JOBS AUDIT

Jobs outlook 2014

The JOBS
ECONOMIST

January 2014

Introduction

2013 proved to be another pleasantly surprising year for the UK economy and labour market. Last January it was feared that the economy might suffer a triple-dip recession and unemployment was expected to rise. But by the time of the Chancellor's Autumn Statement in early December the government's official forecaster, the independent Office for Budget Responsibility (OBR), had doubled its original forecast for annual economic growth to 1.4%, quadrupled its employment forecast for 2013 from zero to 400,000 and lowered its unemployment forecast from 8.2% to 7.5%. Initial gloom had been replaced by a growing mood of confidence. Indeed, not only did the economy avoid a triple dip recession in 2013 but official data revisions showed that there hadn't been a double dip recession in 2012. Moreover, fresh official labour market data published in mid-December pointed to even stronger job growth and lower unemployment for 2013 than the OBR had anticipated.

However, not everything in the garden has been rosy. Pay rises have generally fallen short of consumer price inflation, resulting in a cost of living crisis for many people, which has prevented the economic recovery from improving the social feel good factor. And it's clear the economy is experiencing a consumer led recovery, fuelled by higher household debt, lower savings and the prospect of rising house prices, rather than the hoped for export and investment recovery. Consequently, there is underlying concern that the current the surge in economic growth isn't sustainable. Nonetheless, there is a greater sense of optimism around, especially when it comes to employment prospects. What therefore might 2014 bring?

This *Jobs Audit* compares the UK labour market outturn in 2013 with the Jobs Economist expectations from last January and offers a judgment on what is likely to happen in the coming year.

What did The Jobs Economist get right, and wrong, about 2013?

While we correctly forecast that 2013 would be a 'hard slog' year for most UK workers, with longer hours for no extra real reward, we were far too pessimistic about employment growth and unemployment. Although we were somewhat more optimistic than both the then economic consensus and the OBR on prospects for GDP growth and unemployment, the outturn greatly exceeded our expectations.

We expected the total number of people in employment to increase by 80,000 (the OBR forecast no net employment growth at all).The outturn? Employment had already increased by 485,000 (+1.6%) in the year to the rolling quarter August-October and at the time of writing looked set to increase by more than 500,000 in 2013 as a whole (similar to the increase in 2012). Women account for well over half (58%) of the net increase in the year and also registered a faster rate of annual employment growth (+2.1%) than men (+1.3%).

We expected the balance of employment growth to shift toward full-time and permanent employees. The outturn? Employees account for almost the entire net increase in employment in the year to the August-October quarter (428,000, +1.7%). Self-employment increased by 53,000 (+1.3%). Almost all the net additional people in employment were working full-time. Full-time employment increased by 460,000 (+2.1%), part-time employment by 25,000 (+0.3%). And all the net additional people in employment were employed on permanent contracts (the number of people working in temporary jobs fell by 36,000 (-2.3%).

We expected total unemployment to increase by 120,000 to 2.63 million (an unemployment rate of 8.1%) but as a result of the impact of government policy measures we also expected youth unemployment (people aged 16-24) to fall below 900,000 and for the level of long-term unemployment (i.e. people unemployed for more than 12 months) to remain broadly constant as a share of total unemployment. The outturn? Unemployment fell by 121,000 to 2.388 million (7.4% of the workforce) in the year to the August-October quarter. The fall in unemployment is much smaller than the rise in employment due to an increase of 363,000 (+1.1%) in the size of the economically active population. The number of men unemployed fell by 80,000, to a rate of 7.7%. Female unemployment fell 14,000 to 6.9%. By contrast, youth unemployment was a great disappointment falling by only 4,000 to 941,000. However, long-term unemployment did remain broadly constant as a proportion to total unemployment (at around 36%), falling by 38,000,000 to 866,000.

