Resolution Foundation

The Resolution Foundation Earnings Outlook

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The UK has spent the first quarter of 2021 under renewed restrictions to slow the spread of Covid-19. As the third England-wide lockdown began in January, many businesses were forced to close once again, and the number of jobs furloughed through the Job Retention Scheme (JRS) rose to 4.8 million. There is growing light at the end of the tunnel, in the form of a continued successful vaccine rollout and the Government's roadmap setting out prospects for reopening the economy, but the labour market faces challenging months to come.

At the beginning of March, Rishi Sunak presented his second Budget since becoming Chancellor last year. The main policy news for the labour market was the extension of the JRS and the Self-Employment Income Support Scheme (SEISS): both are now expected to last until the autumn, and the JRS will be phased out from July through gradually increasing employer contributions. The extension of support in line with the roadmap for easing restrictions led the Office for Budget Responsibility (OBR) to revise its forecast for the unemployment peak down to 6.5 per cent, compared to 7.5 per cent in its November forecast.

Only time will tell whether this is an optimistic stance: the OBR projection implies relatively few people moving from the JRS into unemployment, despite an expectation that 2 million jobs will still be furloughed by September. But so far, the impact of the crisis on the labour market has remained much more muted than many expected. The unemployment rate was 5.2 per cent in Q4 2020, up from 4.0 per cent on the eve of the crisis but much lower than the Bank of England and the OBR had initially expected. Real-time data on employee jobs is more pessimistic than the Labour Force Survey, with the latest figures suggesting that 726,000 fewer people were on company payrolls in January 2021 than at the start of 2020 – but even this fall is remarkably low considering that at the same time, GDP was nearly 8 per cent down on pre-crisis levels.

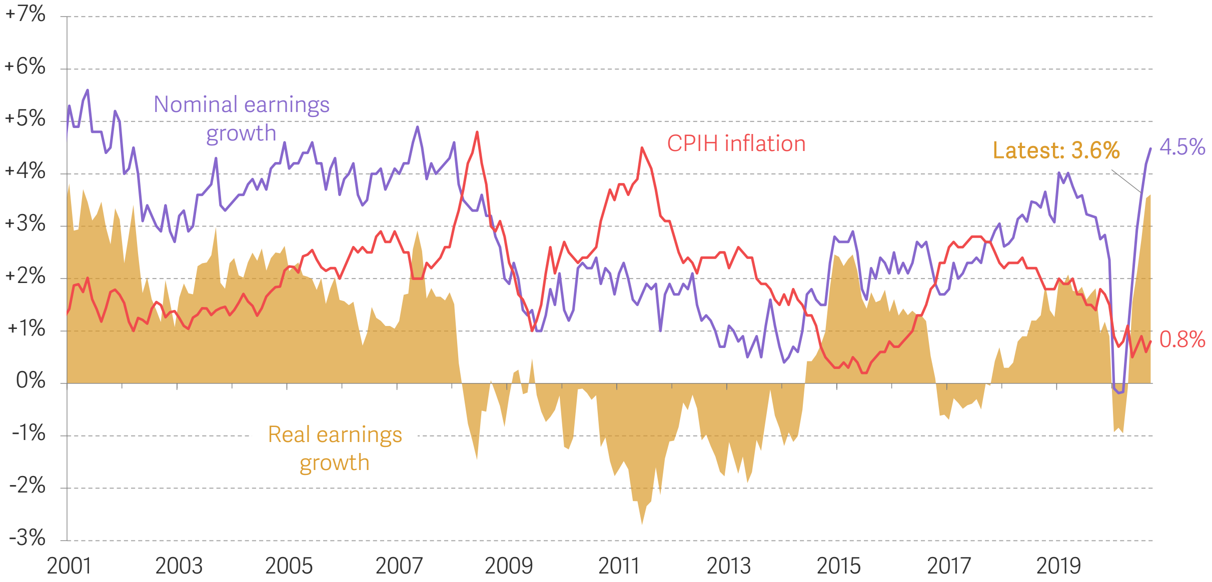
Data on earnings is more difficult to interpret, however. While earnings fell during the first lockdown, real regular pay growth has since risen to rates last seen in 2002, reaching 3.6 per cent in the latest single-month Average Weekly Earnings data. But as this Outlook's spotlight will show, strong growth in average pay does not necessarily reflect good news for individual workers. Our 'Lifting the Lid' section looks at sub-regional falls in employee numbers, job-to-job moves, and the change in zero-hours contracts over the course of 2020.

