



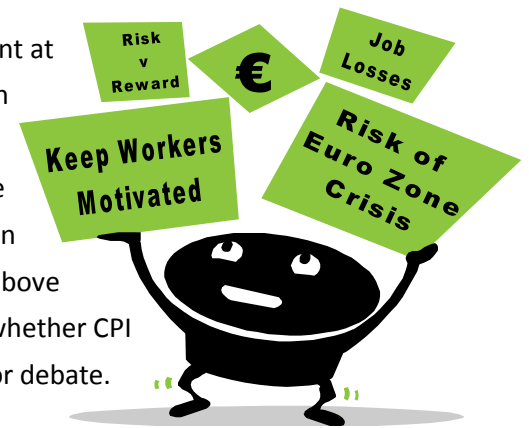
# Pay trends in 2012

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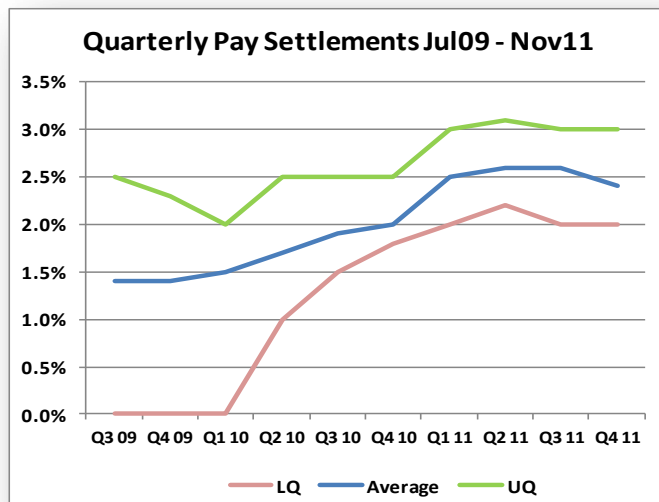
“ Private sector pay awards have crept slowly upwards since 2009, and - despite a dip towards the end of 2011 - there are reasons to believe this trend will continue well into the New Year. ”

With growth forecasts falling ever-lower and inflation and unemployment at record highs, the economic outlook appears bleak for 2012. However, in the private sector pay awards have crept slowly upwards since 2009 (see graph), and despite a dip towards the end of 2011, there are reasons to believe this trend will continue in the coming year. Opinion on whether this will amount to *real* pay increases in 2012 (i.e. above inflation) is mixed. The consensus opinion is that inflation will fall, but whether CPI falls below average pay awards for the first time since 2008 (IDS) is up for debate.



**Bosses face a difficult balancing act in 2012**

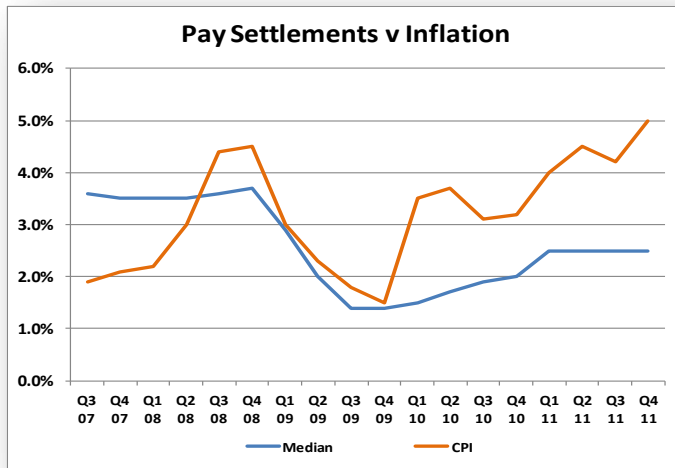
A recent quarterly survey by Mercer predicts that employees in the UK will “experience below-inflation pay rises in 2012”, however the forecasting group ITEM club has put inflation and average earnings in 2012 as almost identical at 2.2% and 2.1% respectively. There are likely to be sector differences with XperTHR predicting 2012 increases of 2% in the not-for-profit, retail and construction industries, 2.25% within services, and topped by manufacturing, chemicals, engineering and utilities at 3%.



