The Rt Hon Greg Clark MP

Department for Business, Energy and Industrial Strategy

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Low Pay Commission

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Dear Secretary of State,

NATIONAL MINIMUM WAGE RATES FOR 2019 INCLUDING THE NATIONAL LIVING WAGE

I write to you today with the Low Pay Commission's (LPC) recommendations for the rates of the National Minimum Wage (NMW) and National Living Wage (NLW) to apply from April 2019, as well as summarising the key evidence supporting the rationale for our recommendations.

Commissioners have reviewed the performance of the economy and the labour market up until the point of our meeting in October 2018. We make our recommendations on this basis. It must be emphasised, however, that our view on the outlook for the British economy in 2019 reflects the forecasts we had at the time. These take no account of any future revisions to economic forecasts or actual outturns of any disruption from a Brexit without a transition period. The Commission will review the economy in 2019 as part of our work on recommended rates for April 2020.

Following Matthew Taylor's review of modern working practices, our remit was expanded this year. We were asked to look at the 'nature and extent' of the issue he identified as 'one-sided flexibility', and 'assess the impact of a higher minimum wage for non-guaranteed hours' alongside 'any alternative policies'. I will write to you on this matter separately by the end of October, as our remit dictates.

Our advice on all the rates is summarised below, though our full report on this will be published shortly.

National Living Wage

For the NLW our remit is to make recommendations on the pace of increase towards a target, stating that 'The ambition is that it should continue to increase to reach 60 per cent of median earnings by 2020, subject to sustained economic growth.' For the other rates we are asked to recommend rates which 'help as many low-paid workers as possible without damaging their employment prospects'.

As with last year, the core decision for our report was whether the most recent economic evidence met the condition of sustained economic growth to enable the NLW to be uprated in line with the path to 60 per cent of median earnings. The latest ONS data for GDP growth suggest that, after slowing in the first quarter of 2018 – which was affected by the severe cold weather conditions – GDP had rebounded in the second quarter, growing by an annualised rate of 1.4 per cent. This was weaker than the growth experienced in 2017 – 1.7 per cent – but in line with the GDP growth forecasts (1.4-1.6 per cent) we had available from the Bank of England and the HM Treasury panel of independent forecasts, when we made our recommendations for the NLW in our 2017 Report last autumn. Further, the latest monthly GDP data show the economy growing by 0.7 per cent in the three months to August – helped by the World Cup and the hot summer. We judged that this met the condition of sustained economic growth. However, we also noted the unbalanced nature of that growth – reliant on consumer spending with both investment and trade acting as a drag – and the uncertainty about the medium-term and the UK's future trading relationship with the EU.

Importantly, the labour market has continued to perform well. While jobs growth slowed in comparison to last year, total employment remains at record highs in both rate and level. As with GDP, this performance also turned out in line with the forecasts by the Bank of England and the HM Treasury panel that we had available last autumn.

On the announcement of the NLW in 2015 the OBR forecast in July 2015 that the UK economy would generate 1.1 million additional jobs by 2020, but this had already been exceeded by 2017 and we have seen employment continue to grow. Unemployment has continued to fall and is now at its lowest rate since the 1970s (4.0 per cent).

Earnings have increased faster this year than last, with hourly pay at the median increasing by 2.7 per cent between April 2017 and April 2018, up from 2.1 per cent last year. This was also in line with the forecasts available last autumn. While, those at the bottom end saw larger increases than the median, driven by the NMW and NLW increases, these impacts have spread less far up the distribution than in previous years. This is perhaps indicative of pressure on pay differentials further up the pay chain. Over the course of the last twelve months, pay settlements have also picked up from around 2 per cent towards 2.5 per cent.

With inflation falling back, as forecast, after peaking at the end of 2017, the UK has experienced seven continuous months of real average earnings growth, having suffered real wage falls over the twelve months prior to that. However, real average wages still remain below their levels in 2008.

