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UK: STRONG LABOUR MARKET IN AUGUST, RATE HIKE ON THE WAY

Berenberg Macro Flash

August	Unemployment rate	Average earnings, ex bonus 3m/yoy
Actual	4.3	2.1
Previous	4.3	2.2
Consensus	4.3	2.0
Berenberg	4.3	2.1

From almost all angles the labour market looks healthy: The uncertainty from the Brexit vote has not impacted labour demand in a serious way. Instead, firms continue to raise the size of their workforces in response to the continued domestic expansion and improving global backdrop. The key highlights from the August jobs report are as follows: (1) the UK added 94k jobs on a 3m/3m basis; (2) unemployment remained at a record low of 4.3%; (3) employment rate for 16-64 year olds was 75.1% - a near-record high; and (4) the number of job vacancies (the key measure of labour demand) was at a near-record high of 783,000. Meanwhile, wage growth including bonuses was 2.2% yoy, unchanged from the upwardly revised estimate of 2.2% in July (prev. 2.1%), while wage growth excluding bonuses dipped to 2.1% yoy from the upwardly revised 2.2% in July (prev. 2.1%). Indicators available for the month of September, which give a good idea of where the main series are heading, show that the UK labour market finished Q3 on a strong footing. The September claimant count rate remained unchanged at 2.3% as jobless claims remained broadly unchanged (up by just 1.7k). With little slack in the labour market, the degree of mismatch between the skills of the remaining workers and the skills demanded by firms will widen, this should underpin a modest acceleration in wage growth over time.

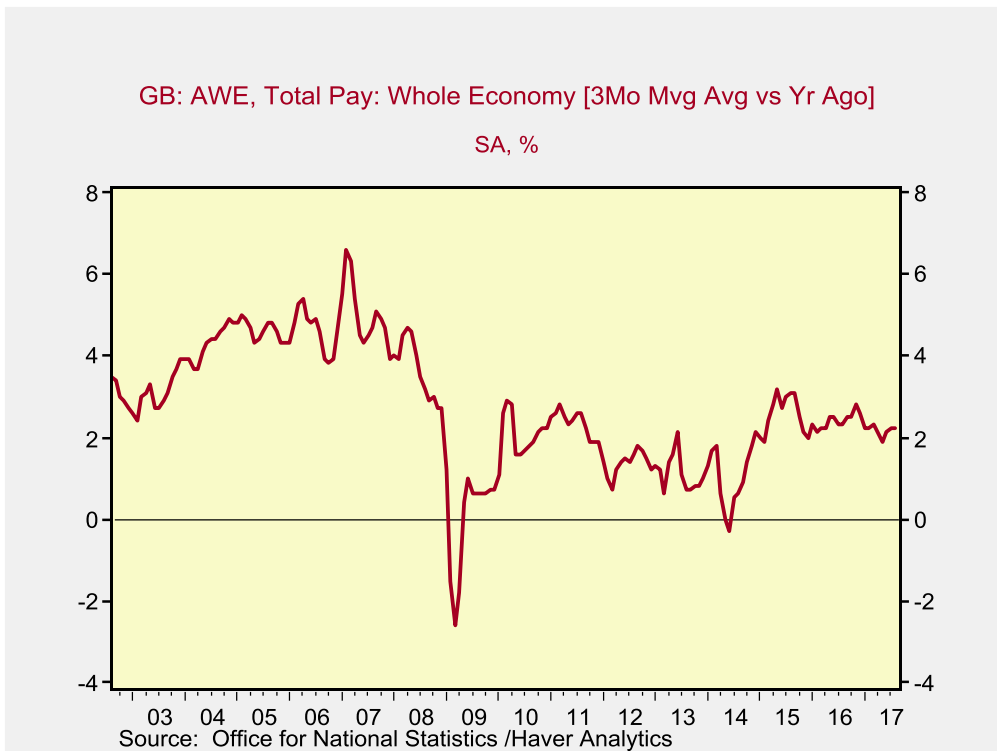
The Phillip's curve puzzle: In the UK, just like in the US, Germany and some other countries, unemployment has fallen back to levels consistent with the market's and the central bank's estimate of "full employment" (c4.5%). In the UK, all key measures of labour market tightness; the unemployment rate, job vacancies, and workers who are economically inactive but want a job, are at levels consistent with record labour market tightness – see charts below. Nevertheless, in contrast to perceived "Phillips curve" wisdom of a clear inverse relationship between unemployment and wage growth, the tightening of the labour market has not gone along with a pronounced acceleration in wage inflation. In our report from 6 October '[Notes on the inflation puzzle](#)' we outlined five major reasons for this persistent wage moderation: (1) workers seem prepared to accept lower wage growth in exchange for job security; (2) the demise of the traditional employment trends has altered wage setting behaviour; (3) with increasing globalisation national labour markets are becoming less relevant for domestic wage inflation over time; (4) increasing rates of female participation and of older workers raises total labour supply; and (5) increased competition from new types of capital – think robotics - can weigh on wages. One further point on the UK: the long-term risks to potential growth coming from Brexit present further downside risks to wage growth. In our base case, Brexit will reduce UK trend growth to 1.8% from 2.2%. The negative effects on real wage growth could be of a similar magnitude in the long run.

