Two puzzles: recent UK labour market dynamics – speech Q&A by Megan Greene at Make UK

16 May 2024

Seamus Nevin - Make UK: Given the issues you've highlighted around the Labor Force Survey, how can we get a good steer on the labor market?

Megan Greene: It's difficult and it's gotten more difficult. I mentioned we have some cross-checks, and so we are looking at all of those cross-checks, particularly for unemployment. The flows data is the trickiest bit because we don't have a great sense of who's going from being inactive into unemployment. Our data around employment is a bit better. The wage growth data is better though, coming from the ONS. It's just that the average weekly earnings for the private sector is a pretty volatile series. We have to look at a bunch of different metrics for pay growth coming from the private sector, from taxes, from surveys. And our agents also provide a lot of intelligence on these things. Just by going out and talking to companies and asking them, they produce reports with scores. So that gives us a steer as well.

Seamus Nevin: Related to that particular issue, if labor hoarding has come down, why are we still seeing such low employment figures?

Megan Greene: So part of it could be what I mentioned in the what else is going on section. It could partly be down to participation. And again, we have to approach that with humility because we don't have great participation data since it's also coming from the U.S.. But if, you know, participation fell and has slowly been recovering, hasn't gotten back up to pre-pandemic trends, then that does mean that, you know, it being lower than it was before just mechanically draws down on an employment.

So that could be a factor. There's another factor I haven't mentioned, which is it could just take some time. So some of these things work through with lags. And there has been considerable uncertainty, I think, over the economic outlook, in part because we've been hit by so many successive shocks that most people didn't forecast. And so the second round effects of all of those have been pretty difficult, in part because I think lots of people have been forecasting recessions for a really long time, not just for the U.K., but also for other developed economies. And so that kind of uncertainty has made it, I think, more difficult for companies to actually make hiring and firing decisions. So it might just come through with a bit of a lag.

Seamus Nevin: Also, in your talk, you kind of framed unemployment being low despite weak economic growth. But to what extent does it go the other way?

Megan Greene: Yeah that's right. So given that unemployment is so low why isn't growth a lot stronger? So to my mind this is another great puzzle that I'm looking into. What is going on with the UK consumer. Because, the terms of trade shock has completely unwound. Real incomes have been rising to some degree. You know, utility prices are still higher than they were pre-pandemic. So that still bites for a lot of households. And inflation is still too high. But it has been surprising just how weak the UK consumer has been. We saw an uptick in consumption for the first quarter of this year. So maybe that's sort of the beginning of consumers actually going ahead and spending. The savings rate has been incredibly high. There's still a lot of uncertainty over where that savings rate will actually settle. It's possible, having been through so many successive shocks and crises, consumers are just going to have more precautionary savings. And so we're not sure where that will settle again when the dust finally settles. But you know, we are expecting a consumption driven recovery. I should highlight that the consumer isn't about to go crazy. So it will be a pretty moderate recovery at that. But I think it's a fair question. I think it is surprising, given how tight the labor market is and how strong the labor market has been, why people haven't been spending more. I think I've highlighted a few of the possible reasons.

Seamus Nevin: You've touched there on the cost of living effect. So just related to that, how concerned are you about wage price?

Megan Greene: To my mind, it's the key to a lot of things. So firms have been pretty consistent in telling us that they don't feel like they can pass through as much of their cost increases to consumers in the form of higher prices, and also the PMI data. The latest outturn in particular really clearly shows that. But I do think there is an issue where we don't know (a) for how long firms have been experiencing margin compression, and (b) when they will determine that to be unacceptable and they'll have to do something to either push through higher prices or lay people off. And that's a choose your own adventure. They go in very different directions. And so again, there's no way to really measure where that capitulation point comes. But it's something I'll be monitoring a lot because it does provide these two very different risks to our forecasts.

Seamus Nevin: The most recent MPR forecast saw inflation revise down and expects inflation to be at target this quarter. Blunt question why isn't this sufficient to cut? And if you can add to that, relatedly, what would it take for you to vote for a cut?

Megan Greene: So we do expect inflation to come down to 2% in the second quarter of this year. So close in April and should be around 2% in May. But we expect it to rebound from there. A lot of why it's coming down has been energy and also base effects. So sort of a statistical quirk. And the base effects are also partly why we expect inflation to rebound. Our mandate is actually, sustainable inflation at 2%. And we do expect it to rebound. So we don't think that our work is done. Also, there are some upside risks to our inflation outlook that come from global factors, particularly tensions in the Middle East. So the pricing and the energy markets hasn't been as dramatic as many of us had feared at the beginning. But you know, that poses a risk. And the risk really only goes one way. So that's another factor to look out for.

In terms of voting to cut rates, I think that the progress that we've seen on the indicators that we look at for inflation persistence have been encouraging. They've come down in line with my expectations, though. And like I said, I don't think that that's a fluke. I think it's partly because, our policy stance is restricted. We know it's restrictive because we see it in the data as well. We debate a lot about inflation persistence because it's been a key feature on the way up and now on the way down. And I do think that there's a lot of uncertainty around how much inflation persistence is still in the system versus how much we've already squeezed out with our restrictive monetary policy stance. So for me, I would need to see more evidence of inflation persistence waning in line with my own expectations to think that a cut in a less restrictive policy stance would be warranted.

So the question I get a lot is when are you guys going to cut? But of course that's also predicated on kind of where we're going. And then the path in between is determined in part by those two things. And so, I'd like to see more evidence of inflation persistence waning before cutting. I also think where rates end up depends in part on your idea of the long run equilibrium rate. So R*. R* fell really significantly after the global financial crisis, it seems. But I think there are reasons to think that it may have crept up since the surveys that we get from market participants suggest that market participants also think it might have crept up since. And so that just suggests that rates, in my view, probably won't go down to where they used to be. And so, you know, if we don't need to cut rates as much to get to a lower R*, then that also suggests that you can take a more gradual path. So, I think again, given all the uncertainty around inflation persistence, a gradual path is warranted anyway.