A new, lower speed limit
LOW GROWTH

HI

There is a 'productivity conundrum' in the UK and the rest of the developed world which questions whether longer-term rates of economic growth can be sustained. There is a long-standing gulf between productivity levels in the UK and its leading competitors. The UK is 18% less productive than the average of the G7 countries. Ultimately, over the longer-term, productivity growth drives economic growth.

The UK faces longer term issue: as the population ages, boosting productivity will become extremely challenging. A school of thought is that current interest base rates have meant that banks have had little incentive to support the innovation in firms that could drive up productivity. A 'normalising' of rates back to 4-to-6% would force banks to search for higher-return investment to make a decent margin, stimulating productivity-boosting activities including the development of new and innovative products.

Recent employment growth has been skewed towards low productivity jobs and industries. This has dragged down average productivity growth in the economy, as well as providing a partial explanation for the weakness in earnings growth. This has accounted for a good part of the weakness in UK productivity growth relative to other advanced economies. Future productivity growth needs future employment growth becomes more balanced.

However, low productivity growth may prove more durable, especially since it appears to be a common phenomenon across the advanced economies. Some commentators argue that we have entered an era of more or less permanently subdued productivity growth for essentially structural reasons. Mark Carney, Governor of the Bank of England, calls this a "new, lower speed limit".

As a consequence, economic forecasts (themselves highly uncertain) expect that the average rate of productivity growth over the next 5 years (1.1%) is only just above pre-financial crisis levels. Beyond that period is highly uncertain, but certain structural weaknesses – such as an ageing society – will provide constraints on the growth potential of the UK economy.

The other significant uncertainty is the UK trade relationship post-BREXIT. The recently partially released – and hotly debated – economic forecasts looking at potential scenarios for the UK economy over the next 15 years suggest that economic growth (under one scenario) could be 8% lower than a 'non-BREXIT situation'. In Wales, this scenario forecasts economic growth to be 9.5% lower than would otherwise be expected. Other scenarios are more sanguine, with growth in the UK and Wales being 2% and 1.5% lower respectively. Again, the uncertainty of these forecasts cannot be underestimated.

The other factor is that productivity growth is highly uneven in the economy, with definite winners and losers. Productivity growth among 'average firms' has stalled, partly due to slow rates of technological adoption, low investment, and weak management. While the top 1% of businesses have seen average productivity growth of around 6% per year since 2000, one-third of UK companies have seen no rise in productivity at all. Overall business spending on ICT, machinery and other equipment has hardly grown in real terms since 2000.

Implications for Gwent

Relative and absolute productivity growth in Gwent has been lower than other areas of the UK over many decades. This 'productivity gap' has not narrowed despite the best efforts of policy makers. According to the latest estimates, the average productivity in Gwent (as measured by GVA per