Spotlight | Earnings in the Covid-19 crisis

Interpreting labour market statistics during the Covid-19 crisis has been fraught with challenge. On the employment side, changes in the headline employment and unemployment rates have been difficult to reconcile with the fall in employee numbers implied by HMRC's payroll data. But pay data has been more counterintuitive still. Earnings growth fell in the early months of the pandemic, and briefly became negative, driven in part by many furloughed workers receiving only 80 per cent of their usual pay. But more recently, both nominal and real earnings have begun to grow at rates not seen since the early 2000s, as Figure 1 shows. This is in stark contrast to what happened to earnings after the financial crisis: nominal earnings growth fell, and real earnings growth turned negative. Earnings took more than a decade to return to pre-financial crisis levels, doing so for the first time only in the three months to February 2020, on the eve of the current crisis.

FIGURE 1: **Earnings growth has reached levels not seen since 2002**

Annual growth in average weekly earnings (regular pay) and CPIH inflation: GB, 2001-2020

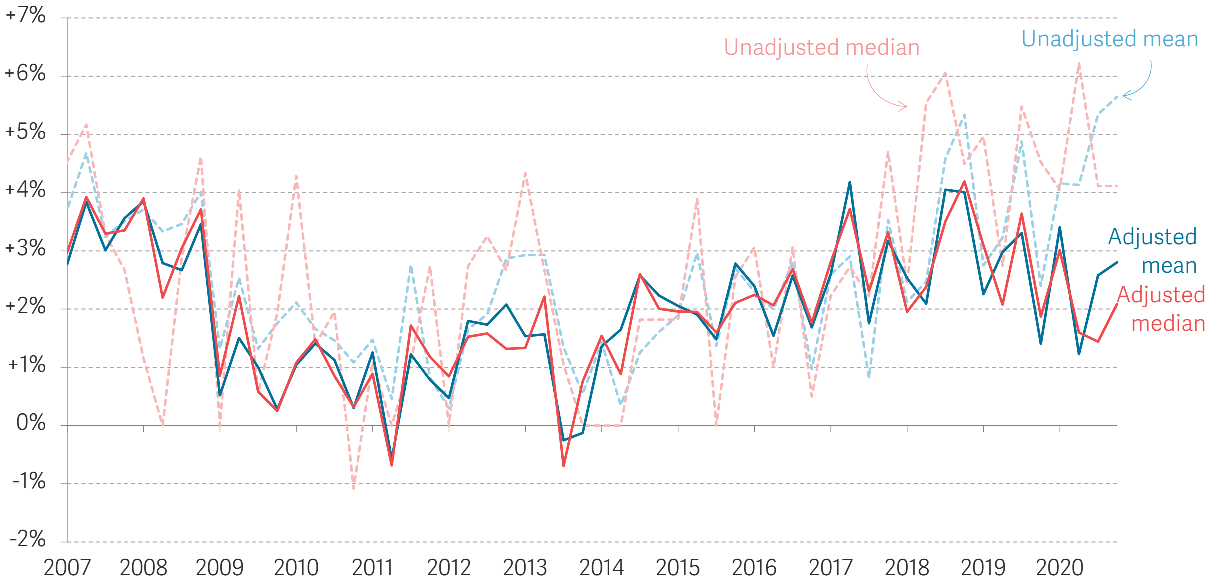


Source: RF analysis of ONS, Average Weekly Earnings.

On the surface, a return to earnings growth might seem like a boon for workers after over a decade of pay stagnation. But as the ONS has noted, at least part of this is down to compositional effects – as lower-paid workers have been more likely to lose their jobs, the average person still in work is higher-paid. In our last Earnings Outlook, we noted that the main compositional drivers of earnings growth have been occupation, hours, and qualifications.

FIGURE 2: **Adjusting for workforce composition accounts for some, but not all, of the growth**

Year-on-year growth in nominal gross weekly earnings, before and after adjusting for workforce composition: UK, 2007-2020



