ies Briefing

Institute for Employment Studies

Labour Market Statistics, July 2022

19 July 2022

This briefing note sets out analysis of the Labour Market Statistics published this morning. The analysis mainly draws on **Labour Force Survey (LFS)** data, which is the main household survey that collects official figures on employment, unemployment and economic inactivity and covers the period up to May 2022 (the most recent quarter being March to May 2022). The briefing also includes findings from the **ONS Vacancy Survey**, which collects employer data on open vacancies; and from the **Monthly Wages and Salaries Survey**, which collects pay data from businesses in order to estimate Average Weekly Earnings (AWE). The Vacancy Survey includes data up to June 2022, and the Wages and Salaries Survey to May 2022.

Summary

There is mixed news in today's figures. After very disappointing data last month, this month has seen significantly stronger data on employment and economic inactivity, with the prospect that employment could return to pre-crisis levels by the end of the year (if – a big if – the cost of living crisis and interest rate rises do not lead to a wider slowdown). In particular, economic inactivity (the measure of those out of work and not looking and/ or not available for work) appears to be falling back for older people, after very large rises through the pandemic.

On the other hand though, there are a number of worrying signs in today's pay data. Pay overall continues to fall sharply in real terms, with soaring inflation wiping out strong nominal pay growth (with nominal pay growth well ahead of the pre-pandemic rate). However underneath this, there are signs that private sector pay is being driven by continued labour shortages and may not be sustainable, especially in private sector services, while public sector pay is barely growing at all – leading to very large real-terms falls.

This will be a very challenging set of circumstances for a new Prime Minister and Cabinet to take on, with the need to raise pay in the public sector, address shortages in the private sector and navigate falling real incomes even as government support payments kick in. As we have said in previous briefings, our view is that a key priority must be to raise participation in the labour force – in other words, to boost labour supply through better support for those out of work, not just try to weaken labour demand through interest rates.

There are savings of at least £2 billion that could be put to use to do this, from underspends on measures for the unemployment crisis that never came. Firms will need to step up too, as many are already doing, with inclusive recruitment, flexible job design, and improving job security, quality and support at work.

Employment growth appears to be picking up (at last), with ‘economic inactivity’ starting to fall

The employment rate rose to 75.9% in today’s data, a jump of 0.4 percentage points on the quarter and 0.3 points higher than the figure reported last month. This growth is being driven in particular by falling ‘economic inactivity’, which fell by 0.4 points over the last quarter to 21.1% (and down two tenths on last month’s reported figure). Unemployment is broadly unchanged at 3.8%. Employment does remain more than half a percentage point below its pre-pandemic rate (and economic inactivity is nearly one percentage point higher), but the recent improvement has been marked and if it continues could see the gap close by the end of the year.

Figure 1 below shows these trends over time, with the single-month estimates in yellow (these are combined to create the quarterly estimates in blue). These single month estimates are highly volatile, but were all strongly positive for the single month of May.

Looking at employment levels (rather than rates), employment remains 210 thousand below its pre-pandemic peak, while economic inactivity is 380 thousand higher. There is more analysis on these trends in the second half of this briefing.

Figure 1: Employment, unemployment and economic inactivity rates (16-64) – quarterly average with single-month estimates

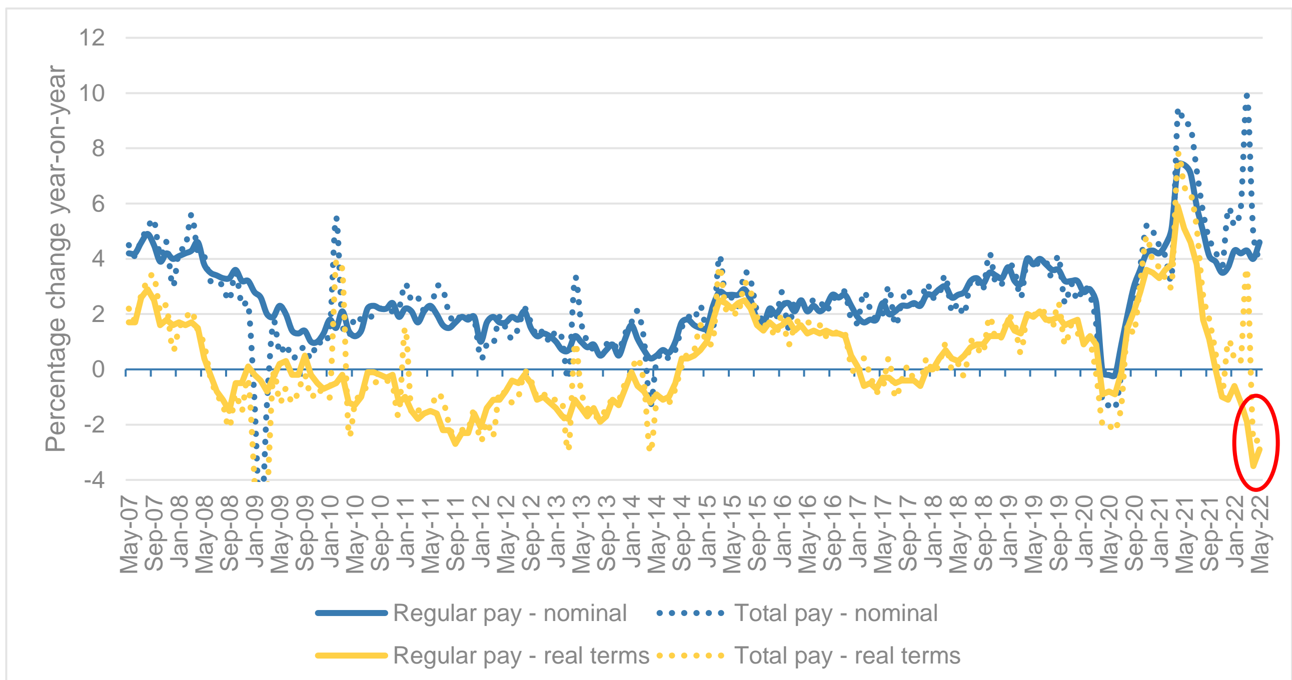
Source: Labour Force Survey

Nominal pay growth remains strong in the private sector, but inflation is pushing 'real' pay negative

Today's earnings figures are a tale of two sectors – with fairly strong nominal pay growth (up by 4.6% for regular pay, between May 2021 and May 2022) disguising very strong growth in the private sector (up by 5.3%) and weak growth in public sector pay (up by just 1.9%). Putting this in context, in the two decades before the pandemic nominal pay growth only average 2.8% overall, and was 2.8% in the private sector and 3.0% in the public sector. However while nominal pay growth has been strong, soaring inflation has pushed 'real' pay negative for the seventh month in a row – with regular pay falling by 2.9% year on year.

