

UK Economic Outlook

November 2019



Contents

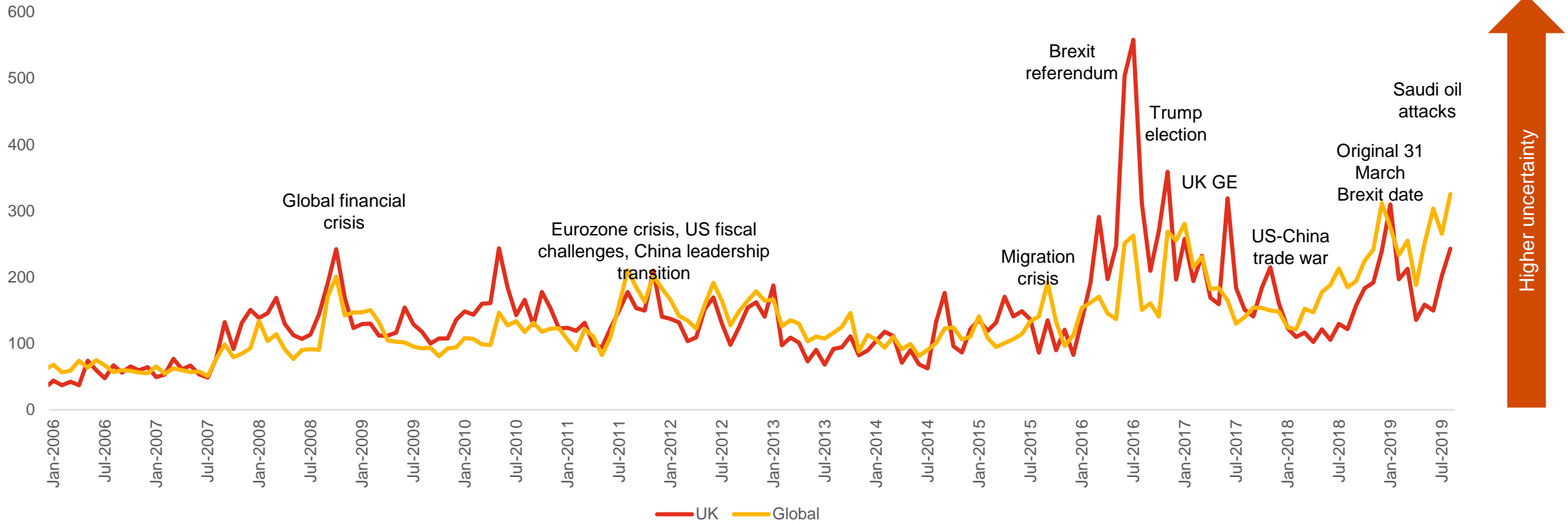
1. Global growth trends and prospects
2. UK economic trends and prospects
3. The Productivity Puzzle revisited: why has UK productivity lagged behind other advanced economies?
4. What drives regional productivity gaps across the UK and how can these be closed?



Global growth trends and prospects

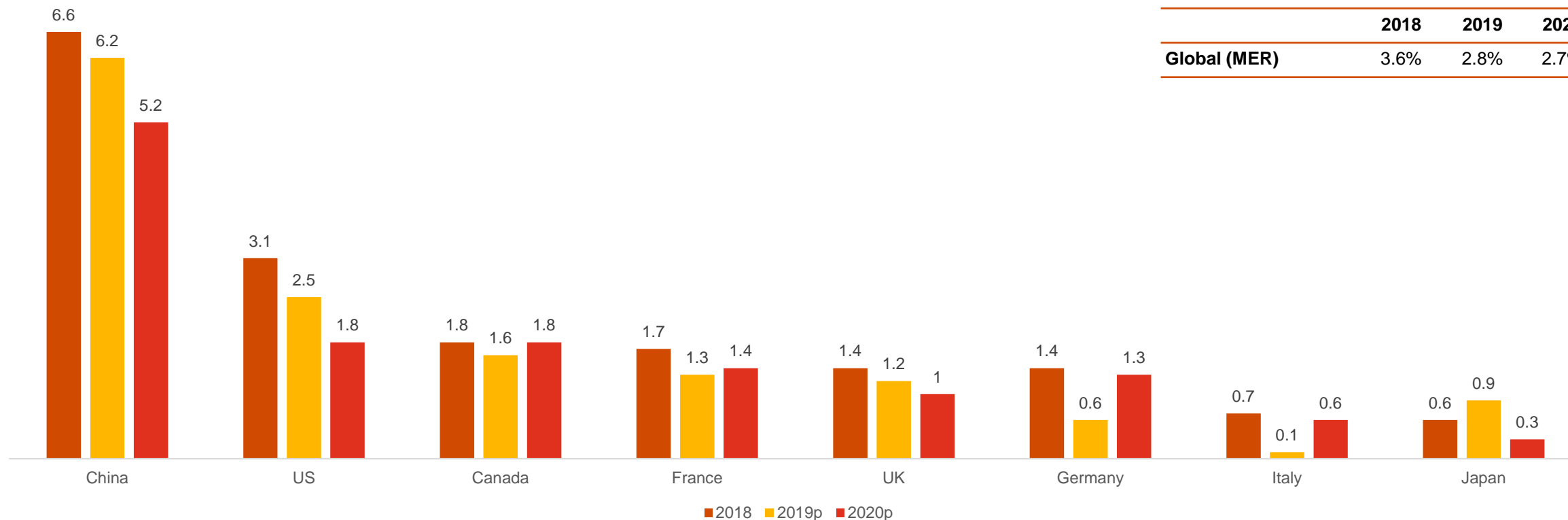
General uncertainty about the future direction on trade of the world's two largest economies and other geopolitical risks are weighing on global growth prospects

Economic policy uncertainty index



2019 saw a synchronised slowdown in economic activity across most major economies – global growth could stabilise in 2020, but risks are weighted to the downside

GDP growth in 2018 and 2019 and 2020 projections (% annual change)



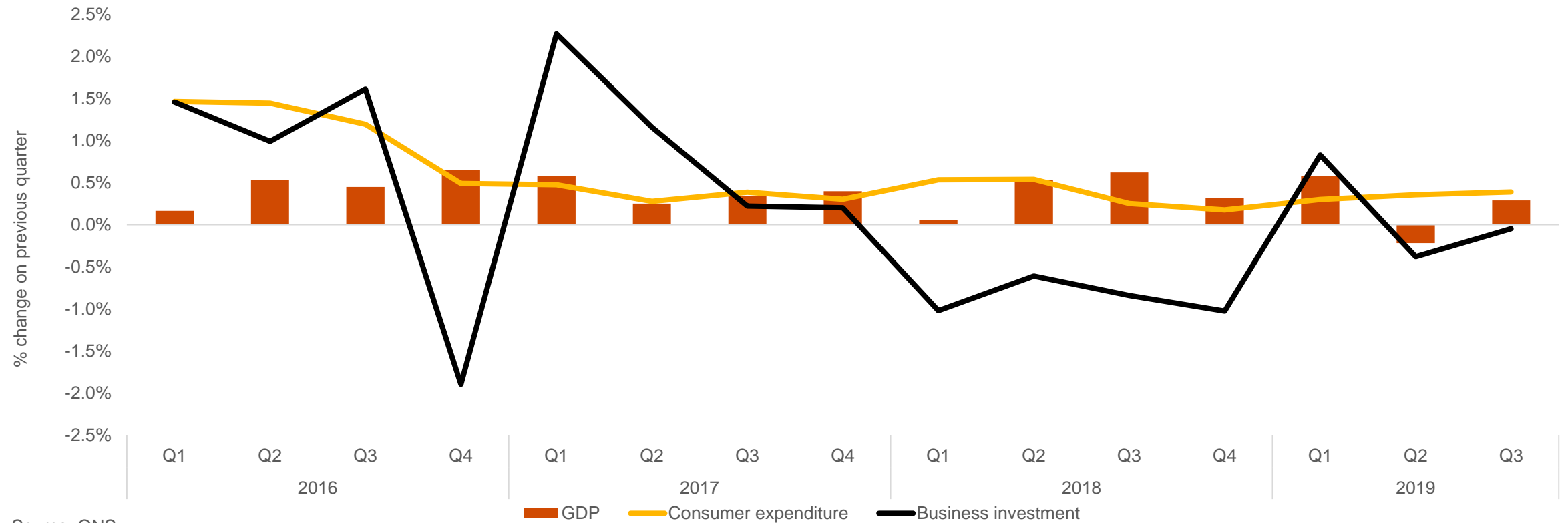
	2018	2019	2020
Global (MER)	3.6%	2.8%	2.7%

2

UK economic trends
and prospects

UK economic growth has been somewhat erratic in 2019, largely due to Brexit timing effects, with the positive contribution of consumer spending offset by weaker business investment

