



Perspectives by Ruth Lea

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The labour market: better than expected so far but hard challenges ahead

Introduction

Despite the severity of the 2008-09 recession in terms of lost output, the impact on the labour market was not as damaging as many feared. It was widely expected that unemployment would top the 3 million mark. But this did not happen – at least to date. Unemployment on the ILO measure peaked at just over 2½ million in 2010Q1, at a rate of 8.0%, and fell by nearly 50,000 in 2010Q2. But, as we discuss below, if there is a “double dip” or if the private sector fails to replace the expected job losses in the public sector over the next few years, unemployment could start rising again.

Three recessions compared

Projections of an increase in unemployment to over 3 million were inevitably based on the behaviour of the labour market in the previous two recessions: of the early 1980s and of the early 1990s.^{1,2}

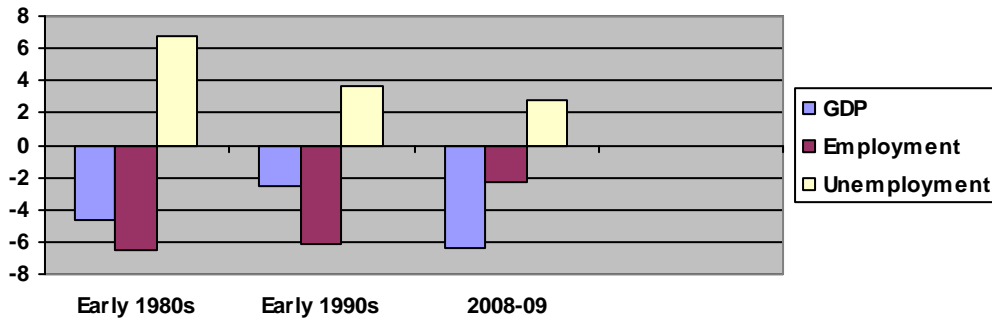
In the early 1980s, GDP fell by over 4½% between 1979Q4 and 1981Q1, before starting to recover. But the labour market continued to deteriorate until the second quarter of 1983. Employment fell further and the level and rate of unemployment both continued to rise. Manufacturing, then a much larger part of the economy, was especially badly hit. All in all, employment declined by 6½% and unemployment rose by over 6½ percentage points to 12%. Unemployment peaked at over 3¼ million. It should however be noted that the unemployment figures were boosted by the 1960s baby boomers entering into the jobs market as well as the poor employment outlook. The annex tables provide the detailed figures for GDP, employment and unemployment.

The recession of the early 1990s was not as severe in terms of lost output – GDP fell by 2½% between 1990Q2 and 1991Q3. But employment continued to decline until 1993Q1 and the overall 6% employment fall was almost as great as in the early 1980s. Partly reflecting demographic factors, unemployment peaked lower than in the 1980s. But it still peaked at 3 million.

The recent 2008-09 recession was even more severe than that of the early 1980s in terms of lost output. GDP decreased by nearly 6½% between 2008Q1 and 2009Q3. But the impact on employment and unemployment was relatively modest. Moreover, even though the labour market continued to deteriorate after the start of the recovery in GDP, it was for a relatively short period of time. The early turn-round in the fortunes of the labour market after a recession, and a vicious recession at that, was unexpected. Employment declined by less than 2½% between 2008Q2 and 2010Q1, an extraordinarily subdued fall under the circumstances, and the rise in the unemployment rate was less than 3 percentage points. Unemployment peaked at 2½ million rather than the expected 3 million.

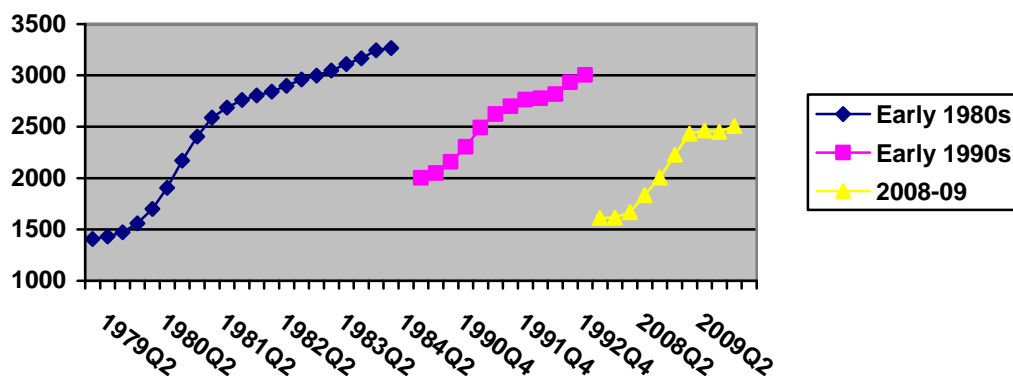
Chart 1 illustrates the key features of the three most recent recessions in terms of GDP, employment and unemployment. Chart 2 shows the quarterly path of unemployment levels.

Chart 1 Peak-to-trough % falls in GDP and employment and trough-to-peak percentage point rises in unemployment



Source: ONS database, www.statistics.gov.uk, and author's calculations. The employment and unemployment (ILO measure) data are from the Labour Force Survey (LFS).

