Rathbones
Look forward

Review of the week

5 June 2023

The great retirement

The UK labour market is in a huge state of flux. The population is ageing fast, people are retiring earlier and changes to immigration are leading to a lack of 'unskilled' workers.

One of the biggest problems facing most major economies in the coming decades is a lack of workers and a preponderance of retirees. Yet nowhere is that problem starker today than in the UK.

Here, most people are focused on the number of people coming in the front door. Net immigration hit 606,000 in 2022, a record high. Yet the number of people falling out of the labour market is very high too. Since the pandemic, 565,000 people of working age have stopped working or looking for jobs. And that doesn't include all the people who have celebrated their 65th birthday and moved out of the labour force (UK employment stats set the working age between 16 and 64, despite the retirement age now being 66). Exact figures for the number of Brits reaching retirement age are hard to find, yet given the rapid greying of the population, they are considerable. Pension provider L&G estimated that 700,000 hit the milestone in 2022 alone.

Long-term sickness in people aged 16-64 has increased markedly. It's not necessarily COVID or complications, but rather other health problems that have rocketed in the years since. That could be because of a change in our post-pandemic habits, a creaking NHS, or both. Former Bank of England chief economist Andy Haldane told a recent House of Lords labour market inquiry that our nation's fading health was "now a strengthening headwind to UK economic growth, for perhaps the first time since the Industrial Revolution". While sickness is rising and contributing to more people dropping out of Britain's workforce, that inquiry noted that it was unlikely to be the main driver of the ebb in UK workers.

The most likely reason for the UK's worker drain? Brits are retiring in droves. This was expected because of ageing demographics. Yet it has been supercharged by a wave of early retirement since the pandemic. This was no doubt driven by people, jarred by lockdowns and COVID itself, reassessing their priorities and deciding to enjoy their twilight years while the sun was higher in the sky. Worldwide, a bull run for stock markets in the aftermath of the pandemic left many feeling wealthy enough to retire much earlier than otherwise. Yet the UK has a much more flexible pension system that accommodated this decision perhaps more than in other nations.

Coming back to record UK immigration, students were actually the single largest bloc, at roughly a third of the total. The number of people immigrating for work has fallen back considerably since Brexit and now make up just a quarter of the total. While it's true that the number of workers coming from the EU has, since Brexit, been replaced by broadly the same number of workers from other parts of the world, they are actually very different. Britain's post-Brexit immigration strategy focuses on offering visas to skilled workers: the number has ballooned from the 100,000 a year to 180,000 and rising. Pre-Brexit, many of the workers arriving from the EU were 'unskilled'.

'Unskilled' is a terrible term that underplays the expertise of practiced farmhands, labourers, fruit pickers and wait staff. Anyone who has ever spent a day in an orchard, worked in a café or helped on a building site will know how useless you can be without experience. This change in the make-up of workers flowing into the country has caused shortages in parts of the economy, particularly hospitality, food production and construction. That has pushed up wages and dragged down productivity. Funnily enough, these areas are also those that are suffering from runaway inflation. The government reportedly plans to add builders to the list of skills that can be waved through at the lower wage level of £20,480, compared with the skilled visa's £25,600.

These dynamics have huge ripple effects, beyond just inflation. As yet more people retire and approach it, the flow of UK pension money tends to be away from stocks and into safer assets such as UK government bonds. That may be playing some part in continued outflows from UK stocks. It could also make it harder for companies to raise capital, as without the support of sustained purchases from pension funds the 'cost of equity' rises. Essentially, UK stocks are worth less than peers abroad, so companies selling their stock get less cash for each share. This means higher expected returns for shareholders, all else being equal, yet it also means new projects must be much more profitable to get off the ground, so business investment may fade.

The UK is in the strange situation where it is welcoming a record number of immigrants while suffering from rampant inflation, arguably driven by a lack of workers. Meanwhile, investment in automation and better technology to offset this lack of unskilled labour might be being curtailed by effects of a wave of retirement. If there's one thing to take from all this, it's that economic policy is tremendously complicated and shouldn't be driven by headlines. It's intricate, with one decision flowing into another which impacts yet another. And it's incredibly important.

An uncertain outlook

The US Congress managed to pass the debt ceiling deal without upset. Exactly when the shortfall between America's tax revenue and its healthcare and pensions liabilities will be addressed is anyone's guess. Just a few months after the next presidential election seems an inopportune time… In the meantime, while the agreement curtails government spending, most economists expect it to stop short of causing a significant drag on US GDP.

The US jobs market also offers a confusing picture. The unemployment rate jumped from 3.4% to 3.7% in May, while the number of new jobs created was much higher than expected. Wages grew 4.3% year-on-year, a 10-basis-point (bps) fall on the previous month and slightly lower than forecast. We still believe the US will fade into a mild recession this year as higher interest rates start to take their toll on households and businesses.

Unlike in the UK, Eurozone inflation is falling faster than expected. Continental CPI dropped 70bps to 6.1% in May, below expectations of 6.3%. Food prices, non-energy industrial goods and services fell compared with the previous month - it was first slowdown in services inflation this year. Part of this could be driven by a slump in economic activity, however. Eurozone manufacturing PMI surveys (a mixture of sales figures, confidence and hiring intentions) fell to a three-year low of 44.8 (below 50 signals a contraction in output). Lack of customer demand has led companies to reduce their production even though factories were cutting prices. In contrast, the UK manufacturing PMI came in higher at 47.1 versus a forecast 46.9, which was the result in the previous month.

Finally, at a meeting over the weekend, OPEC extended the timeline for its current oil production cuts from the end of 2023 to the end of 2024. On top of this agreement, Saudi Arabia announced it would reduce its output by a tenth to 9 million barrels a day (bpd) for the month of July. This is Saudi Arabia's biggest reduction in years and follows a 500,000bpd cut already announced in April. The cut could be extended beyond July, too, depending on how the price of crude fluctuates. According to the IMF, the Saudis need the price of Brent to trade above $80 to balance its government budget. Brent Oil traded in that range for most of 2022, but has slipped below so far this year. The news gave Brent Oil a bump, but only to $76. Concerns about a global recession, particularly in the US, will no doubt be weighing on the price of oil.

If you would like to hear more about what's going on in the global economy and how it affects the way we invest, please join us for our next Investment Insights webinar on Tuesday 11 July at 12.30pm. You can register here.

If you have any questions or comments, or if there's anything you would like to see covered, please get in touch by emailing review@rathbones.com. We'd love to hear from you.

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