Forecasts for pay awards in 2017/18

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Forecasts for pay awards in 2017/18

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Despite a pick-up in economic growth, pay award levels remain static. XpertHR's survey of pay forecasts reveals the expected value of pay awards for the coming year and the upwards and downwards influences on them.

Forecasts for pay growth in the year to 28 February 2018 are subdued, standing at 2% for a third consecutive year. Despite the Bank of England revising the expectation for GDP growth upwards to 2% in 2017 (an increase on the 1.8% recorded for 2016), pay growth remains weak.

The Bank of England's February Inflation Report stated that the Monetary Policy Committee (MPC) had previously expected falling unemployment and firmer productivity growth to lead to a pick-up in wage growth, but that this had not happened.

The MPC notes how:

- "recent weakness in wage growth has occurred alongside weak productivity growth";
- "subsequent falls in unemployment have not been matched with rises in wage growth" (meaning there is uncertainty around the relationship between slack and wage growth); and
- "wage growth will also be affected by increases in the national living wage and other costs related to employment" (which include pension contributions).

Despite pay growth being weak, the pay landscape is settled. Over the 12-month period to the end of February 2017, the median basic pay award across the economy recorded by XpertHR stood at 2% and awards have largely been at this level for five years.

To some extent, the stability of our 2% pay award forecast for the year to 28 February 2018 is reassuring, given a drop last year in the level of the rolling three-month median private-sector pay award; the median pay award fell to 1.8% and 1.6% over the three months to September and October 2016, respectively.

The fall was, however, shortlived. Pay awards returned to 2% in the three months to November 2016 and remained there in the three months to the end of February.

There is also a chance that the 2% pay forecast for the year ahead could shift upwards, given that survey respondents have cited inflation/cost of living as a strong upwards pressure on pay awards. The rate of retail prices index (RPI) inflation moved from 1.8% in August 2016 to 3.2% in February 2017, and many pay-setters will have their eye on this measure, not because pay awards have a direct link to the rate of inflation but in an attempt to provide employees with real wage growth.

XpertHR's pay forecasts survey is based on responses from 212 organisations that provided information on 297 employee groups - respondents were asked to provide separate information where employees have differing pay arrangements. We look at the expectations for pay rises, and at what level. We also uncover the factors influencing pay awards.

This research covers the private sector only; the public sector is covered by the Government's pay policy to restrict pay awards in the public sector to 1% for four years from 2016/2017.
Pay intentions for 2017/2018

The next pay review for more than four-fifths (82.5%) of employee groups (in the period between 1 March 2017 and 28 February 2018) is expected to result in a pay rise. The expectation of a pay freeze is low at 4.4% of employee groups.

A pay review will not be conducted for a further 4.4% of the employee groups surveyed. For 8.8% of employee groups, there is no clear decision yet on the pay award for the coming year. Although the samples are not matched with previous years’ research, the likelihood of a pay freeze appears to be lessening. In our autumn 2016/2017 pay forecasts survey a freeze was expected for 12.1% of employee groups.

There are some variations by sector and organisation size. While only 2.3% of employee groups in private-sector-services organisations expect a pay freeze, this increases to 9.5% among those employed in manufacturing-and-production organisations. None of the larger organisations (with 1,000 or more employees) in our sample expect to freeze pay and a pay rise is expected for more than nine employee groups in 10. Correspondingly, for smaller organisations (between one and 249 employees), the expectation is that pay freezes will be applied to 6.8% of employee groups, while 78.2% will receive a pay rise.

Level of pay awards

The expected outcome for pay reviews in the year to 28 February 2018 was provided by respondent organisations in the form of a percentage. The distribution of pay awards is shown in chart 1 below, representing a total of 201 employee groups where a figure on the likely pay award could be provided.

The median estimate for the value of the next pay award is 2%, and the key findings are as follows:

- The 2% median is the same across both broad sectors - manufacturing and production and private-sector services.
- A quarter of pay awards are predicted to be set at or below 1.5%, and a quarter are predicted to be worth 2.5% or more. This middle half of awards, known as the interquartile range, is therefore predicted to lie between 1.5% and 2.5%. The only exception to this by sector is in manufacturing-and-production where the lower quartile is 1.6% (and the upper quartile is 2.5%).
- February 2017’s rate of RPI inflation at 3.2% is considerably higher than the 1.3% RPI inflation figure recorded in February 2016 and the 1% RPI inflation figure recorded in February 2015. For 2017/2018, only 8.5% of expected pay awards are set to be at or above the current inflation rate.

