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News release

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The labour market, productivity and inflation – speech by Martin Weale

In a speech to be delivered on Wednesday 21 November, at the Manchester Economic Seminar, Martin Weale – External Member of the Monetary Policy Committee (MPC) – reviews the characteristics of the labour market since the financial crisis in 2008. He examines whether, and how far, labour market developments help explain what has happened to productivity in the recent past. Finally he examines the role of unemployment on wage and price inflation.

Martin Weale outlines the details of analysis he has undertaken looking at patterns of unemployment, movements in wages and job dynamics and productivity. He observed that "the last few years have been particularly unkind to young people. No one should expect to remain unscathed while GDP remains some three per cent lower than at the start of 2008... But when people close to retirement draw attention to the effects of monetary policy on annuity rates, it is important to remember the economic reality faced by young people."

In terms of productivity, his analysis suggests that there may have been a change in the working of the labour market which has had some implications for the growth of labour productivity. In the period before the crisis changing occupation resulted, on average, in an increase in earnings over and above general market movements. But since the crisis it has resulted in a more marked reduction in earnings. This change in the working of the labour market, nevertheless, accounts for at most just under ten per cent of the total shortfall in productivity growth since the crisis.

Weale goes on to look at the relationship between labour market pressures and inflation. He finds that, in the year to April 2011, over twenty per cent of employees suffered pay cuts and a further ten per cent experienced pay freezes with freezes in particular having become more common recently. He explores the relationship between unemployment and wage changes, finding that the pattern depends very much on whether a role is given to spare capacity. His reading of the data is that it is appreciably more likely than not that the current elevated level rate of unemployment is playing a role in limiting wage growth and thus labour costs. He questions why, if unemployment continues to exert downward pressure on both wage and price inflation, do they both seem becalmed? He provides one possible explanation that the effect of unemployment may be being offset by upward pressure on real wages as a response to the recent squeeze on living standards. Overall, there appears to have been little change in the relationship between unemployment and inflation since the crisis.

Finally, Martin Weale considers the appropriate setting for monetary policy. In terms of inflation and the role of additional asset purchases, he says: "I think it is more likely than not that inflation will remain above target for much of the next two years. My analysis suggests that additional stimulus would, without any corresponding improvement in productivity, add to inflation. There is, nevertheless, an argument for a further stimulus. It is possible... that a revival of demand would lead to a sharp improvement in productivity growth from sources other than those discussed here.... But, at the moment I do not feel we have a quantitative understanding of the factors contributing to weak productivity clear enough to be confident that productivity would move in line with a sharp increase in demand."

Key Resources

The labour market, productivity and inflation (158k)

Full speech by Martin Weale