Faster UK wage growth unwelcome news for the Bank of England

The surprise pick-up in UK wage growth casts doubt over recent indications that pay pressures have started to ease. We should caution that one month doesn't make a trend, though a similar surprise blowout in services inflation due on Wednesday would inevitably move the dial in favour of a 25bp rate hike from the Bank of England next month

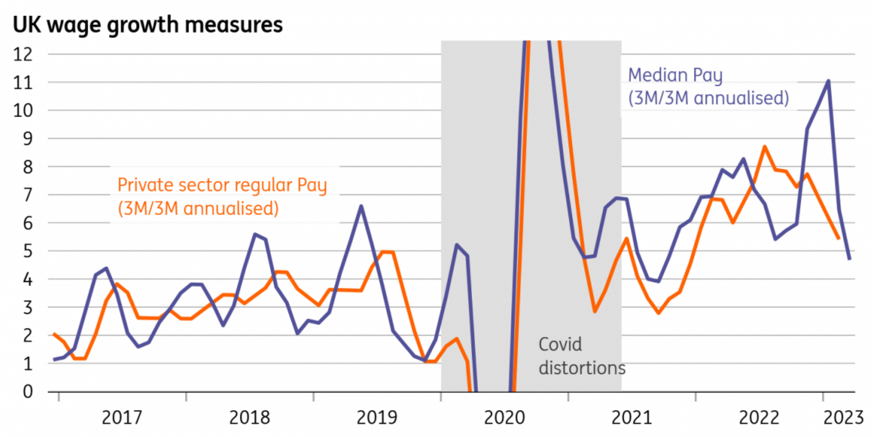
Pictured: NHS junior doctors strike in London. The number of workers out of the labour force has continued to increase in recent months

For those of us expecting the Bank of England to keep interest rates unchanged next month, the latest surprise pick-up in UK wage growth undoubtedly puts a spanner in the works.

The headline measure, which compares the most recent three-month period to a year ago, saw regular pay growth pick up to 6.6% from 6.5% previously. But a better way of thinking about this is the level of private sector weekly pay. Over the past couple of months, that had only been increasing by £1-2/month, compared to larger monthly increases through much of 2022. However, the most recent month of data shows a £5 increase in the average weekly pay packet in the private sector.

Importantly, momentum in wage growth is still lower than it was a few months ago. If we smooth through recent volatility and look at the most recent three months compared to the three months prior, private sector regular pay was 5.4% higher on an annualised basis, down from 8-9% last summer. And that tallies with other survey evidence, including the Bank of England's own Decision Maker Panel, which shows firms are raising pay less aggressively than they were.

UK wage growth momentum is slowing, despite latest data

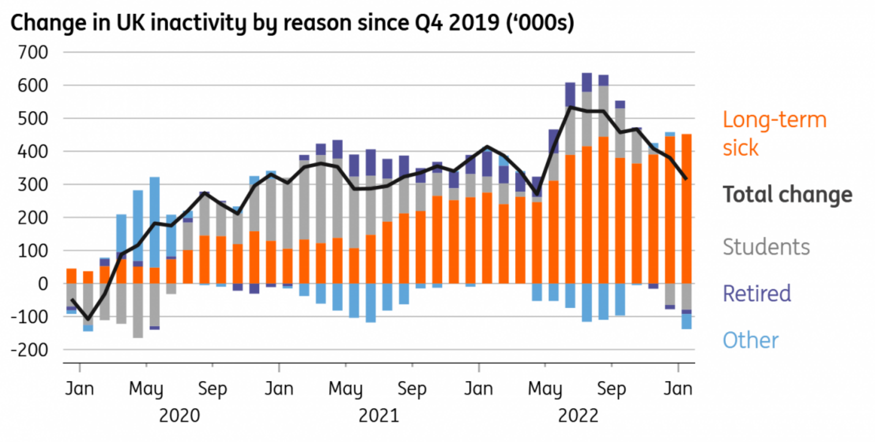


Source: Macrobond, ING calculations

In short, we should avoid drawing heavy conclusions from one set of data. One month doesn't necessarily make a trend, but it does complicate the BoE's decision in May. A similar blowout in services inflation tomorrow would probably be enough to lock in another 25bp rate hike next month. Both the BoE and ourselves think services inflation is most likely to remain broadly unchanged or fractionally higher in Wednesday's data.

Looking longer-term, the equally important question is how quickly wage growth (and with it, services inflation) will descend back towards levels seen before Covid. On that front, there was a sliver of good news in that inactivity in the labour market has continued to trend downwards – that is, people who are neither employed nor actively seeking work. On paper that's good news for worker shortages, which the Bank's DMP survey has suggested have begun to ease in recent months.

UK worker inactivity has been falling in recent months



Source: Macrobond, ING calculations

Then again, the fall in inactivity is predominantly linked to lower student numbers, and in fact the number of workers out of the labour force has continued to increase. To the extent that challenges in the health service and long waiting lists are contributing to worker shortages, this suggests the story is still only getting worse.

Author

James Smith
Developed Markets Economist
james.smith@ing.com

Disclaimer