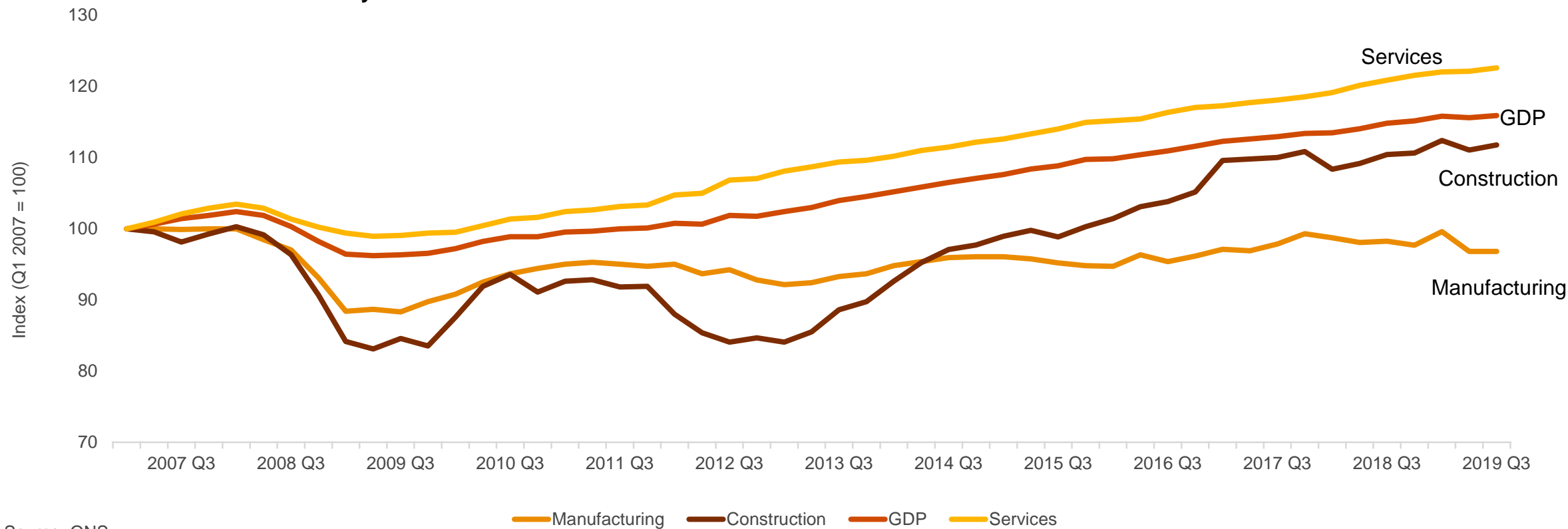
Growth in GDP, consumer expenditure and business investment



Source: ONS

Services sector output has grown relatively steadily since the crisis, while manufacturing has suffered from the slowdown in the global economy since mid-2018 and construction has been volatile

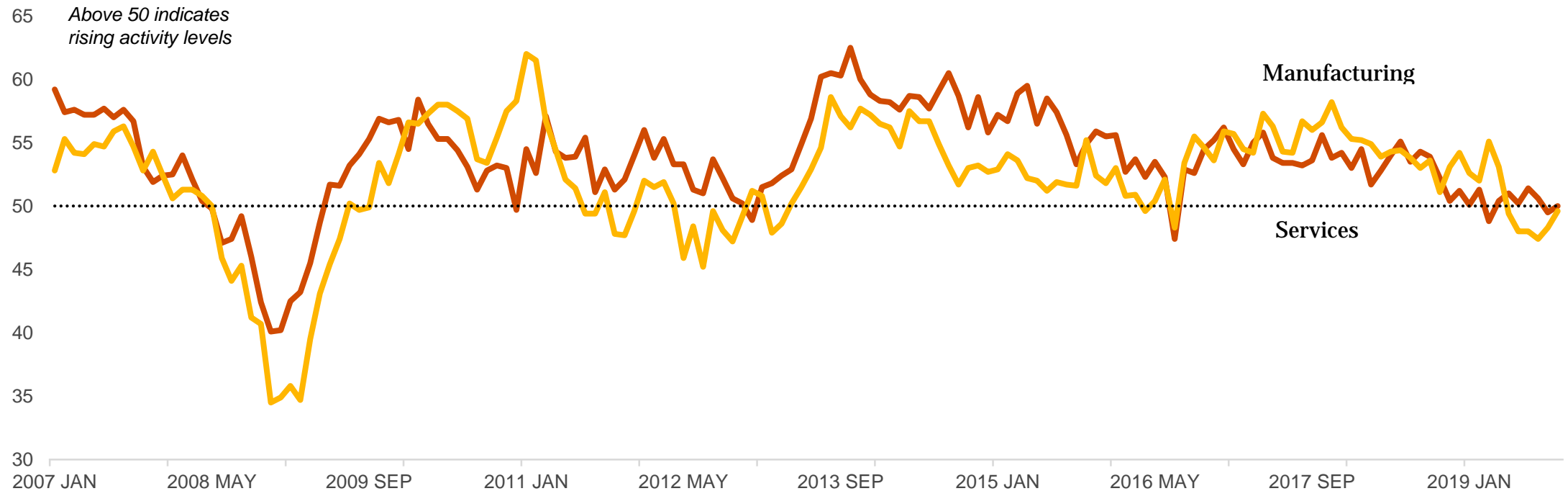
Growth in GDP and selected industry sectors



Source: ONS

The manufacturing PMI has weakened since 2017 apart from a pick-up in early 2019 due to 'no deal' stockpiling, and services PMI has been subdued for most of 2019 – latest data point to flat output levels

