HM Treasury

Economic Evidence to the Pay Review Bodies

2027-28 Pay Round

November 2026

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Chapter 1
Summary

1.1 The UK economy has demonstrated resilience this year, with the second fastest growth in the G7 in 2026 to date,[1] leading forecasters to revise up expectations for 2026. The conflict in the Middle East, however, continues to push up energy prices and weigh on the global economic outlook. As a result of this terms-of-trade shock, UK growth is expected to slow in 2027, with the Office for Budget Responsibility (OBR) forecasting growth of 1.0%.[2]

1.2 Most Pay Review Bodies (PRBs) will make their recommendations for 2027-28 in Q1 2027, at a time when inflation is expected to constrain growth in public sector real earnings. In this context, it will be important to note demand for labour remains subdued in the broader economy. The OBR forecasts whole economy average weekly earnings growth of 2.9% and average hourly earnings growth of 2.5% in 2027-28.

1.3 Since July 2024, the government has addressed low average public sector pay growth[3] and increasing vacancies in the health, education, public administration and defence sectors seen during the last parliament. HM Treasury's analysis, which does not account for pensions, shows that public sector employees earned 0.4% more than individuals with similar characteristics in the private sector. This is a 0.9 percentage point increase on the estimate for 2024-25 and represents the highest public sector premium since 2020-21. Vacancies in the health, education and public administration and defence industries have fallen for 12 consecutive months,[4] and recruitment and retention in many workforces has improved.[5]

1.4 Departments are required to manage pay awards within existing budgets and no additional funding is available for pay. Affordability must therefore remain central to PRB recommendations. With departments already managing the ongoing costs of previous awards and lower growth in day-to-day budgets from 2027-28, awards above departmental affordability assumptions would add further pressure to already strained budgets. Depending on the scale of any additional costs, these choices could have implications for frontline services and workforce numbers. In addition, rising government borrowing costs due to the war in the Middle East are reducing fiscal space, adding to pressures on public finances.

[1] GDP international comparisons: Economic indicators - House of Commons Library
[2] 'Economic and Fiscal Outlook', Office for Budget Responsibility (OBR), October 2026.
[3] Between December 2019 and May 2024, private sector regular pay growth averaged 1 percentage points higher than public sector regular pay growth.
[4] VACS02: Vacancies by industry, Office for National Statistics (ONS), November 2026.
[5] See paragraph 3.31 for further details.

Chapter 2

Macroeconomic context

Economic context

2.1 UK growth has been resilient across 2026 to date. Real GDP grew by 0.6% in Q1, 0.5% in Q2 and 0.7% in Q3.[6] Stronger-than-expected outturns have led a range of forecasters, including the OBR, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD), to upgrade expectations for 2026 compared with earlier this year.[7] [8] The OBR now expects growth of 1.2% in 2026.[9] With continued strength into Q3, more recent data suggests the UK is on course to exceed this forecast. The Bank of England's central forecast, which accounts for some of these recent releases, expects even stronger growth for 2026 at 1.6%.[10]

2.2 The UK faces another global shock that will weigh on the outlook. The conflict in the Middle East has increased global energy prices, raising the cost of the energy the UK imports and pushing up inflation. As the UK is a net importer of energy, the UK faces a terms-of-trade shock, as it must use more of its national income to pay for imports, reducing the purchasing power of households and businesses and weighing on UK living standards. The OBR expects growth to slow to 1.0% in 2027, before recovering to 1.6% in 2028.[11]

2.3 In addition to rising prices that individuals and firms face, the conflict in the Middle East is leading to tighter financial conditions for households, firms and governments as higher inflation is raising interest rate expectations. Since the start of the conflict in the Middle East, UK gilt yields have increased broadly in line with the G7 average; all G7 countries have seen their borrowing costs rise, at times to, or near, highs not seen for decades.[12]

2.4 As global uncertainty puts pressure on households, businesses and borrowing costs, the government is providing breathing space to help manage higher energy and other commodity prices. The government is continuing to deliver on its commitment to fiscal discipline, helping to bear down on inflation, mortgage rates and the cost of business, whilst remaining focused on delivering good growth and sustained improvements in living standards in every part of the UK.

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[6] 'GDP first quarterly estimate, UK: July to September 2026', ONS, November 2026.
[7] 'Economic Outlook, Interim Report: Weathering Successive Shocks', Organisation for Economic Cooperation and Development (OECD), September 2026, Table 1.
[8] 'World Economic Outlook', IMF, October 2026, Table 1.1.1. 'World Economic Outlook', International Monetary Fund (IMF), April 2026, Table A2.
[9] 'Economic and Fiscal Outlook', Office for Budget Responsibility (OBR), October 2026.
[10] 'Monetary Policy Report – November 2026', The Bank of England, November 2026.
[11] 'Economic and Fiscal Outlook', OBR, October 2026.
[12] HMT calculations and Bloomberg. Data as of 25 November 2026.

Inflation

2.5 Before the onset of the conflict in the Middle East, inflation had been falling and was forecast to return to the Bank of England's 2% target this year. Inflation fell to 2.6% in June 2026, having fallen for nine consecutive months, down 1.0 percentage points from a year earlier.[13] Alongside falling headline inflation, there were also signs that domestic inflationary pressure was easing – services inflation had fallen to 3.6% in June 2026, 1.1 percentage points lower than a year ago, and 2.1 percentage points lower than in June 2024. Core CPI inflation, which excludes volatile items in the basket including energy, food, alcoholic beverages and tobacco, was 2.6% in June, having fallen by 1.1pts on the year.

2.6 As energy prices have increased sharply following the start of the conflict in the Middle East, this has fed into higher inflation. Inflation rose to 3.6% in October. Motor fuel inflation caused by the conflict has been a key driver of headline inflation in recent months and is now at its highest rate since July 2022.[14]

2.7 In its October 2026 forecast, the OBR expected inflation to continue to rise and peak at 3.8% in Q1 2027, before falling again. The OBR expects inflation to fall across the rest of 2027, before returning to the Bank of England's 2% target by Q3 2028 – where it remains around 2% to the end of the forecast horizon. The OBR forecasts CPI inflation to be 3.1% in 2027-28, 2.0% in 2028-29 and 2.1% in 2029-30. In its November 2026 central forecast, the Bank of England expects inflation will peak higher, at 4.9% in Q2 2027, though it also expects inflation will fall back to target by Q3 2028.[15]

2.8 The outlook for inflation remains highly sensitive to wholesale oil and gas price movements and the evolving situation in the Middle East. The OBR notes that a higher path for energy prices could lead to larger impacts on inflation than in its central forecast, and potentially larger second round effects through wages, whilst a more orderly resolution could conversely mean inflation falls more quickly than expected. Further detail on how this risk might affect the inflation outlook is set out in the risks section below.

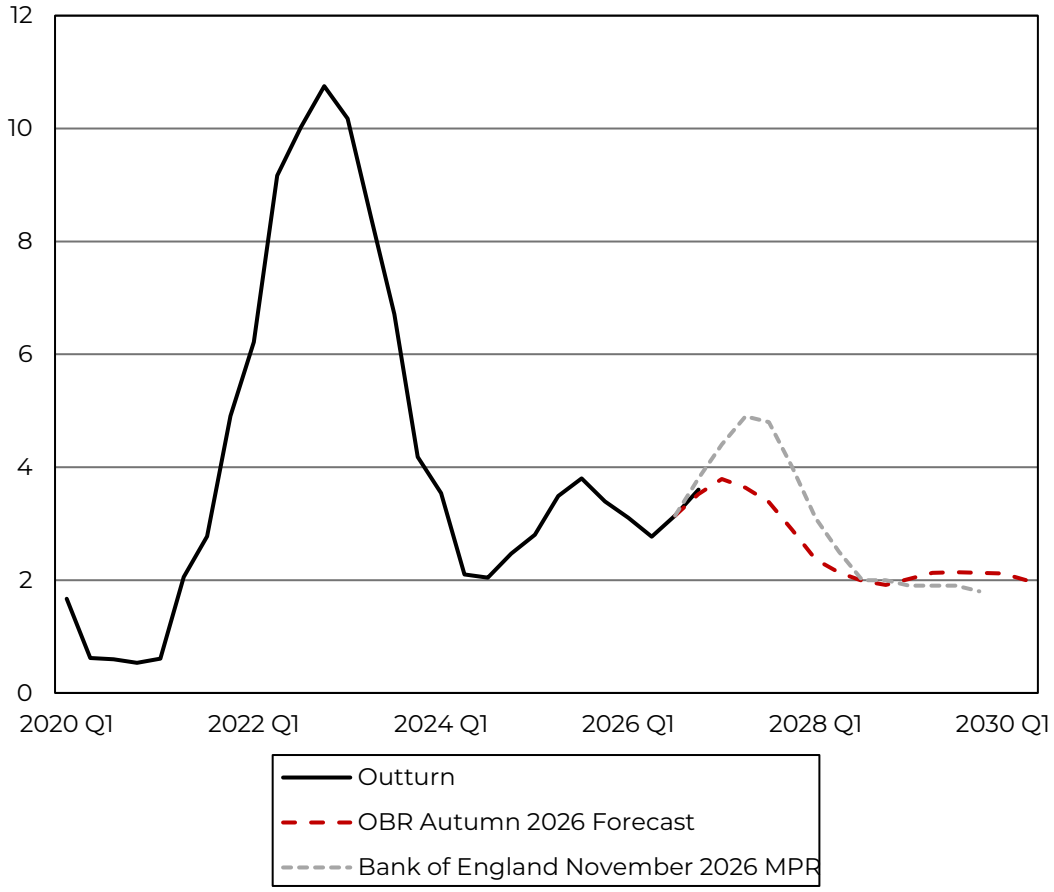
2.9 Although inflation is rising and the outlook is uncertain, the economic effect on the UK is expected to be less acute than in 2022. Inflation is expected to peak much lower than in 2022, when it reached over 11%.[16] This reflects lower pass-through of global energy prices into UK inflation as growth in clean power and changes in the energy market have reduced the UK's exposure to global energy market volatility and the international gas price. Inflation is expected to be less persistent compared to the 2022 price shock. This reflects different domestic economic conditions from 2022, underpinned by

