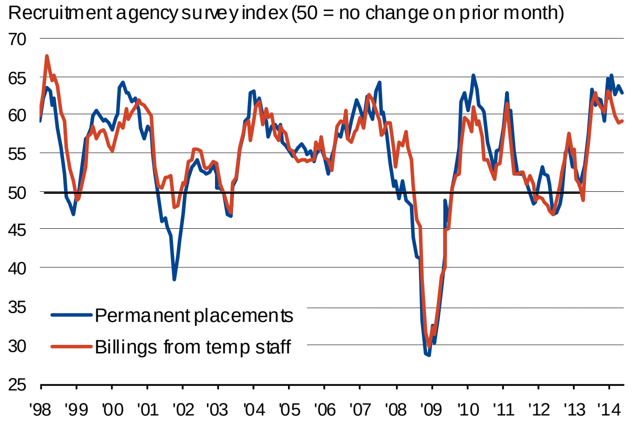
These rates are still well below levels that would worry policymakers, who most likely consider headline wage growth of around 4-4.5% to be compatible with the 2% inflation target. But the survey data indicate that the rate of increase could pick up sharply in coming months.

Recruitment survey staff availability



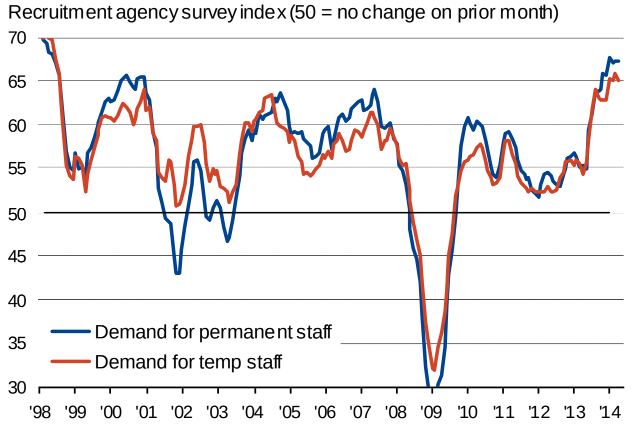
Source: Markit (KPMG/REC Report on Jobs).

Recruitment survey actual staff placements



Source: Markit (KPMG/REC Report on Jobs).

Recruitment survey demand for staff



Source: Markit (KPMG/REC Report on Jobs).

The chances are that low pay growth in the government sector could help keep open the Bank of England's window for keeping policy on hold, at least until next year. However, even here (excluding the part-nationalised banks), pay growth has picked up from near zero in the third quarter of last year to 1.5% in the first quarter.

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