Purchasing Managers' Indices of business activity

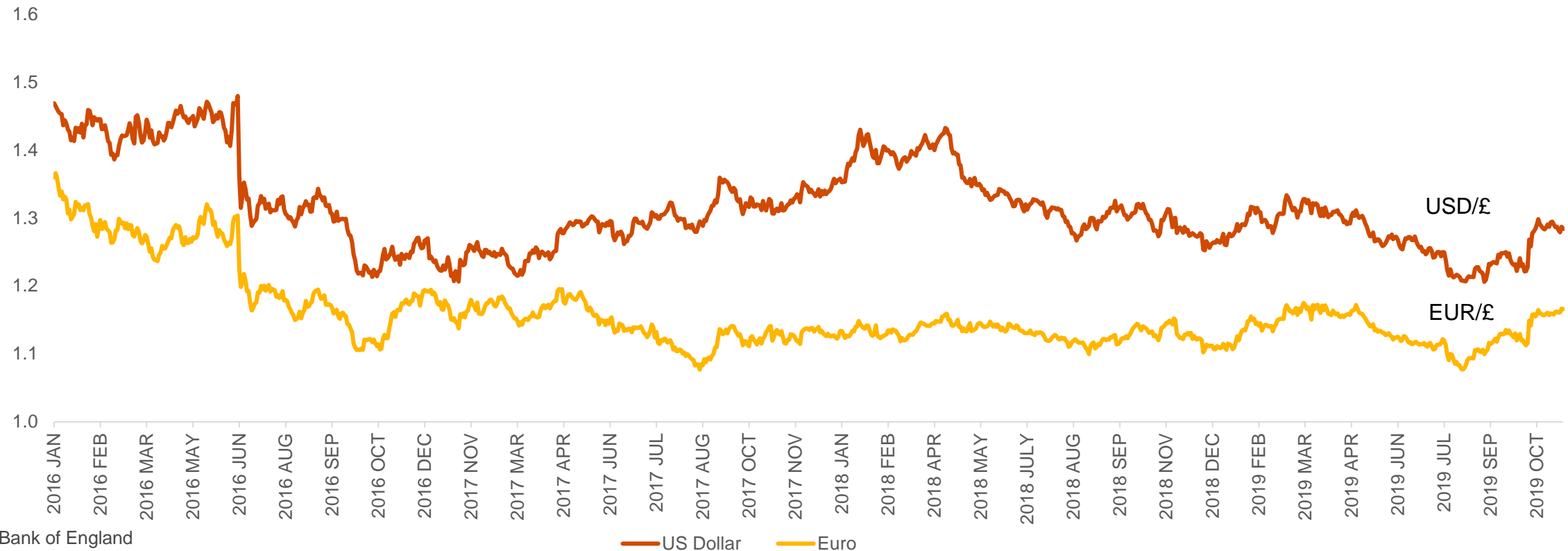


Source: Markit/CIPS

— Services — Manufacturing

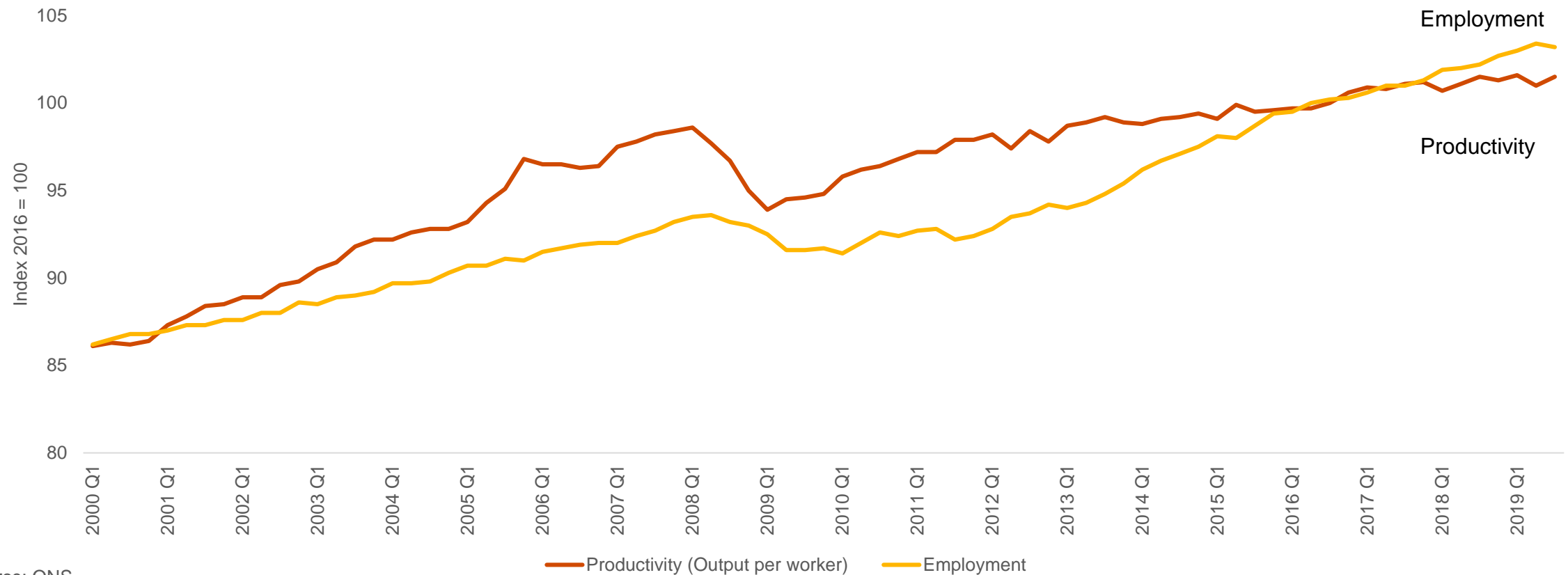
Sterling regained some ground during October as fears of a no deal Brexit receded, but remains weak by pre-referendum standards - continued volatility likely until there is more clarity over Brexit

US dollar and euro exchange rates against the pound



Source: Bank of England

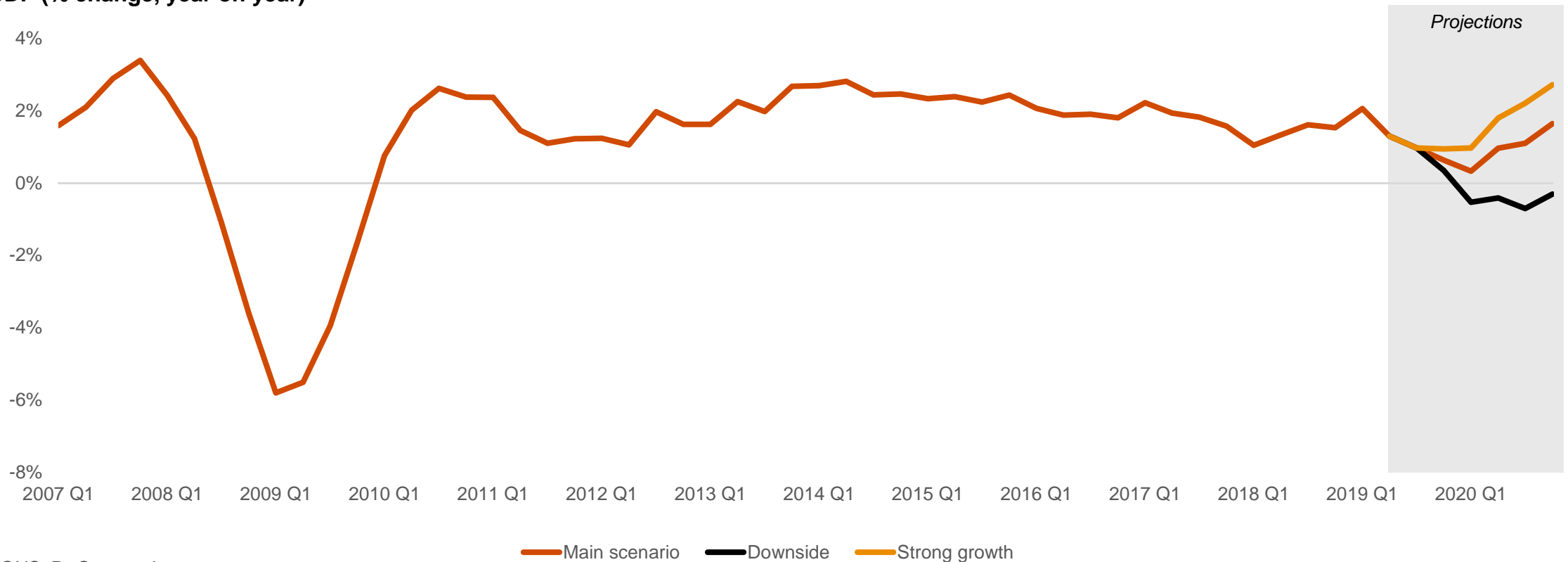
UK productivity growth has been relatively weak since the financial crisis, but the upside has been strong jobs growth, particularly since 2012



Source: ONS

Our main scenario is for real GDP growth of 1.2% in 2019 and around 1% in 2020, but risks are weighted to the downside

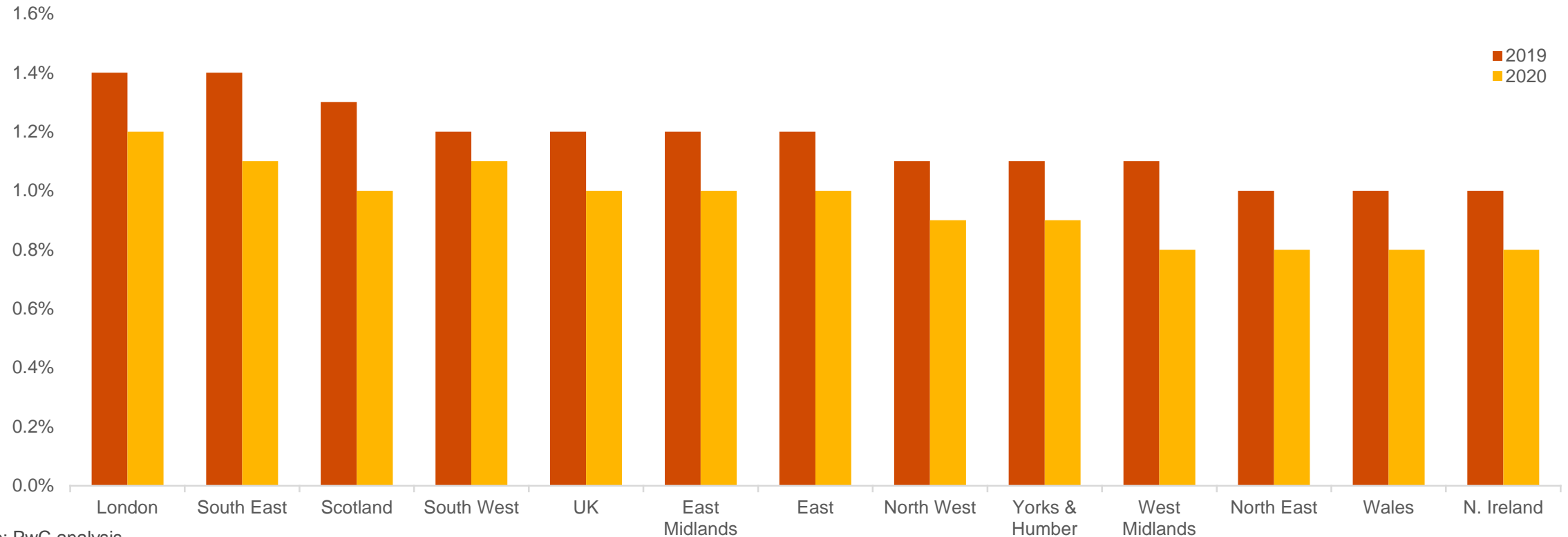
Real GDP (% change, year on year)



Source: ONS, PwC scenarios

We expect UK growth to be more balanced across regions in 2019-20, with London only growing slightly faster than the UK average

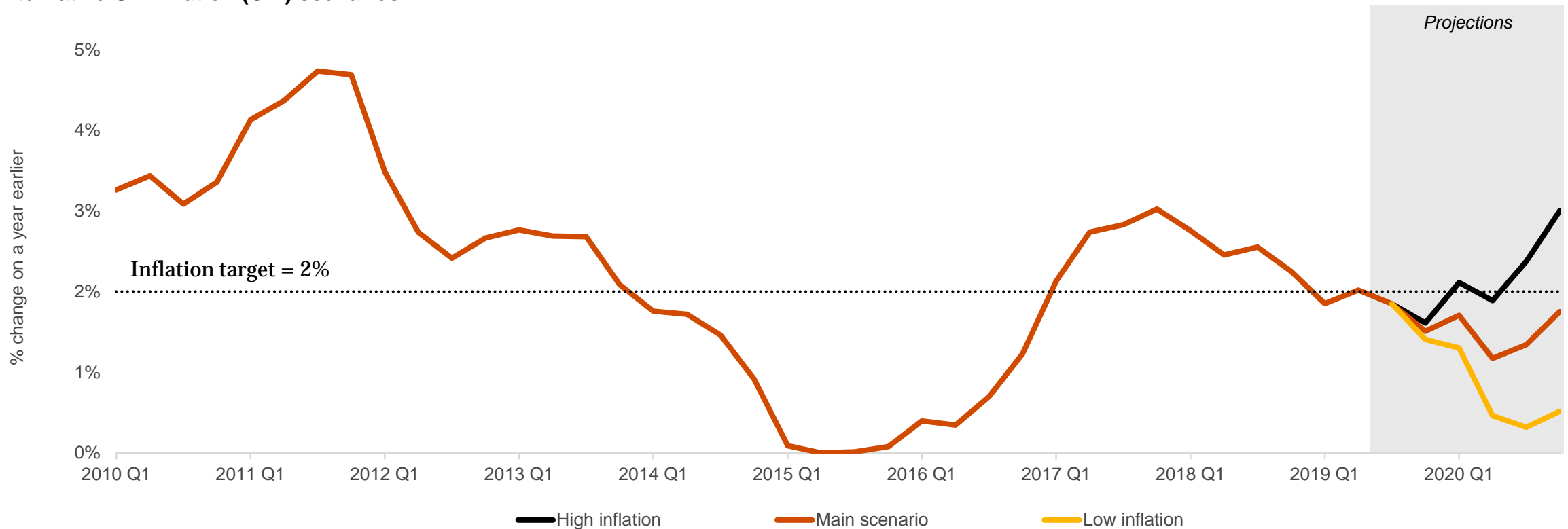
Real GDP (% change, year on year)