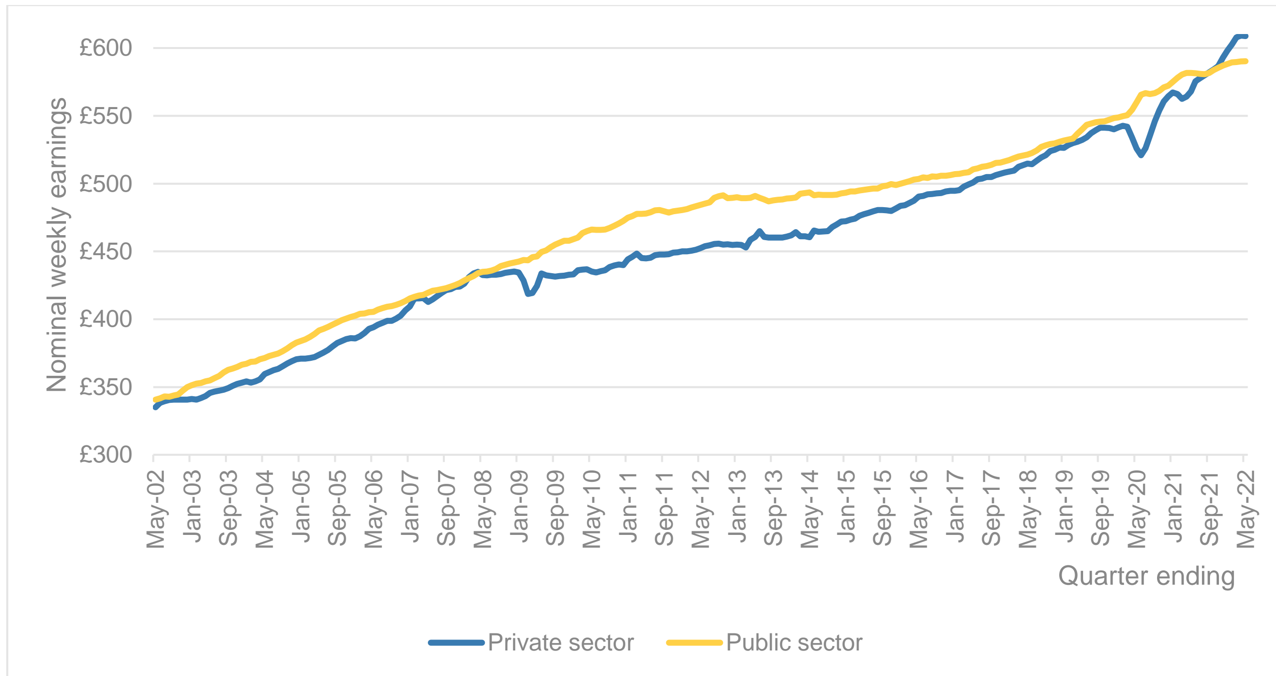
These divergent trends for nominal and regular pay overall are shown in Figure 2 below (with nominal pay in blue and real pay after inflation in yellow – the solid lines indicate regular pay, and the dotted lines pay including bonuses). Figure 3 then shows average total pay in nominal terms for the private and public sectors – illustrating how both grew through the 2000s, private sector pay fell back after the financial crisis and again in the pandemic, and the private sector now pulling away from the public sector in the recovery.

Figure 2: Year-on-year change in regular and total pay – nominal terms and adjusted for inflation (real terms)



Source: ONS Monthly Wages and Salaries Survey. Regular pay excludes bonuses and arrears; measure shown is year-on-year change in single month estimate.

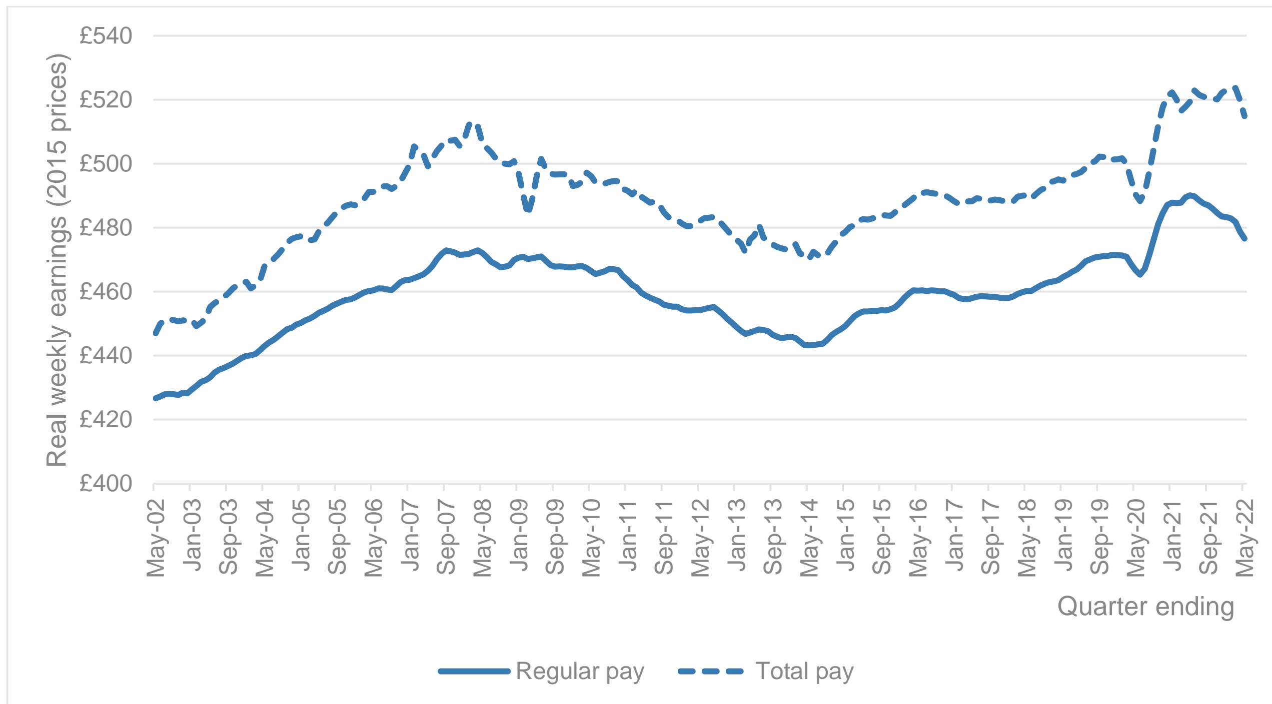
Figure 3: Nominal total weekly pay in the private and public sectors



