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UK: CONTINUED WAGE PICK-UP = FASTER PACE OF RATE HIKES AHEAD

Berenberg Macro Flash

October	Unemployment rate %	Av. earnings, ex bonus 3m/yoy	Av. earnings, 3m/yoy
Actual	**4.1**	**3.3**	**3.3**
Previous	4.1	3.2	3.1
Consensus	4.1	3.2	3.0
Berenberg	4.1	3.3	

The UK labour markets is showing real signs of tightness. 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. 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 and that going forward, as long as the UK avoids a hard Brexit, the BoE will need to speed up the pace of normalisation in the coming years.

Key takeaways from the October report:
(1) The UK added 79k jobs on a 3m/3m basis as employment rose to a record high of 32.5 million. Unemployment remained stable at 4.1% (Chart 1);
(2) the number of job vacancies (the key measure of labour demand) was 848k – broadly unchanged from the record high of 849k in September (Chart 2);
(4) Wage growth excluding bonuses rose to 3.3% 3m/3m yoy in October (highest since July 2008), while wage growth including bonuses edged up 0.2ppts to 3.3% (Chart 3).

The BoE has its work cut out
The clear signs of tightness in the labour market underpin a strong case for the BoE to continue to gradually normalise monetary policy. Based on the recent pace of acceleration in UK wage growth, the BoE is at risk of falling behind the curve. As a result, the BoE will need to step up the pace of rate hikes next year as faster wage growth adds to underlying inflationary pressures. It is highly unlikely that the BoE would hike rates again before the Brexit question is settled. However, a February rate hike – ahead of our call for a May rate hike - could happen if three conditions are satisfied: a) the UK wraps 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 (10% 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 and economic growth improves – see UK: Growth spurt ahead if Brexit deal is struck. 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

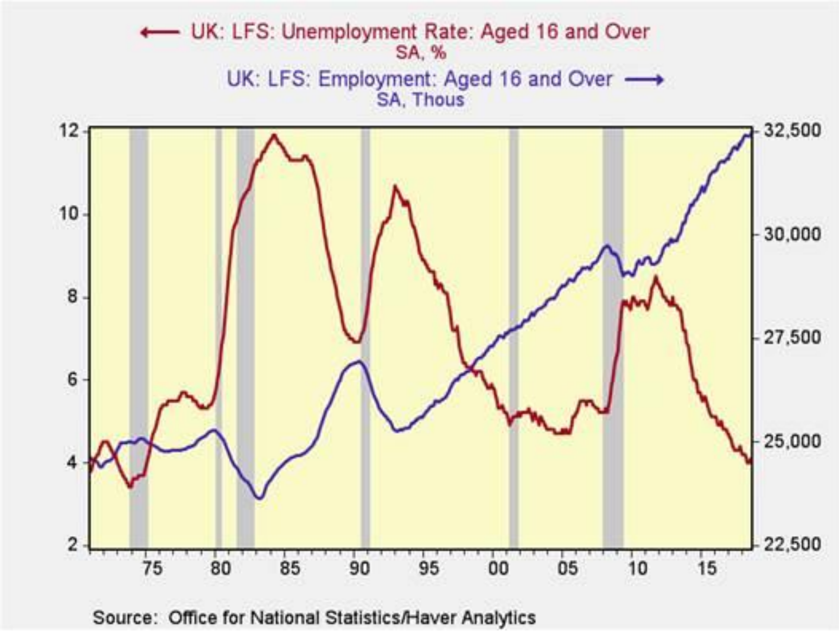

Chart 2

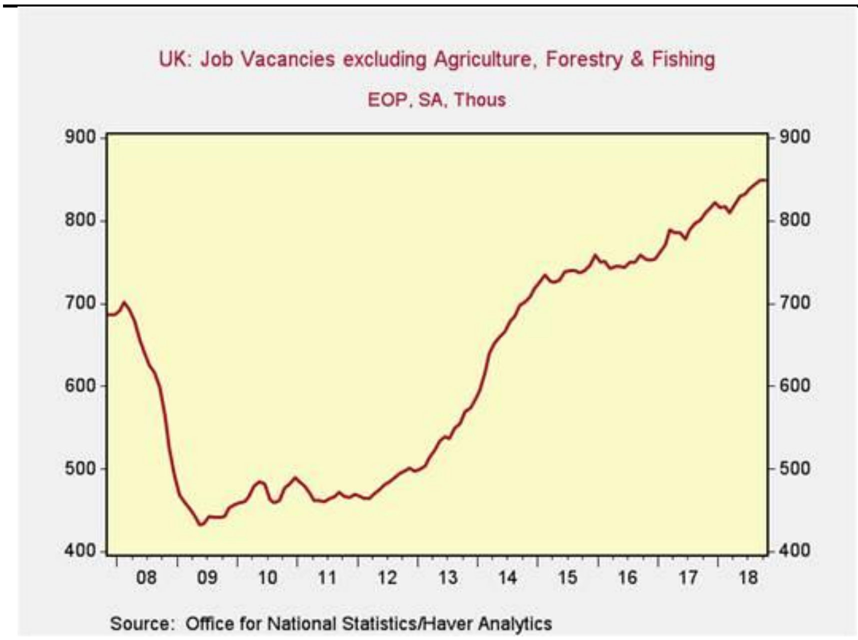

Chart 3

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