

Has UK Unemployment Peaked?

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Helped by improved wage flexibility, the UK labor market has been surprisingly resilient during the recent recession. Indeed, recent data suggest the unemployment rate may already have peaked. Even if it has not, the resilience over the last year has helped reduce the risks of a downward economic spiral.

Last week saw encouraging news on the UK labor market. The claimant-count measure of unemployment fell by 15,000 in December, the second consecutive monthly decline and a far cry from the 136,000 rise seen last February. This has raised hopes that unemployment may be peaking earlier, and at a lower rate, than widely expected (**Display 1**).

The claimant count is the most timely measure of unemployment in the UK and is therefore the best leading indicator of turning points in the labor market. It does, however, suffer from two defects. First, it is a measure of registered unemployment and, as such, can be distorted by changes in the eligibility criteria governing access to unemployment benefits. This means the claimant-count measure of the unemployment rate, currently 5.0%, is not a useful guide to the level of unemployment. Second, it provides no detail on underlying trends in the labor market.

The good news is that the encouraging message from the claimant-count data is

also evident in the more comprehensive Labor Force Survey (LFS) data. According to last week's release, the LFS measure of the unemployment rate fell to 7.8% in the three months to November from 7.9% in the previous three-month period. The decline was, in part, driven by a drop in the working population. But it is also clear that employment trends are improving. In the three months to November, employment fell by just 14,000. This is a big improvement on the early months of 2009, when employment was contracting at a quarterly rate of over 250,000 (**Display 2**).

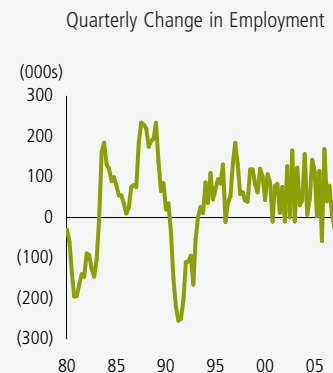
The resilience of the labor market has been one of the most remarkable features of the recent downturn. Since the peak of the economic cycle in the first quarter of 2008, UK output has fallen by 6.0%, the biggest contraction of the post war era. But the unemployment rate has risen by just 2.7% over this period. This is much smaller than during either of the previous two (smaller) recessions—3.7 percentage points during the recession in the early 1990s and 6.4 percentage points during the early 1980s.

Display 1
Is the Labor Market Turning?



Source: Haver Analytics and AllianceBernstein

Display 2
Employment Is Stabilizing



Source: Haver Analytics and AllianceBernstein

The relatively modest size of the labor market adjustment is evident when we compare economic growth with the annual change in unemployment over the last three decades (**Display 3**).

What can explain this phenomenon? There are several possibilities. One is that firms may have decided to hoard workers in the hope that the recession would be relatively short-lived. But this is an implausible explanation given the severity of the downturn and the collapse of business confidence in late 2008 and early 2009.

One factor that has helped limit the overall increase in unemployment has been rising public sector employment. Since the first quarter of 2008, employment in public administration, health and education has risen by 260,000; in marked contrast to the sharp declines seen in other sectors (**Display 4**). However, this is only a partial explanation. We estimate that private sector employment has fallen by 4.4% since the first quarter of 2008. At the same stage of the last two downturns, private sector employment had fallen by almost 6% (and, in both cases, went on to decline by 9%).

Perhaps the most important factor behind the resilience of the labor market has been increased wage flexibility. In the first ten months of 2009, average earnings (including bonus payments) rose by just 1.2%, the smallest increase since records began back in 1963. Moreover, this figure is flattered by a 3.3% increase in public

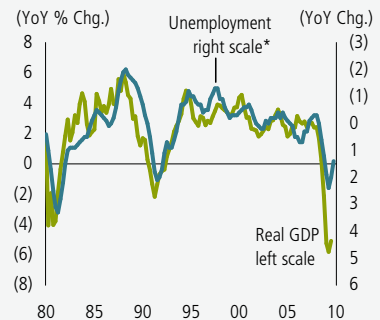
sector wages. Average earnings in the private sector rose by just 0.6%. In other words, companies have been able to slash their wage bills without laying off as many workers as during past downturns.

Of course, it may be premature to suggest that unemployment has peaked. Indeed, past experience suggests that the labor market usually continues deteriorating for several quarters after the trough of the economic cycle. But recent survey data from the Confederation of British Industry (for manufacturing companies) and the British Chamber of Commerce (covering both manufacturing and services) provide some grounds for optimism. Both show that hiring intentions have improved markedly since the opening months of 2009. Indeed, the CBI reading is now above its long-term average (**Display 5**).

A year ago, most forecasters—including ourselves—expected the UK unemployment rate to rise to 10% or higher. The latest data suggest this is now unlikely. Moreover, even if unemployment creeps slightly higher, we should not underestimate the importance of its resilience over the last year. Had unemployment risen as rapidly as it has done during past recessions, the fallout for the housing market and the banks would have been far greater than it has been. And this could have pushed the economy into a vicious downward spiral. ■

Display 3
Modest Rise Compared With Past Cycles

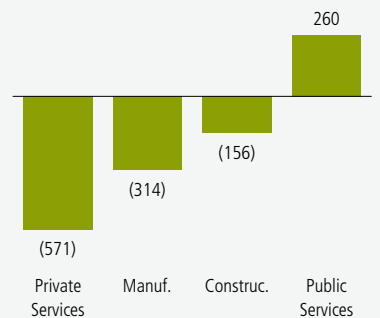
Real GDP Growth and Annual Change in the Unemployment Rate



*Inverted
Source: Haver Analytics and AllianceBernstein

Display 4
Strong Growth in Public Sector Jobs

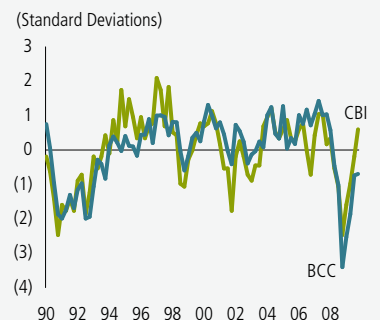
Change in Workforce Jobs (000s); 1Q 2008 to 3Q 2009



Source: Haver Analytics and AllianceBernstein

Display 5
Hiring Intentions Start to Improve

Employment Expectations



Source: Haver Analytics and AllianceBernstein

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