Source: ONS Monthly Wages and Salaries Survey. Total pay includes bonuses but excludes arrears. Measure shown is rolling three month average of weekly nominal pay (i.e. not adjusted for inflation).

It should also be noted that these significant recent falls in real terms pay do come after a strong recovery in real pay after the Covid-19 pandemic. As Figure 4 below shows, average real pay (finally) surpassed its 2008 peak in late 2020, driven in particular by declines in lower paid work (in hospitality and cleaning in particular) and growth in employment in higher skilled jobs like professional services. As employment has recovered, real pay has remained above pre-pandemic levels but is is clearly now starting to fall – especially if bonuses are excluded.

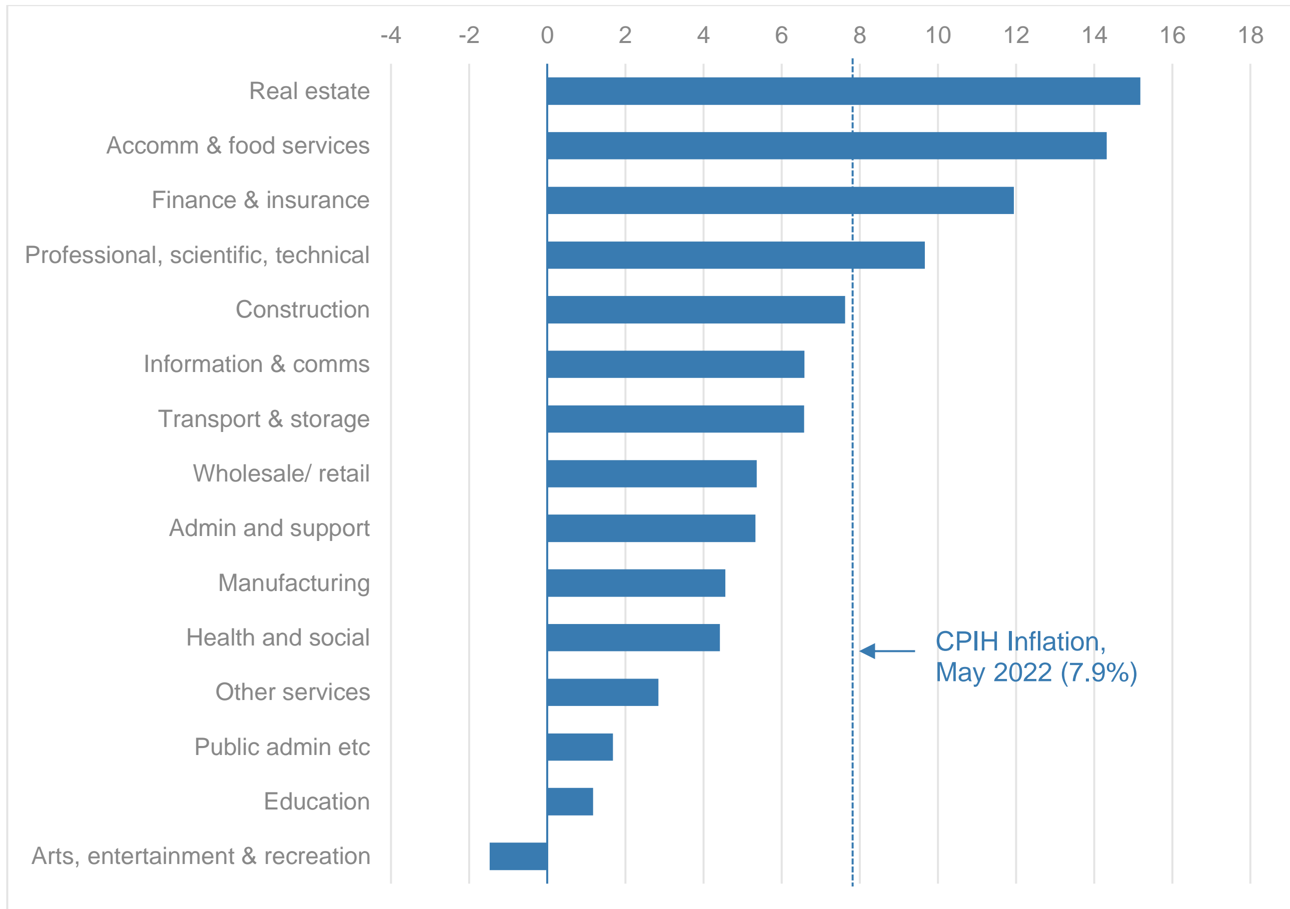
Figure 4: Average weekly pay, adjusted for inflation – regular and total pay



Source: ONS Monthly Wages and Salaries Survey. Total pay includes bonuses but excludes arrears. Measure shown is rolling three month average of weekly real terms pay (in 2015 prices).

