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News release

8 December 2014

The UK productivity puzzle: an international perspective

In a speech to the Mile End Group at Queen Mary University London, MPC member Dr Martin Weale compares the UK's recent productivity growth to that of other developed countries and considers what their experiences might tell us about the causes of weak productivity. He then turns to the prospects for UK productivity growth and its underlying trend before finally weighing the potential implications for monetary policy in the medium term.

Martin begins by observing that "the UK is not alone in having weak productivity growth recently." In fact, the relationship between pre and post crisis productivity in the UK is similar to that of twenty-three other developed countries, suggesting "our experience is far from unique". And, like the UK, these countries now have productivity growth rates which are "at best only very weakly correlated with those in the period before the crisis."

A regression analysis of the circumstances facing these countries suggests that the depth of a country's recession and subsequent poor productivity performance between 2008 and 2010 are "still casting a long shadow over the OECD countries". There is, however, no precise indication of the factors which might be responsible. Martin notes that if labour hoarding or capital misallocation were responsible, he would have expected to see a recovery in productivity growth by now. He also observes that attempts to explain differences in output per head in different OECD countries via regulatory arrangements are not very satisfactory.

Finally Martin considers what, if anything, this may mean for UK productivity in future and its underlying rate of growth in particular. He considers both arguments for and against optimism in the productivity outlook and finds little conclusive evidence on either side. But his analysis does discount the claim that lower trend growth preceded the crisis. Rather, he states that "the crisis itself had a very large impact, and it is of course possible that this will continue to have a permanent effect of the level of productivity".
In sum, it is too soon to brand the recent uptick in productivity the beginning of a thaw but "in real life, time is a great healer and perhaps we can hope that is true even for Britain's productivity growth". He shows it is possible to distinguish between three productivity states, contraction, weak growth and strong growth. The

economy has experienced a protracted period consistent with weak underlying growth, although the MPC's forecast assumes that the crisis has not reduced the likelihood of returning to strong rates of growth.

Turning to the implications for monetary policy should productivity growth be weaker than the MPC expects, Martin notes: "Persistently slower productivity growth would have two implications for interest rates; in the short term, interest rates would need to be higher in order to prevent demand running ahead of supply. But over the medium term, interest rates may remain lower than they were before the crisis, reflecting weaker underlying growth." However, "the MPC does not have the luxury of being able to wait for the fog of uncertainty over productivity growth to clear up. Exploration of recent trends provides some help, but understanding what they imply for the future remains essentially a matter of individual judgement."

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