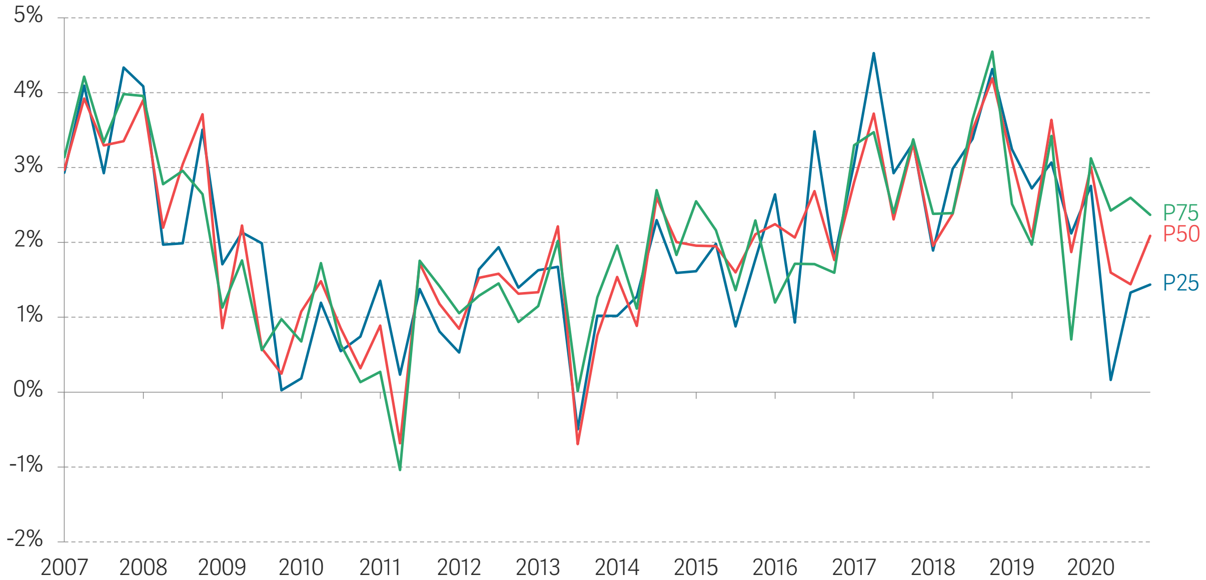
NOTES: The adjusted results are derived from a hedonic regression of logged gross weekly earnings on sex, age, qualification level, industry, occupation, length of employment, whether born in the UK, region, public or private sector, whether full time or part time, and quarterly time dummies. Analysis of the mean uses an Ordinary Least Squares (OLS) model, and analysis of the median uses a quantile regression model.
SOURCE: RF analysis of ONS, Labour Force Survey.

What is happening to earnings growth underneath these compositional effects?[1] Figure 2 uses regression analysis of Labour Force Survey (LFS) data to isolate the changes in pay after accounting for changes in workforce composition.[2] In the LFS, average gross weekly earnings rose by 5.6 per cent in the year to Q4 2020; after adjusting for other characteristics, the underlying growth in mean pay was half that rate (2.8 per cent). Similarly, growth in median pay was 4.1 per cent before adjusting for other characteristics; after adjusting, it was just 2.0 per cent. Underlying pay growth is therefore much more in line with the last few years than the headline rate – though notably, even after adjusting for compositional factors we do not see signs of the falls in pay growth that followed the financial crisis.

The fact that growth of mean pay is higher than that of median pay in Figure 2 also indicates that growth is not spread evenly across the distribution. Figure 3 uses quantile regressions to look at pay growth at different points in the earnings distribution, whilst still controlling for employee characteristics. Pay growth at the 75th percentile has remained relatively stable over the course of 2020, falling from 3.1 per cent in Q1 2020 to around 2.5 per cent thereafter.[3] Pay at the 25th percentile, however, has been much more volatile – here, there was a much more discernible earnings fall in Q2 2020, likely in part to reflect the fact that low earners have been more likely to be furloughed.[4] Composition-adjusted pay growth fell to 0.2 per cent, and only recovered to 1.6 per cent by the end of the year. More positively, there is evidence that pay growth was stronger at the very bottom of the distribution: the series is much more volatile and so is not shown in Figure 3, but pay growth was around 3.5 per cent at the 10th percentile in the second half of 2020, likely reflecting the minimum wage uplift in April.

FIGURE 3: **Growth has been much weaker towards the bottom of the distribution**

Year-on-year growth in nominal gross weekly earnings growth, after adjusting for workforce composition, by percentile of the earnings distribution: UK, 2007-2020