While the labour market has performed well and there is evidence that wages have started to outpace inflation, there were some macroeconomic indicators that gave us cause to be concerned. While growth in real household income has stalled since the end of 2015, consumer spending maintained its momentum, leading to the savings rate falling below pre-financial crisis levels, raising questions about sustainability. Trade has been weaker than expected, especially given the depreciation of sterling and the strengthening of the global economy in 2017 and 2018. Investment has also continued to underperform despite favourable credit conditions. Measures of profits have shown little change over the last year, although share prices – an indicator of future profits – have performed well.

With output having slowed and the labour market continuing to generate jobs, productivity growth measured per worker and per job has also been relatively stagnant. The number of hours worked has increased by less than the increase in employment, leading to productivity per hour performing better than the other measures but, even so, it has only grown by 1.5 per cent in the last three years.

Since the introduction of the NLW we have heard in our written and oral evidence sessions and visits that some employers have concerns, and this remains the case. With each year of the NLW we have seen that more employers need to act in response to increases in the rate. As the NLW increases more employers are affected, while the greater costs have a larger overall effect. Surveys from the Federation of Small Businesses and the British Chambers of Commerce show declining shares of employers taking no action. The most common responses are to absorb the extra costs through lower profits, raise prices or make savings elsewhere. Employers, particularly in the smallest firms, are concerned at the sustainability of repeated reductions in margins.

However, as with last year, the evidence from stakeholders suggested that employers have coped better with NLW increases than they originally anticipated, although some called for a move off the path.

While the extra costs for employers have been a concern, they have also told us that indicative future rates for the NLW have been helpful in aiding planning. Since the autumn of 2016 these have been consistently within a few pence of £8.20 and £8.60 for 2019 and 2020 respectively. Furthermore, these on-course rates are much lower than those anticipated when the NLW was first announced in 2015. The NLW's flexible nature means that is automatically adjusted downward when earnings forecasts are lowered. These lower estimates of future rates remain more palatable for many employers, though some do still remain concerned.

Employee stakeholders welcomed the pay increases for workers and pointed to the continued strong labour market performance and high profitability levels as evidence that NLW increases were affordable. They called for (at a minimum) a recommendation for an on-course rate as a fair outcome, given strong employment, low unemployment rates and rising inflation.

The forecasts, available to us when we agreed our recommendations, suggested that economic growth would be sustained in the rest of 2018 and in 2019, just below its level in 2017. Employment was forecast to grow at 0.4 per cent in 2019, in line with similar growth in 2018, but below the strong job growth experienced in 2017. Unemployment was forecast to fall even further, having reached a 40 year low in 2018. The forecasts also suggested that average earnings growth would pick up from around 2.7 per cent in 2018 to 2.9-3.3 per cent in 2019. With inflation forecast to fall back towards target, that would result in further real average wage gains, recovering some of the ground lost since 2008.

Commissioners have weighed these considerations carefully and judged that the evidence available was consistent with the NLW remaining on its path to 60 per cent of median earnings by 2020. Having discussed whether to round to the nearest 5 pence, we judged that, as last year, we should stay on the on-course path, and **we therefore recommend that the NLW should increase by 38 pence or 4.9 per cent to £8.21 an hour in April 2019**. On balance, we felt unable to deny workers an additional penny an hour. This approach fulfils our remit, while also taking into account the issues raised by both employers and workers.

In line with our original intention, our recommendation for the National Living Wage is the on-course rate using the median of available forecasts from the Bank of England and the HM Treasury panel of independent forecasts (we did not have access to the Office for Budget Responsibility's forthcoming October forecasts). Our recommendation is close to the indicative on-course rate that we set out in our Autumn 2016 Report and our 2017 Report, and thus continues to support employers in their forward planning.

To this end, using HM Treasury panel and Bank of England forecasts, we estimate that the NLW will reach its target of 60 per cent of median hourly earnings at an indicative on-course rate of £8.62 in 2020.

