

UK wages

High inflation showing little sign of feeding through to pay rates

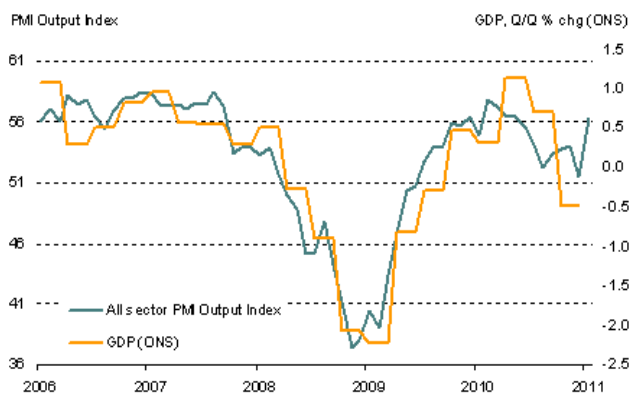
- **Muted earnings growth allowing Bank of England to keep interest rates on hold.**
- **Job insecurity preventing pass-through of higher prices to wage packets.**

The Bank of England left policy unchanged after its February meeting. It is likely that the debate heated up further from the January meeting, with increased pressure from some members of the Monetary Policy Committee to raise rates and shore up the Bank's inflation fighting credibility. However, this looks to have been the most appropriate outcome given the data that are currently available.

Spike in inflation likely to be temporary

Crucially, there is still little evidence to suggest that the current commodity price- and VAT-driven inflation surge will prove to be anything other than a temporary spike. If output continues to grow strongly in coming months, underlying inflationary pressure may well build. But at the moment all we have seen for January is a rebound in business from a snow-affected December, which probably leaves the underlying rate of economic growth at a level which, in the past, would not have unduly worried the MPC.

Whole economy output v. GDP

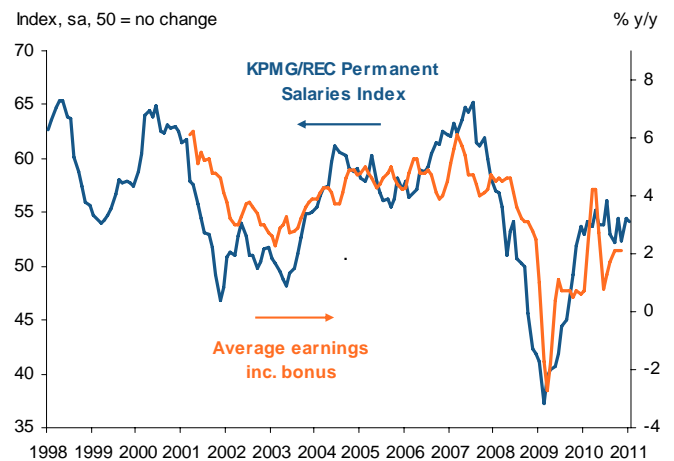


Sources: Markit, ONS.

Furthermore, price pressures continue to be focused on the manufactured goods and energy sectors, while prices charged for many services are showing far more modest growth (and in some cases falling) due to weak domestic demand. This is linked to the unemployment rate running at 7.9% and widespread job insecurity, which suggests that demand for many goods and services will remain subdued in coming months.

Perhaps most importantly, high unemployment is also still restraining wage growth. The KPMG/REC survey of UK recruitment agencies, for example, yesterday showed that pay growth remained very subdued in January despite the number of people placed in permanent jobs rising at the fastest pace for six months.

Permanent Salaries v. Average Earnings

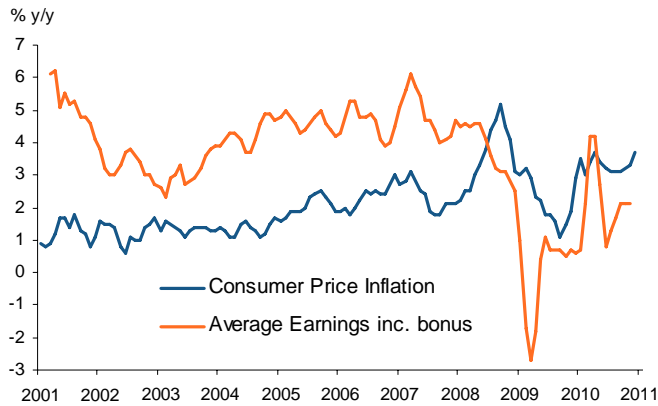


Sources: Markit, ONS.

Pay growth failing to keep pace with rise in consumer price inflation

Official data showed that the annual rate of pay growth remained at 2.1% in November for the third month running. The subdued trend in earnings contrasted with the latest rise in consumer price inflation to an eight-month high of 3.7% in December.

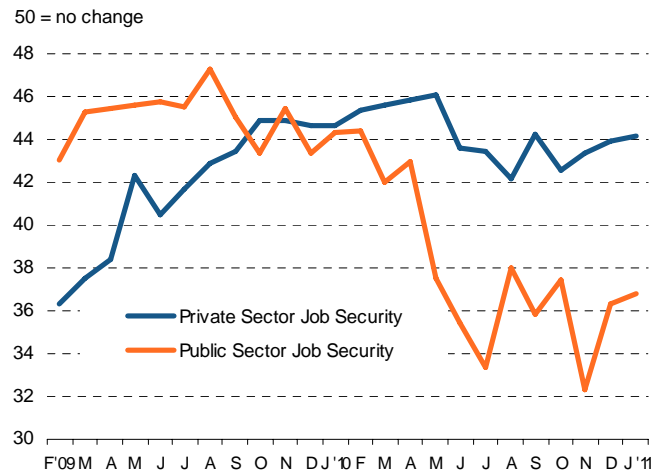
Average Earnings and Consumer Price Inflation



Source: Markit.

Employees have so far had little success in negotiating higher pay increases amid continuing worries over job security. The latter is highlighted by the Markit Household Finance Index, which has shown heightened levels of anxiety over job safety during recent months, particularly in the public sector.

Markit HFI survey: Job Security



Source: Markit.

Ultimately, the strength of the economic recovery will determine the extent to which the current short-term manufacturing-oriented price pressures will feed through to the wider price pressures and wages. The next few months' economic data will therefore be crucial to the next move in policy rates.

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