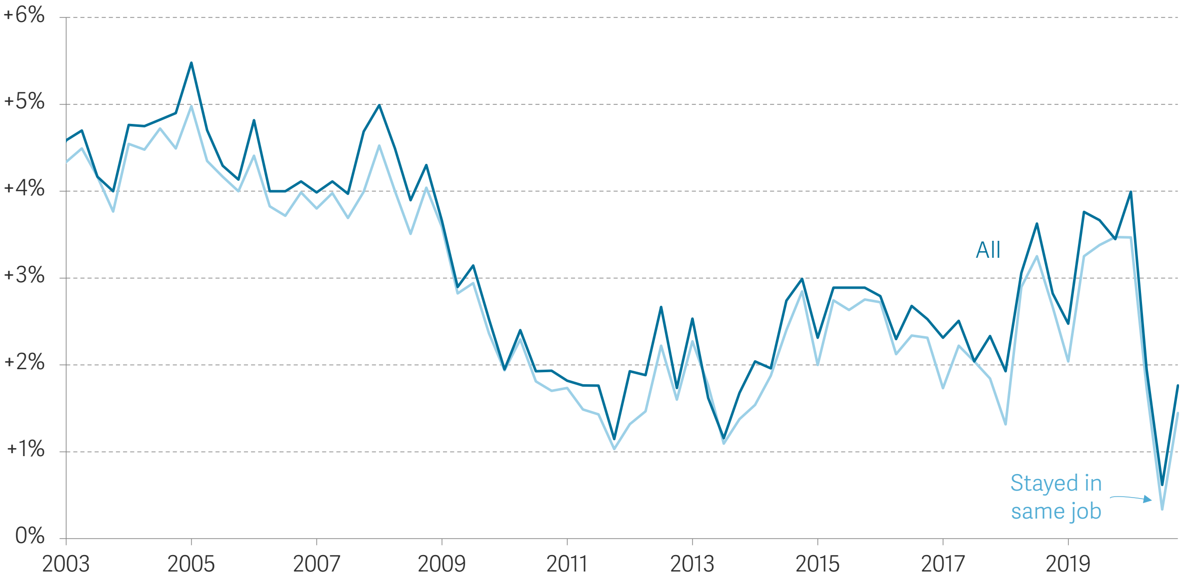
NOTES: These results are derived from a hedonic regression of logged gross weekly earnings on sex, age, qualification level, industry, occupation, length of employment, whether born in the UK, region, public or private sector, whether full time or part time, and quarterly time dummies, using quantile regression models.
SOURCE: RF analysis of ONS, Labour Force Survey.

1 Changes in weekly earnings can be driven by both changes in hourly pay rates and by changes in the number of hours worked. In this spotlight, we focus on weekly pay because of its importance for living standards; however, the broad patterns presented here still hold when we run the same analysis for hourly pay.
2 While the LFS is not the usual source for earnings data, it has the benefit of including a range of personal and job characteristics that we can use as controls. The LFS may be more prone to recall error than other sources, however, and so caution should be taken when interpreting exact rates of change. For more information, see: Office for National Statistics, A guide to sources of data on income and earnings, March 2021.
3 Because this analysis adjusts for compositional drivers of pay, the 75th percentile will reflect employees who are still high-paid after adjusting for their personal and job characteristics.
4 Furloughed workers are still included in the earnings data, as they are still getting paid. However, many will only receive 80 per cent of their previous earnings up to a cap of £2,500 (the amount covered by the Government) unless their employer tops up the remainder.

The charts above show us how average pay, and pay at other points across the distribution, are changing. But another measure that is important for living standards is whether individuals who stay in work from one year to the next experience a pay rise.[5] Figure 4 tracks the median of all individuals' percentage change in weekly earnings over the course of a year. The impact of the crisis on changes in individuals' pay is stark: the median pay change over the year to Q3 2020 was just 0.3 per cent among people who stayed in the same job, and 0.6 per cent across all workers, the latter representing a real pay cut of 0.2 per cent.[6] By Q4 2020, the typical worker had received a pay rise of 1.8 per cent over the preceding year (or 1.0 per cent in real terms) – an improvement, but still the lowest since 2013.

FIGURE 4: **In Q3 2020, the typical person who stayed in their job experienced annual earnings growth of just 0.3 per cent**

Year-on-year growth in nominal gross weekly earnings growth, after adjusting for workforce composition, by percentile of the earnings distribution: UK, 2007-2020



NOTES: Base = those who were in work in the current quarter and the same quarter a year earlier. This analysis is not conditional on individuals having stayed in work in all interim quarters. The 'all' line includes those who changed jobs over the past year (which we do not present here as a separate series due to considerable volatility) and those who did not state how long they had been in their current jobs.
SOURCE: RF analysis of ONS, Labour Force Survey Five-Quarter Longitudinal Datasets.

