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UK: SOLID LABOUR MARKET CAN SETTLE NERVES AFTER SOFT Q1 GDP

Berenberg Macro Flash

March	Unemployment rate %	Av. earnings, ex bonus 3m/yoy	Av. earnings, 3m/yoy
Actual	4.2	2.9	2.6
Previous	4.2	2.8	2.8
Consensus	4.2	2.9	2.6
Berenberg	4.2	2.8	2.8

It was not all bad in Q1: The March jobs report tops off a solid first quarter for the UK labour market, with employment and wages both rising at healthy rates. Along with the PMIs and other key soft data such as consumer confidence, the Q1 labour market data strengthens the case that the overall momentum in the UK economy at the start of the year was probably stronger than the first reading of real GDP - at a meagre 0.1% qoq - suggested and more in line with the BoE's view that the Q1 estimate will probably be revised up to 0.3% eventually.

The key highlights from the March report are as follows:

- (1) the UK added 197k jobs on a 3m/3m basis – the largest gain since late-2015 - while unemployment remained stable at 4.2% (the lowest since 1975);
- (2) the employment rate for 16-64 year olds edged up 0.2ppt to 75.6% - the highest since comparable records began in 1971;
- (3) the number of job vacancies (the key measure of labour demand) was 806,000, close to the record high of 823,000 reached in December 2017;
- (4) wage growth excluding bonuses rose to 2.9% yoy from 2.8% in February, while wage growth including bonuses dipped 0.2ppts to 2.6% as the large contribution from bonuses in December dropped out of the comparison.

More evidence that real wage growth is recovering: Real wage growth typically reflects supply and demand conditions in the labour market. The shock Brexit vote in June 2016 temporarily forced a gap in this relationship – see Chart 1. The sharp fall in trade-weighted sterling after the Brexit vote, as market expectations for UK potential growth declined, caused a temporary jump in import prices and pushed the inflation rate towards 3%. From April onwards last year, real wages were declining at an annual rate of around 0.5% as inflation outpaced nominal wage growth. But the squeeze seems to be over. Real wages have risen on an annual basis for the second month in a row. Thanks to the drop in headline inflation to 2.5% yoy in March (from 2.7% in February), and the uptick in nominal weekly earnings to 2.9%, real average weekly earnings increased by around 0.4% yoy in March. Tight labour markets should push nominal wage growth higher over the medium term as inflation gradually trends towards a rate of about 2.0-2.5%. Real weekly earnings growth can rise towards 1.0% by the end of 2018. As Chart 2 shows, an improvement in real wage growth should lead to a recovery in consumer confidence.

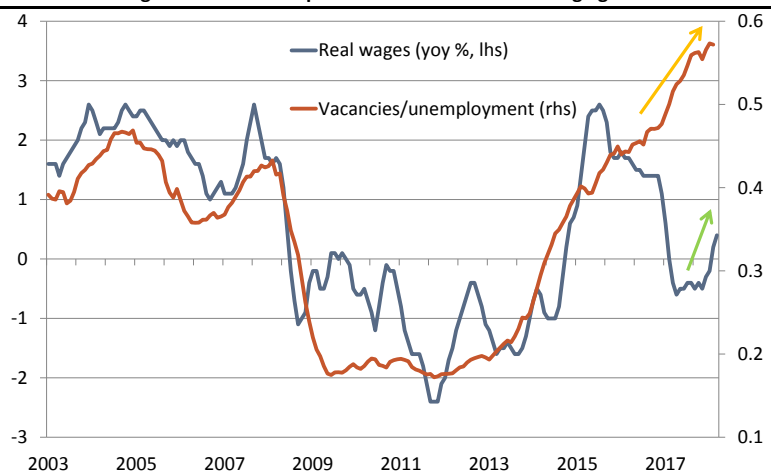
Implications for the BoE's monetary policy outlook: Despite the record-high labour demand, employment gains have slowed from an annual pace of around 2.5% in 2014 - when unemployment was close to 7% - to a current annual rate of just above 1% as the UK has approached full employment. At 4.2%, the current unemployment rate is below the BoE's estimate of full employment of 4.5%. The BoE kept rates on hold at the May Inflation Report after the soft Q1 GDP data but signalled that the medium-term policy outlook for a



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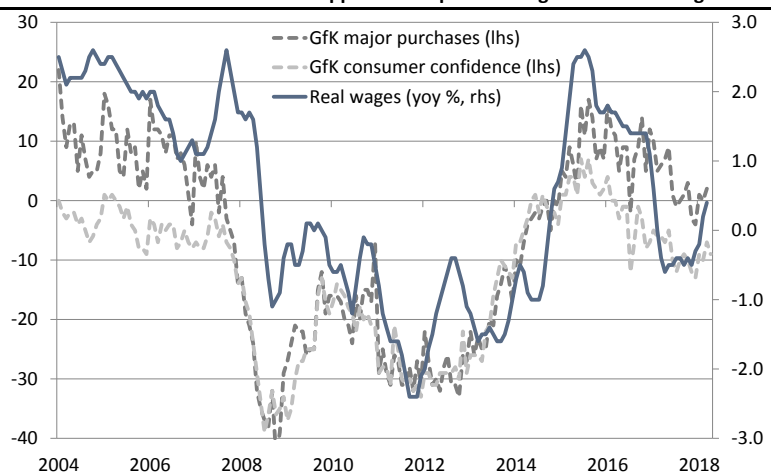
gradual policy normalisation remained unchanged. Although we expect the real GDP growth rate to rebound in Q2 (0.5% qoq), we think the BoE will need to see evidence that the stronger growth is sustained in Q3 before hiking again. We therefore expect the BoE to wait until November for the next hike. However, if the labour market data surprise to the upside in the coming months and wage growth accelerates to well above 3% yoy (currently 2.8%) on a sustained basis in Q2, then August could come into play for the next hike.

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: ONS, Berenberg calculations

Chart 2: Consumer confidence and appetites to spend track growth in real wages



Monthly data. Source: ONS, GfK, Consumer confidence data shows a % balance

%	MAR	FEB	JAN	DEC	NOV	OCT
Unemployment rate	4.2	4.2	4.3	4.4	4.3	4.3
Average earnings, 3m/yoy	2.6	2.8	2.8	2.6	2.5	2.5
Average earnings ex. bonus, 3m/yoy	2.9	2.8	2.6	2.5	2.4	2.3



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