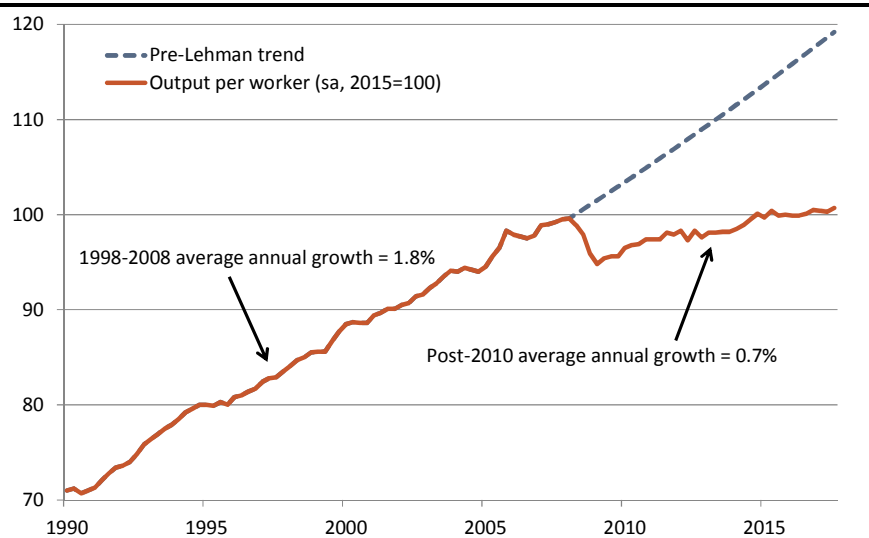


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17 November 2017

## Revisiting the UK productivity puzzle

The productivity puzzle – UK worker output is barely above the pre-Lehman peak



Quarterly data: 1990 Q1 to 2017 Q2. Source: Office for National Statistics, Berenberg calculations

- The economic problem of our age:** UK productivity gains – the major determinant of long-run economic growth – have slowed sharply since the financial crisis (see chart). In fact, underlying productivity growth probably decelerated well before the post-Lehman recession. Until the crash, this was masked by the credit-fuelled boom in demand and output. At any rate, the slowdown, dubbed the “productivity puzzle”, is dramatic. Average annual growth in output per worker has fallen from 1.8% before 2008 to 0.7% thereafter. Due to the sharp fall in output per worker in 2009 and slow recovery, UK workers in Q2 2017 were only about 1% more productive than in Q1 2008.
- The critical question:** How much of the slowdown in productivity growth is cyclical? Amid the post-Lehman caution, companies have relied on the UK’s flexible labour markets to cheaply expand their workforces to raise productive capacities while shying away from big risky investments in illiquid capital. But this process cannot go on indefinitely. As the UK labour market is now at, or close to, full employment, employment gains will slow. Companies will thus need to raise capacities through higher investment to produce more. Doing so would help to eliminate the cyclical shortfall in productivity growth. If companies do not raise their investment at faster rates, real GDP growth would decline.
- The impact of Brexit:** Leaving the EU could hurt UK productivity in two ways. 1) In the near-term, uncertainty lowers companies’ willingness to invest. This should, however, prove temporary. Uncertainty should lessen over time as the UK and the EU agree their new terms of trade. 2) In the long run, Brexit could damage the UK’s trade and investment relationship with its biggest market, the EU, which will weigh on the recovery in productivity. Including the effects on the labour force from lower inward migration, we estimate that Brexit could reduce the UK’s real GDP growth potential from 2.2% (as an EU member) by 0.4 to 0.7pts, depending on the nature of future UK-EU relations.
- Not just a UK issue:** In the US, the rise in output per hour has declined from 2.5% in the decade to 2008 to 1.2% since 2010. EU28 output per hour has fallen from 1.5% to 1.0% over the same period. In a way, the developed world’s critical economic and political problems can be linked to the slowdown in productivity growth. Because of persistently weak gains in productivity, in real incomes and real GDP per capita have been much weaker during the post-Lehman recovery than in previous upswings. These economic problems have exacerbated the drift toward populism in the UK and elsewhere. They may even be a major cause of it.
- A reason to be optimistic:** History shows large fluctuations in rates of productivity growth across the advanced world over time. Surges typically come after major revolutions in technology. Comparing the Western world’s current struggle for productivity gains against the ongoing fast rates of technological discovery in energy, artificial intelligence and robotics, to name but a few, suggests that we may be on the cusp of a rebound in productivity growth that goes well beyond a mere cyclical uptick. If economies can fully exploit the potential of the current wave of new technologies, the future may hold more opportunities than risks.

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