As noted, these impacts are also being felt unevenly across industries. Figure 5 illustrates this point, showing growth in total pay by detailed industry. As noted in previous briefings, these figures do need to be treated with some caution as Covid-19 restrictions and furlough support continued to some extent through spring 2021 (which will over-state underlying pay growth particularly in hospitality), but the broad picture is nonetheless clear with pay in private sector services growing very strongly – often above inflation – while pay in public services falls behind (especially in education and public administration – i.e. local and national government).

Figure 5: Year-on-year change in total pay by industry, nominal terms



Source: ONS Monthly Wages and Salaries Survey. Pay growth is average of published single-month estimates of year-on-year growth in total pay including bonuses and arrears for Feb-Apr 2022 (not seasonally adjusted).

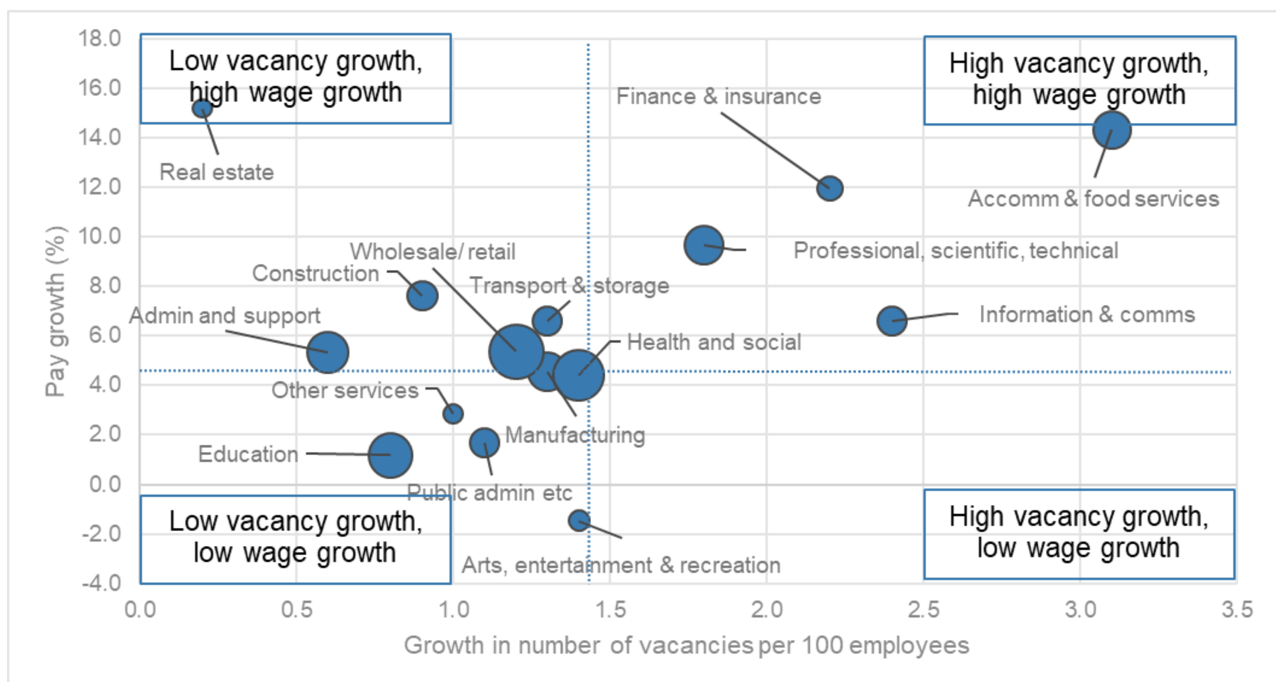
There are signs that these higher wages are being driven by continued labour shortages (covered in the second half of the briefing), with Figure 6 below showing the 'vacancy ratio' by industry (the number of vacancies per 100 employees) against total pay growth for that industry, with the size of the bubble indicating the relative size of each sector. Vacancy data is for the most recent quarter (April-June), while pay data again averages single month estimates for March, April and May. The dotted lines indicate the average growth for each.

This does appear to show a pretty clear correlation (and stronger than in recent months) between vacancy growth and pay growth, with in particular private sector services all in the top right quadrant and public services in the bottom left. And while these increases in pay, in private sector services in particular, mean that the cost of living crisis may so far not be quite as bad as it could have been, there are risks that if firms cannot meet higher wages through lower profits or higher productivity, then they will be passed on through higher prices and therefore add to inflation. The Bank of England in particular have made

clear that this is a key concern in their current decisions to raise rates[1], while business surveys are now identifying labour costs as a key driver of higher prices (with two thirds of respondents to the British Chambers of Commerce Quarterly Economic Survey stating that labour costs are putting upward pressure on prices).

As we have said in previous months, concerns around the knock-on impacts of rising pay on inflation is understandable. In our view however a key part of the answer to this must be to try to boost labour supply and productivity rather than just try to slow the economy through interest rates and tax rises.

Figure 6: Year on year growth in vacancies (per 100 employees) and total pay, by industry



Source: IES analysis of ONS Vacancy Survey (VACS02) and Monthly Wages and Salaries Survey (EARN03). Vacancy growth is Mar-May 2022 compared with same quarter in 2021; pay growth is average of published single-month estimates of year-on-year growth for Feb-Apr 2022.Size of bubbles indicates size of industry by employee jobs.

