UK jobs market heats up as unemployment rate falls to pre-virus low

Wage pressures are building as skill shortages come to the fore. But while some of this is driven by structural forces that are unlikely to disappear rapidly, part of the recent tightness is borne out of the jobs market coming out of an unusually dormant phase

The UK labour market is cooling more noticeably

The UK jobs market is undeniably hot right now. The unemployment rate is now at 3.8%, which equals the multi-decade lows seen just before the pandemic. There's now also one vacancy for every unemployed person, the first time this milestone has been reached since the data began in the early-2000s.

Unsurprisingly wage growth is running at, or a little faster, than it was pre-Covid, judging by the recent three-month annualised growth rates. That's been a key factor behind the three consecutive Bank of England rate hikes, and likely means we should expect one or two more before the summer.

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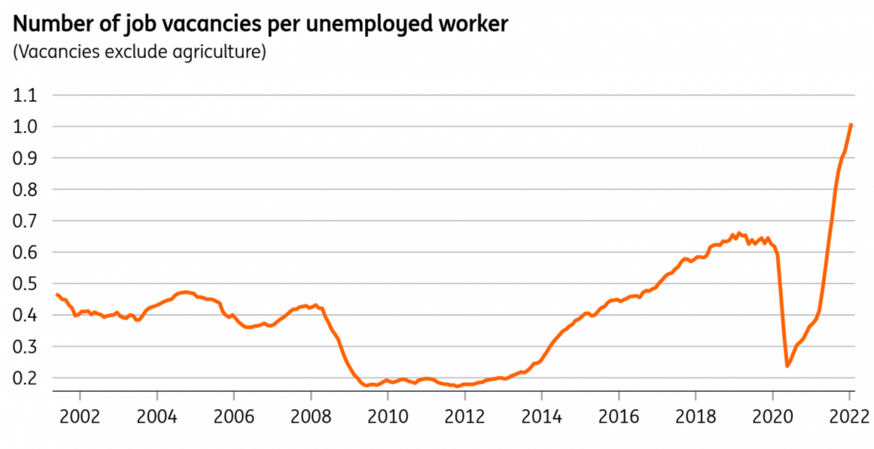


Source: Macrobond, ING

But as the economy flirts with recession over the summer, there's growing uncertainty surrounding the outlook for wages. And the key challenge is to understand what the biggest sources of skill shortages in the jobs market are – and how long-lasting they are likely to be.

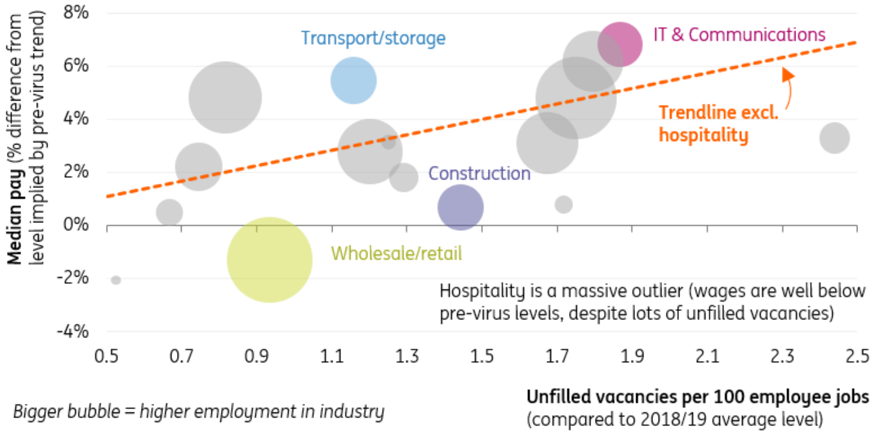
Some of the story – and recent pay pressures – are undoubtedly down to lower inward migration following Brexit and the pandemic, as well as other longer-term structural factors. That appears to be a key reason behind the recent shortage of lorry drivers and chefs, to give a couple of examples. These hiring challenges are unlikely to resolve themselves quickly.

Labour market participation in general is also lagging behind. The percentage of the population in employment is roughly one percentage point lower than it was pre-virus, partly because of early retirement but increasingly because of rising long-term sickness rates. The jury's out on exactly why this is – or indeed how long it might last – but in the meantime it's adding to labour shortages.

But some of these hiring challenges are almost certainly exacerbated by the economic reopening over the past few months. We've seen increased churn in the jobs market as both hiring demand and workers' desire to move roles surged last summer, after an unusually dormant phase. The number of people waiting to start, or had recently started, a new job spiked last autumn, though has fallen back since.

That process has inevitably resulted in some large mismatches, and often in areas where consumer demand increased abruptly through the pandemic. Online retail is a good example, and logistics-related roles stand out for being in shortage as firms scramble to adjust to the large upshift in demand. And in general, the wage story varies greatly depending on sector. The chart below shows – unsurprisingly – that those sectors where unfilled vacancies tend to be more prevalent than they were in 2018/19 have seen a faster pace of wage growth.

Sectors with more unfilled vacancies relative to pre-pandemic have seen above-trend pay growth



Source: Macrobond, ING

In short, there's little reason to expect wage growth to fall back materially in the short-term, not least given some of the structural issues in the jobs market and overall tightness right now. But as the mismatch in the jobs market dissipates following last summer's reopenings, so too should one source of the related pay pressures. That adds another potential reason for the Bank of England to pause its tightening cycle through the second half of the year.

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