Implications of the wage puzzle for monetary policy: Over time, as the Lehman caution gradually fades and the labour market tightens further, nominal wage growth will gradually trend upwards. However, because of the structural factors mentioned above, nominal wage growth will probably remain well below historical averages unless nominal GDP growth begins to surprise to the upside. The critical takeaway for



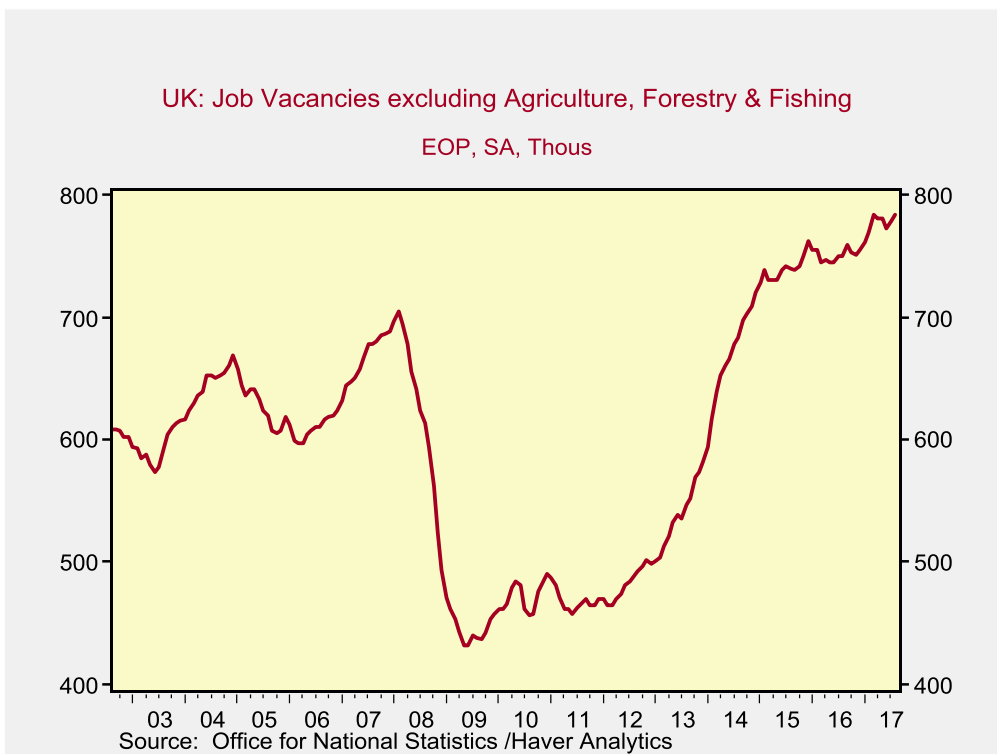
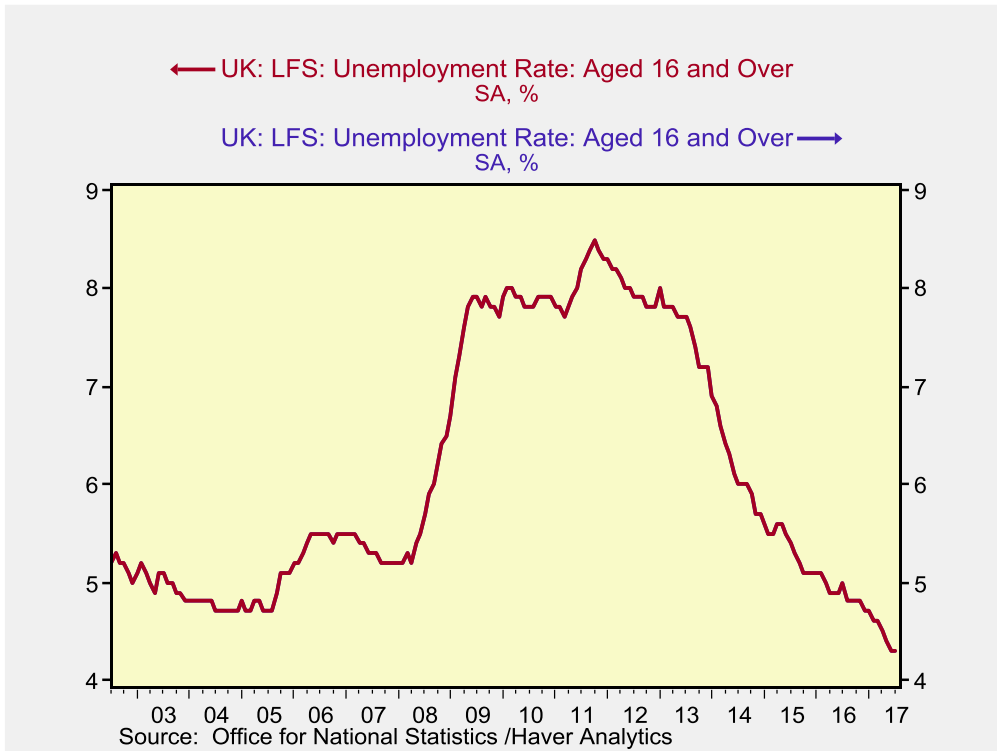
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monetary policy is that in the long-run, the central bank's main policy rate will need to be lower than in the past during normal times. Moreover, it further implies that the risk of a major overheat in the economy is lower than before and central banks can go slower when tightening. It does not imply, however, as some pundits often argue, that the bank rate cannot go up at all. In our view, the BoE's likely path of a gradually tightening over the medium-term, with the first hike coming next month, is consistent with achieving its remit of 2% inflation, even in a somewhat sluggish wage growth world. Keep in mind that even with a modest tightening cycle, say of 100bps between now and 2019 (our base case), the real policy rate would remain negative and the bank's balance sheet large by historical standards. Monetary policy would remain highly accommodative well into the medium-term.