Chart 2 Unemployment, thousands, quarterly data, seasonally adjusted



Source: ILO unemployment measure, ONS database, www.statistics.gov.uk

The 2008-09 recession: the labour market performed better than expected

To sum up: the labour market in the 2008-09 recession performed better than expected, and better than the previous two recessions, in at least two respects:

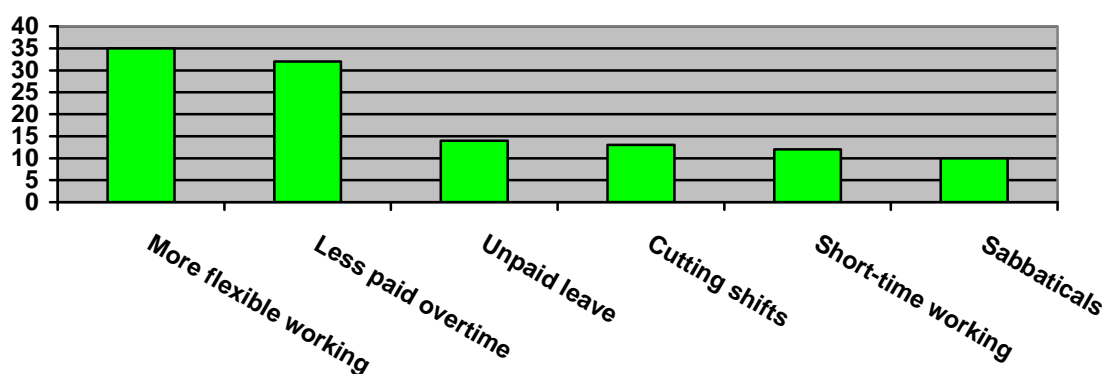
- Employment turned round quicker when GDP started to recover. Even though the 2008-09 recession lasted longer than its predecessors (6 quarters compared with 5 quarters in the early 1980s and early 1990s), employment fell for a shorter period of time. In the early 1980s and early 1990s employment declined for 14 and 11 quarters respectively. In 2008-09 it fell for 7 quarters.
- Partly reflecting the speed of turn-round, the overall decrease in employment and concomitant increase in unemployment were less than in previous recessions. Employment fell by 1.6million in both the early 1980s and the early 1990s, but by around 700 thousand in 2008-09. Unemployment peaked lower.

The labour market was therefore more resilient this time around. And it is now clear that the “pass-through” from falling GDP into labour market outcomes is not straightforwardly predictable.

One of the key reasons for the relative resilience in 2008-09 seems to be the willingness of employers to offer, and employees to accept, various cost-saving and job-saving measures. The partial replacement (or displacement) of full-time by part-time work is well documented. The ONS’s LFS shows that full-time employment fell by 888,000 between 2008Q2 and 2010Q1, whilst part-time employment rose by 225,000. The partial replacement of full-time jobs by part-time jobs also happened in the early 1990s recession – though to a significantly smaller extent. (The data for the early 1980s recession are unavailable.)

A recent CBI survey shows that a variety of measures have been used by employers to hold on to workers and save jobs. (There may be an element of “labour hoarding”.) The measures included encouraging more flexible working, reducing paid overtime, unpaid leave of absence, cutting some shifts, short-time working and sabbaticals. Chart 3 shows the percentage of respondents who had implemented worker-retaining measures.

Chart 3 CBI survey: measures taken to retain workers, % of respondents



Source: Source: Brian Groom, “Short-time working fuels hope of recovery”, *FT*, 11 August 2010

Another contributing factor to the early stabilisation in the labour market in late 2009 and early 2010 appears to have been “an unprecedented increase in young people staying on in education in the autumn of 2009”.³ Rather than attempt to find employment in a depressed labour market, these young people chose education over unemployment.

Another factor is compositional, relating to manufacturing sector’s shrinking share of GDP. The volatility of both output and employment in the manufacturing sector tends to be significantly greater than in the much larger services sector. As manufacturing’s share has shrunk, the hit on total unemployment has lessened with each recession. Between the late 1970s and mid-1980s manufacturing lost 2 million jobs. Between 1990 and 1993 over 800,000 jobs were lost. But, even though manufacturing was again very badly hit in the last recession, structural changes meant that the sector’s job losses were relatively subdued. Between June 2008 and March 2010 employment fell by “only” 337,000.⁴ Manufacturing’s job losses were however much more severe, proportionately, than in the services sector where jobs fell by 417,000 over the same period.

But there are challenges ahead

Even though the labour market was encouragingly resilient during the recession, there are major challenges ahead – specifically concerning job creation. Assuming for the sake of argument there is no “double dip”, one big challenge relates to the ability of the private sector to replace the anticipated job losses in the public sector and then create more. If these lost public sector jobs are not replaced by private sector jobs, then unemployment could start rising again. If there is a “double dip”, unlikely in our view, then the situation for the labour market would, of course, look worse.