Source: PwC analysis

Inflation is expected to remain below target for the rest of 2019 and 2020 due to cut in regulated energy and water prices, but there are considerable uncertainties around this outlook

Alternative UK inflation (CPI) scenarios



Source: ONS, PwC scenarios

As inflation has slowed, real earnings have now started to grow again at a reasonably strong pace and we expect this upward trend to continue in 2020 even if nominal earnings growth levels off

CPI inflation vs. average earnings growth



Source: ONS, PwC analysis

Summary: UK economic prospects and policy implications

1

UK economic growth has slowed since early 2018 as Brexit-related uncertainty has dampened business investment, but consumer spending has held up better so far, supported by a recovery in real wages.

2

Our main scenario is for UK GDP growth to remain subdued, growing by around 1% in 2020, assuming an orderly Brexit and moderate global growth. However, risks are weighted to the downside.

3

Most industry sectors are projected to see relatively modest growth in 2019-20, although short-term trends remain volatile and highly dependent on how events develop on Brexit. Manufacturing also faces pressures from the downturn in global and particularly euro area growth over the past year owing to heightened trade tensions.

4

The Bank of England is expected to keep interest rates on hold until greater clarity has been provided on Brexit and the wider global economic outlook. The next move in rates could be either up or down depending on how events develop.

5

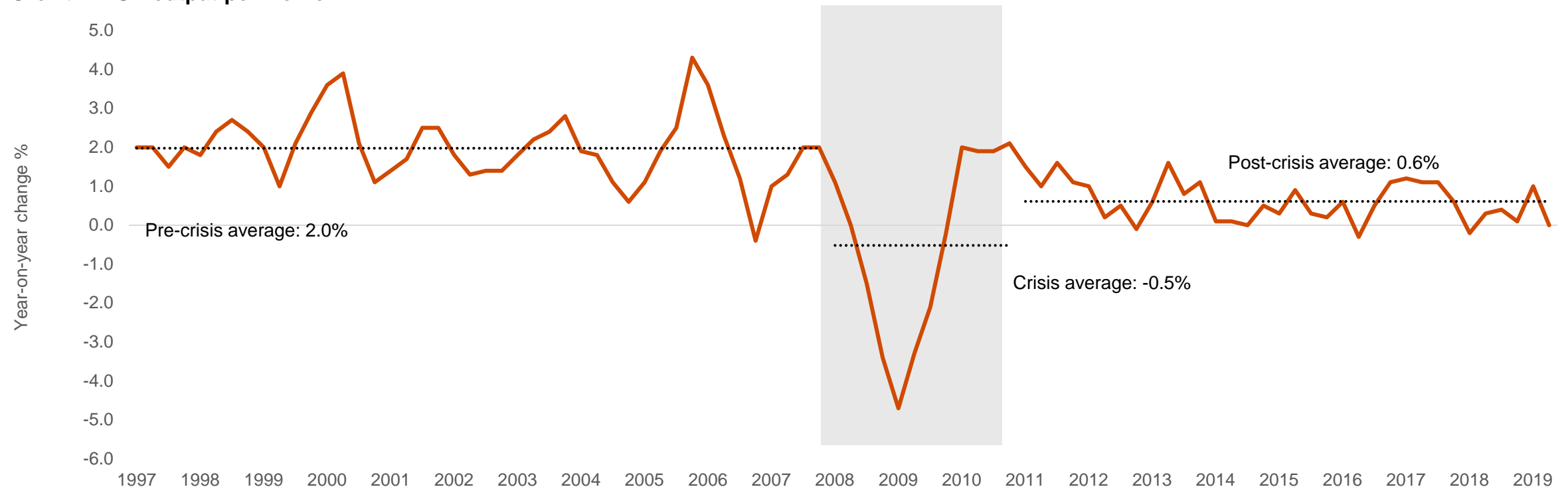
There are particularly large uncertainties around UK economic projections at present. Organisations should stress test their business and investment plans against alternative economic and political scenarios.

3

The Productivity
Puzzle revisited: why
has UK productivity
lagged behind other
advanced
economies?

UK productivity growth has slowed since the financial crisis, with average growth since 2011 less than half of pre-recession levels

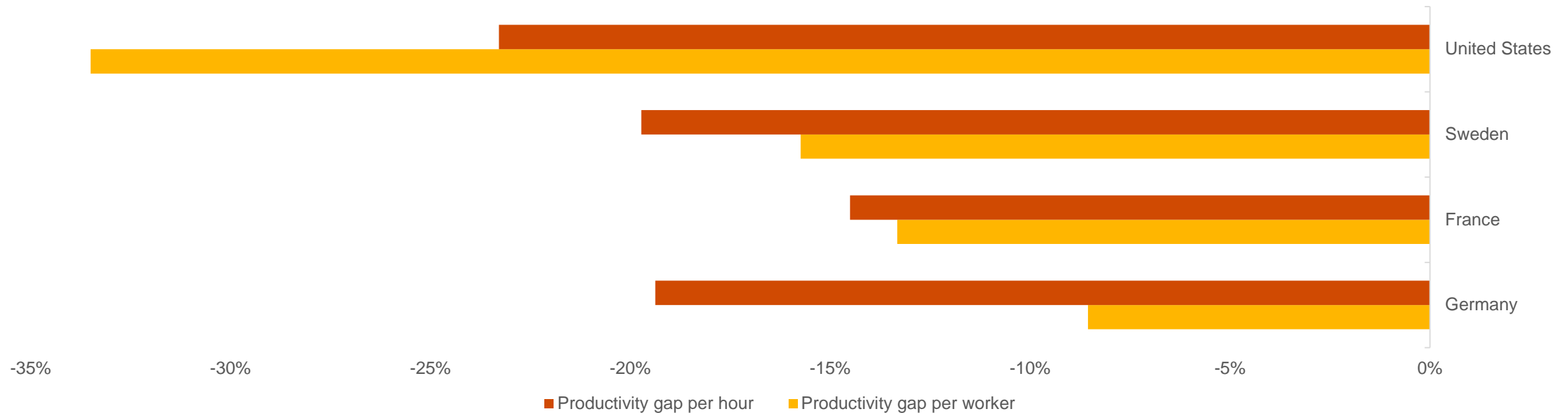
Growth in UK output per worker



Source: ONS, PwC analysis

Labour productivity in the UK has consistently lagged behind a number of other advanced economies including France, Germany, Sweden and the US

The UK productivity shortfall (% difference)

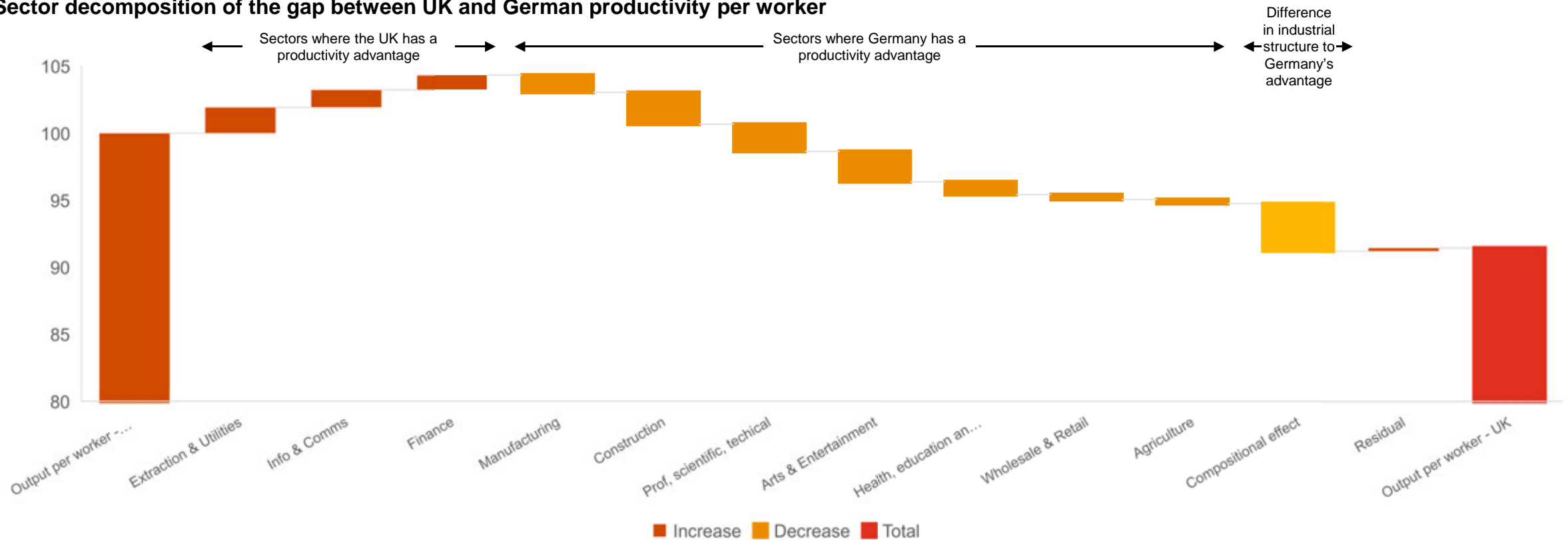


Source: Eurostat

Note: Productivity is measured here by GVA per hour and GVA per worker at PPP exchange rates, 2017 data. PPP exchange rates take account of differences in prices between countries and are generally acknowledged as the most appropriate measure when making international comparisons of output or productivity. Data excludes the real estate sector as differences in measurement of imputed rents can distort the figures.