Here we look at some of the factors affecting pay rates, both positively and negatively, and attempt to draw a conclusion on what 2012 might have in store.

### Key reasons why pay will rise in 2012

**Pay is slowly trending upwards:** The latest data from IDS shows that private sector pay rates in the UK have been increasing steadily for the past 28 months. Despite a slight lull toward the end of last year, median pay awards have increased from 1.1% in the third quarter of 2009 to 2.5% for the fourth quarter of 2011. The gap between the lower and upper ends of the settlement spectrum, as shown by the pink and green lines in the graph opposite, narrowed significantly over the same period. A continuation of this trend is a distinct possibility.



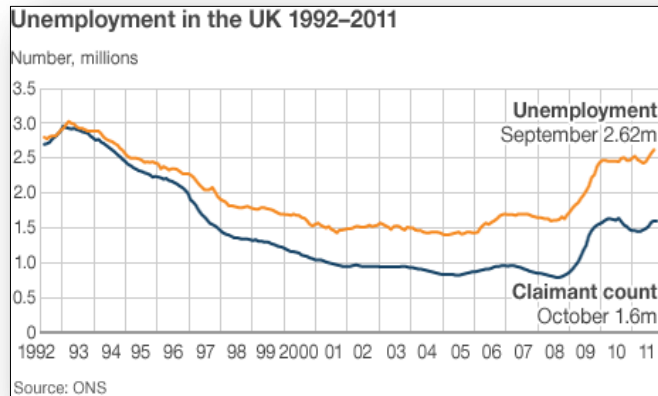
**Inflation has lessened the value of current pay levels:** The past couple of years have seen pay increases consistently below inflation. This contrasts with the previous 10 years, where pay settlements were broadly in line with or above inflation. The two measures are expected to get closer again in 2012, helped in part by the anticipated fall in inflation due to the reduced effect of the VAT hike in January 2011, and also by an increase in pay awards. Workers have experienced falling ‘real’ incomes for a while now and we predict companies will start to feel pressure to halt this trend.

**Believe it or not, the economy is growing:** Despite many analysts downgrading their forecasts for 2012, the economy is expected to show consistent positive (although small) growth this year. The recovery from the recent recession may be taking longer than hoped, but with three consecutive quarters of growth in 2011 and the majority of forecasts for GDP growth in 2012 around the 1% mark there is reason to believe that the economy is doing exactly that - recovering. If the economy continues to grow then it might not be long before we see pay settlements back at their pre-recession levels of 3% - 3.5%.



And a growing economy may also affect factors such as the National Minimum Wage. Any increase in the NMW has a domino effect as it ripples through the salary hierarchy. Whilst 2010 and 2011 saw relatively modest NMW increases in the face of economic uncertainty of 2.2% and 2.5% respectively, these were below inflation and this cannot be sustained if we are to protect our lowest-paid workers. The TUC general secretary Brendan Barber has said that “there will be room for much more generous increases in future years as the economy begins to recover”, and there is already talk of two year increases and removal of the tax burden at this level.

## Key reasons why pay will fall in 2012



**Unemployment is at its highest for 17 years:** Pay settlement rates will fall during 2012 because people will be willing to do the same job for less money. Latest figures from the Office of National Statistics (see chart) show that some 2.62 million or 8.3% of all economically active people remain unemployed as at the end of 2011, its highest since 1994.

The Chartered Institute of Personnel and Development recently predicted that these figures will continue to rise in 2012, peaking at 8.8%. Against this backdrop the business case to increase salaries will weaken in the face of a buyers' market for talent.

**Euro Zone gloom not going away:** The threat of a crisis in the Euro Zone means companies here in the UK remain wary, and that includes when it comes to pay increases. Whilst a safe resolution to the problem is widely expected, the fear of a collapse dragging the UK economy back into recession will make organisations hesitate when reviewing pay awards.



**There isn't the money available:** For many companies, increases in pay are simply not affordable right now. Challenging economic times, and increased people costs on the horizon as a result of pension auto-enrolment, will put many pay review budgets under pressure.

All of this means we may see a fall in pay settlements in 2012, particularly at the beginning of the year.