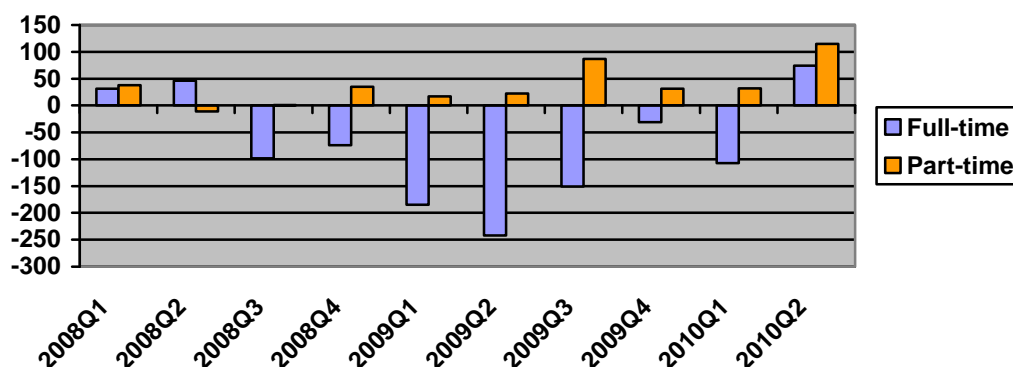
As we discussed in a recent Perspective, if the OBR’s Budget forecasts for employment and unemployment are to be achieved, the private sector will have to create 2 million new jobs by FY2015.⁵ Britain last saw such buoyant private sector job creation in the mid to late 1990s. But economic growth was strong then, which is unlikely to happen in the near to medium-term. There have to be doubts that the OBR’s forecast can be achieved. A note of doubt about the future path of employment was recorded in the latest minutes of the Monetary Policy Committee:⁶

- “It was unclear the extent to which private sector employment and wages would adjust as public sector spending cuts gathered pace.”

Another factor which may depress job creation in the near-term is the knock-on effect of the creation of the part-time jobs over the past two years. (See chart 4 below.) The very phenomenon that helps explain why the labour market was resilient during the recession, could now act as a drag on job creation going forward. According to the ONS over a million people are working part-time because they cannot find a full-time job. Some of these people may not want to work full-time, but it can be assumed that many would. As the demand for labour increases, it could be supplied by people already in work rather than new employees.

“Underemployment” is a better measure of the pent-up demand for work by those already in employment than frustrated part-timers. This is a measure of both the willingness and availability to work more hours, assuming these desired hours are within the law. According to research published by the ONS, the LFS data suggested that there were 2.8 million such underemployed people in the UK in 2009Q3. This represented 9.9% of the total workforce or 9.0% of the economically active population.⁷ By any standards, this implies that there is very considerable pent-up demand for more work by those already in employment.

Chart 4 Full-time and part-time employment, quarterly changes, thousands



Source: ONS database, www.statistics.gov.uk.

As can be seen from chart 4 there was a pick-up in full-time employment in 2010Q2, the first increase since 2008Q2, though less than for part-time jobs. Surveys suggest however that this pace of recovery may not be sustained. The latest CIPD quarterly employment report, for example, indicated that “the employment recovery signalled in the previous quarterly had eased over the past quarter. Recruitment intentions were similar to their levels in the spring report, but redundancy intentions had picked up”.⁸ But surveys can be misleading.

Incidentally, the CIPD’s latest forecasts were very pessimistic, suggesting that unemployment will start to rise again when public sector job losses start to mount in a few months’ time.⁹ We take the view that the CIPD’s assessment is too pessimistic. Providing the economy keeps growing, jobs should on balance be created. But, given the public sector job losses and the underemployment overhang, the OBR’s Budget forecasts do look optimistic.

Table 3 Trough to peak changes in unemployment, ILO definition: levels (thousands) and percentage points increases, quarterly data

			Unemployment, thousands			Unemployment rate (%)		
	Trough	Peak	Trough	Peak	Change	Trough	Peak	Change
1980s	1979Q4	1983Q2	1405	3265	1860	5.3	12.0	6.7
1990s	1990Q2	1993Q1	2002	3004	1002	7.0	10.7	3.7
2008-09	2008Q2	2010Q1	1611	2506	895	5.3	8.1	2.8

Source for tables 1-3: ONS database for GDP and LFS data, author's calculations

Table 4 Peak to trough changes in employment, full-time and part-time, thousands, quarterly data

			Full-time			Part-time		
	Peak	Trough	Peak	Trough	Change	Peak	Trough	Change
1980s	Na	Na	Na	Na	Na	Na	Na	Na
1990s	1990	1993	17700	16233	-1467 (-8.3%)	5854	6102	248 (+4.2%)
2008-09	2008Q2	2010Q1	19043	18155	-888 (-4.7%)	7499	7724	225 (+3.0%)

Source: ONS database. Note no annual data available before 1984 and no quarterly data available before 1992Q2. Therefore there are no data for the early 1980s recession and incomplete quarterly data for the early 1990s recession. Annual data are therefore taken for the early 1990s recession. The % changes are in brackets. Currently in employer surveys, people are classified as part-time if they work 30 hours or fewer in a week, and full-time if they work more than 30 hours a week.

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