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UK: TIGHT LABOUR MARKET, WAGES RISING - TIME FOR ANOTHER RATE?

Berenberg Macro Flash

November	Unemployment rate	Average earnings, ex	Average earnings,
	%	bonus 3m/yoy	3m/yoy
Actual	4.3	2.4	2.5
Previous	4.3	2.3	2.5
Consensus	4.3	2.3	2.5
Berenberg	4.3	2.4	2.6

Rising wages, low and stable unemployment – has the UK finally reached full employment? Yes, it would seem so. Strong labour demand is no longer driving employment up. Instead, the degree of mismatch between the skills of the remaining workers and the skills demanded by firms is widening, driving a modest acceleration in wage growth. The key highlights from the November jobs report are as follows:

- (1) the UK added 102k jobs on a 3m/3m basis while unemployment remained at a record low of 4.3%;
- (3) employment rate for 16-64 year olds was stable at 75.1% - a near-record high;
- (4) the number of job vacancies (the key measure of labour demand) was at a record high of 798,000;
- (5) wage growth ex. bonuses rose to 2.4% yoy from 2.3% in October while total wage growth remained stable at 2.5% yoy.

Watch out for an upside surprise to wage growth: As is often the case in economics, things take longer to happen than you expect, but when they finally happen, they happen by more than you had expected. Wage growth has languished so far during the post-Lehman upswing. However, following on from the upside surprise to domestic and global growth last year, wage growth could surprise on the upside this year. Typically, real wage growth tracks the degree of tightness in the labour market – chart 1. The jump in imported inflation from the shock Brexit vote temporarily forced a gap in this relationship. But as the initial concerns of a collapse in short-term demand after the UK voted to leave the EU have not materialised in a serious way, labour demand has continued to rise relative to supply. Meanwhile, with the risk of a hard Brexit falling – we reduced our risk from 30% to 20% in December – the UK could begin to participate more strongly in the synchronised global upswing this year. Together, these factors should contribute positively to wage growth. We expect real wage growth to turn positive by Q2 2018 before rising towards 1% per year by 2019. Given the current fundamentals, risks to this call seem skewed to the upside.

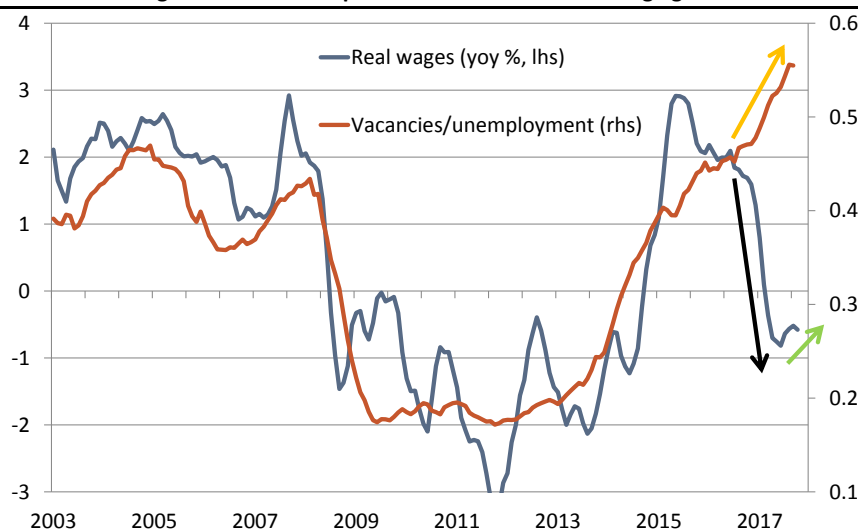
Expect another rate-hike in Q2: While the BoE had initially responded to the risks to demand from the Brexit vote by easing its policy in August 2016, it became increasingly data dependent over the course of 2017, eventually hiking its main policy rate by 25bp in November – the first hike in a decade. This came as a bit of a surprise for markets that seemed to be focusing more on downside risks to demand from Brexit than the signs of growing underlying inflationary pressure. According to market pricing, the BoE is set to hike the bank rate once again towards the end of the year. In our view, this seems still seems inconsistent with the BoE's data dependant approach and outlook for GDP and wage growth. Economic growth is likely to remain robust, partly helped by the strong global backdrop. Meanwhile, the BoE expects the unemployment rate to remain below its estimate of full employment (4.5% unemployment) throughout its forecast. It is becoming increasingly difficult for the BoE to justify its ultra-accommodative policy stance. We



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therefore look for two hikes in the Bank Rate in 2018, one in Q2 and one in Q4, followed by one in Q3 2019. Even with a modest continued tightening in which the Bank Rate increased to 1.25% by the end of 2019, UK monetary policy would remain highly accommodative. We will be paying close attention to the forward guidance at the February Inflation Report for signs the BoE is preparing markets for another rate hike soon.

Chart 1: UK's tight labour market points to a rebound in real wage growth in 2018



Monthly data. Real wages = average weekly earnings adjusted by headline CPI. Source: Source: ONS, Berenberg calculations

%	NOV	OCT	SEP	AUG	JUL	JUN
Unemployment rate	4.3	4.3	4.3	4.3	4.3	4.4
Average earnings, 3m/yoy	2.5	2.5	2.3	2.3	2.2	2.1
Average earnings ex. bonus, 3m/yoy	2.4	2.3	2.2	2.2	2.2	2.1

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