Market Insights Economics

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UK Labour Market: Softer demand persists beneath the surface

- Employment rose by 84k (3m/3m), below both the Bloomberg consensus (+130k) and our forecast (+175k), while the unemployment rate held at 4.9%, against expectations for a fall
- HMRC data showed a 13k drop in employee numbers in July. Payrolled employment has now fallen in each of the last six months, pointing to continued weakness in hiring activity
- Private sector regular pay growth held at 2.8% (3m/yr), slightly firmer than expected but still consistent with easing underlying wage pressures

Headline indicators remain resilient

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The latest labour market release portrayed a mixed picture. Employment rose by 84k in the three months to June, below both the Bloomberg consensus forecast of +130k and our expectation of a stronger 175k increase. Meanwhile, the unemployment rate held at 4.9%, disappointing expectations for a modest decline to 4.8%. The unchanged unemployment rate masks some interesting dynamics beneath the surface. Given that the reported measure is a rolling three-month average, many forecasters had expected the rate to fall as the relatively elevated 5.3% single-month reading in March dropped out of the calculation. However, this was offset by a rise in the single-month unemployment rate to 5.4% in June, following readings of 4.7% and 4.6% in April and May. As a result, the headline three-month measure remained unchanged.

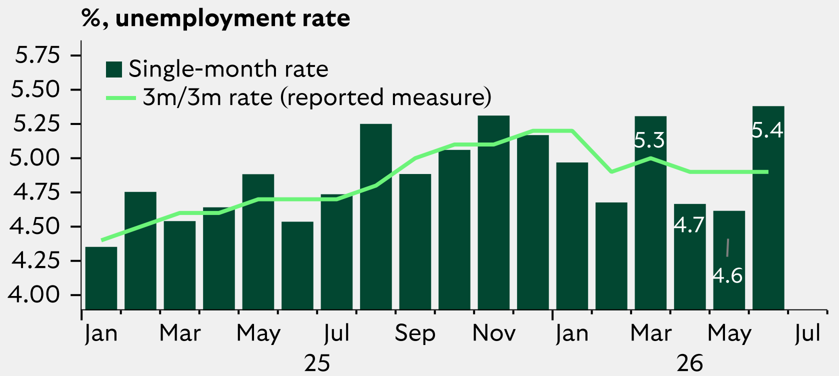
Despite the softer headline employment outturn, the composition of employment growth was relatively encouraging. The number of employees rose by 157k on the quarter, while self-employment fell by 50k. Similarly, full-time employment increased by 96k, while part-time employment edged lower. This marks a notable shift from the pattern seen through much of the past year, where employment growth was disproportionately driven by self-employment rather than employee jobs.

More timely indicators, however, continue to paint a softer picture. HMRC payroll employment, which is available one month ahead of the Labour Force Survey, fell by 13k in July following a revised 13k decline in June. Payrolled employment has now declined in each of the past six months and is almost 70k lower than at the start of the year. The underlying picture also continues to point to weaker hiring rather than widespread job shedding, with employee inflows remaining below outflows. Taken together, the PAYE data suggest labour demand remains softer than implied by the headline LFS figures.

Wage pressures remain subdued

The earnings data were marginally firmer than expected but remain broadly consistent with a gradual easing in wage pressures. Annual regular earnings growth increased to

Chart 1: Higher unemployment in June prevented the headline rate from falling



Source: ONS, Macrobond, Lloyds Bank Market Insights

3.5% in the three months to June, slightly above both consensus and the previous month's outturn. Total pay growth, however, slowed to 4.1% from 4.4%.

More importantly for the MPC, private sector regular pay growth held at 2.8%, compared with expectations for a slight decline to 2.7%. While modestly firmer than anticipated, this remains close to its weakest pace since late 2020 and well below the rates seen through much of 2024 and 2025. Combined with weaker payroll employment and a continued decline in vacancies, the pay data provide little evidence that domestically generated inflation pressures are beginning to re-intensify.

Labour market loosening remains the broader trend

Taken together, the latest release does little to alter the broader labour market narrative. While employment continued to rise and the composition of employment growth improved, the headline figures were generally softer than expected and more timely indicators continue to point to subdued labour demand.

There are nevertheless some tentative signs that the composition of labour market growth is improving. Employee employment rose by 157k on the quarter while self-employment fell by 50k, marking a reversal of the pattern seen through much of the past year. Even so, payroll employment has now fallen for six consecutive months, vacancies declined to their lowest level since early 2021 and there are around 2.5 unemployed people competing for every available role. Taken together, these indicators suggest labour demand remains weaker than the headline figures imply. The balance of evidence therefore continues to point to a labour market that is gradually loosening beneath relatively resilient headline indicators.