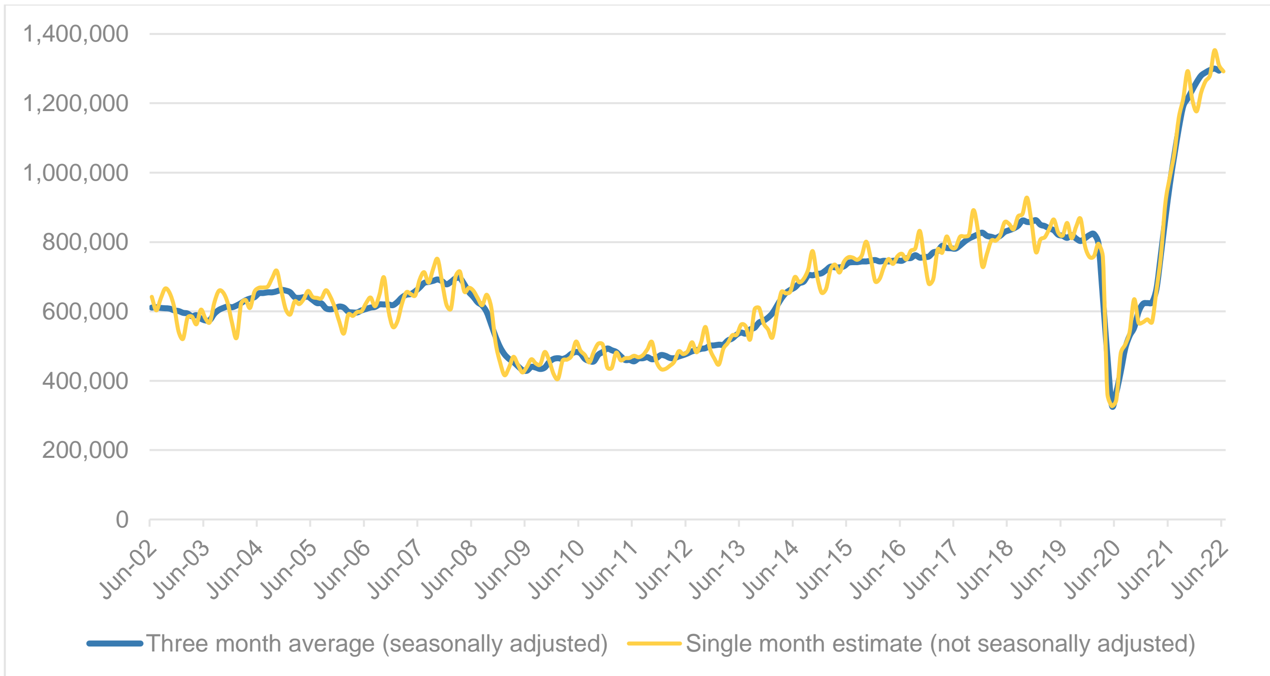
Labour shortages remain acute, with vacancies still at record levels and above pre-pandemic in all industries

There are clear signs in today's data that vacancies may now be starting to level off, but at around 1.3 million – about double where they were two years ago, and 50% higher than before the pandemic began (Figure 7 below, showing the latest quarterly and single month estimates). Figure 8 then illustrates how low unemployment and high vacancies

[1] Paragraph 36 onwards of their most recent minutes sets this out clearly: https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2022/june-2022

have combined to lead to the tightest labour market in at least fifty years – with for the first time in living memory now more job vacancies than there are people unemployed.