Differences in industrial structure explain around half of the overall gap in productivity between the UK and Germany. The other half can be explained by superior German productivity performance in most sectors

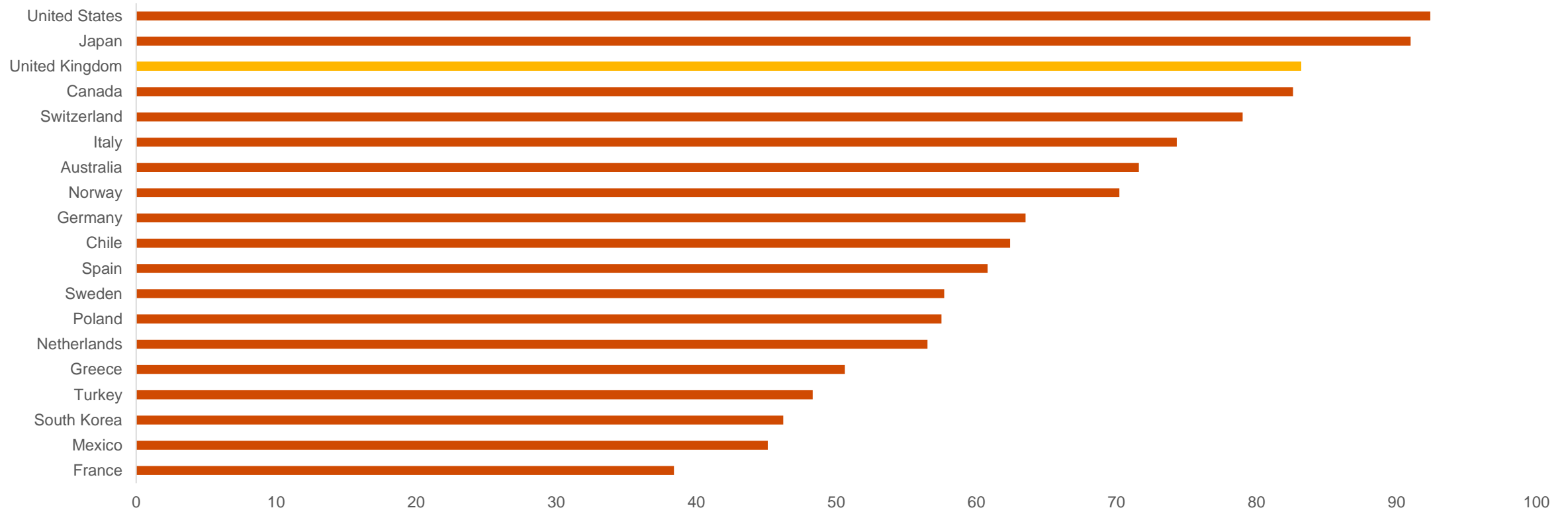
Sector decomposition of the gap between UK and German productivity per worker



Source: Eurostat, PwC analysis

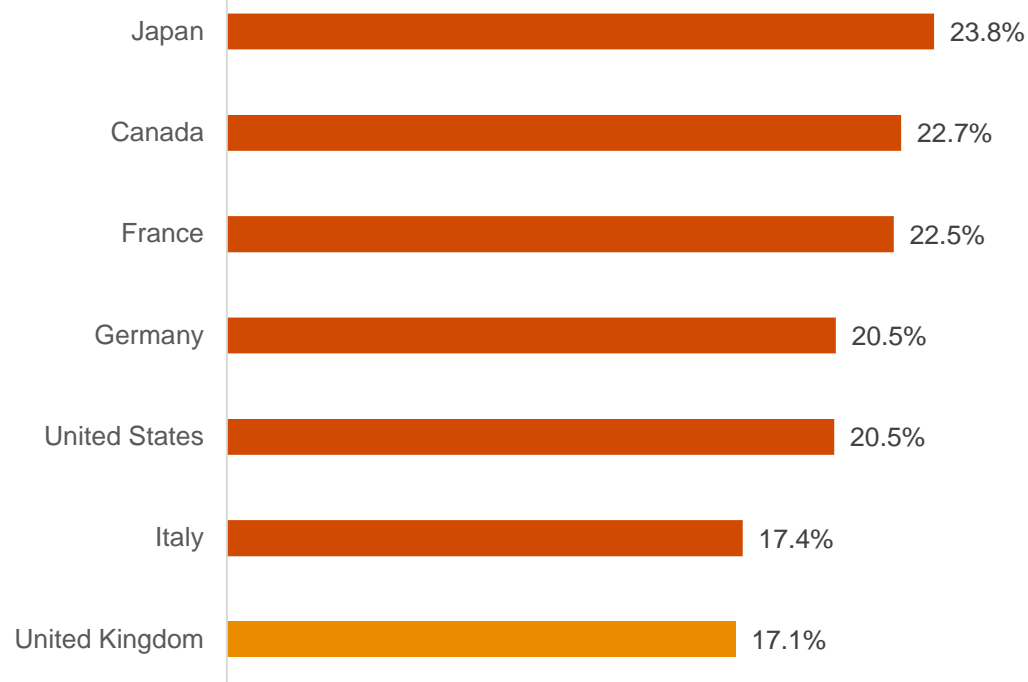
The UK's flexible labour markets, supported by the influx of migration and longer working lives, may have encouraged a relatively labour-intensive business model in the UK

OECD index of labour market flexibility, 2019



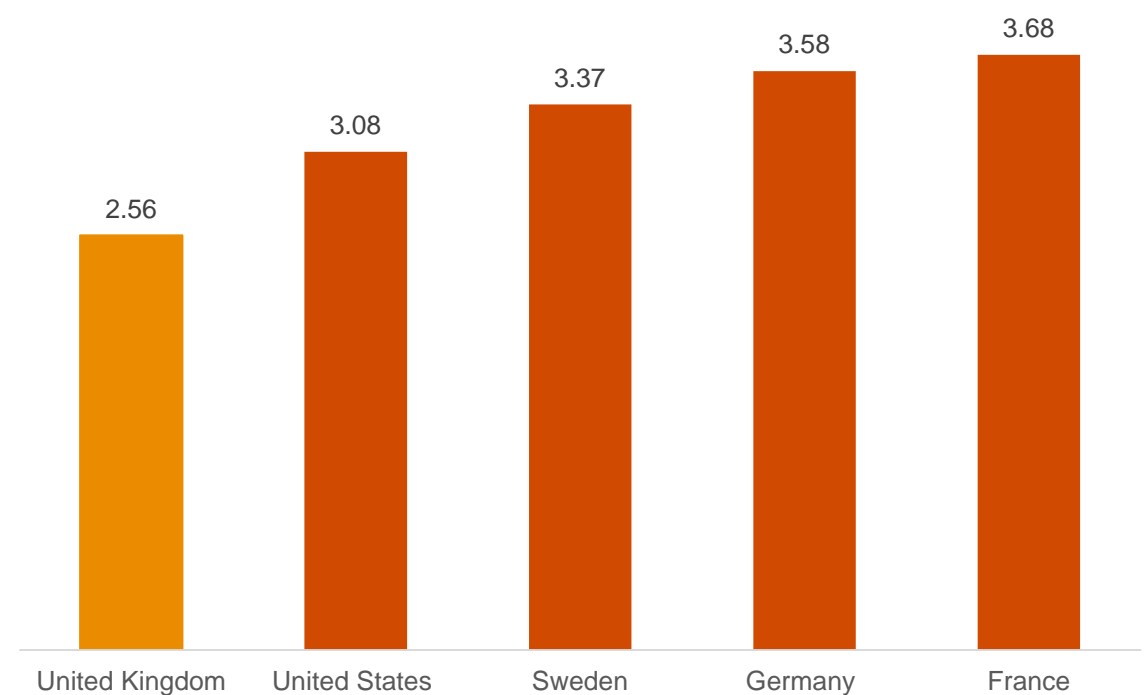
Investment rates in the UK have been low for a long time, which has translated into a capital-output ratio that is lower than in many of its peers, helping to explain low productivity

