

United Kingdom

Pay growth slides to new low despite further tightening of the labour market

- Unemployment falls to 6.4%, lowest since late 2008
- Employment shows 167k increase in Q2, but pace of hiring slows
- Pay growth at record low

Unemployment dropped to its lowest since late 2008 in the three months to June, as employment continued to rise. The puzzle persists, however, as to why this tightening of the labour market is not feeding through to higher pay. Pay, excluding bonuses, rose at the weakest rate since records began in 2001.

With inflation running three times faster than wage growth, policymakers will be wary of hiking interest rates though in fear of stalling the recovery.

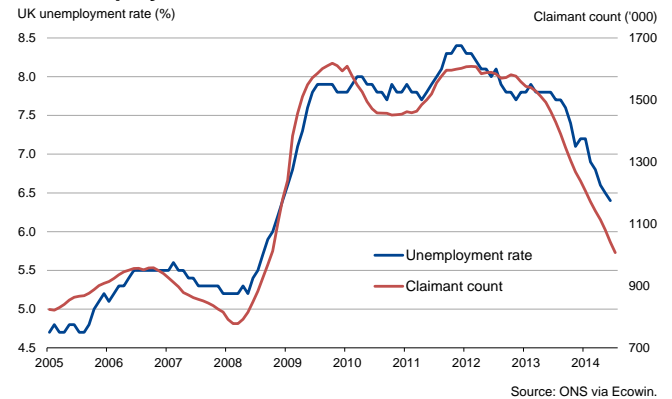
Tightening labour market

Unemployment fell to 6.4% in the three months to June, in line with expectations and the lowest since late 2008. The narrower, but more up to date, measure of claimant count unemployment meanwhile also fell, dropping by a substantial 33,600 in July.

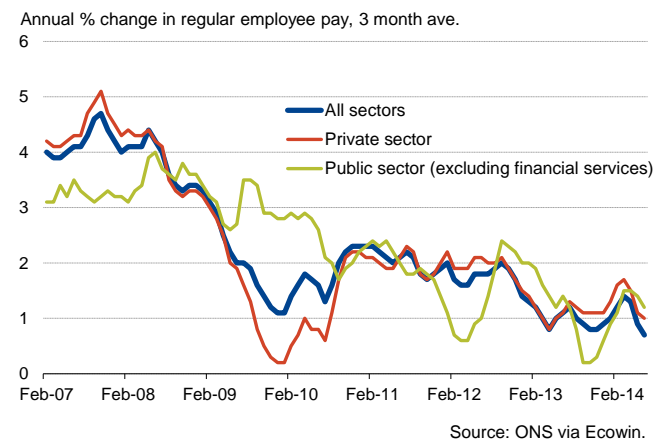
Employment surged again, rising by 167,000 in the second quarter. Although impressive, that was the weakest quarterly rise seen for a year, suggesting there may be some slowing in the pace of hiring. However, it is not clear whether this slowing is due to weakening demand for staff, or whether it is because skill shortages are developing. Survey data suggest the latter.

With just 3.2 people unemployed for every job vacancy, the labour market appears to be at its tightest since 2008. [Recruitment agencies](#) have also been reporting that the demand for staff has been rising in recent months at the fastest rate seen since 1997. Companies have been hiring in line with the surging pace of economic growth seen over the past year, a growth spurt which showed no sign of abating at the start of the third quarter, according to the [PMI surveys](#).

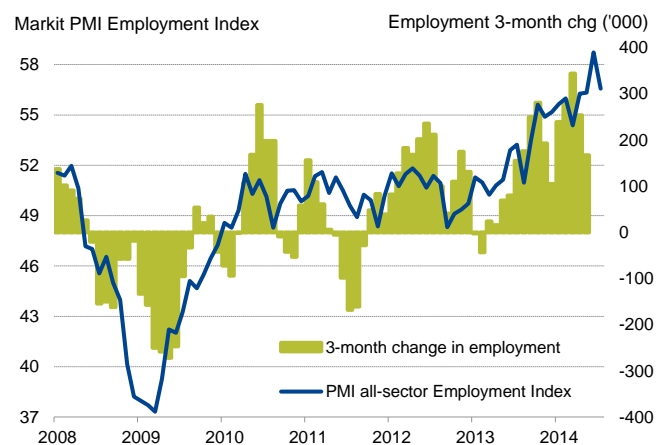
UK unemployment



Pay growth



Employment



Further fall in unemployment likely in July

A further drop in the unemployment rate to 6.3% is likely to have occurred in July, based on strong survey data and the on-going fall in the claimant count numbers.

The improvement in the general economy means unemployment is set to fall further as we move through the second half of the year, with a high probability that joblessness will drop below 6% by the end of the year. There's much less certainty, however, about wage growth.

Uncertainty over pay growth

Wage growth fell to a record low, with regular pay up just 0.6% on a year ago in the three months to June. Pay dropped 0.2% on a year ago if bonuses are included.

What's extremely odd about the wage data is that rising pay pressures that were apparent earlier in the year have all but disappeared, despite the further tightening of the labour market.

It therefore looks likely that the pay data have been distorted by last year's cut to the top rate income tax band.*

Pay growth should therefore start to pick up again in July, once the April year-on-year comparisons start to fall out of the headline (three month) rate. Recruitment agencies have reported that the upturn in demand of employees has led to the steepest deterioration in staff availability since the late 1990s as skill shortages have developed, which has in turn driven up pay rates.

First rate hike timing uncertain

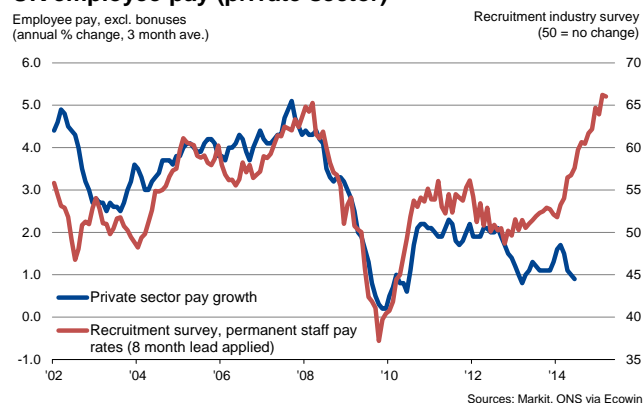
Another uncertainty is whether the Bank of England will hold off on raising interest rates until pay starts rising in real terms. Policymakers want to ensure pay is rising in order to help households afford higher borrowing costs. Although inflation is likely to fall back in coming months from its current 1.9% rate, it may well be next year until pay is rising in real terms.

However, fears of falling behind the curve in terms of the build-up of inflationary pressures, and of putting too much dependence on potentially distorted official pay data, may mean some policymakers feel rate rises should not be delayed until next year.

There's also an important difference between pay and incomes, the latter having been rising due to increased employment and longer working hours.

The timing of the first hike in interest rates therefore remains uncertain. A rise in February of next year looks the most likely scenario, although an earlier hike in November of this year remains a distinct possibility.

UK employee pay (private sector)



*This led to companies deferring bonuses, and possibly in some cases regular pay, until the lower tax rate came into effect. The result is that private sector pay rose sharply in April 2013 (up 4.2% on a year ago). The knock-on effect has been that pay in April of this year was 2.0% down on a year ago.

Chris Williamson

Chief Economist

Markit

Tel: +44 207 260 2329

Email: chris.williamson@markit.com

[Click here](#) for more PMI and economic commentary.

For further information, please visit www.markit.com

Purchasing Managers' Index™ and PMI™ are either registered trade marks of Markit Economics Limited or licensed to Markit Economics Limited.