[13] Consumer price inflation tables', ONS, November 2026.
[14] 'Consumer price inflation tables', ONS, November 2026.
[15] 'Monetary Policy Report – November 2026', The Bank of England, November 2026.
[16] Consumer price inflation tables', ONS, November 2026.

monetary and fiscal policy, which mean the domestic inflationary risk of the external price shock is lower.

2.10 The independent Monetary Policy Committee of the Bank of England is responsible for bringing inflation to its 2% target in the UK. To support bringing inflation down to this target, Bank Rate is currently 4.0%, up from 0.1% in December 2021.

Figure 2.A CPI Inflation (%)



Source: Office for National Statistics,[17] OBR October 2026 Economic & Fiscal Outlook,[18] Bank of England November 2026 Monetary Policy Report.[19]

Productivity

2.11 Productivity growth is the long-run driver of economic growth, higher wages, and living standards. From November 2026, the ONS has introduced a new headline measure of productivity[20] based on the component approach, bringing the methodology more closely in line with international best practice. This measure suggests that productivity growth (output per hour) was weak across 2022 and

[17] 'Consumer price inflation tables', ONS, November 2026.
[18] 'Economic and Fiscal Outlook', OBR, October 2026.
[19] 'Monetary Policy Report – November 2026', The Bank of England, November 2026.
[20] Labour productivity, UK - Office for National Statistics

2023, before rebounding strongly since late 2024. Productivity has grown at an annualised rate of 1.9% since Q2 2024, compared with an average growth rate of 0.7% between 2019 and 2024. In the latest data for Q3 2026 it grew by 2.5% on the year.

2.12 The outlook for productivity remains a key uncertainty in the OBR's forecast. The OBR expects productivity growth to slow to 0.7% in 2027 due to the rise in energy prices. The OBR expect productivity to rise by 1.0% in 2028 and by 1.1% a year between 2029 and 2031.

2.13 Tackling the longstanding barriers to growth, including weak historic productivity growth, is the only sustainable route to higher living standards and higher real wage growth. This government is focused on delivering good growth in every postcode through backing British business, seizing the opportunities created by AI, providing public control to boost investment and increase accountability, and delivering an ambitious package of devolution and regional growth reform.

Risks to the outlook

2.14 There are several risks to the economic outlook. Around its central forecast, the OBR notes key risks to the economic outlook from the conflict in the Middle East, the path of productivity growth and the outlook for the labour market.

2.15 The path for conflict in the Middle East and its impact on wholesale oil and gas prices remain highly uncertain and will be key to determining the economic outlook. That is why ending the conflict, fully reopening the Strait of Hormuz, and repairing the damage to energy infrastructure is the single biggest priority to improve the global outlook, including for the UK.

2.16 The OBR uses scenario analysis to consider the risk to the outlook from the conflict. In a 'severe shock' scenario, energy prices follow a higher path and stay elevated through 2027 and beyond. In this scenario, CPI inflation could be 2.25 percentage points higher, and real GDP growth 0.75 percentage points lower in 2027 than in the central forecast. The OBR also considers an 'orderly recovery' scenario where energy prices fall back more quickly than assumed in the central forecast. In this scenario, CPI inflation could be 1.25 percentage points lower and real GDP growth could be 0.5 percentage points higher in 2027 than assumed in its central forecast.[21]

[21] Economic and Fiscal Outlook', OBR, October 2026.

Chapter 3

Labour market context

Overview

3.1 The labour market has been subdued in 2026. Payroll employment and vacancies have been falling over the past year, with surveys pointing to subdued demand for labour. Pay growth has also slowed across a range of measures, while settlement data and forecasts suggest further moderation over the coming year.

3.2 The government accepted the majority of the PRBs' 2026-27 pay recommendations for public sector workers. These awards followed several years in which whole-economy pay growth has been elevated, the labour market was tight, and PRB awards broadly tracked wage growth.

3.3 Recent data demonstrate that public sector pay growth has outpaced private sector pay growth.[22] Whilst this is in part due to the timing of pay settlements[23] and compositional effects,[24] there is evidence of underlying strength in public sector pay. When controlling for individuals' characteristics, our analysis suggests the relative gap between public and private sector pay rose by 0.9 percentage points in 2025-26 to 0.4%.

Labour market indicators

3.4 Estimates of employment growth have diverged significantly across sources. Although Labour Force Survey (LFS) response levels have improved, the ONS continues to advise caution when interpreting changes over time and more detailed estimates. The ONS recommends using a range of different sources to assess the labour market, including Real Time Information (RTI) and Workforce Jobs data.

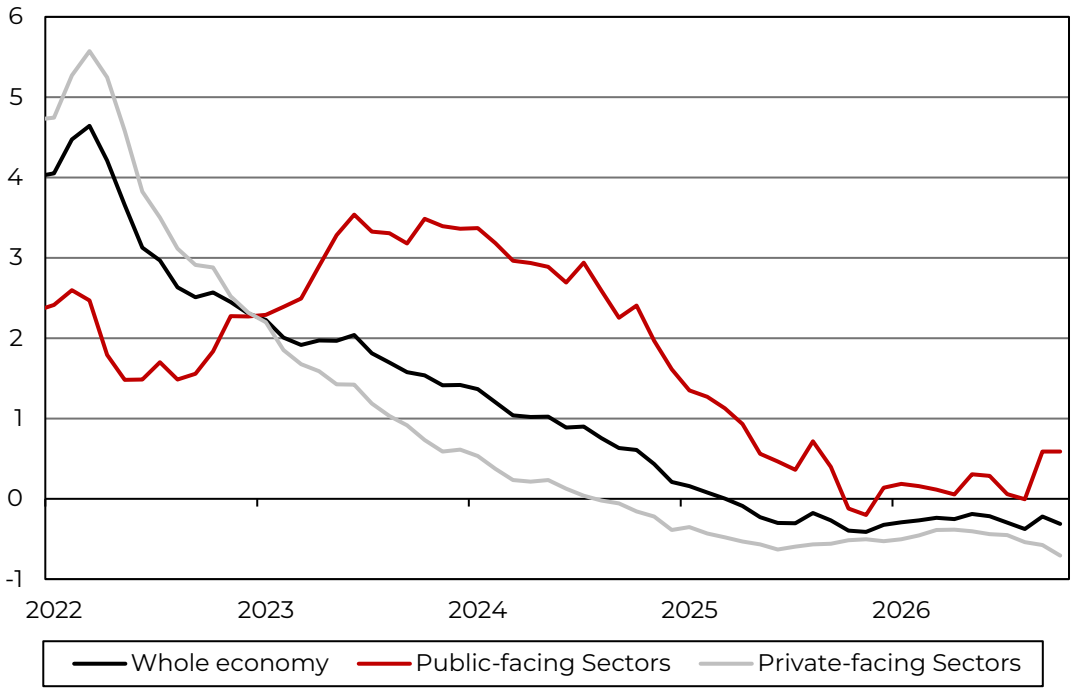
3.5 HMRC RTI data,[25] which provides a reliable and timely measure of payrolled employees, indicates that employees fell by 95,000 (0.3%) between October 2025 and October 2026, compared with a fall of 120,000 (0.4%) in the year to October 2025.