We expected labour productivity to increase having fallen in 2012, which in conjunction with longer hours of work was expected to increase the rate of growth of average weekly earnings to 2.2% by the end of 2013. With CPI price inflation expected to be running at 2.3% by the end of 2013 it was thus our expectation that 2013 would be the fifth consecutive year of average real pay cuts albeit the real pay squeeze would be less severe than in 2010, 2011 or 2012. The outturn? Output per worker did increase, by 0.5% in the year to the second quarter, though subsequent very strong employment growth suggests that this might not have continued into the third quarter. Either way the rate of growth of average weekly earnings on the measure the ONS publishes each month fell to 0.8% by August and remained at that rate until October. CPI price inflation fell but only in line with expectations, so the real wage squeeze thus remained severe, although the ONS's annual survey of hours and earnings (ASHE) suggested a stronger rate of median weekly wage growth (an increase of above 2% in the year to April 2013).

The jobs outlook for 2014

Our expectation for 2014 is that employment will continue to increase very strongly, especially in the first half of the year, before faster growth in productivity moderates the pace of job creation. We expect the unemployment rate to fall quite quickly to 7% by mid-year before stabilising at around that rate until the end of the year. However we do not think the Bank of England will decide to raise base interest rate until November at the very earliest, and then only to 0.75%.

The background economic forecast underpinning this 2014 jobs outlook assumes that the base interest rate set by the Bank of England will be unchanged at 0.5% until at least November and then increase to 0.75%, that the Bank of England will maintain its policy of quantitative easing as at the end of 2013, and that the trajectory of fiscal policy is that as last set out in the Chancellor's December 2013 Autumn Statement.

Our resulting expectation for consumer spending, government spending, investment, net exports and price inflation suggests annual growth in real GDP of 2.6%, higher than the latest Office for Budget Responsibility (OBR) forecast.

We expect private sector employment (including self-employment) to increase by 450,000, more than offsetting a fall in public sector employment of 130,000. Despite much stronger output growth we expect the resulting net increase in total employment of 320,000 (+1.0%) to be smaller than in 2012 and 2013 because of correspondingly stronger we growth in labour productivity.

Our employment forecast draws heavily upon surveys of employers' hiring intentions which suggest substantial net hiring by private sector employers as we enter 2014. As a result we also expect the official measure of unfilled job vacancies to return to the pre-recession (i.e. spring 2008) peak by mid-year.

The level of unemployment is forecast to fall to 2.3 million (7%) by the end of the second quarter, the pace of reduction moderated by continued strong growth in the size of the economically active population. We expect faster growth in recruitment and vacancies in 2014 to be particularly beneficial to young job seekers, enabling youth unemployment to fall below 900,000, while policy measures should help reduce the level of long-term unemployment to 820,000. However, the likely path of unemployment in 2014 is particularly difficult to assess because of uncertainty about the scale of inward migration of workers from Bulgaria and Romania.

The rate of growth of average weekly earnings is expected to rise to 2.4%, upward pressure from higher labour productivity, longer working hours and more job vacancies being moderated by the still high rate of unemployment and public sector pay constraints. Consequently, there will be no risk of serious wage inflation in 2014, which is why the rapid fall in unemployment to 7% is unlikely to persuade the Bank of England of the need for an early interest rate rise. With inflation on the CPI measure forecast at 2.2% by the end of the year, 2014 will thus just about see the end of the post-recession squeeze on real earnings**.** However, the increase in real pay will be too small to have a perceptible impact on the financial well-being of most employees for whom 2014 will feel like yet another year of relatively slim pickings.

The combination of increased job vacancies and falling unemployment is forecast to trigger an increase in the rate of voluntary labour turnover as more employees seek to switch jobs in an effort to improve pay and conditions. Despite the absence of overall wage inflation this will put pressure on employers to respond by increasing the relative pay of some workers in an effort to recruit and retain individuals in greatest demand across the occupational skill spectrum. The impact of this on pay inequality at a time of meagre growth in average real pay as employers keep a firm grip on overall pay bills could thus result in feelings of unfairness in many workplaces and give rise to disharmony

In this context reward management will become even more difficult as organisations balance the need to pay above the odds for some workers against the frustrated pay aspirations of their workforces as a whole. In order to maintain harmonious employment relations, the rationale for individual pay awards will have to be as transparent as possible in order to avoid any sense of cronyism toward favoured employees. In particular, organisations will need to ensure that simplistic reference to the importance of ‘top talent’ is not used as justification for increased executive reward in the absence of clear evidence of exceptionally high performance.