Rejoice? Wages now rising faster than inflation

Vicky Pryce

So here we are again, in positive earnings territory, with real wages in the three months to August including bonuses, rising by 8.1% while inflation averaged some 7% . Unless something dramatic has happened since, this is likely to have continued in September when we get the wage data for that month as the rate of inflation remained at 6.7%, the same as in August.

All good news- except it will worry the Bank of England which has, through this latest inflationary period, been particularly concerned about signs that strong wage growth has become embedded in the economy . The US Fed chair is also hinting that rates may need to stay high for longer given stronger than expected recent jobs data and retail sales there . This has caused the markets to re-evaluate whether indeed we have seen the peak in rates and pushing US bond yields up to 16 year high triggering similar moves around the world.

In the UK too, bond yields have risen in the past few days. What the data here also suggests is that despite a small slowdown in payroll numbers in September and a drop in vacancies, the labour market appears still strong and skill shortages persist in many sectors. What this means if it continues is that inflation may be harder to shift. Admittedly, the overall earnings data was temporarily boosted by public sector bonus payments over the summer which saw public sector pay therefore growing by 6.8% year on year. But it is the private sector where pay is now increasing more strongly , by 8% on a year ago ,with finance, business services and manufacturing seeing the biggest hikes.

There is though concern that maybe we are getting too worried about trends in wages. MPC member Swati Dhingra expects wages to be moderating ahead, which makes sense as firms will be struggling to remain profitable in the current environment. Mortgage affordability is becoming a major issue in the housing market . And the government's tax take is rising as thresholds are frozen. The small real wage increase therefore is unlikely to make up for the continued pressure on real disposable incomes. This may indeed explain the sharp drop in consumer confidence in October after what had been a steady improvement in the last few months and the renewed concern that rises in petrol and other energy costs are once again going to put a dampener on growth.

The latest conflict in the Eastern Mediterranean may indeed mean that we may soon have to go back to the drawing board as to what monetary policy should be, particularly if oil and gas prices start rising sharply again. Not an easy job for policymakers still struggling to cope with the last crisis, particularly as some of the data has now started to be quite benign. In the Eurozone for example, the rate of inflation fell further in September to 4.3% from 5.2% in August. This was the lowest since October 2021. There are of course worries. Inflation rose in some countries such as in Italy and Spain, as earlier subsidies and other base effects disappeared from the 12 month comparison and petrol and diesel price have been on the up. But core inflation in the Eurozone has been moving in the right direction and is now at the lowest level since August 2022 .

So how confident can we be for the way ahead. A tough question frankly. Following from the Bank of England admitting that they got their inflation forecast wrong and calling Ben Bernanke in to sort it for them, we now have the OBR saying almost the same thing. In their just published evaluation of their forecasts for the 2022/23 financial year made in March 2021 and then again in March 2023, they acknowledge that they 'significantly underestimated the strength and persistence of inflation'.

While admiring their honesty , it would be a shame if we were to cease trusting anything coming out of the government or its independent bodies. Surely we don't want to go back to the sentiments expressed by David Davis in 2018 after he had quit as Brexit Minister when he said that : *"Treasury forecasts in the past have almost never been right and have more often been dramatically wrong."*

Perhaps we should just go back to the time honoured way of forecasting: a spare envelope with a clean back we could write on anyone ??

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