3.6 The reduction in the number of employees has been accounted for by private-facing sectors,[26] with the number of employees in these sectors declining by 0.6%[27] in the year to October 2026. Employee

[22] 'AO1: Summary of labour market statistics', ONS, November 2026.
[23] Average weekly earnings in Great Britain, ONS, November 2026
[24] DHSC written evidence to NHS Pay Review Body 2027-28, pg 49.
[25] Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics
[26] Includes all sectors except public administration and defence, social security, education, and health and social work.
[27] 'A01: Summary of labour market statistics', ONS, November 2026.

growth has remained positive in public-facing sectors, although the rate of growth has declined compared to previous years (figure 3.A).

Figure 3.A RTI employee growth (% change on year)



Source: ONS.[28]

3.7 According to the LFS, the UK unemployment rate was 4.6% in Q3 2026, which is 0.3 percentage points down on both the year and the previous quarter.[29]

3.8 Vacancies have continued to fall. The total number of vacancies has fallen by 5.0% over the last twelve months and now stands at its lowest level, outside the pandemic period, since 2014.[30]

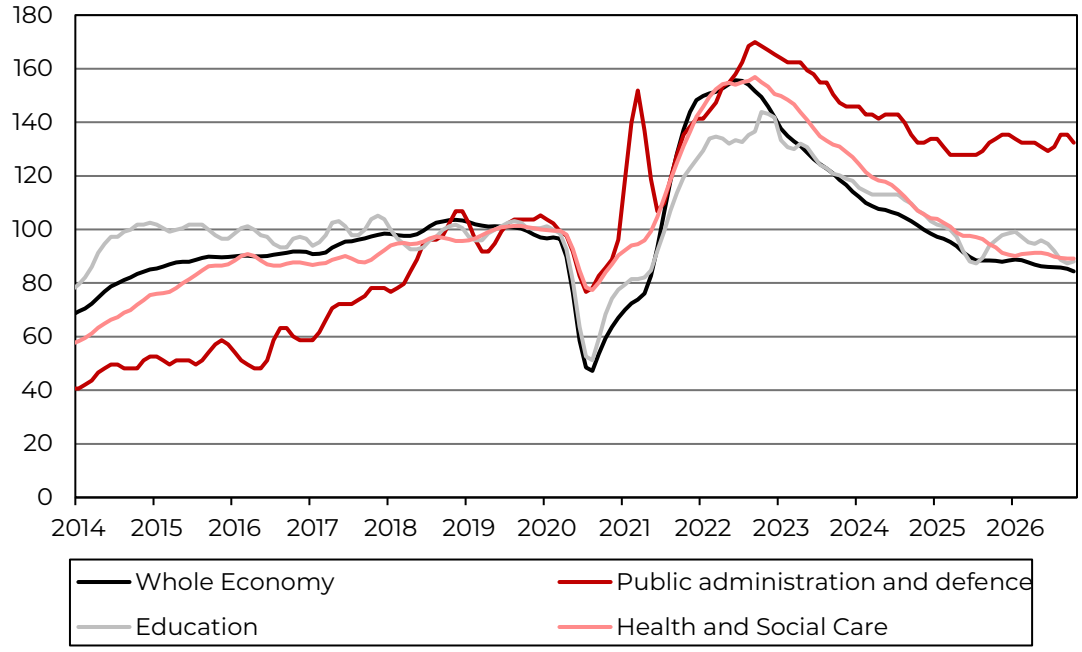
3.9 In the public sector, vacancy levels have fallen from the peaks in 2022. There remains variation within the sector (Figure 3.B): the number of vacancies remains below 2019 averages in both the education sector and health and social care sector. Vacancies in the public administration and defence sector remain elevated compared to the 2019 average, consistent with trends in the past two years.

3.10 Business surveys continue to point to subdued demand for labour. The index of demand for staff from the REC/KPMG Report on Jobs has fallen for 36 successive months, although the pace of decline is now slower than across 2024/25.[31] The ONS's Business Insights and Conditions Survey[32] and the Bank of England's Decision Maker Panel

[28] 'Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted', ONS, November 2026.
[29] 'A01: Summary of labour market statistics', ONS, November 2026.
[30] A01: Summary of labour market statistics' , ONS, November 2026.
[31] 'Report on Jobs', Recruitment and Employment Confederation, November 2026.
[32] 'Business insights and impact on the UK economy', ONS, November 2026.

data[33] suggest that hiring intentions have been negative or flat throughout 2026.

Figure 3.B Vacancy levels (indexed, 2019 average =100)



Source: ONS.[34]

Earnings Growth

3.11 There are several sources for timely estimates of earnings growth. Together, they suggest that pay growth has continued to ease over 2026.

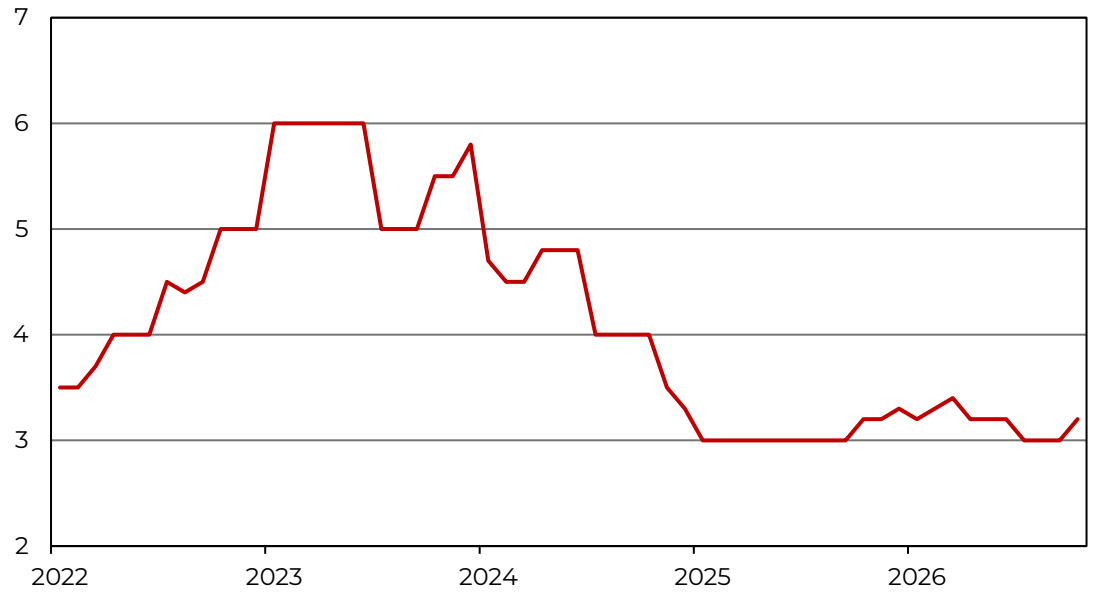
Settlement data

3.12 Settlement data are the most comparable data to PRB decisions, as they are a direct measure of consolidated pay awards and are not affected by changes in working hours or workforce composition, unlike many other measures of earnings growth.

3.13 Brightmine settlement data shows that median pay settlements are now broadly in line with 2025 levels, which were the lowest since 2021 (Figure 3.C). Median pay settlements for the private sector were at 3.0% in the twelve months to October 2026, unchanged from the twelve months to October 2025.[35] Median pay settlements in the public sector were higher than those in the private sector but also stable, at 3.5% in the twelve months to October 2025 and 2026. The cost-weighted average of the PRBs' 2026-27 awards was 3.4%.[36]

[33] Decision Maker Panel, Bank of England, October 2026.
[34] A01: Summary of labour market statistics', ONS, November 2026.
[35] Pay trends | Total rewards | Brightmine, November 2026.
[36] HMT calculations based on taking the average public sector pay awards and weighting them by the estimated cost of the workforce.

Figure 3.C Whole economy median pay settlements (3-month average, %)



Source: Brightmine.[37]

3.14 The Bank of England Agents' Pay Survey,[38] which excludes the public sector, indicates that average wage settlements in 2026 have been 3.6% so far, down from realised average settlements of 4.0% for 2025 as a whole.

Average Weekly Earnings (AWE)

3.15 Average Weekly Earnings (AWE) offers timely splits between public and private sectors and between total and regular pay (including and excluding bonuses, respectively). AWE is affected not only by pay awards but also by changes in working hours, overtime and workforce composition, for both public and private sectors.