Figure 7: Vacancies – quarterly and single-month estimates



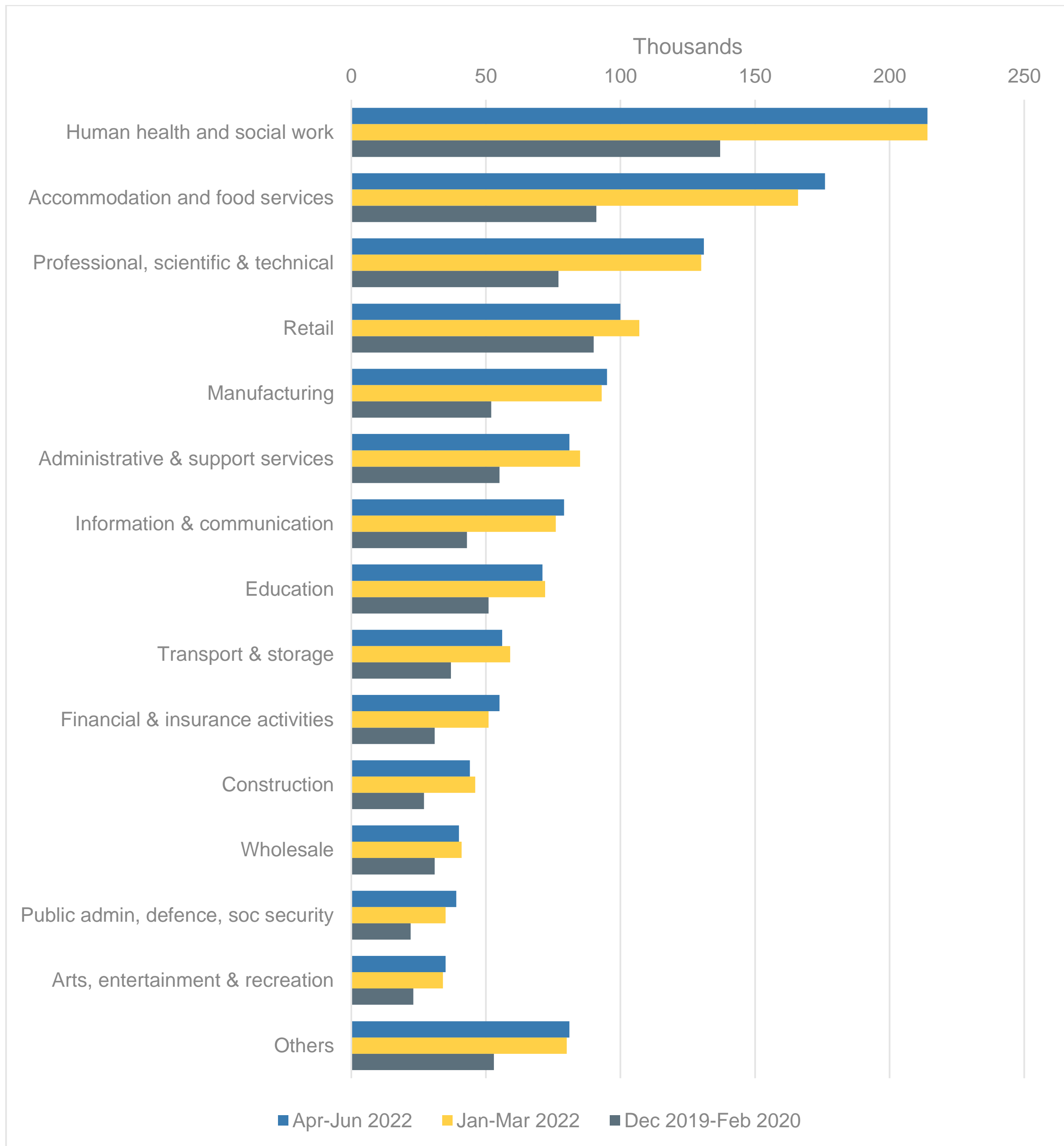
Source: ONS Vacancy Survey

Figure 8: Unemployed people per vacancy (exc. Agriculture, forestry and fishing)

Source: ONS Labour Force Survey and Vacancy Survey

Vacancies remain above pre-pandemic levels in every industry (Figure 9 below), although we can see clearer signs in today's data that vacancy growth is levelling off and is now falling back in some industries. In particular retail, administrative and support services, transport and construction are seeing vacancies fall back compared with the previous quarter (comparing the blue and black lines below).

Figure 9: Vacancies by industry, pre-crisis, latest data and previous quarter

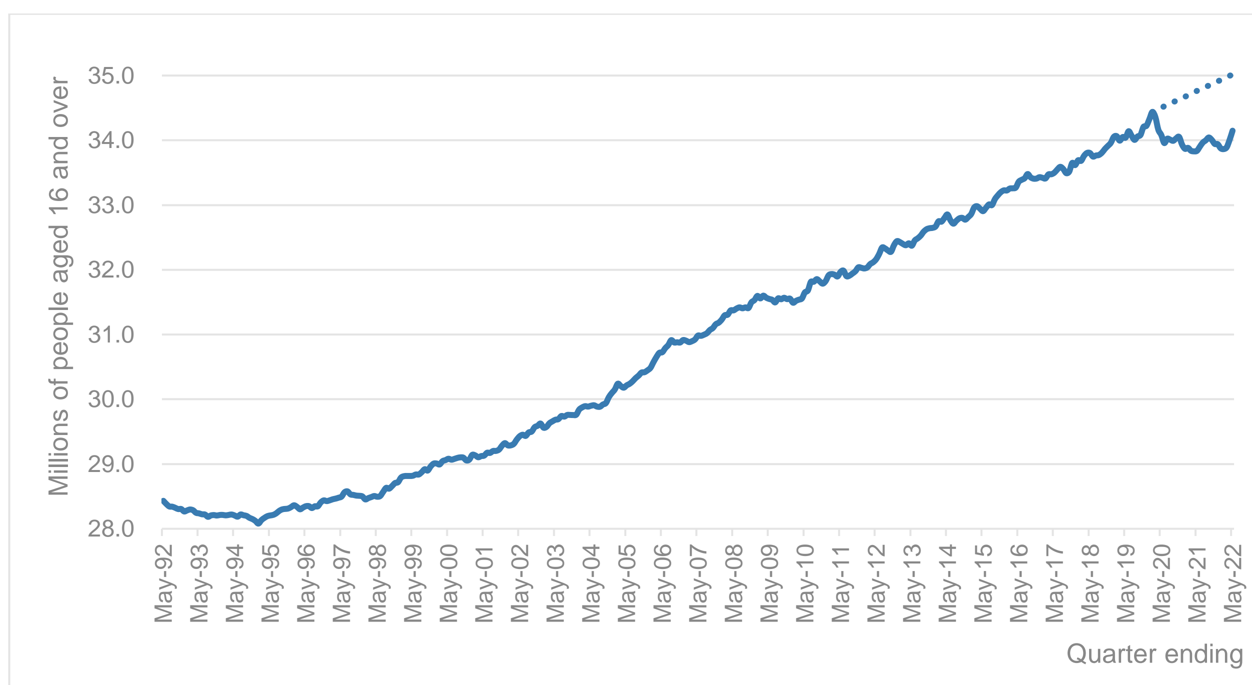


Source: ONS Vacancy Survey

Labour shortages are due to lower participation, especially for older people and those with poor health

These shortages, as previous briefings have set out, are being driven by a number of factors including very high turnover in work (with record numbers of people changing jobs) and a shift towards higher skilled work (leading to skills shortages). However the most important driver has been lower participation in the labour force. As noted, economic inactivity is higher than it was before the first lockdown, but the shortfall in participation is even greater when the pre-pandemic trend – of a continually growing labour force – is taken into account. This is illustrated in Figure 10 below. Recent increases in employment have helped to narrow the gap somewhat, but there remain nearly 900 thousand fewer people in the workforce than there would have been had the pre-pandemic trend continued. This matters because through thick and thin, firms have been able to respond to higher demand through higher supply. But post-Covid and post-Brexit, that link appears to have been broken at least temporarily.