Implications for the Bank of England

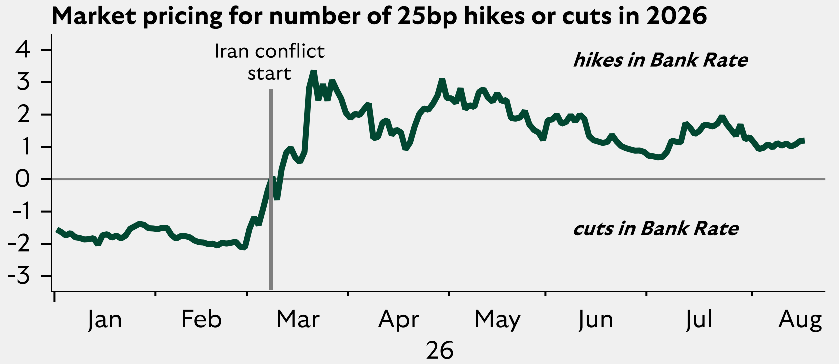
The latest labour market data are unlikely to materially alter the monetary policy outlook. While employment growth remained positive and the composition of employment improved, the overall picture remains one of gradually easing domestic inflation pressures rather than a material deterioration in labour market conditions. The unemployment rate also remained above the Bank of England's forecast of 4.8% for Q2.

Instead, the policy outlook continues to hinge largely on global developments. Ongoing tensions between the US and Iran, and the resulting implications for energy prices and the broader inflation outlook, remain the key focus for policymakers. As such, individual domestic data releases are likely to carry less weight than they otherwise might.

Financial markets continue to anticipate Bank Rate moving higher over the coming months, reflecting concerns that renewed energy price pressures could feed through into inflation. However, a 25bp increase is not currently fully priced until the December MPC meeting, suggesting investors do not expect policymakers to respond aggressively in the near term.

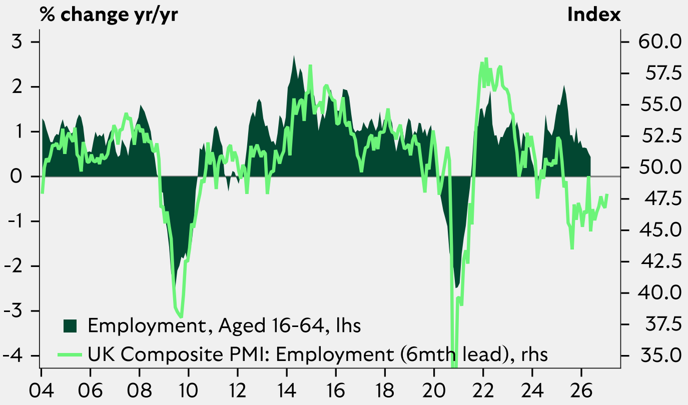
That market pricing appears broadly consistent with the latest labour market data. Private sector regular pay growth remains below 3%, payroll employment continues to decline and vacancies remain on a clear downward trend. With measures of labour market tightness continuing to ease, there remains little in the domestic labour market data to suggest underlying inflation pressures are re-accelerating. As such, the release remains consistent with a cautious, wait-and-see approach from the MPC as it assesses how geopolitical developments and energy markets evolve over the coming months.

Chart 2: Financial markets continue to price in the likelihood of rate hikes in 2026



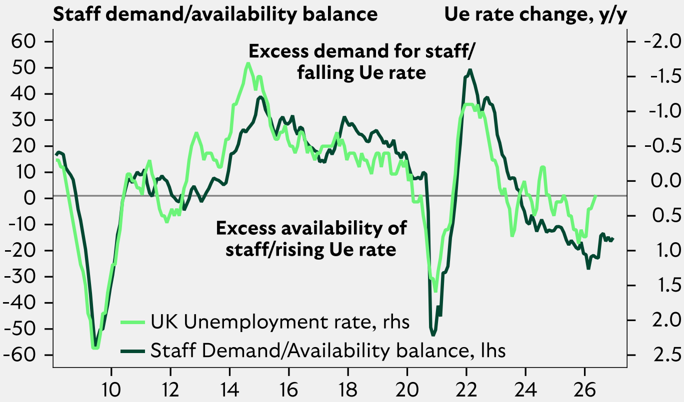
Source: Bloomberg, Macrobond, Lloyds Bank Market Insights