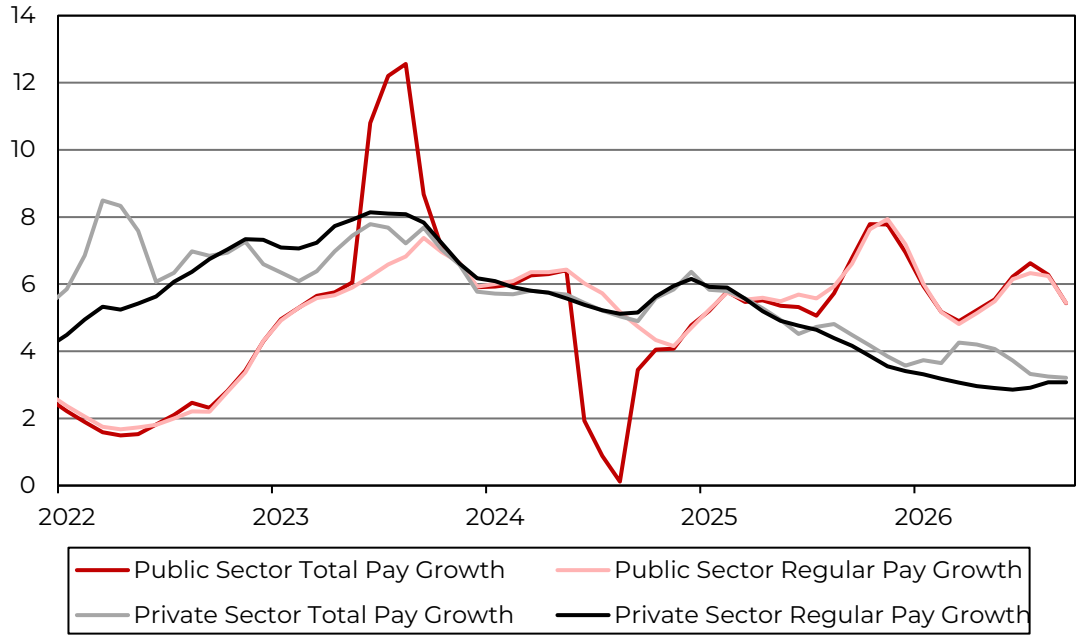
3.16 On the basis of the AWE measure, whole-economy total pay growth has continued to ease this year, reaching 3.6% in Q3 2026, down from 4.9% a year earlier (Figure 3.D).[39] Private sector total pay growth was 3.2% in Q3 2026, down from 4.0% a year earlier.[40] Public-sector total pay growth was 5.4% in Q3 2026, down from 7.8% a year earlier, partly reflecting the timing of public sector pay awards, which have temporarily boosted annual pay growth.[41]

3.17 Whole economy regular pay growth, which better captures underlying trends as it is unaffected by the timing of bonuses, was 3.5% in Q3 2026, down from 4.6% a year earlier.[42] Private-sector

[37] 'Pay trends | Total rewards | Brightmine, November 2026.
[38] Agents' summary of business conditions, Bank of England, November 2026.
[39] 'EARN01 Average Weekly Earnings', ONS, November 2026.
[40] 'EARN01 Average Weekly Earnings', ONS, November 2026.
[41] 'EARN01 Average Weekly Earnings', ONS, November 2026.
[42] 'EARN01 Average Weekly Earnings', ONS, November 2026.

regular pay growth was 3.1% in Q3 2026, down from 3.9% a year earlier.[43]

Figure 3.D Average weekly earnings total and regular pay growth (three month on year, %)



Source: ONS.[44]

Other measures of wage growth

3.18 HMRC's Pay As You Earn (PAYE) RTI data is an administrative measure covering all payrolled employees. On the basis of this measure, whole-economy mean pay growth was 4.2% in Q3 2026, down from 5.3% in Q3 2025.[45] As with a number of other measures, these figures reflect the effects of the timing of recent public sector pay settlements. The RTI estimate of whole-economy median pay growth, which is available on a timelier basis than the mean estimate, was 4.3% in the three months to October 2026, down from 5.2% in the three months to October 2025.

Labour Market Outlook

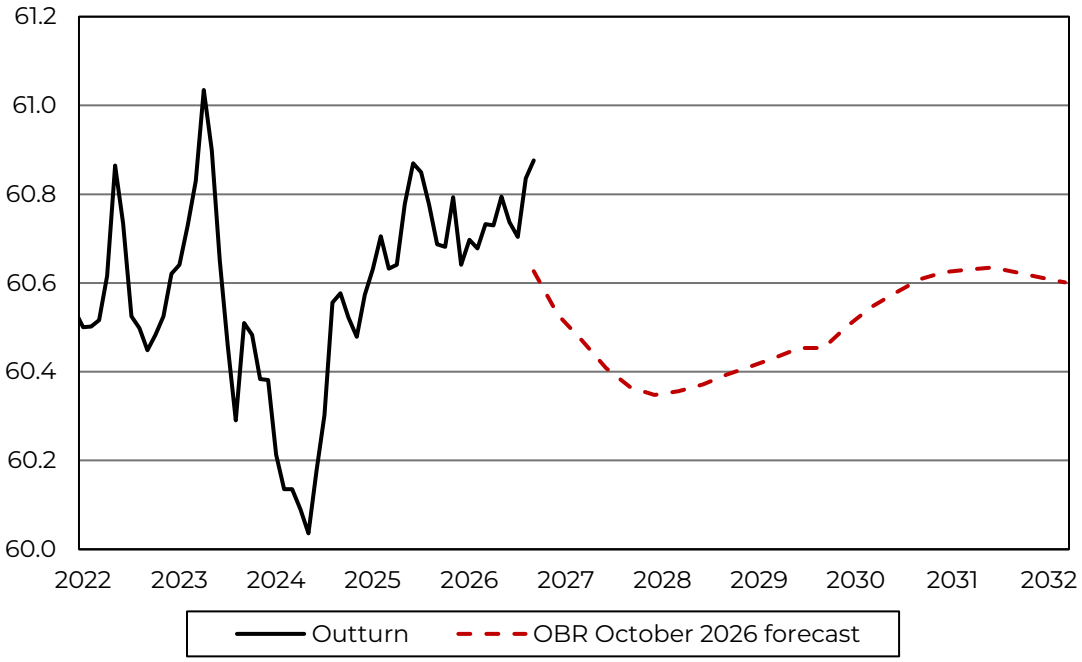
3.19 Wage growth is expected to continue to ease, consistent with ongoing spare capacity in the labour market. The accelerated timing of the 2026-27 pay round, launched two months earlier than the 2025-26 round, means that forecasts of earnings growth and the wider labour market are particularly relevant for PRB deliberations.

[43] 'EARN01 Average Weekly Earnings', ONS, November 2026.
[44] 'AO1: Summary of labour market statistics', ONS, November 2026.
[45] 'Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted', ONS, November 2026.

Employment and unemployment

3.20 The OBR forecasts that the 16+ employment rate will fall from 60.7% in Q2 2026 to 60.4% in 2027 and rise slightly in subsequent years (Figure 3.E).[46] The OBR forecasts the unemployment rate to be 5.1% in 2027 and to then fall to 4.1% by 2031.[47] The Bank of England forecasts that the headline unemployment rate will remain at 4.8% in the medium term, before rising to 5.0% in Q4 2027 (Figure 3.F).[48]

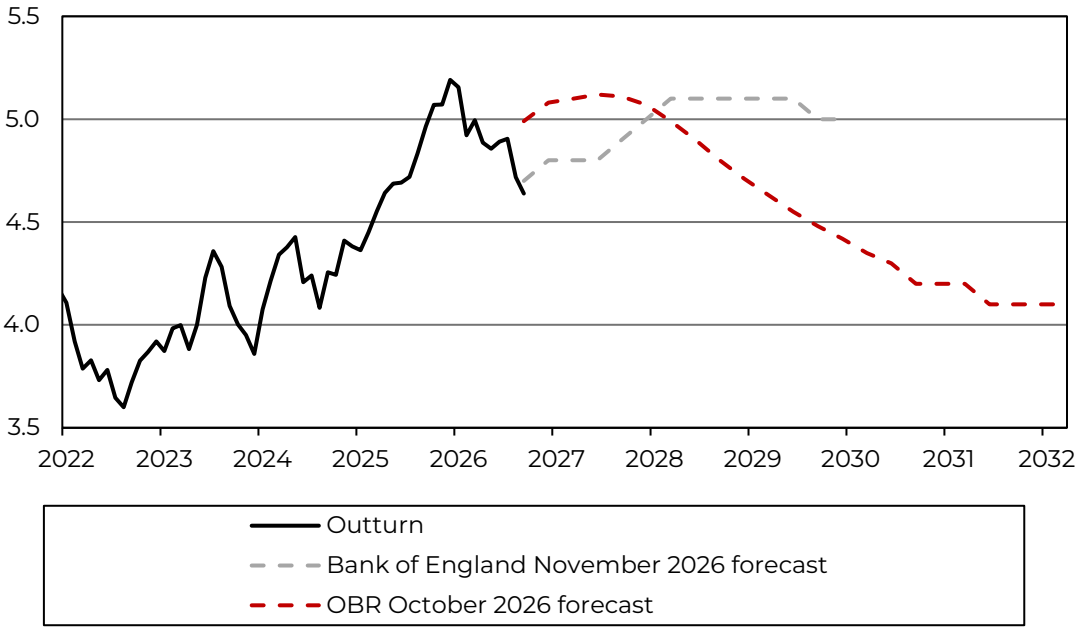
Figure 3.E Employment Rate Outturn and Forecast (16+, %)