Figure 10: Level of economic activity – actual and if pre-crisis trend had continued



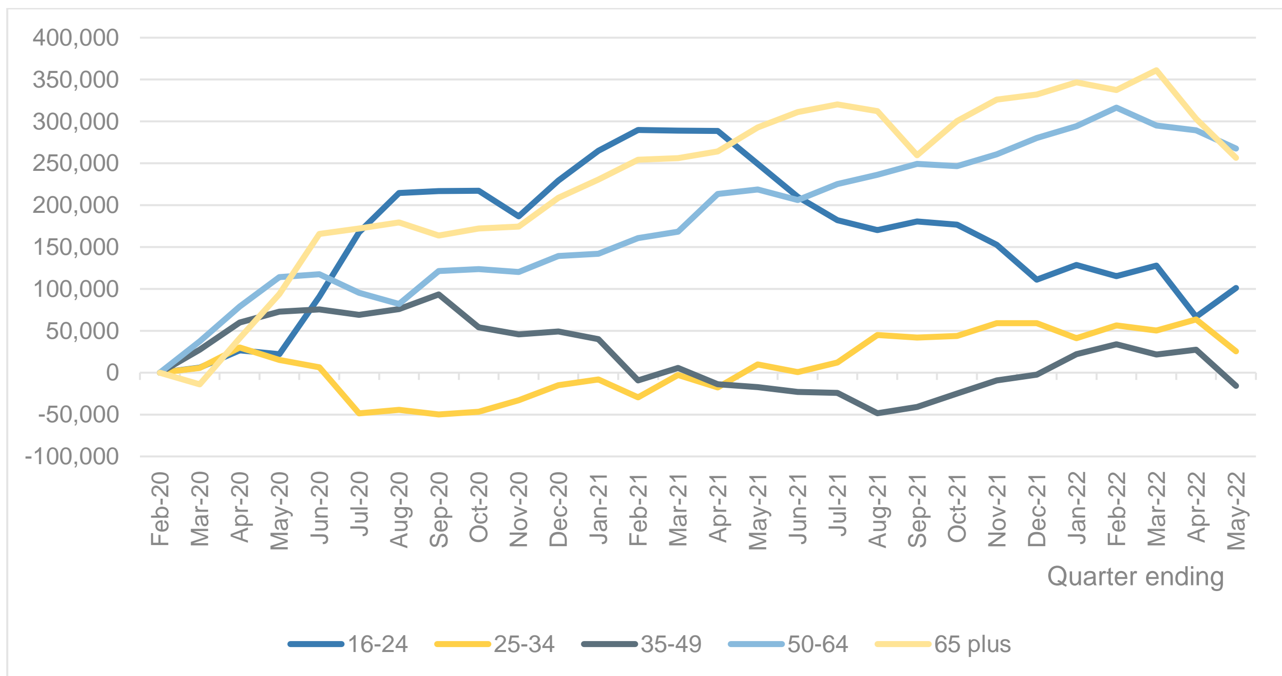
Source: Labour Force Survey and IES estimates

We estimate that around a quarter of this participation gap is explained by a smaller population (and particularly by lower migration), while the remainder is explained by higher economic inactivity. And as with previous months, higher economic inactivity is particularly due to more older people leaving the labour force and more people off work due to long-term ill health.

Figure 11 shows changes in economic inactivity by age. Just over two thirds of the growth since 2019/20 is explained by more older people outside of the labour force, although this

proportion (and levels of economic inactivity) have fallen back in the last couple of months – perhaps a sign that older people are being pulled back by a greater availability of jobs, or pushed back by rising costs of living.

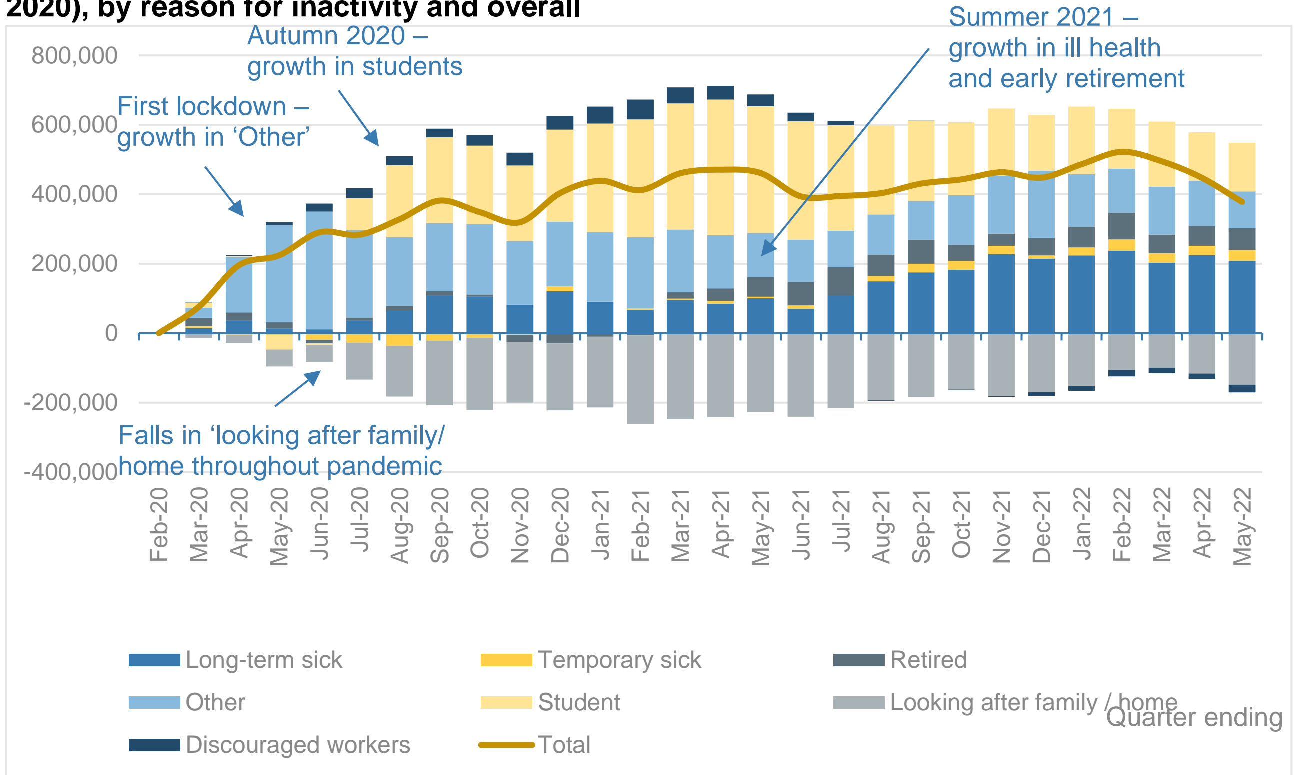
Figure 11: Change in economic inactivity by age, since start of Covid-19 pandemic