April continues to be the most popular month for pay reviews to take effect, with 42.6% of the reviews in our survey taking effect in this month. This concurs with the findings in our pay bargaining calendar. With the national minimum wage and national living wage rates being updated every April from 2017, there may be an increase in April effective dates going forward.

For most organisations the period of stability in pay continues. Just over half (52.2%) of employee groups are likely to receive a pay award that is the same in 2017/2018 as they received in 2016/2017. Three organisations in 10 expect the awards to be higher while less than one-fifth (17.8%) expect them to be lower.
Predicted pay awards by industry

There is some variation in pay forecasts by industry, with several organisations expecting to pay at a level above or below the 2% median pay award recorded for the private sector overall.

Table 1 shows the pay forecasts by sub-sector for industries where information was provided for at least nine employee pay groups. Pay levels below the 2% median are expected in the not-for-profit (1.5%), electricity, gas and water (1.6%), and the transport and storage (1.8%) sectors.

Sectors forecasting pay awards above the 2% median include general manufacturing (2.5%), retail and wholesale (2.5%) and the hotels, catering and leisure sector (2.3%).
### Table 1: Pay award forecasts by industry sector, 2017/2018

<table>
<thead>
<tr>
<th>Industry sector (number of groups)</th>
<th>Lower quartile, %</th>
<th>Median, %</th>
<th>Upper quartile, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chemicals, pharmaceuticals and oil (9)</td>
<td>1.0</td>
<td>2.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Electricity, gas and water (9)</td>
<td>0</td>
<td>1.6</td>
<td>2.0</td>
</tr>
<tr>
<td>Engineering and metals (13)</td>
<td>1.5</td>
<td>2.0</td>
<td>2.5</td>
</tr>
<tr>
<td>General manufacturing (13)</td>
<td>2.0</td>
<td>2.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Hotels, catering and leisure (12)</td>
<td>1.5</td>
<td>2.3</td>
<td>3.0</td>
</tr>
<tr>
<td>Information and communication (19)</td>
<td>1.5</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Not-for-profit (34)</td>
<td>1.0</td>
<td>1.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Professional and business services (48)</td>
<td>1.5</td>
<td>2.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Retail and wholesale (11)</td>
<td>2.5</td>
<td>2.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Transport and storage (12)</td>
<td>1.5</td>
<td>1.8</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>Total private sector (201)</strong></td>
<td><strong>1.5</strong></td>
<td><strong>2.0</strong></td>
<td><strong>2.5</strong></td>
</tr>
</tbody>
</table>

Breakdowns are not provided for sectors where the sample is too small, but are included in total figures. Source: XpertHR.

### Factors with an upwards influence on the overall level of pay awards

Survey respondents were asked to identify which factors are likely to influence the pay awards at their organisation. The factors that are expected to have the strongest influence on pushing pay awards upwards have been identified as:

- inflation/cost of living (73.2%);
- employee retention (73.2%); and
- pay levels in the same industry (71.3%).

The level of the compulsory national living wage is an upwards influence for almost one-third (31.1%) of organisations. Approximately a quarter of organisations cite the national minimum wage and/or the level of the voluntary living wage for the UK or London supported by the Living Wage Foundation as upwards influences, at 26.3% and 23% respectively.

### Factors pushing pay awards down

Approximately half (49.4%) of organisations say the ability/inability to raise prices of products/services is expected to have a downwards influence on the level of pay awards. A related factor, the organisation's performance/ability to pay, is a factor for 42.9% of organisations.

Pension costs generally and/or movements in the exchange rate are expected to exert a downwards influence on the level of the pay award at approximately three organisations in 10, at 31.4% and 30.1% respectively.

Movements in the exchange rate are a concern for a higher proportion of manufacturing-and-production organisations than those in private-sector services, at 37.8% and 27% respectively. This may be due to the fact that manufacturing-and-production organisations are more likely to be importing goods into the UK than services organisations.
Net balance of pressures on pay awards

The strongest factors pushing pay upwards and downwards have been identified - but to get a true picture of the impact of these on pay award levels, we calculate a net balance of pressures on pay. The net balance is the difference between those seeing each factor as an upwards pressure and those who believe it will have a downwards influence (see chart 2). Retention of employees is the biggest expected upwards pressure on pay, with a balance of 66.8%. Recruitment issues are also expected to put upwards pressure on pay awards, with a net balance of 59.2%.