Source: ONS,[49] OBR October 2026 Economic & Fiscal Outlook.[50]

[46] 'Economic and Fiscal Outlook', OBR, October 2026.
[47] 'Economic and Fiscal Outlook', OBR, October 2026.
[48] 'Monetary Policy Report', Bank of England, November 2026.
[49] 'A01: Summary of labour market statistics', ONS, November 2026.
[50] 'Economic and Fiscal Outlook', OBR, November 2026.

Figure 3.F Unemployment Rate Outturn and Forecasts (16+, %)



Source: ONS,[51] OBR October 2026 Economic & Fiscal Outlook,[52] Bank of England November 2026 Monetary Policy Report.[53]

Earnings growth

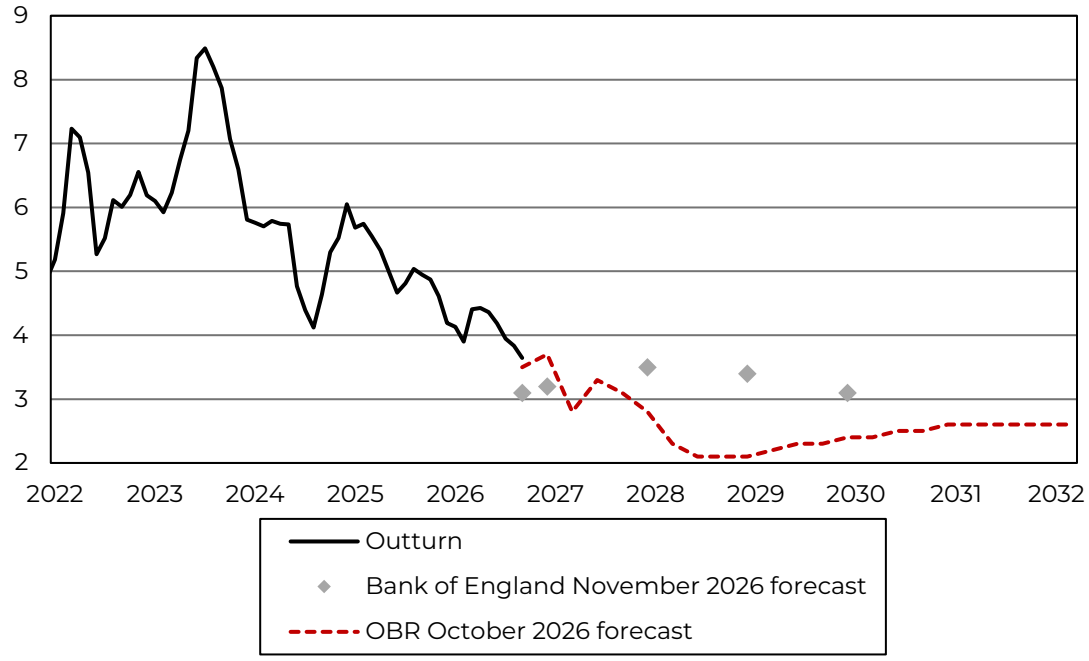
3.21 The OBR forecasts whole economy nominal average weekly earnings growth to decline to 3.0% in 2027 and to remain between 2.2% and 2.6% between 2028 and 2031 (Figure 3.G).[54] This measure represents weekly earnings growth and is therefore affected by changes in average hours worked. The OBR forecasts whole economy average hourly earnings growth of 2.5% in 2027-28, 2.1% in 2028-29 and 2.5% in 2029-30.[55] In its November 2026 Monetary Policy Report, the Bank of England forecasts four-quarter private sector regular pay growth to be 3.5% in Q4 2027 and 3.4% in Q4 2028.

3.22 Timely survey evidence and settlement data also point to further moderation in pay growth. The Bank of England's Decision Maker Panel reported that expected year-ahead wage growth was unchanged at 3.4% in the three months to October. Brightmine data indicates that firms are expecting a median 3% pay award over the next 12 months.[56] Evidence from the Bank of England's Agents suggests that pay settlements will be similar to 2026 or slightly lower in 2027, with the most recent Agents' report stating that most firms expect 2027 settlements to be broadly unchanged from 2026 at 3.6%.[57]

[51] 'AO1: Summary of labour market statistics', ONS, November 2026.
[52] 'Economic and Fiscal Outlook', OBR, October 2026.
[53] 'Monetary Policy Report', Bank of England, November 2026.
[54] 'Economic and Fiscal Outlook', OBR, October 2026
[55] 'Economic and Fiscal Outlook', OBR, October 2026
[56] Pay trends | Total rewards | Brightmine, November 2026.
[57] 'Monetary Policy Report', Bank of England, November 2026.

3.23 The November 2026 Comparison of Independent Forecasts also points to easing of pay growth, indicating an average independent forecast for wage growth of 3.7% in 2026, falling to 3.3% in 2027.[58]

Figure 3.G Average earnings growth outturn and forecasts (%)



Sources: ONS,[59] OBR October 2026 Economic & Fiscal Outlook,[60] Bank of England November 2026 Monetary Policy Report.[61]

Public and private sector remuneration

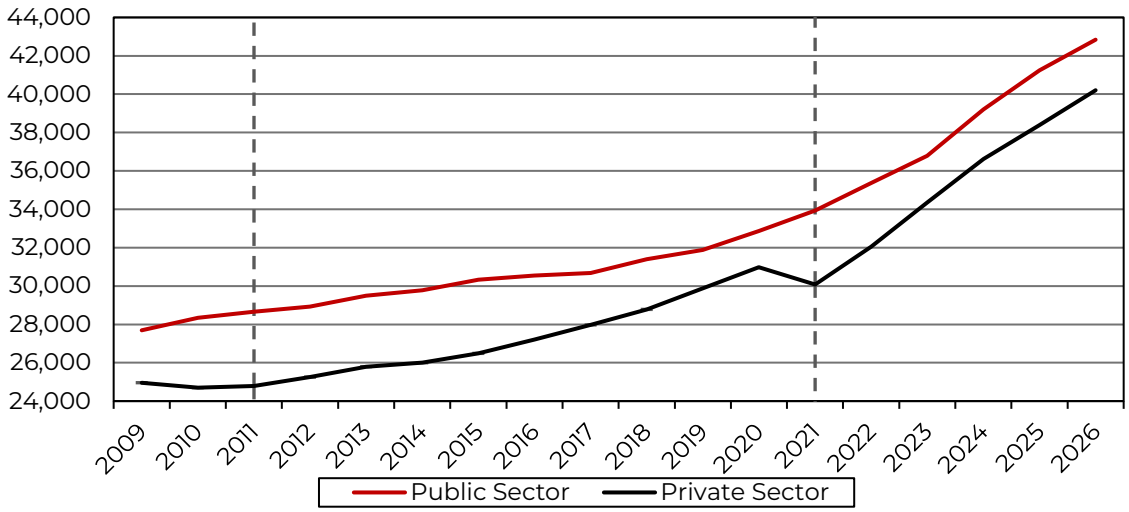
3.24 As the private sector is an alternative source of employment for public sector workers (and vice versa), comparisons between public and private sector remuneration are important for understanding recruitment and retention trends across public sector workforces.

3.25 The Annual Survey of Hours and Earnings (ASHE) continues to be the most comprehensive source of earnings information in the UK, due to its large sample size and UK wide coverage.[62] This section uses ASHE data as the best source of comparisons of the level of public and private sector pay, but as this data is only released annually, it does not use it to focus on recent trends.

3.26 Annual gross pay for full-time workers was 6.6% higher in the public sector than in the private sector in 2026. Median full-time annual earnings in 2026 were £42,839 in the public sector and £40,204 in the private sector.