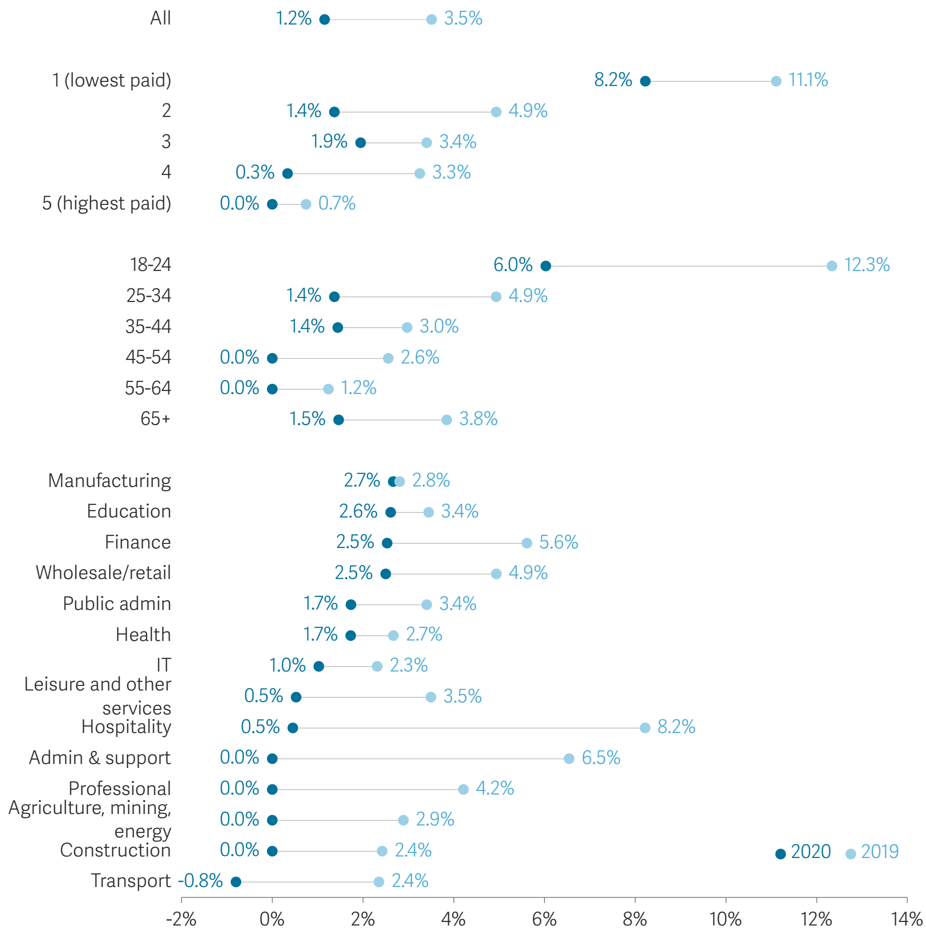
Some groups of workers have done better than others. Figure 5 shows how the median pay change over the year to the second half of 2020 varies across different groups of workers, and how this compares to a year earlier. While the young and the low paid who are still in work have had above-average pay rises over the past year, these workers would normally experience a much larger pay boost in a normal year conditional on staying in work – and the typical pay rise for 18-24-year-olds has halved compared to 2019, from 12.3 per cent to 6.0 per cent.

Pay changes also vary significantly by industry: sectors like manufacturing and education have been relatively immune to falling pay growth (at least among those who are still in work), but after accounting for inflation of 0.8 per cent, the typical worker in sectors like professional services, construction, transport, and leisure and other services has seen a real pay fall. And altogether, 49 per cent of employees – or more than 13.5 million people – had experienced a real pay fall in the second half of last year.

5 Furloughed workers are still included in the earnings data, as they are still getting paid. However, many will only receive 80 per cent of their previous earnings up to a cap of £2,500 (the amount covered by the Government) unless their employer tops up the remainder.
6 Adjusted for CPIH inflation.

FIGURE 5: **The typical employee in the professional, admin, agriculture, and construction sectors has faced a pay freeze, and pay has fallen for the typical transport worker**

Median annual change in nominal gross weekly earnings, by pay quintile, age and industry at the start of the year: UK, Q3-Q4 2019 and Q3-Q4 2020

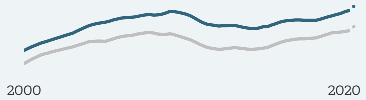
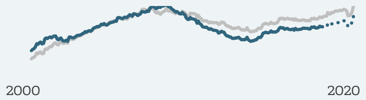
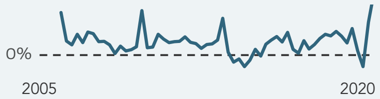
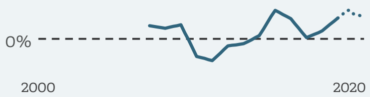
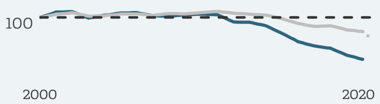
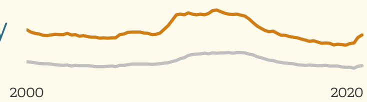
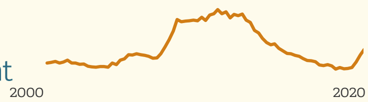
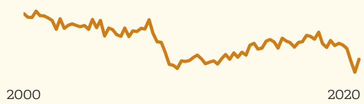
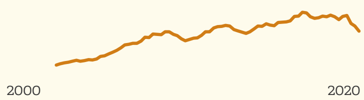
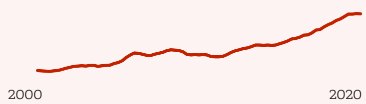
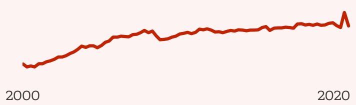
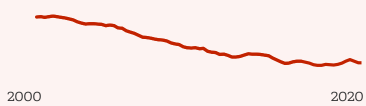
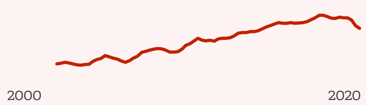


NOTES: Base = those who were in work in the current quarter and the same quarter a year earlier. This analysis is not conditional on individuals having stayed in work in all interim quarters. The 'all' line includes those who changed jobs over the past year (which we do not present here as a separate series due to considerable volatility) and those who did not state how long they had been in their current jobs.
SOURCE: RF analysis of ONS, Labour Force Survey Five-Quarter Longitudinal Datasets.