Investment (corporate, government, household) as % of GDP



Source: OECD

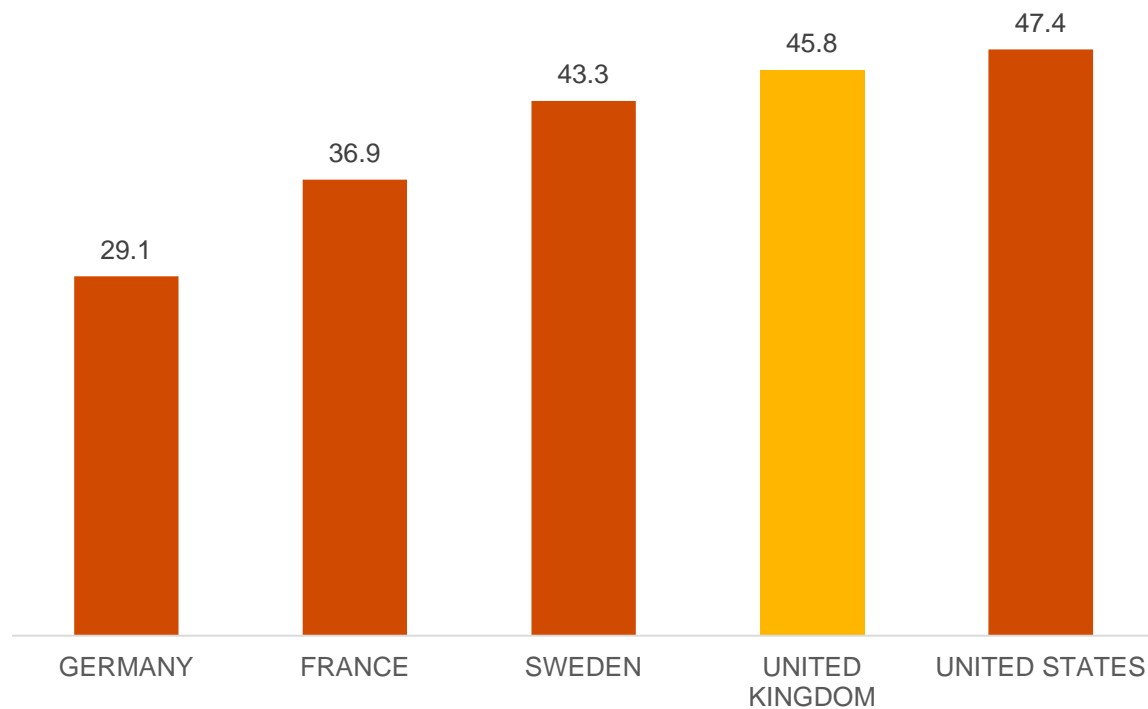
Capital-output ratios for selected countries



Source: Eurostat, EUKLEMS

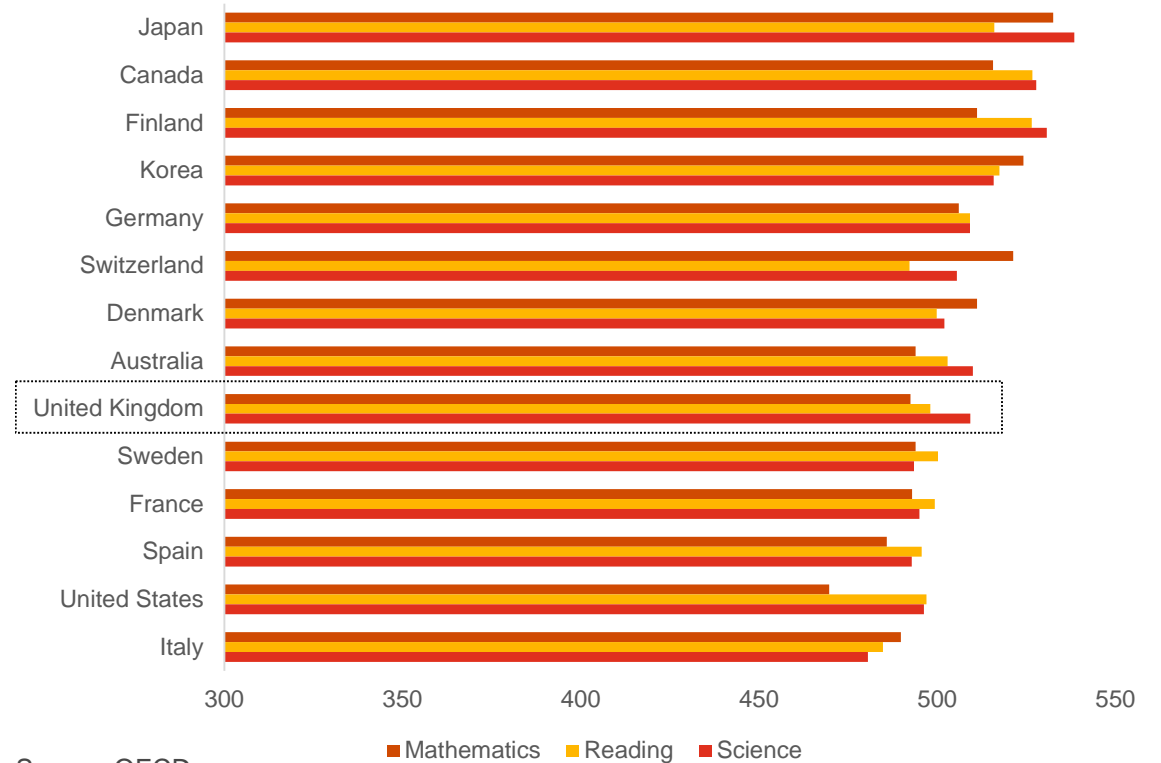
The UK now has a relatively high share of graduates in the adult population, but the average performance of UK school students on maths, reading and science is less impressive

Proportion of adults with tertiary education, 2018, %



Source: OECD

PISA scores in maths, reading and science



Source: OECD

Summary: International productivity analysis and policy implications

1

A key economic challenge for the next UK government will be to address the long-standing shortfall in our productivity levels relative to other advanced economies. Latest data suggest that UK output per worker lags around 10-15% behind Germany, France and Sweden and more than 30% behind the US

4

Future policy needs to be targeted on investing more in each of these areas, but business also has a key role to play in achieving these aims, notably through upskilling their employees.

2

Our analysis shows that the industrial structure of the UK is not the primary reason for this shortfall, and strategies that seek to close this gap by promoting any one sector are unlikely to be successful.

5

A focus on upskilling and investment together with more regionally balanced growth could all help the UK reduce or close the productivity gap with other advanced economies such as Sweden, the US and Germany.

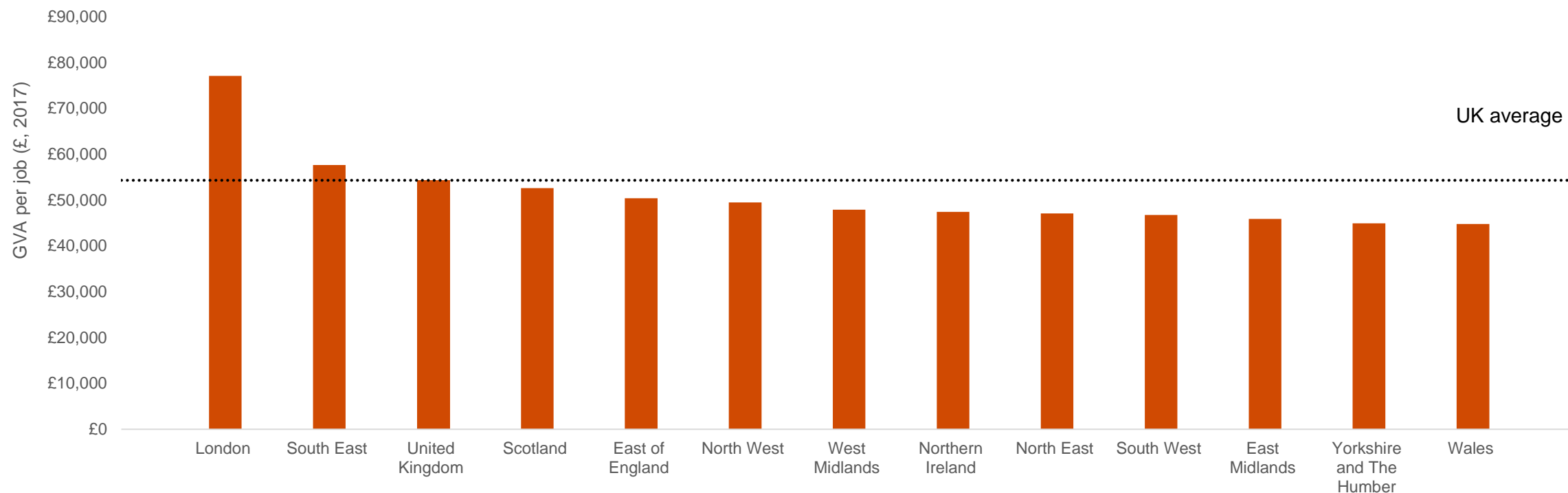
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Comparative international evidence suggests that relatively low UK levels of investment and R&D spending and a longer tail of companies and workers with relatively low productivity and skills are the main reasons for lower UK productivity relative to other advanced economies.