[58] 'Forecasts for the UK economy', HMT, November 2026.
[59] 'AO1: Summary of labour market statistics', ONS, November 2026.
[60] 'Economic and Fiscal Outlook', OBR, October 2026.
[61] 'Monetary Policy Report', Bank of England, November 2026.
[62] Annual Survey of Hours and Earnings (ASHE), ONS, April 2026.

Figure 3.H Median annual pay across full-time employees (£)



Source: ONS Annual Survey of Hours and Earnings.[63] *Dotted lines indicate breaks in the series due to changes in occupational classifications.*

3.27 Simple comparisons of average pay across the public and private sectors do not account for the variation in employees' characteristics across the two sectors. They therefore do not give an accurate sense of the different earnings potential individuals will experience between the public and private sectors. In particular, public sector workers are, on average, slightly older[64] (indicating greater experience in the labour market) and more educated[65] than their private sector counterparts. We would expect this to result in a higher average earnings potential regardless of which sector they work in.[66]

3.28 HMT regression analysis, using individual-level LFS data on gross hourly pay, controls for a range of observable characteristics to obtain a more robust estimate of the difference in earnings potential across the public and private sectors. In particular, this analysis controls for individuals' sex, age, highest level of education and region, along with whether their role is temporary or permanent and full-time or part-time. More detail on the methodology used for this analysis is available in Annex A.

3.29 Figure 3.I shows both the raw average public-private sector pay differential (the "unconditional (raw) pay differential") and the estimated differential when controlling for individual characteristics (the "conditional pay differential"). Both estimates are for public sector pay relative to the private sector (i.e., a positive differential implies public sector pay is above the private sector, and vice versa for a negative differential). The gap between the unconditional and

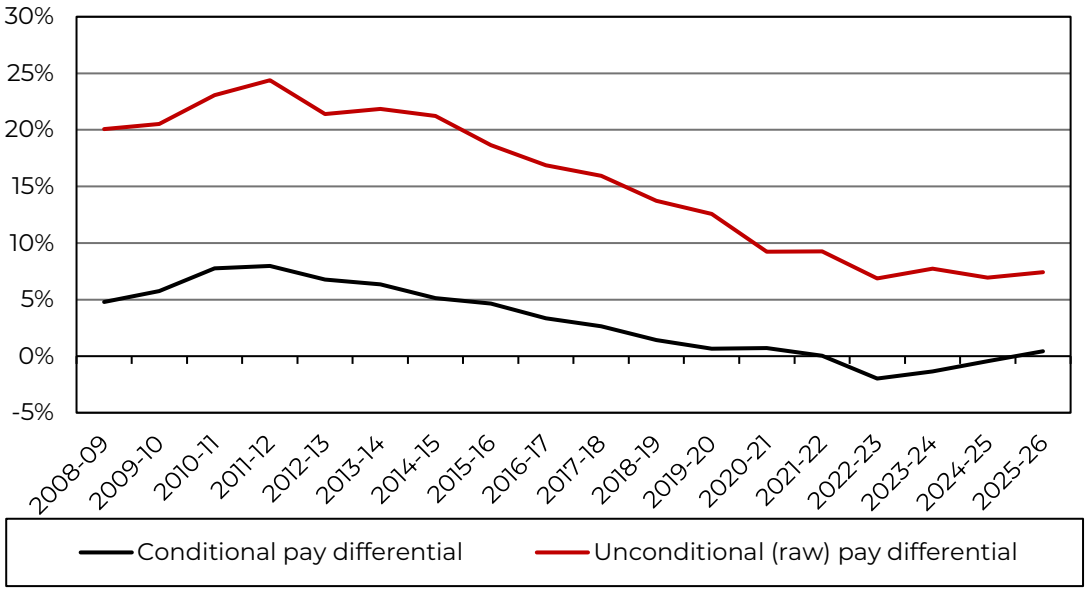
[63] 'Earnings and hours worked, public and private sector: ASHE Table 13', ONS, November 2026.
[64] According to the LFS data in Q3 2026 the average age of those working in the public sector was 43, compared with an average age of 42 across those working in the private sector.
[65] According to LFS data, in Q3 2026 61% of individuals working in the public sector had a degree or equivalent, compared with 41% in the private sector.
[66] Mincer's earnings function explains that earnings are a function of education and experience. Mincer, 1974 available here: c1767.pdf.

conditional differential falls over time, indicating structural changes in the composition of employees between the two sectors.

3.30 In line with the ASHE data outlined above, this analysis suggests a narrowing of the gap between public and private sector pay levels from the early 2010s. The estimated conditional pay differential falls from 7-8% in the early 2010s to 0.4% in the most recent outturn data for 2025-26. This suggests that on average public sector workers are paid 0.4% more than individuals with similar characteristics in the private sector. The results of this analysis are broadly consistent with those from the Institute for Fiscal Studies (IFS)[67] and the Resolution Foundation,[68] who also find a fall in the pay differential from the early 2010s, and that the conditional differential becomes negative in the early 2020s.

3.31 The public sector is large and heterogeneous, but many sectors have seen improvements in morale, recruitment, retention and related indicators recently.[69] This follows a period where recruitment and retention had been worse in many parts of the public sector.[70]

Figure 3.I Estimated public and private sector hourly pay differential (%)



Source: Internal analysis using ONS LFS microdata.

[67] Green Budget, Chapter 4: Public spending, pay and pensions, IFS, October 2022.
[68] The Resolution Foundation Labour Market Outlook Quarterly Briefing Q2 2023: LMO-Q2-2023.pdf 20 0.1% to one decimal place.
[69] For example,
DHSC and NHS England joint written evidence to the NHS Pay Review Body for the 2027 to 2028 pay round cites improvements in vacancy rates
Review Body on Doctors' and Dentists' Remuneration Fifty Fourth Report 2026 cites improvements in recruitment and morale.
Armed Forces' Pay Review Body Fifty-Fifth Report 2026 cites improvements in recruitment and retention.
Government evidence to the Schools Teachers' Review Body 2026 cites improvements in recruitment and retention and a fall in vacancies.
[70] For example, figure 3.B indicates high levels of vacancies,
Review Body on Doctors' and Dentists' Remuneration Fifty Fourth Report 2026 page 2, Executive Summary paragraph 14, DDRB, March 2026

Pensions

3.32 The evidence above only accounts for pay, but pensions are also a key part of the overall remuneration package that workers receive. Public service pension schemes remain among the most generous schemes available in the UK.

3.33 Over 80% of public sector workers are part of defined benefit schemes in which employers typically contribute around 20% (albeit just over 18% for some schemes, ranging up to 43.8% for the Armed Forces Pension Scheme) of earnings for future service (as of the 2020 valuations). This compares to most private sector employees who receive defined contribution pensions, and for whom employer contributions are significantly lower, with most (over 80%) employees receiving less than 10% employer contributions.[71] Employer pension contribution rates will fall from April 2027 based on the 2024 valuation reports published so far, e.g. to 15.5% for the NHS Pension Scheme England & Wales and 17.6% for the Teachers' Pension Scheme England & Wales, including future and past service.[72] However, this does not affect the pensions being accrued by members.

3.34 Under defined contribution schemes, volatility in investment returns can affect pension outcomes for members, in contrast with the more stable level of pensions members can expect in the current public service schemes.

3.35 Excluding pensions can significantly understate the value of public sector remuneration relative to the private sector. For example, the IFS estimated in 2022 that including pensions in its analysis would significantly increase the conditional differential between public and private sector remuneration by around 9 percentage points.[73]

[71] Employee workplace pensions in the UK', ONS, April 2022 ; 'Public Service pensions: 2020 actuarial valuation reports' Government Actuary's Department, May 2024;
[72] Public Service pensions: 2024 actuarial valuation reports - GOV.UK; Government Actuary's Department, 2026
[73] IFS Green Budget 2022 Chapter 4: Public spending, pay and pensions – the IFS' estimate of the conditional differential in remuneration goes from -3% in 2021 when employer pension contributions are excluded, to 6% when employer pension contributions are included.

Chapter 4
Fiscal policy

Overview

4.1 The government's economic objective is to deliver good growth and sustained improvements in living standards, underpinned by sustainable public finances and economic stability.

4.2 Commitment to fiscal discipline remains vital, particularly given the conflict in the Middle East which is increasing government borrowing costs and reducing fiscal space. The government's fiscal strategy is to deliver lower borrowing while enabling the public investment needed to drive long-term economic growth.

4.3 Departments must manage pay awards within existing budgets, alongside pressures carried forward from previous pay rounds. The Reserve, which exists in case of exceptional, unforeseen circumstances, will not provide additional funding for pay awards, reinforcing the need for PRBs to give full weight to departmental affordability.