Some of the sectors with below-average pay rises are those where the employment hit has been concentrated, too. In 2019, the typical worker in the hospitality sector saw their pay grow by more than 8 per cent (accounted for in part by moves into higher-paying sectors); this year, the typical pay rise was just 0.5 per cent. But others are more unexpected. The median worker in the professional services sector experienced a pay freeze, despite the fact that workers in this industry have been more likely than average to be able to work from home. Many of those in sectors that have been relatively sheltered from pandemic-related job losses and furloughing are nonetheless facing an economic hit.

Beneath the headline figures, then, pay trajectories in 2020 look a lot less rosy: around half the growth is due to compositional changes in the make-up of the workforce, while close to half of those in work have experienced a fall in their real earnings. Weak pay growth is likely to continue beyond this year, however. The incidence of pay freezes doubled between 2019 and 2020, rising from 5 per cent to 20 per cent of settlements, and the public sector is set for pay freezes in 2021-22. And in the longer term, the OBR expects real earnings to be 4.3 per cent below the OBR's pre-crisis forecast by 2025. After the financial crisis, it took six years for average weekly earnings to start growing again in real terms. Returning to employment growth and a tight labour market as quickly as possible, alongside continued increases in the minimum wage to support lower-paid workers in particular, will be crucial for boosting living standards as the recovery takes hold.

The Scorecard | Quarter 1 2021

Median employee earnings		↑ 4.1% on yr (all) ↑ 3.8% on yr (private sector)	In the most recent data, real median hourly pay grew by 4.1%. Pay growth picked up in the second half of 2020, largely due to compositional factors.
All worker earnings		Employee earnings and all worker ↓ 14%	Our all worker earnings measure is based on pre-pandemic data, so the falling gap does not reflect changes in self-employment earnings since the crisis.
Earnings decomp.		↑ 1.7ppts on yr	Pay growth was 1.7 ppts higher as a result of compositional effects. This Outlook's spotlight explores underlying pay growth in more detail.
Pay rises		↓ 0.5ppts on yr	Median year-on-year real hourly pay growth for employees in work over a year (both job stayers and changers) stood at 2.2% in Q3 2020, 0.5 ppts lower than the previous year.
Earnings Inequality		r75:25 ↓ 2.4% on yr r90:10 ↓ 1.6%	Our headline measures of earnings inequality continue to fall, but low paid workers have been more likely to face reductions to hours and pay or to have lost work.
Unemployment by duration		↑ 1.3 ppts on yr (all) ↑ 0.2ppts on yr (long-term)	The unemployment rate rose to 5.1% in the latest data, and there are signs that long-term unemployment is starting to increase
Underemployment		↑ 55% on yr	Under-employment has risen significantly in the crisis, likely due to employers making hours reductions in the face of weak demand and supply constraints.
Job-to-job moves		↓ 30% on yr	The proportion of workers voluntarily moving job was 30% down on the previous year. This will have a negative effect on pay growth, though job-to-job moves are up on the previous quarter.
Migrant job entry		↓ 16% on yr	The share of jobs going to new migrants has fallen by 16% across the past year.
Workforce participation		↑ 0.2% on yr	The labour force participation rate of 18-69-year-olds reached 76.8% in Q4 2020, but the crisis has caused recent growth to plateau.
Labour productivity		↓ 1.2% on yr	Hourly productivity rose sharply in Q3 2020, possibly for compositional reasons (people in lower-productivity sectors losing their jobs), but fell back in Q4 2020.
Training intensity		↓ 2% on yr	The long-term trend in falling 'off-the-job' training has flattened out, but the proportion of workers receiving such training remains low – a potential drag on productivity.
Graduates in non-graduate occupations		↓ 3% on yr	The proportion of graduates in non-graduate roles (a measure of mismatched demand and supply of skills) has fallen over the past year, and stands at 35.0%.