What drives regional
productivity gaps
across the UK and
how can these be
closed?

Regional productivity gaps are large, with average output per job around 40% above the UK average in London, but about 18% below the national average in Wales

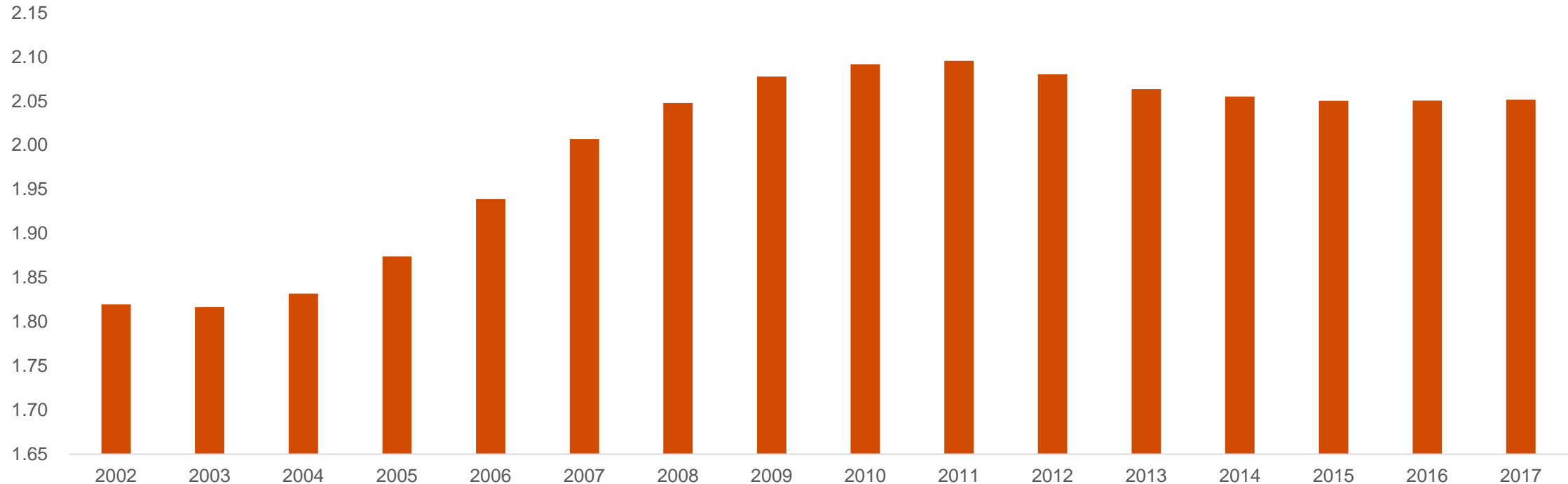
Productivity (GVA per job) by NUTS 1 region, 2017



Source: ONS, PwC analysis

This disparity has also grown over time, with the most productive LEP now more than twice as productive as the least productive LEP, compared to 1.8 in 2002

GVA per job for highest productivity LEP / GVA per job for lowest productivity LEP ratio



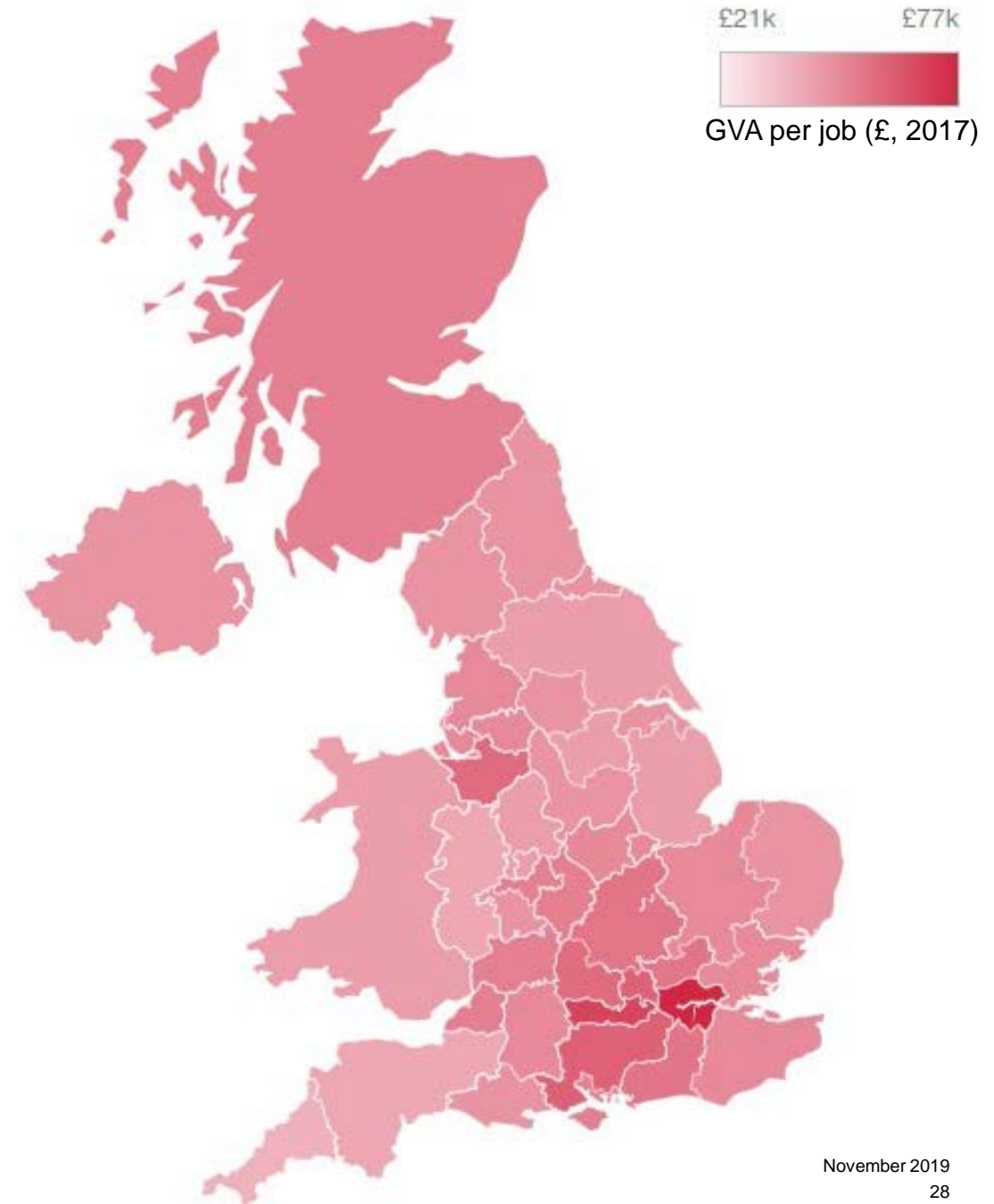
Source: ONS, PwC analysis

Five of the eight LEPs with above average productivity are located in London or the South East

A number of these LEPs are located along the M3 and M4 corridor towards the west of London, an area that encompasses tech clusters that are relatively prosperous such as Oxford and Swindon.

The next best performing LEP in the country after London is Thames Valley Berkshire, where Reading, its biggest city, is home to tech multinationals such as Oracle, Cisco, Microsoft and Huawei.

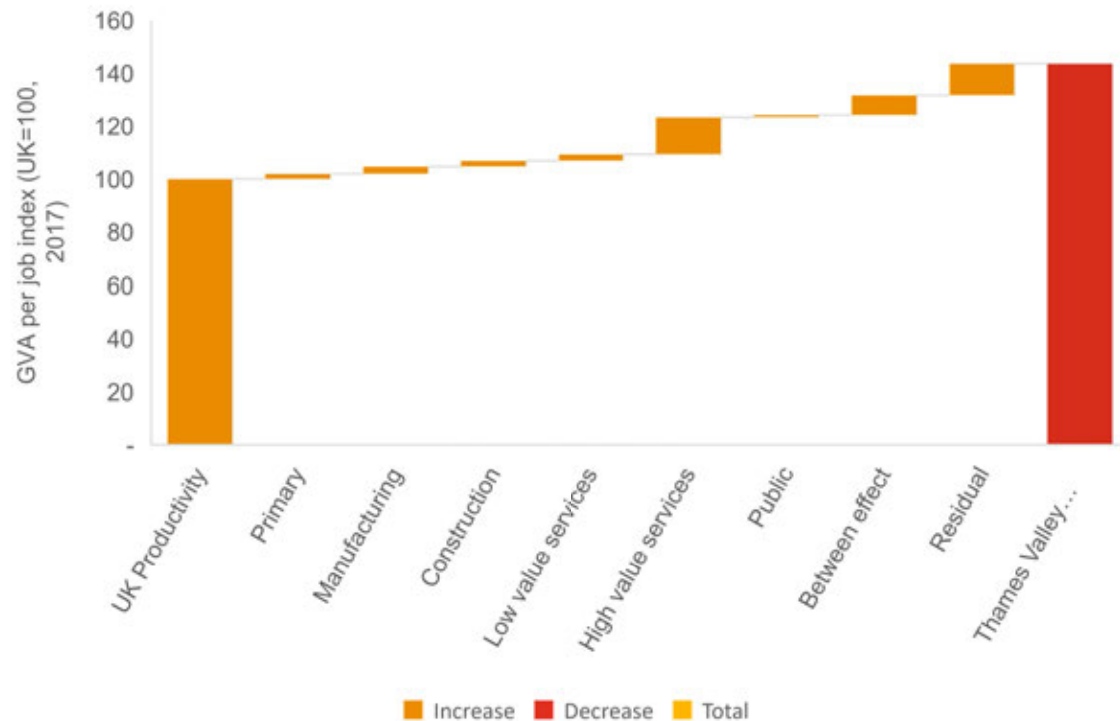
Source: ONS, PwC analysis



There is a small ‘between effect’ at work relating to differences in industrial structure, but variations within sectors account for a larger proportion of local productivity differences