Source: Labour Force Survey

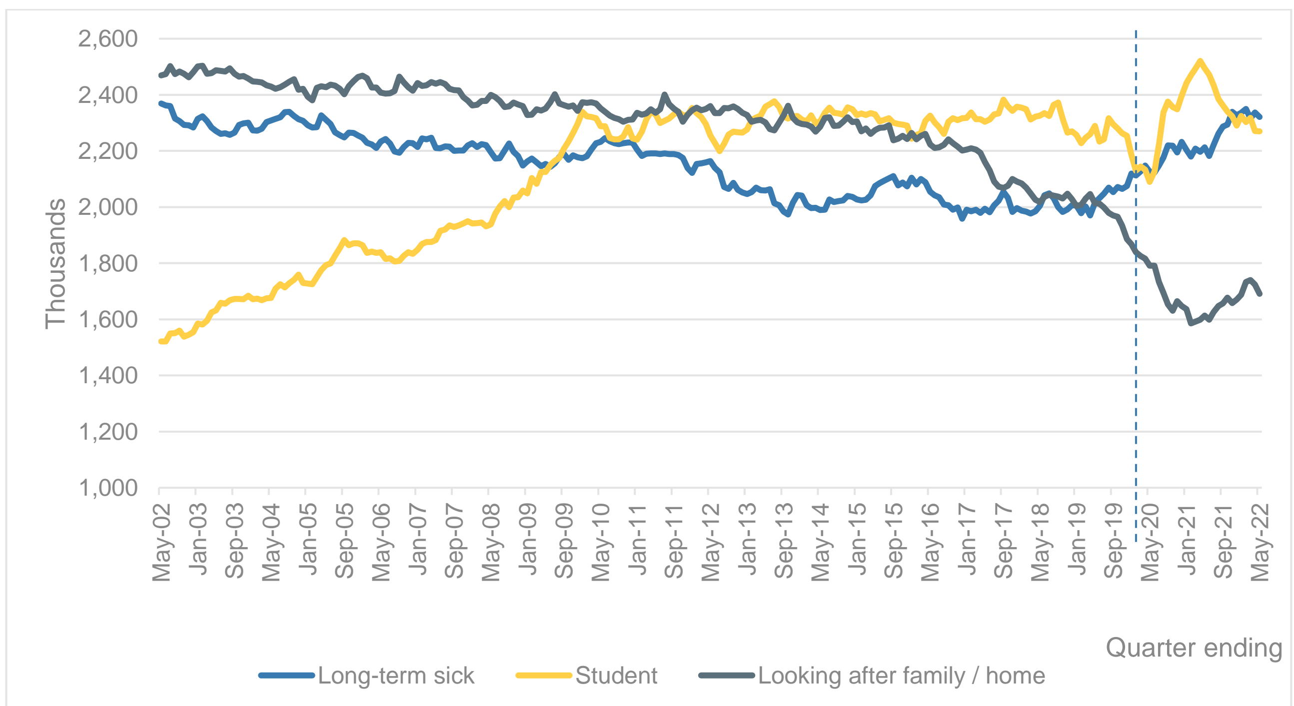
Figure 12 then shows changes in economic inactivity by reason since the start of the pandemic and has been discussed in previous briefings. The key developments this month are that all main reasons for economic inactivity are either flat or falling compared with last month's reported figures – which is reiterated in Figure 13 which shows overall levels for those out of the labour force due to studies, caring and long-term health. Again, there may be a combination of 'push' and 'pull' factors driving this, but it does appear that worklessness due to long-term ill health may be levelling off and those out of work due to caring my have stopped rising. However the long-term ill health figures in particular are very worrying, with the data plateauing at its highest level in nearly two decades. This is likely to be due to a combination of factors including delays in treatment for chronic or work-limiting conditions, pre-existing conditions getting worse through the pandemic, long Covid, and people with underlying health conditions being more likely to leave or less likely to enter work because of changes in the labour market (and the health risks of working over the last two years).

Figure 12: Changes in economic inactivity since start of pandemic (December-February 2020), by reason for inactivity and overall



Source: Labour Force Survey

Figure 13: Levels of economic inactivity for the three main reasons given, 2002-present



Source: Labour Force Survey

Conclusion

Overall, then, there is mixed news in today's data. The headline figures on employment and economic inactivity are showing signs of significant improvement, which is particularly welcome after very weak data last month. This holds out the hope that employment may continue to rise in the coming months as more people (re)enter the labour market, as long as demand continues to hold up.

However economic inactivity remains very high for those with long-term health conditions in particular, and continued labour shortages are holding back economic growth – and may in turn be feeding inflationary pressures in the private sector. The public policy response of raising interest rates to weaken demand, alongside the continued impacts of soaring inflation, could yet feed through into weaker growth in the next few months as confidence falls and spending slows. But this also reiterates why we need a more balanced response to the problems we are facing. For all the leadership talk of tax cuts and re-doing Brexit, the top priority in the labour market should be to balance measures to temper labour demand with measures to boost labour supply – in particular through more targeted help for those out of work who want to get back in, alongside more universal access to employment services for all of those who want help to find their first or next job.

As we have said before, the good news though is that there is at least £2 billion underspent through Plan for Jobs and Spending Review measures (in particular on Restart, Kickstart and Jobcentre Plus support) that could be put to use for this. Alongside this, businesses will also need to do more to make work better, more inclusive and attractive – in particular through more inclusive recruitment, better job design, more flexibility and security at work, and improved workplace support. Many are doing this already, but many more should be helped and encouraged to do so too.

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About IES

The Institute for Employment studies is an independent, apolitical centre of research and consultancy in employment policy and human resource management. It works with employers, government departments, agencies and professional and employee bodies to support sustained improvements in employment policy and practice.

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