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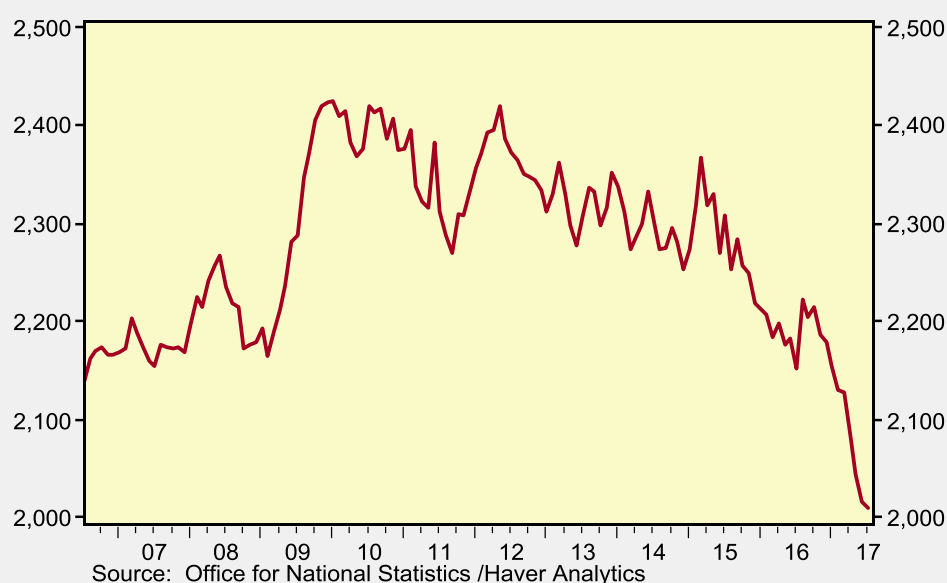
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UK: LFS: Economically Inactive: Wants a Job

SA, Thous



%	AUG	JUL	JUN	MAY	APR	MAR
Unemployment rate	4.3	4.3	4.4	4.5	4.6	4.6
Average earnings, ex bonus 3m/yoy	2.1	2.2	2.1	2.0	1.8	1.8

Source: Office of National Statistics

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