4.4 Against this backdrop, pay recommendations should take account of departments' affordability positions. Where pay awards exceed the amounts departments have budgeted for, the additional costs would need to be managed alongside other pressures and priorities within departmental budgets.

Fiscal context

4.5 The government's fiscal strategy is to reduce borrowing to sustainable levels while maintaining the investment needed to support long-term growth in a sustainable way. Public sector net borrowing (PSNB) fell by 0.7 percentage points last year to 4.4%[74] of GDP and continues to fall over the OBR's forecast, reaching 1.8% of GDP in 2031-32.

4.6 The government is meeting its fiscal rules with a buffer to give the government flexibility to weather shocks by reducing the need to make immediate changes in tax and spending plans when there are changes in the global and UK economy. The current budget is forecast to be in balance by 2029-30, meaning day-to-day spending is met with revenues so that the government only borrows to invest. Debt, defined as net financial liabilities, stabilises from 2028-29 and is forecast to be lower at the end of the OBR's forecast (2031-32) than at the start (2026-27).

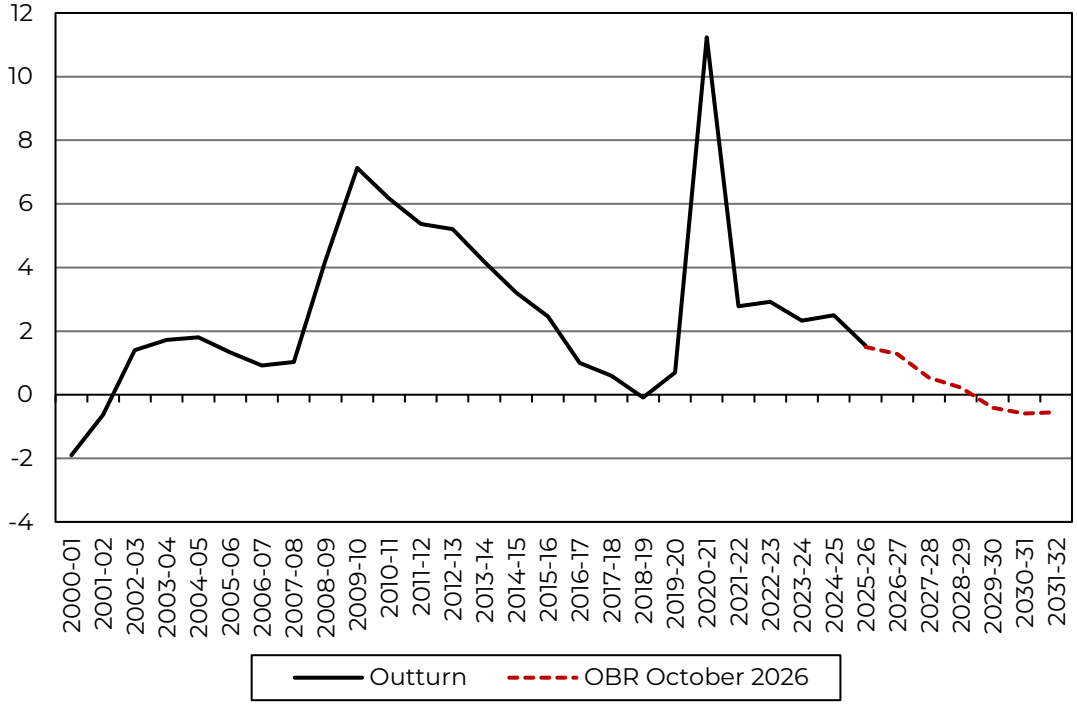
4.7 However, the conflict in the Middle East has pushed up borrowing costs relative to earlier in the year. The OBR forecasts an average of £14 billion per year in extra government debt interest, compared

[74] Public sector finances, UK - Office for National Statistics

with its March forecast. The government has chosen to use some of its headroom against the fiscal rules to absorb this impact while the outlook is uncertain.

4.8 The economic and fiscal outlook remains uncertain, with the OBR estimating that a higher and more sustained path of energy prices could add a further £17 billion to borrowing in 2027-28. These global developments demonstrate the sensitivity of the public finances to shocks and reinforce the importance of maintaining fiscal discipline. Bearing down on inflation also helps the Bank of England to maintain price stability, reducing mortgage costs for households and borrowing costs for businesses.

Figure 4.A Current budget deficit (%GDP)



Sources: ONS, OBR October 2026 Economic & Fiscal Outlook.[75]

Responsible spending control

4.9 Departments must make pay decisions within their existing budgets. If departments are unable to absorb 2027-28 PRB recommendations in full, they will not be able to accept them. Recent pay rounds demonstrate that affordability remains a critical consideration when the government responds to PRB recommendations, which have not always been accepted in full.

4.10 2026-27 PRB awards were on average 1 percentage point above departmental affordability assumptions, creating an estimated £2

[75] 'Economic and Fiscal Outlook', OBR, October 2026.

billion of additional costs in 2027-28,[76] which departments have taken action to manage within their settlements. As growth in day-to-day budgets was concentrated in the first year of the Spending Review period and is lower from 2027-28 onwards, managing these costs will require departments to continue prioritising carefully across their budgets.

4.11 Departments have set out their affordability positions for 2027-28 pay awards in their written evidence to the PRBs. Where recommendations are above the level departments have provisioned for within their budgets, departments will need to consider how any additional costs could be managed, including through offsetting savings. Depending on the scale of any additional costs, these choices could have implications for frontline services and workforce numbers. Departments must also consider the recurring costs of new awards into 2028-29, on top of pressures already carried forward from the previous pay round.

4.12 Departments will not receive additional funding to meet the costs of pay awards. Following the £22 billion of spending pressures identified in the 2024-25 Spending Audit,[77] the government significantly strengthened spending control and tightened access to the Reserve. This included returning the Reserve to its intended purpose of managing a limited number of unforeseen, unavoidable pressures that departments cannot otherwise absorb, as set out in Consolidated Budgeting Guidance.[78] Pay awards do not meet these criteria and must therefore be managed within departments' existing settlements. The Reserve also remains deliberately small, reflecting its intended purpose of managing only a limited number of unforeseen, unavoidable pressures that departments cannot otherwise absorb: at £2.5 billion, the 2027-28 RDEL Reserve is equivalent to 0.5% of RDEL,[79] compared with 2.4% at Spending Review 2021.[80]

4.13 Departments are also unable to meet the costs of pay awards by switching funding from their capital budgets, as they often did prior to 2025-26. Maintaining public investment at the highest sustained

[76] HMT calculations based on departmental written evidence to Pay Review Bodies and Pay Review Body reports found at: 'Joint DHSC and NHS England written evidence for the NHSPRB: pay round 2027 to 2028', DHSC, October 2026;
'Joint DHSC and NHS England written evidence for the DDRB: pay round 2027 to 2028', DHSC, October 2026;
'Joint DHSC and NHS England written evidence for the SSRB: pay round 2027 to 2028', DHSC, October 2026;
'HMPPS evidence to Prison Service Pay Review Body: 2027', HM Prison and Probation Service, October 2026;
'Ministry of Justice evidence to the Senior Salaries Review Body 2027 to 2028', Ministry of Justice, October 2026;
'Government evidence to the Senior Salaries Review Body on the pay of the Senior Civil Service', Cabinet Office, October 2026;
'Evidence to the STRB: 2026 pay award for teachers and leaders', Department for Education, October 2025; and
Office for the Pay Review Bodies
[77] Fixing the foundations, HM Treasury, July 2024
[78] Consolidated budgeting guidance, HM Treasury, 2026
[79] Budget 2026, HM Treasury, 2026
[80] Autumn Budget and Spending Review 2021, HM Treasury, 2021

level in four decades is central to the government's growth strategy. Since 2025-26, capital-to-resource switches have been prohibited under Consolidated Budgeting Guidance, protecting investment budgets from being used to meet day-to-day pressures and ensuring funding intended to support long-term growth is used for that purpose.

Chapter 5
Conclusion

5.1 The government continues to operate in a challenging economic and fiscal environment and government decisions, including on pay, must be affordable. Compared to 2025-26 and 2026-27, day-to-day spending growth in 2027-28 and 2028-29 will be more gradual.

5.2 This comes after departments have funded real terms pay increases for public sector workers in recent years. Public sector regular pay growth has been higher than private sector regular pay growth for 18 consecutive months[81] and HMT's analysis suggests that as of 2025-26, people in the public sector earned 0.4% more than individuals with similar characteristics in the private sector. This is a 0.9 percentage point increase on our estimate for 2024-25 and represents the highest public sector premium since 2020-21.