One factor that has leapt tremendously as an upwards pressure is inflation/cost of living - currently with a balance of 59.7%. The jump from the balance of 21.9% in our spring 2016/2017 pay forecasts survey can largely be attributed to RPI inflation's rise from 1.3% in January 2016 to 2.6% in January 2017 and XpertHR's panel of forecasters expect RPI inflation to rise to 3.5% by the fourth quarter of the year.

Awareness of inflation levels may also play a part in inflation/cost of living becoming the second strongest upwards pressure on pay. Since the Brexit vote in June 2016, media coverage on the economy has become more mainstream and employees' knowledge of inflation may have increased.

On a related note, the factor "movements in the exchange rate" was added to our survey in response to currency fluctuations following the Brexit vote. It is likely that the change in the rate itself is the key reason why this is one of the strongest negative influences on pay levels, at -19.1%, but awareness could also play a part. This factor had a balance of -3.3% in our autumn 2016/2017 survey.

Other pressures that have become stronger or weaker during the past year include:

- The level of the voluntary living wage for the UK or London supported by the Living Wage Foundation, which has increased from 13.6% in 2016/2017 to 21.7% in 2017/2018; and
- Pension costs generally have become a stronger downwards influence, falling from -5% in 2016/2017 to -20.4% in 2017/2018.
Chart 2: Balance of pay pressures 2017/2018

- Retention factors: 65.8%
- Inflation/cost of living: 59.7%
- Recruitment factors: 59.2%
- Pay levels in the same industry: 59.1%
- Pay relativities within your organisation: 44.9%
- Pay levels in the same locality: 43.6%
- Pay levels in the same occupational group: 41.9%
- Employee productivity: 29.6%
- National "going rate" of pay settlements: 28.0%
- The level of the compulsory national living wage: 26.6%
- The national minimum wage: 21.8%
- The voluntary living wage rates used by the Living Wage Foundation: 21.7%
- Your organisation's performance/ability to pay: 18.3%

-3.2% Public sector - pay levels
-5.5% Public sector - government policy on public-sector pay
-11.3% Pension costs - due to pensions auto-enrolment
-19.1% Movements in the exchange rate
-20.4% Pension costs - generally
-34.1% Ability/inability to raise prices of products/services

n = 212 organisations.
Source: XpertHR.
Paybill costs in the coming year

More than two-thirds of respondents (69.3%) expect their organisation's paybill to increase over the coming year, while 18.4% think it will stay the same. This leaves just over one organisation in 10 (12.3%) expecting a decrease in the paybill, which is positive compared with the figure of 20.3% (non-matched sample) recorded in our pay forecasts survey this time last year.

The most common reason for an increase in the paybill (cited by four organisations in 10) was due to increased headcount. Another key reason was the annual pay review driving up paybill costs. The national living wage was mentioned by several organisations. For example, one medium-sized manufacturing-and-production organisation said: "The impact of the national living wage is pushing our pay rates structure upwards [and] business growth will require additional staff."

A large manufacturing-and-production organisation reported: "Hiring should exceed staff reductions this year and [the organisation] should give an inflationary salary increase."

Among the organisations that think the paybill will stay the same or decrease, natural wastage was mentioned by several as a reason for this. Approximately three organisations in 10 that expected a decrease said this is due to redundancies and/or a restructure. A typical response from one organisation expecting a decrease in the paybill was the following: "[There will be a] company restructure, including additional redundancies [and] downsizing of our UK operations."

Only two organisations mentioned Brexit in the factors that might affect the paybill. For one organisation the apprehension around Brexit means the paybill will decrease in the coming year, while the other organisation said: "If the effects of Brexit, the economy and business performance are positive there is likely to be an increase in the pay award."

Proposed steps to control paybill costs

Over the coming year, almost two-thirds (64.2%) of respondents expect to take steps to control paybill costs. Chart 3 shows the steps that organisations will take, as well as those taken over the past year. Approximately the same percentage of employers took steps to control the paybill in 2016/2017 as are expected to in 2017/2018.

