UP THE WORKERS

Strategy and economics

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With events in Greece capturing the headlines, it might seem rather parochial to be writing about the domestic labour market. But I have set out my position on Greece previously in this column, and there seems no point in repeating it. More to the point, perhaps, for most people who read this article, it will not be events in Greece that impact them but events closer to home - events that could cause the Monetary Policy Committee to begin rethinking its stance on interest rates. That is not to say Greece is unimportant: the fact that the situation has become so fraught is, in my view, testament to the fact that the formation of the euro was a massive step too far for many members of the eurozone, foisted upon populations that had too limited an understanding of its long-term implications. The euro was supposed to be a mechanism for forcing greater political union within Europe. Well that's working well.

The headline following last week's labour market data was that employment dropped during the three months to May. Quel choc! Quelle horreur! For those whose daily lives bring them into frequent contact with economic statistics, numbers such as these should not come as a surprise. Economics data are erratic and trends are not necessarily a straight line. What is important is to assess the overall picture and ask the question whether we have the first hint of a change in trend or are we merely looking at a statistical aberration? I would tend towards the latter – but with a few caveats. I think there has been a tendency amongst many commentators to assume it would be onwards and upwards in growth terms – and that demand for labour would rise accordingly. I have always been much more cautious about the potential of the economy during this phase of growth. Hence, employment was likely to rise less quickly than might have been implied by stronger growth assumptions.

The other caveat is more interesting, with potentially very positive implications. The reasons for the recently reported decline in employment were a fall in the number of self-employed and also in the number of people working part time. The number of people in full-time employment actually increased – albeit modestly. While it is possible this had something to do with the general election (these were May figures), it seems more likely that we are beginning to see slower employment growth because the supply is diminishing. In addition, we may also be seeing the first signs of the effects of previous capital spending coming through. According to ONS data, business investment rose 8.0% in 2014. Within this, spending within the category 'ICT equipment and other machinery and equipment' rose a whopping 13.7%. You would hope, following this, to see a reasonable improvement in productivity. In fact, in the market sector of the economy (which can be loosely equated to the private sector), productivity per person rose 1.2% in 2014 following an increase of just 0.2% in 2013. While this is better than most economists seem to realise, it still falls short of the 2%+ that we would hope to see at this stage of the cycle. But maybe – just maybe – we are beginning to see the combined impact of a tightening labour market and stronger productivity growth come through in employment numbers. If so, I would suggest that it is not something that we should fret about. Far from it: it is another major step along the road towards sustainably stronger growth.

But before we get all the bunting out of the locker, we should note another effect of the tightening labour market: the impact on the cost of labour. Alongside the employment numbers, the ONS released data for average earnings. As is well known, household incomes had been growing very slowly. However, there seems to have been a decisive change in trend in recent months. In the three months to May, private sector employees enjoyed an average increase in total pay of 3.8% when compared to a year earlier. This compares to zero percent in the year to May 2014. Were productivity growth to remain at 1.2%, growth in earnings at this pace would be inconsistent with the government's inflation target of 2%. Even with an improving productivity trend, the recent acceleration in average employee earnings looks troubling, particularly as, in the hotter areas of the economy, construction and wholesaling, retailing, hotels and restaurants, earnings have risen much faster over the past year – by 4.9%.

These numbers ought to give the Monetary Policy Committee pause for thought. While the possibility that productivity growth is improving can only be welcomed, evidence that a tightening labour market is beginning to push up employment costs fairly rapidly is a real cause for concern, and suggests that interest rates should now be nudged higher.

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