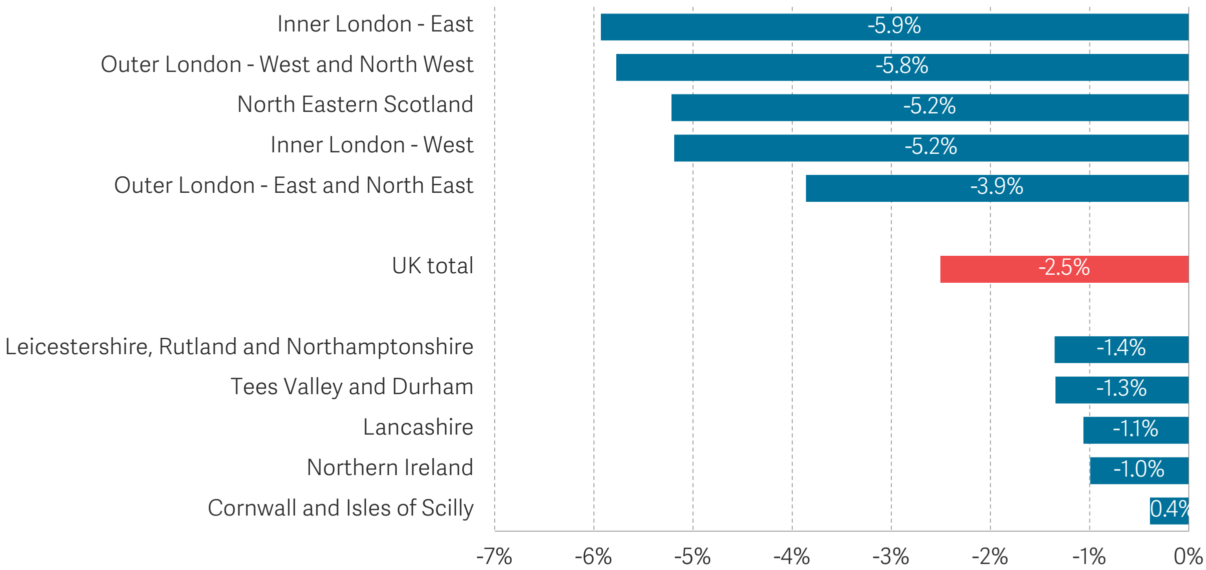
Lifting the lid | The picture across different groups and areas

Here we explore a few of the most interesting developments for different groups of workers and different parts of the country. A comprehensive breakdown of each indicator is available online: resolutionfoundation.org/earningsoutlook

The sectors that have been hardest hit by social distancing restrictions, such as hospitality, retail, and leisure, are found right across the country. But the geographic hit of the crisis has not been even: we have previously noted that London, city centres, and tourist-reliant areas have faced the biggest impacts. New data on payrolled employees at NUTS2 level underline the differential geographic effects of the crisis. Figure 1 shows that while employee numbers have fallen in every local area since the start of the crisis (the smallest fall, of 0.4 per cent, was in Cornwall and the Isles of Scilly), the hit has been most widespread in London: four out of the five worst-hit areas were in the capital.

FIGURE 1: **Percentage change in the number of payrolled employees (seasonally adjusted), highest and lowest changes by NUTS2 region: UK, February 2020-January 2021**

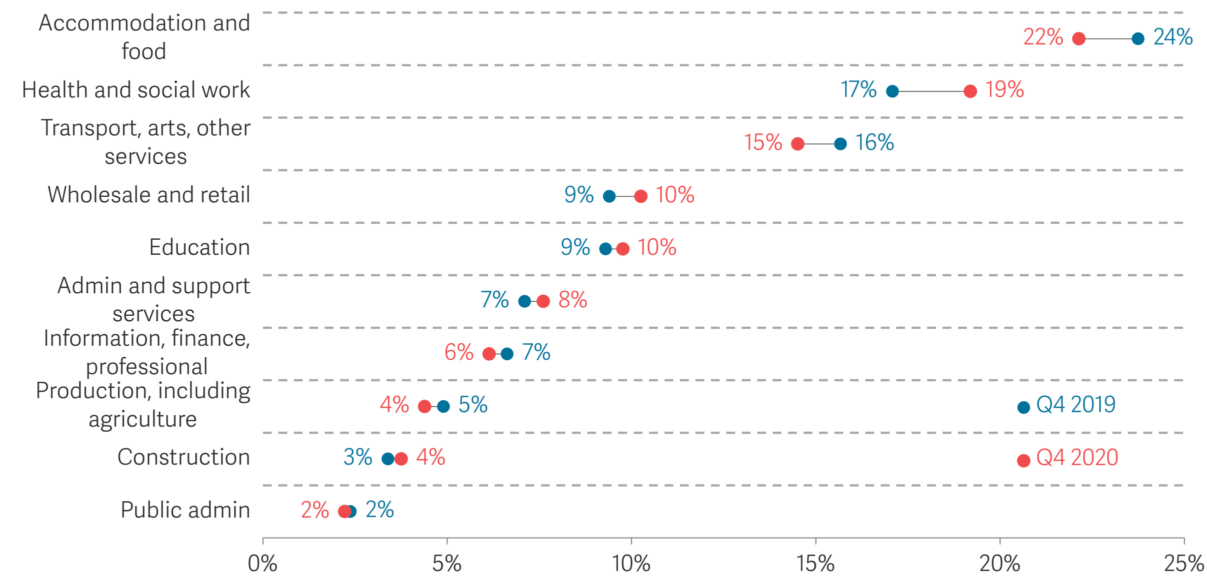
SOURCE: RF analysis of ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted.