5.3 Departments have set out their affordability positions for 2027-28 pay awards in their written evidence to the PRBs, taking into account the recurring costs carried forward from the previous pay round. If recommended pay awards exceed what has been budgeted for, departments will need to manage the additional costs through offsetting savings elsewhere within their existing budgets. Departments will not receive additional funding to meet these costs, and if they are unable to absorb 2027-28 PRB recommendations in full, they will not be able to accept them.

5.4 PRBs are asked to take full account of departments' affordability positions, recent economic data and forecasts for wage growth across the wider economy. Departments' published affordability figures for headline pay this year were all between 2.3% and 2.4%.[82]

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[81] 'EARN01: Average weekly earnings', ONS, November 2026

[82] 'Joint DHSC and NHS England written evidence for the NHSPRB: pay round 2027 to 2028', DHSC, October 2026;
'Joint DHSC and NHS England written evidence for the DDRB: pay round 2027 to 2028', DHSC, October 2026;
'Joint DHSC and NHS England written evidence for the SSRB: pay round 2027 to 2028', DHSC, October 2026;
'HMPPS evidence to Prison Service Pay Review Body: 2027', HM Prison and Probation Service, October 2026;
'Ministry of Justice evidence to the Senior Salaries Review Body 2027 to 2028', Ministry of Justice, October 2026;
'Government evidence to the Senior Salaries Review Body on the pay of the Senior Civil Service', Cabinet Office, October 2026;

Annex A
HMT Public sector pay analysis

A.1 This annex provides details on the assumptions and methodology underpinning HMT's analysis of public-private sector pay differentials, referenced in Chapter 3 and shown in Figures 3.I and A.1.

A.2 This analysis estimates both the 'unconditional pay differential', a measure of the raw difference in average hourly pay between the public and private sectors, and the 'conditional pay differential', which accounts for the different characteristics of public and private sector workers and provides a more robust measure of the percentage difference in hourly pay a given worker would obtain in the public sector, compared with the private sector.

A.3 This analysis uses ONS Labour Force Survey (LFS) microdata, which is available on a quarterly basis. The LFS is a household survey regarding the employment circumstances of the UK population.[83]

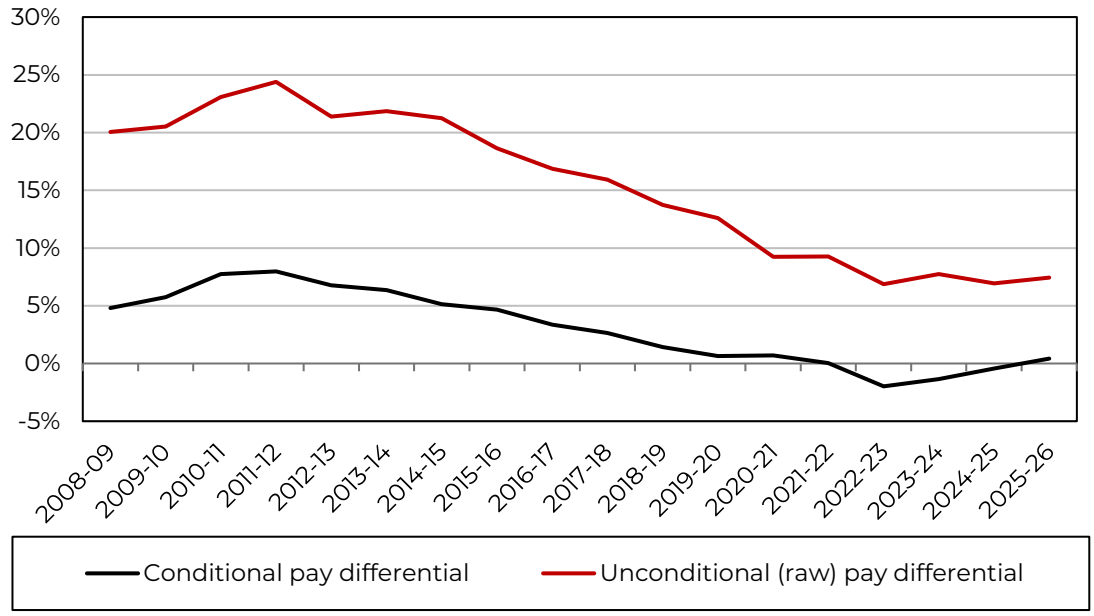
A.4 Analysis using outturn LFS data is conducted for each quarter between Q2 2008 and Q1 2026, and is averaged across the financial year to account for seasonal variations. The analysis is based on individuals' reported 'average gross hourly pay'.[84] Throughout the analysis, frequency weights are used in line with the ONS' recommendations.

A.5 It should also be noted that as LFS data are self-reported, it is typically seen as a less accurate measure of earnings than other data sources, and it has struggled to achieve the desired sample size in recent years. However, assuming that any biases are broadly consistent across the public and private sectors, the comparison of public and private sector pay should still provide useful outputs.

[83] 'Labour Force Survey', ONS

[84] It is unclear whether this includes bonuses and/or overtime payments. On asking the ONS, they advised it is the respondent's discretion whether to include these payments. In order to ensure consistency, and also to avoid distortion from the impact of the one-off public sector payments in 2023, the analysis only looks at individuals who answer 'yes' to the following question: "was your gross pay last time what you usually receive every period?". Doing so leads to a lower measure of the conditional pay differential in all financial years of the analysis.

Figure A.1 Estimated public and private sector hourly pay differential (%)



Source: Internal HMT analysis using ONS LFS microdata.

Unconditional pay differential

A.6 The 'unconditional pay differential' is estimated using the following Ordinary Least Squares (OLS) regression:

$$ln(Hourly\ pay_i) = \alpha + \beta_1 Public_i + \varepsilon_i$$

where $ln(Hourly\ pay_i)$ takes the natural log (ln) of an individual i's reported average hourly pay[85] and $Public_i$ is a dummy variable indicating whether an individual works in the public sector.[86]

A.7 β_1 is then converted into a percentage differential based on the formula set out in Halvorsen and Palmquist (1980),[87] which can be interpreted as the 'unconditional pay differential' between the public and private sectors.[88]

Conditional pay differential

A.8 The 'conditional pay differential' is estimated using the following OLS regression:

$$ln(Hourly\ pay_i) = \alpha + \beta_1 Public_i + X_i\boldsymbol{\beta} + \varepsilon_i$$

[85] Taking the natural log of hourly pay is in line with the approach taken by the ONS. The distribution of hourly pay is positively skewed and taking the natural log makes the distribution closer to that of a normal distribution, allowing the regression to produce more consistent estimates.
[86] The analysis drops those that are in a Public Limited Company, or a nationalised industry or state corporation.
[87] Halvorsen, R. and Palmquist, R, 1980. The interpretation of dummy variables in semilogarithmic equations.
American Economic Review, 70(3), 474–5, http://www.jstor.org/stable/1805237
[88] A positive differential implies public sector pay is above the private sector.

A.9 X_i is a vector of observable individual and role characteristics that include:

- Dummy variables indicating sex, highest level of education (7 options) and region (13 options);
- Age as a proxy for experience and the square of age to account for diminishing returns to experience;
- Dummy variables to indicate if the individual is in a full-time or part-time role, and a permanent or a temporary role; and
- Interaction terms of the above variables, to capture the joint impact of some variables on earnings.[89]

A.10 These variables are conventional for this type of analysis, as they are shown to have an effect on an individual's earnings.[90] The characteristics selected are broadly in line with those used by the ONS (2020),[91] IFS (2022),[92] and Resolution Foundation (2023)[93] in their analysis of the public-private sector pay differential.

A.11 β_1 is converted into a percentage differential based on Halvorsen and Palmquist (1980), which can then be interpreted as the 'conditional pay differential' between the public and private sectors. It provides a more accurate estimate for the percentage difference in hourly pay a given individual can expect to receive, on average, in the public sector compared with the private sector, by reducing the bias that might be introduced if the observable characteristics set out in paragraph A.9 were not accounted for.

A.12 While this analysis gives a more accurate estimate of the different earnings potential an individual may face across the public and private sectors, it does not account for differences in unobservable characteristics (such as ability and motivation), which could have an effect on differences in earnings potential between the public and private sectors.

[89] Interactions are included between age and the square of age with each of sex and education, and between sex and education, sex and region, and education and region.
[90] For example, see "Earnings Over the Lifecycle: The Mincer Earnings Function and Its Applications", Polachek, 2007, available here: Earnings Over the Lifecycle: The Mincer Earnings Function and Its Applications
[91] 'Public and private sector earnings', ONS, September 2020
[92] 'Public spending, pay and pensions', IFS, October 2022
[93] 'Labour Market Outlook', Resolution Foundation, 2023

HM Treasury contacts

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If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk