GLOBAL ECONOMICS UPDATE

Will rising labour supply help wage pressures to ease?

- **One development that would help to ease wage pressures would be an increase in the labour supply; there is still a significant group of countries where the pandemic is having lingering effects. The good news is that the size of the workforce is now moving in the right direction in many places. A key exception is the UK, suggesting that wage growth there may be a bit slower to fall than elsewhere.**
- We have explained before why the workforce fell in most developed economies at the start of the pandemic (see here) and how recoveries are subsequently underway to different degrees in different places (see here).
- **The labour supply has continued to rise most rapidly in Australia and Canada, in part reflecting the recovery in immigration, which is normally a strong driver of workforce growth in these two countries.** (See Chart 1.) In fact, immigration seems to be rising above pre-pandemic levels, making up some of the shortfall that occurred when it plummeted during 2020 and 2021. (See Chart 2.) If this continues, it will help the workforce to close its gap with the pre-pandemic trend.
- **In many other countries, including the US and larger euro-zone countries, a reasonable recovery also now appears underway.** (See Chart 3.) In some places, including the US, the labour force is still smaller than it would be had it kept growing through the pandemic. But we continue to think that there is scope for it to get back to this trend eventually, even if it takes a few years. For example, some of the inactive will only look for a job when they have exhausted their "excess savings" accumulated during the lockdown. And the impact of extra early retirees will fade as we see fewer retirements than usual in the coming years.
- **Chart 4 shows that the UK, Italy and Japan remain the primary disappointments, with the workforce flatlining below pre-pandemic levels.** In the case of Italy and Japan, demographics are a key factor. The working age population in both is falling and, in Italy's case, at a worsening pace. Before the pandemic, rising participation, particularly in Japan, helped the workforce to rise despite this demographic headwind. But the participation rate, while still rising recently, has been doing so at a slower pace. With the demographic outlook poor for both countries, the labour supply may keep struggling to rise. (See Chart 5.)

Chart 1: % Change in Labour Force

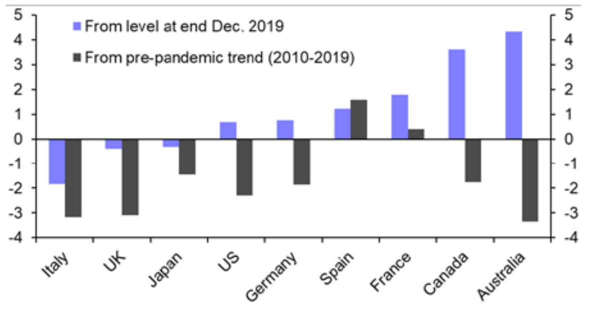


Chart 2: Net Migration Per Quarter (000s)

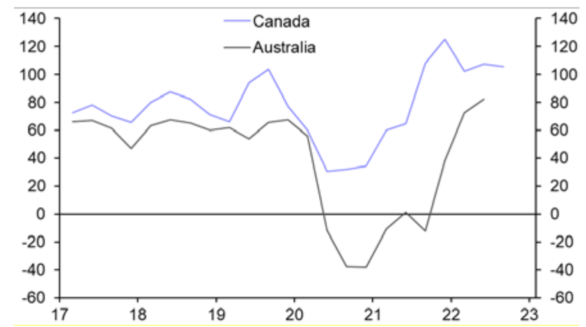


Chart 3: Labour Force (Dec. 2019 = 100)

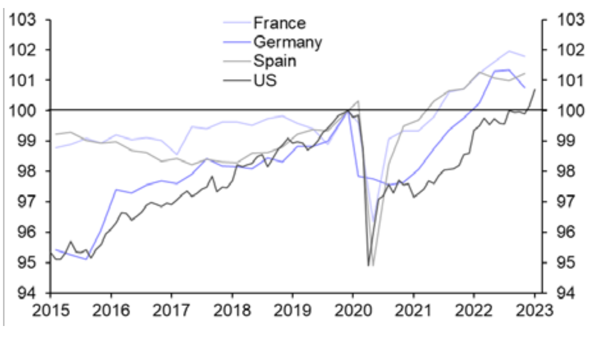
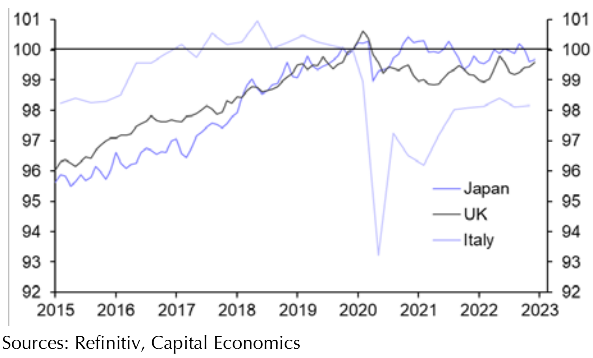


Chart 4: Labour Force (Dec. 2019 = 100)



Sources: Refinitiv, Capital Economics

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- The UK's current problem is not demographics; its working age population has been rising over the past few months at an annual rate of 0.4%, its fastest pace since 2016, and is set to keep rising. **Instead, the UK's problem is its participation rate.** The UK is not alone in having a participation rate that is still below its pre-pandemic level. (See Chart 6.) But at least in other countries, it is not still *falling* as it is in the UK.
- The problem has been seen across all age groups, but the key driver is a drop in participation among the 50-64 year old age group, which contrasts with the upward trend in participation in this group before the pandemic. **Although the participation rates of older workers dipped at times during the pandemic in some other countries, including the US and Canada, none seem to be seeing the consistent decline witnessed in the UK.** (See Chart 7.)
- There has been much speculation in the UK about what has driven this, with many attributing it to the current poor state of the UK's National Health Service and long waits for treatment. This would tally with the rise in the number of people who are not economically active because of illness. (See Chart 8.) Admittedly, the UK is not the only country, as far as we can tell from the limited data available, where inactivity due to illness has risen. But the number of "inactive ill" seems higher as a share of the workforce in the UK compared to elsewhere, meaning it could be having a disproportionate effect in the UK. Other factors may also be behind the drop in participation of older workers in the UK, such as an increase in early retirement due to quirks in the system of taxing pensions.
- **The upshot is that we expect a continued recovery in the labour supply in most countries and this should help to alleviate wage pressures. However, progress may remain slow, especially in countries like the UK where issues such as creaking healthcare systems may need addressing. We have explained elsewhere how falling inflation and an unwinding of labour market mismatches could also help to ease the pressure on wage growth.** (See here.) **But ultimately, labour demand will need to soften too.**

Chart 5: Working Age Population (2022 = 100)

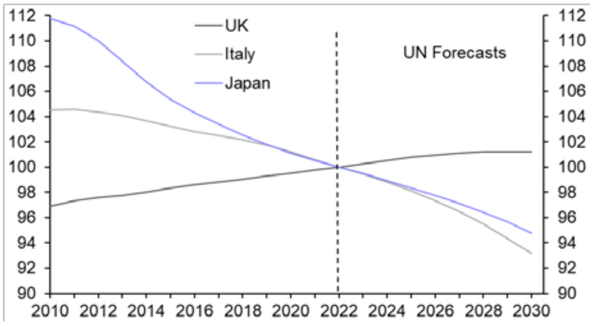


Chart 6: % Point Change in 16+ Participation Rate Since Dec. 2019

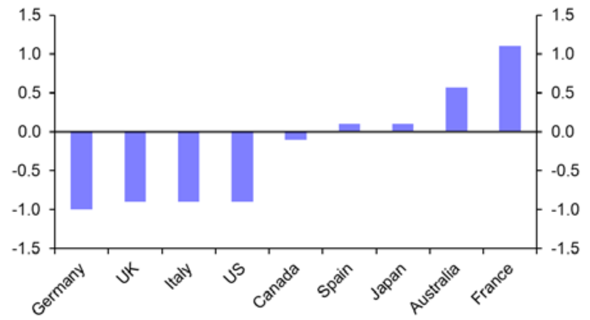


Chart 7: Participation Rate of 55-64 Year Olds (%, 50-64 for the UK)

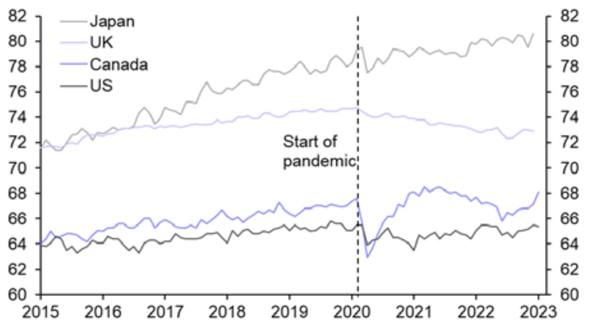
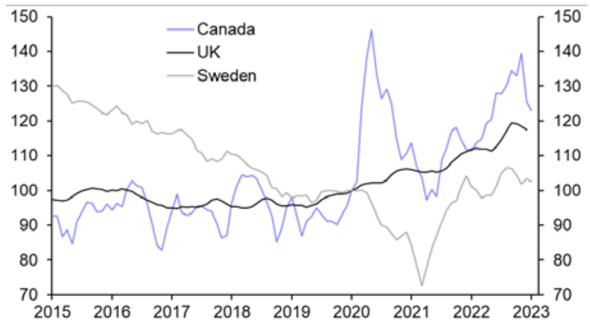


Chart 8: Inactivity Due to Illness (3m average, Dec. 2019 = 100)



Sources: Refinitiv, Capital Economics, Statistics Canada

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