There have been two key changes to insecure work since the crisis hit: on the one hand, people in atypical forms of work have been most at risk of losing their jobs since the start of the crisis; on the other, people who have got a new job since the crisis began are disproportionately likely to be on an atypical contract. Figure 2 looks specifically at how the share of workers on a zero-hours contract (ZHCs) has changed since before the pandemic.

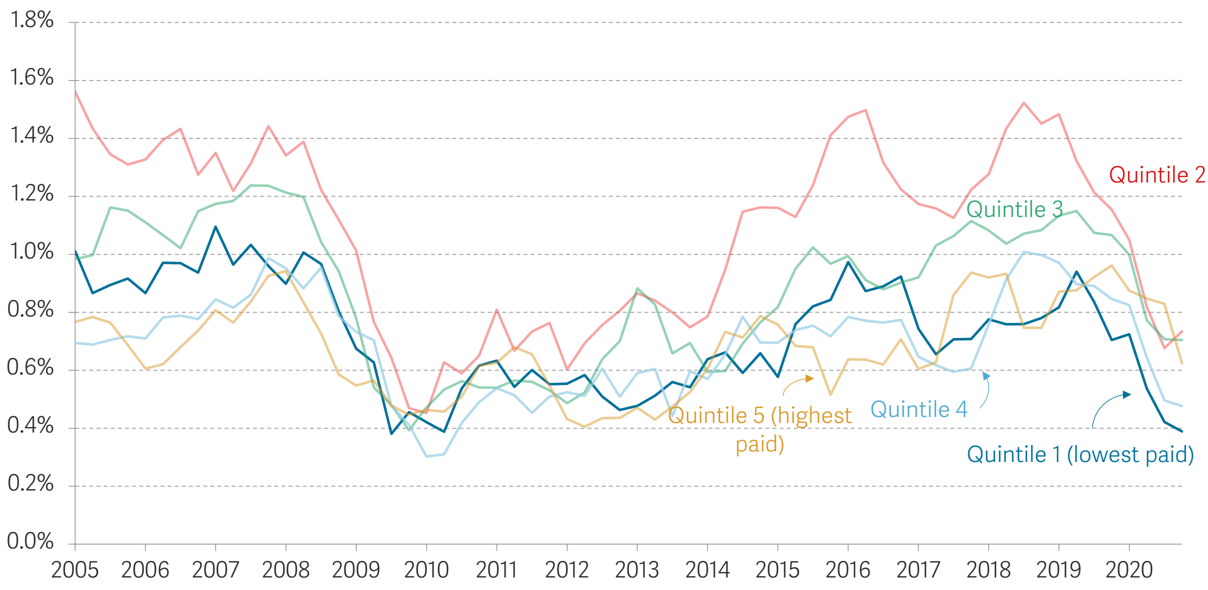
. The two sectors where ZHCs are most prevalent, hospitality (accommodation and food) and health and social work, have behaved very differently. While the share on a zero-hours contract has fallen in hospitality (possibly reflecting higher-than-average job losses in that sector), it has risen in health and social work. This will be one important metric to keep an eye on as the economy begins to recover: the prevalence of insecure work rose sharply in the aftermath of the financial crisis.

FIGURE 2: **Share of workers on a zero-hours contract, by industry: Q4 2019-Q4 2020**



SOURCE: ONS, People in employment on zero hours contracts.

FIGURE 3: **Voluntary job-to-job moves (four-quarter rolling average), by weekly pay quintile: 2005-2020**



SOURCE: RF analysis of ONS, Labour Force Survey.

Voluntary job-to-job moves have fallen to record lows over the past year. As the crisis has hit, new opportunities have dried up and those lucky enough to still have a job lack the confidence to move. Figure 3 shows that voluntary moves have been least frequent among the lowest paid. In part, this trend pre-dates the pandemic – but it is also likely to reflect the fact that the sectors where low earners tend to work have been hardest hit by the crisis, and so those still in work are reluctant to risk moving. Low earners are also more likely to be furloughed, which may make them less likely to consider moving mid-pandemic. This may signal job moves to come once the crisis has passed: in January, furloughed workers were more likely than other workers to say they planned to move sectors after the pandemic.