A material worsening in economic performance and prospects would lead us next year to consider whether to recommend that the NLW should not increase relative to median earnings, moving below a straight line path to 60 per cent in 2020, to safeguard employment.

National Minimum Wage

Last year we made recommendations for the largest increases in the youth rates for a decade. Those increases allowed a restoration of some of the value the youth rates lost during the recession and its aftermath. Those recommendations were based on strong employment and earnings growth for all young people at that time. This year Commissioners noted that while labour market conditions are still strong they have softened slightly in some areas. This, combined with the fact that the evidence is not yet sufficient to understand the impact of these large increases, has led to a slightly more cautious approach – though all rates will still see real and relative (to average earnings) increases in value.

For 21-24 year olds labour market performance was weaker than last year. Commissioners noted that employment fell slightly for this group over the year, with inactivity increasing. This increase was evenly divided between those going into full-time education and those who were inactive for other reasons. The increase in inactivity is something Commissioners will consider further as part of their review into the youth rates – due in Spring 2019.

However, on the positive side, the share of 21-24 year olds paid at the rate for their age remains low, as many employers choose to pay above this rate. Furthermore, the unemployment rate for those not in full-time education is at a historic low. A further consideration was the gap between the 21-24 Year Old Rate and the NLW. Commissioners were concerned about this gap widening, with the consequent risk of substitution effects. **On balance, the evidence led Commissioners to recommend a 4.3 per cent or 32p increase in the 21-24 Year Old Rate to £7.70.**

Last year we recommended increases above 5 per cent for 18-20 year olds because of both strong earnings and employment growth. While employment has continued to increase and unemployment has continued to fall the earnings picture has slightly weakened across the distribution this year. **For these reasons, Commissioners recommend an increase of 4.2 per cent or 25p to £6.15 for 18-20 year olds.**

For 16-17 year olds our priority remains their effective entry into the labour market. They are the most vulnerable age group in the labour market due to their relative lack of experience. However, their labour market and earnings performance is in line with last year's positive trends. On this basis, Commissioners recommended an equivalent increase that is also above average earnings growth and inflation. **We recommend the 16-17 Year Old Rate increase by 3.6 per cent or 15p to £4.35.**

Making recommendations on the Apprenticeship Rate is challenging because of the ongoing impact of the policy changes taking place in England and the lack of a recent Apprenticeship Pay Survey. Nevertheless, we did not get a sense from either worker or employer stakeholders that recent increases in the Apprentice Rate had affected the uptake of apprenticeships. **On this basis Commissioners recommend an increase which is similar to last year's increase: by 5.4 per cent or 20p to £3.90 for apprentices.** Commissioners will look in detail at the operation and effectiveness of the Apprentice Rate as part of the youth rates review.

Finally, in keeping with our aim to bring the accommodation offset up to the level of the 21-24 Year Old Rate as long as that rate is rising in real terms, we agreed to try and achieve this commitment over two years. **We therefore recommend a 55 pence increase in the Accommodation Offset to £7.55 in 2019 and we aim to finally close the gap next year**. This means the rate better reflects the costs of providing accommodation and helps the horticulture sector in particular.

Yours sincerely,

Bryan K. Sanderson

Bryan Sanderson
Chair, Low Pay Commission

Letter copied to the Rt Hon Theresa May MP and Kelly Tolhurst MP

Appendix 1: NMW and NLW Rate recommendations for April 2019

NMW/NLW	Rate	Penny increase	Percentage increase
National Living Wage	£8.21	38p	4.9
21-24 Year Old Rate	£7.70	32p	4.3
18-20 Year Old Rate	£6.15	25p	4.2
16-17 Year Old Rate	£4.35	15p	3.6
Apprenticeship Rate	£3.90	20p	5.4
Accommodation Offset	£7.55	55p	7.9