Chart 3: Surveys point to subdued hiring activity



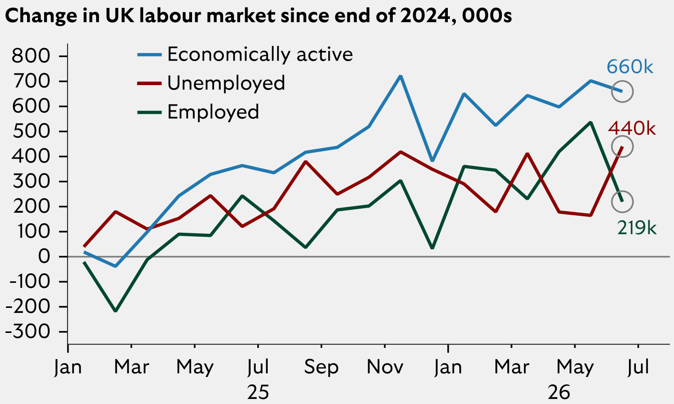
Source: ONS, Macrobond, Lloyds Bank Market Insights

Chart 4: REC survey suggests availability of staff continues to exceed demand for labour



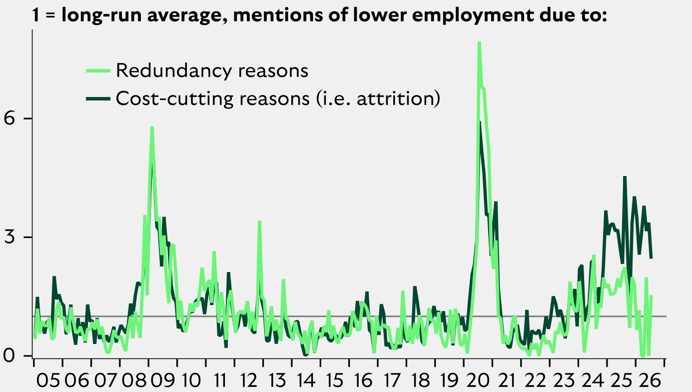
Source: REC/KPMG, ONS, Macrobond, Lloyds Bank Market Insights

Chart 5: Rise in unemployment due to employment gains not being matched by number of people looking for work



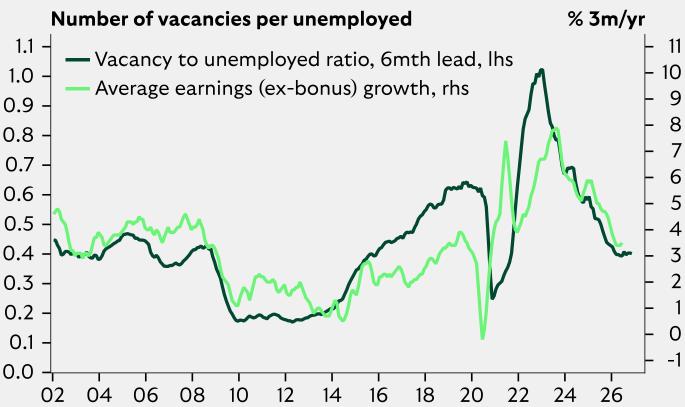
Source: ONS, Macrobond, Lloyds Bank Market Insights

Chart 6: Our UK Sector Tracker suggests that firms remain focused on cost-cutting



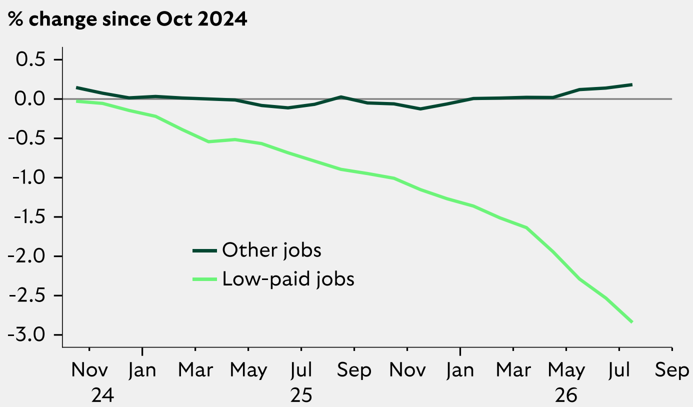
Source: Lloyds UK Sector Tracker, Macrobond, Lloyds Bank Market Insights

Chart 7: Labour market dynamics currently still point to softer rates of pay growth



Source: ONS, Macrobond, Lloyds Bank Market Insights

Chart 8: HMRC data shows that lower-paid jobs have fallen sharply since Q4 2024



Source: ONS, Macrobond, Lloyds Bank Market Insights

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