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UK: MORE SIGNS OF FULL EMPLOYMENT

Berenberg Macro Flash

Aug	Unemployment rate %	Av. earnings, ex bonus 3m/yoy	Av. earnings, 3m/yoy
Actual	**4.0**	**3.1**	**2.7**
Previous	4.0	2.9	2.6
Consensus	4.0	2.9	2.6
Berenberg	4.0	2.9	2.7

Rising wages, low and stable unemployment – has the UK finally reached full employment? Yes, it would seem so. The great weather across the UK and a decent World Cup run for England boosted consumer demand over the summer. GDP data for Q3 – published 9 November – will probably show that real GDP growth accelerated from 0.4% in Q2 to 0.6% in Q3. However, despite still solid labour demand - reflected in the record-high number of vacancies - employment gains dropped off in August (-5k) after only modest gains in July (+3k). On its own, the drop of in employment growth might be a cause for concern. That vacancies rose to a record high over the same period negates this risk. The rise in labour demand relative to supply contributed to a surprise uptick in the annual rate of nominal wage growth (3.1% vs. expected 2.9%).

After several years in which unemployment has fallen further than we, the market, and the BoE had anticipated, recent developments in the labour market suggest the UK is finally approaching full employment. The improving wage growth reflects a widening degree of mismatch between the skills of the remaining workers and the skills demanded by firms. The data continues to support our view that, despite heightened uncertainty linked to Brexit, the steps towards policy normalisation that the BoE has taken so far have been appropriate.

Key takeaways from the August report:
(1) Although the UK lost 5k jobs on a 3m/3m basis employment remained at a near-record high of 32.4 million. Unemployment remained stable at 4.0% - the lowest since 1975 (Chart 1);
(2) the number of job vacancies (the key measure of labour demand) was 833k – a record high (Chart 2);
(4) Wage growth excluding bonuses jumped to 3.1% yoy in August (highest since Feb 2009), while wage growth including bonuses edged up 0.1ppts to 2.7% (Chart 3).

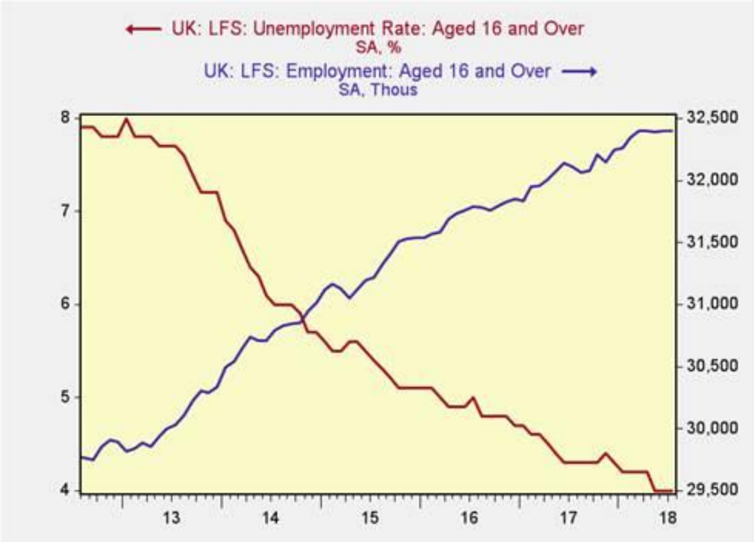
Possible rate hike before Brexit? With economic growth running at slightly above trend (trend is c0.4% qoq vs. current c0.5%) and clear signs of tightness in the labour market, there is a strong case for the BoE to continue to gradually normalise monetary policy. The annual rate of nominal wage growth in August was a full percentage point higher than a year ago and the strongest in almost a decade. If this rate of change in wages continues going forward, the BoE will need to step up the pace of rate hikes next year. Looking beyond the modest oil-related boost in the current inflation rate, faster wage growth will add to underlying inflationary pressures over the medium-term.

It is highly unlikely that the BoE would hike rates again before the Brexit question is settled. However, based on recent trends in wages, there is some chance of a rate before Brexit happens in March 2019. A February rate hike – ahead of our call for a May rate hike - could happen if three conditions are satisfied: a) the UK and EU wrap up a deal on Brexit soon – thus eliminating the hard-Brexit risk ahead of March 2019;

2) wage growth continues to pick up; and 3) real GDP growth remains at or above the BoE estimate of potential (1.5% yoy).

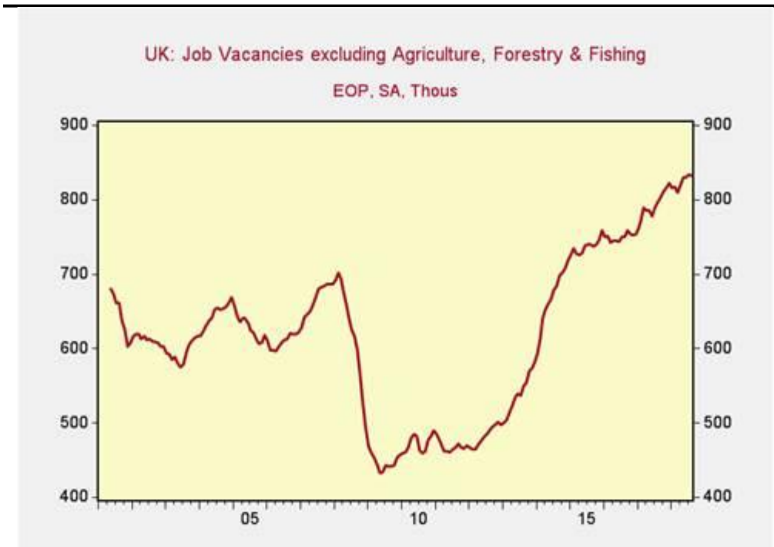
For now though, our base case remains that the BoE will wait until May 2019 before hiking. As long as the UK avoids a no-deal hard-Brexit (20% risk), we look for the BoE to pick up the pace of rate hikes to two per year in 2019 and 2020 as wage growth edges further above 3% yoy. This would take the Bank Rate to 1.75% by Q4 2020. Judging by recent trends in the labour market, the risks to our profile for rate hikes is clearly skewed to the upside.

Chart 1: Unemployment and employment



Source: Office for National Statistics/Haver Analytics

Chart 2: Vacancies



Source: Office for National Statistics/Haver Analytics

Chart 3: Nominal wage growth

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