There appears to be a slight reduction in terms of plans to cut or stabilise employee numbers. In 2016/2017, redundancies were planned by 17.8% of organisations and this has fallen to 13.7% for 2017/2018. A recruitment freeze was also planned by a higher percentage of organisations for 2016/2017, compared with 2017/2018, at 11.2% and 6.6% respectively.

However, the number of organisations planning natural wastage, whereby leavers are not replaced, has remained consistent at 24.8% for 2016/2017 compared with 23.6% for 2017/2018.
A notable difference by organisation size was that only 6.5% of smaller organisations (with between one and 249 employees) plan to make redundancies - among medium- and larger-sized organisations this increases to 21.3% and 21.1% respectively.

By sector, one step to control the paybill that is more common in the manufacturing-and-production sector than in private-sector services is reducing overtime or overtime payments (36.2% compared with 12.3% among private-sector-services organisations). 

One large manufacturing-and-production organisation said: "[We are] considering freezing head office salaries, possibly with a business-performance-related 1% or 2% bonus." Another specified: "[There will be a] lower pay rise for HQ staff to fund sites staff [who are] on the national living wage."
Changes to pay or employee terms and conditions

More than two-thirds of organisations (69.8%) do not expect to make changes to pay (outside of the annual pay review), or to employee terms and conditions, over the coming year. Changes planned by the remaining 30.2% of organisations include: pension provision (including auto-enrolment); job evaluations; grading structures; benefits; and bonus schemes.

One large manufacturing-and-production organisation said: "[We will carry out a] grading structure review, which will lead to a benefits review. A new bonus structure is also to be launched this year."

A small private-sector-services organisation that is adding benefits stated that it is planning: "[An] increase on statutory benefits such as sick pay and maternity/paternity pay plus the introduction of a buy/sell holiday scheme and potentially medical insurance."

Challenges in pay and the year ahead

In terms of employee expectations, six organisations in 10 agree that their employees will be expecting higher pay rises in the coming year. This is consistent with the findings in our reward priorities survey that most employees would like higher basic pay.

The number of organisations that have had to increase salaries for some job roles in order to attract skilled staff is overwhelming, with 86.3% agreeing with this statement. This figure is higher for organisations with 1,000 employees or more, with 93% agreeing with this statement. Typical skills shortage areas are listed in our reward priorities survey.

Almost half (48.2%) of the survey respondents believe that their organisation has prioritised maintaining jobs over awarding higher pay rises (38.2% disagree and 3.8% don't know). Optimistically, 58% of organisations agree that they expect to take on more staff over the next year. Three organisations in 10 (30.6%) disagree with this statement while 11.3% don't know.

Outlook

In recent years, the outlook for wage growth has been stable and little on the horizon suggested a change to future pay award growth. However, for 2017/2018, factors that could potentially push up pay award levels include stronger economic growth; falling unemployment; and rising inflation.

Although the path for wages could change in the longer term, our forecast of 2% remains realistic as employers are likely to remain cautious about awarding higher pay awards. The ability/inability to raise prices of products and services was cited as a negative influence on pay awards by half (49.4%) of organisations, and the deep recession has left its mark, deterring organisations from awarding high awards until they are confident that they can afford them, even when pressure is coming from employees for higher pay growth.
Our research

Our survey of pay forecasts for the private sector 2017/2018 was conducted online in January and February 2017. We received useable responses from 212 organisations, collectively employing 541,340 staff. Organisations were invited to respond to the survey for their two largest pay groups, where they have different pay arrangements. For some topics there are therefore responses for up to 297 employee pay groups.

By sector, the respondents are divided as follows:

- 154 (72.6%) are in private-sector services; and
- 58 (27.4%) are in the manufacturing-and-production sector.

By organisation size, respondents are broken down as follows:

- 108 (50.9%) employ between one and 249 employees;
- 47 (22.2%) employ between 250 and 999 workers; and
- 57 (26.9%) have 1,000 or more employees.

What should I do now? (subscription required)

- Read our reward priorities survey to discover the activities that reward departments will work on this year.
- See the latest findings on pay settlements in Pay trends March 2017: pay awards set to remain stable.
- Read Public-sector pay 2016/2017: Government keeps the focus on pay restraint for a detailed look at pay awards in the private sector.
- Understand how to benchmark your organisation's pay rates.
- Check your organisation's salary levels using XpertHR's Salary surveys.

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