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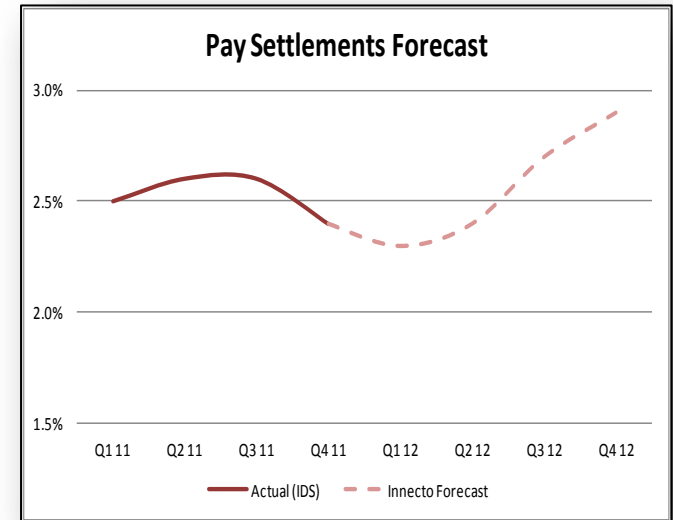
### Conclusions

In 2012 a number of factors will influence what happens to employee pay, and many of these are difficult to predict. On the one hand, pay settlements are trending upward and they have been lagging behind inflation for a couple of years now. However the uncertainty around the euro as well as persistently high unemployment threatens to make companies think twice before awarding substantial pay increases, looking instead at how they could realign their current spend more effectively.

### So how will the game play out, and what do we think pay will do over the coming year?

For the economy as a whole we predict median pay settlements to continue to stall, or even decline in the beginning of 2012 hovering around the 2-2.5% mark. However as the year progresses we expect this figure to rise, reaching 3% or higher by the fourth quarter of 2012. This is shown in the graph opposite.

On balance we feel with inflation running so high, workers will demand higher pay to offset real term losses of income. The uncertainty within the Euro Zone however is likely to offset these pressures early on in the year, but assuming a safe resolution to the crisis is found, the pressure from workers will begin to tell.



Note : The above trends relate to private sector employees, with the public sector likely to see predominantly zero pay rises in 2012 due to the governments two-year pay freeze.



If you wish to discuss an issue raised by this paper, or a wider Reward issue affecting your organisation, then please contact:

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**In summary** 2012 will begin much like last year, with pay increases lagging behind inflation. With people becoming increasingly dissatisfied with real income losses, employers will need to find ways of keeping their workers satisfied and motivated.

We've seen a number of new trends emerging in reward management over the last couple of years:

- ❖ Clients have started to look at their business model to ensure their employees are aligned to it. Having the behaviours that attract and encourage long/loyal customers, and giving value to those customers whilst ensuring profit remains are driving more focused reward systems to be developed.
- ❖ Organisations are taking a fresh look at their pay framework, ensuring that it rewards for performance and that it is effectively aligned to the external market.
- ❖ Attention and budget is being dedicated to communication and engagement activities alongside major changes in reward.
- ❖ We have been extremely busy in re-designing bonus scheme and sales commission schemes. The designs are more commercially focused and rewarding for individuals and teams.

Whatever happens, the smarter amongst us will be ensuring that every penny awarded as a salary increase is of maximum value to the recipient, as for some employee groups it may not necessarily be good news. For example, with the removal of child benefit on the cards for higher rate tax payers in 2013, a salary increase that tips an individual into this tax band will result in a significant loss of benefit to them (currently over £20 per week). Surely this is a prompt for us all to conduct a review of our benefits offering and ensure we are providing some flexibility through attractive salary sacrifice options.

**References:** *'2012 Employee Salary Increase Forecasts'* (Mercer, November 2011), *'2012 Pay Rises Set to increase'* (Xpert HR Blog, referencing 'IRS Employment Review' October 2011), *'ITEM Club Autumn Forecast'* (Ernst & Young, October 2011), *'Labour Market Statistics'* (ONS, December 2011), *'TUC Welcomes Planned Minimum Wage Increase'* (TUC, April 2011).