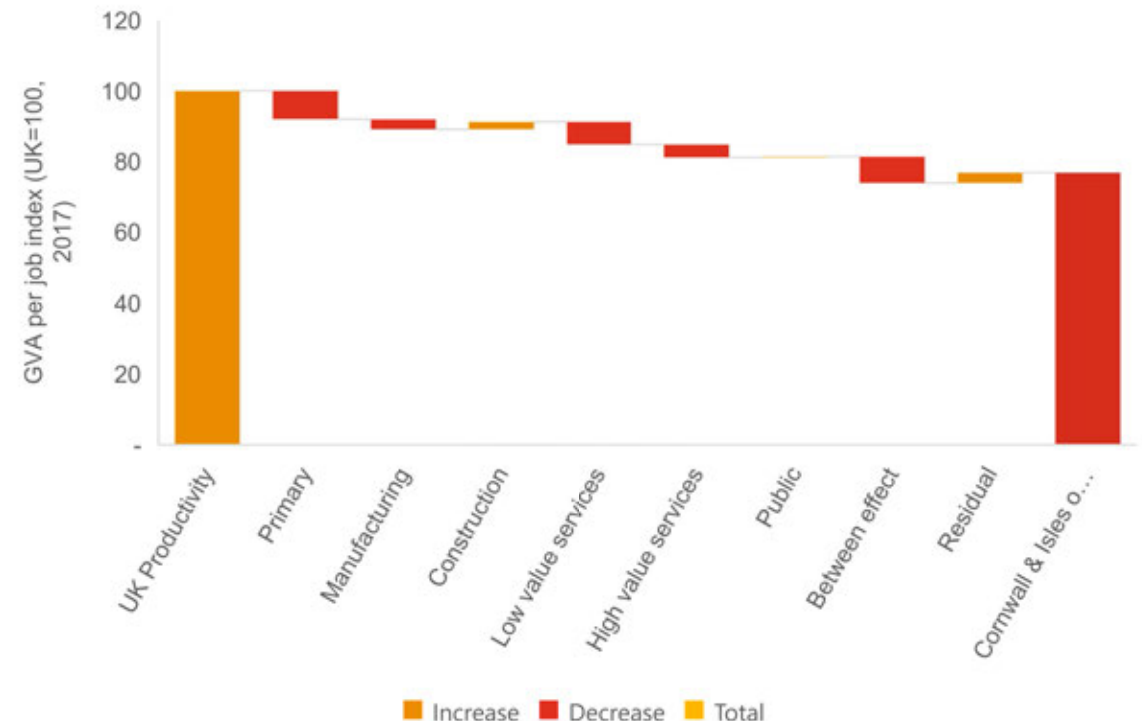
TVB has a much larger employment share within high value services (31%) compared to the UK on average (20%), which enjoys productivity levels that are 44% higher than the UK average. C&IS, in contrast, has a much higher share of employment (46%) in low value services (predominantly tourism-related) compared to the UK (39%), which are a third less productive than the UK average.

Decomposition of productivity differences – UK vs Thames Valley Berkshire, 2017



Source: ONS, PwC analysis

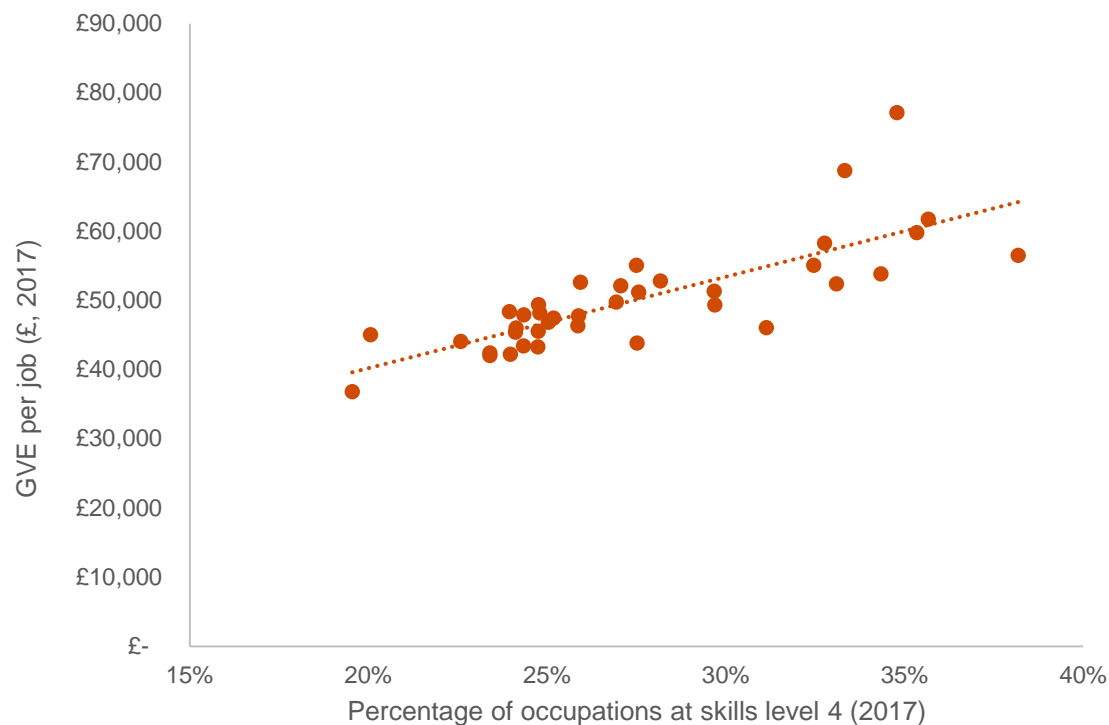
Decomposition of productivity differences – UK vs Cornwall & Isles of Scilly, 2017



Source: ONS, PwC analysis

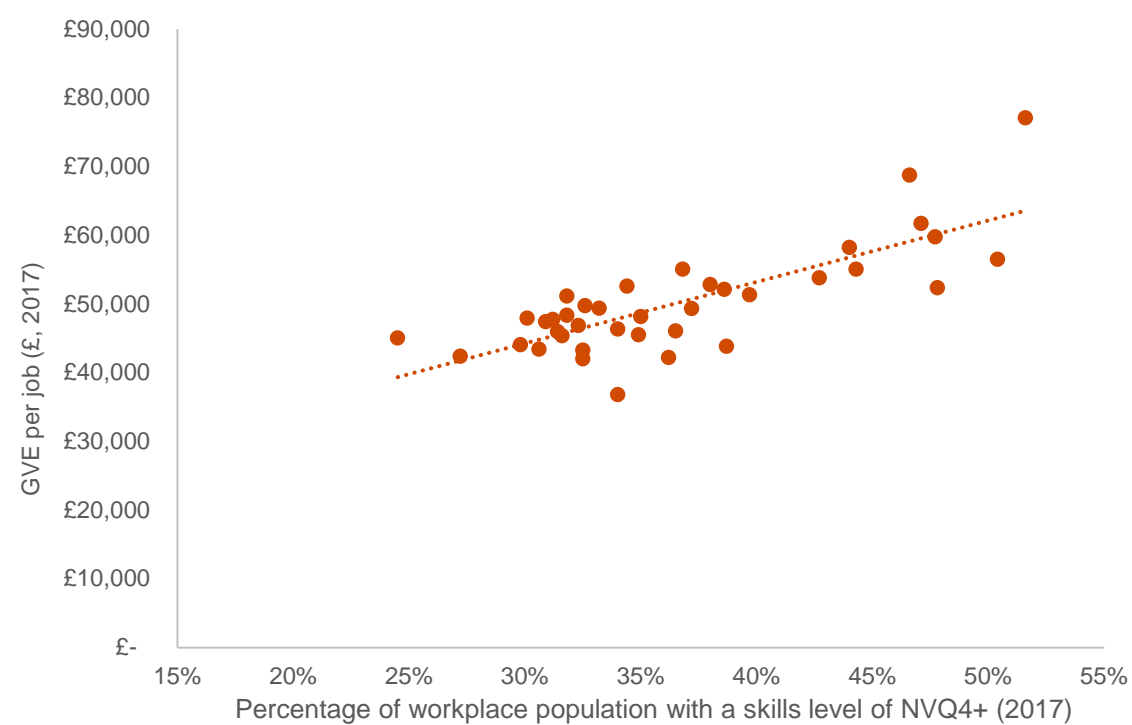
Our analysis suggests that regional differences in workplace skills may play a significant role in local productivity differences

GVA per job vs occupational skill levels, at the LEP level, 2017



Source: ONS, PwC analysis

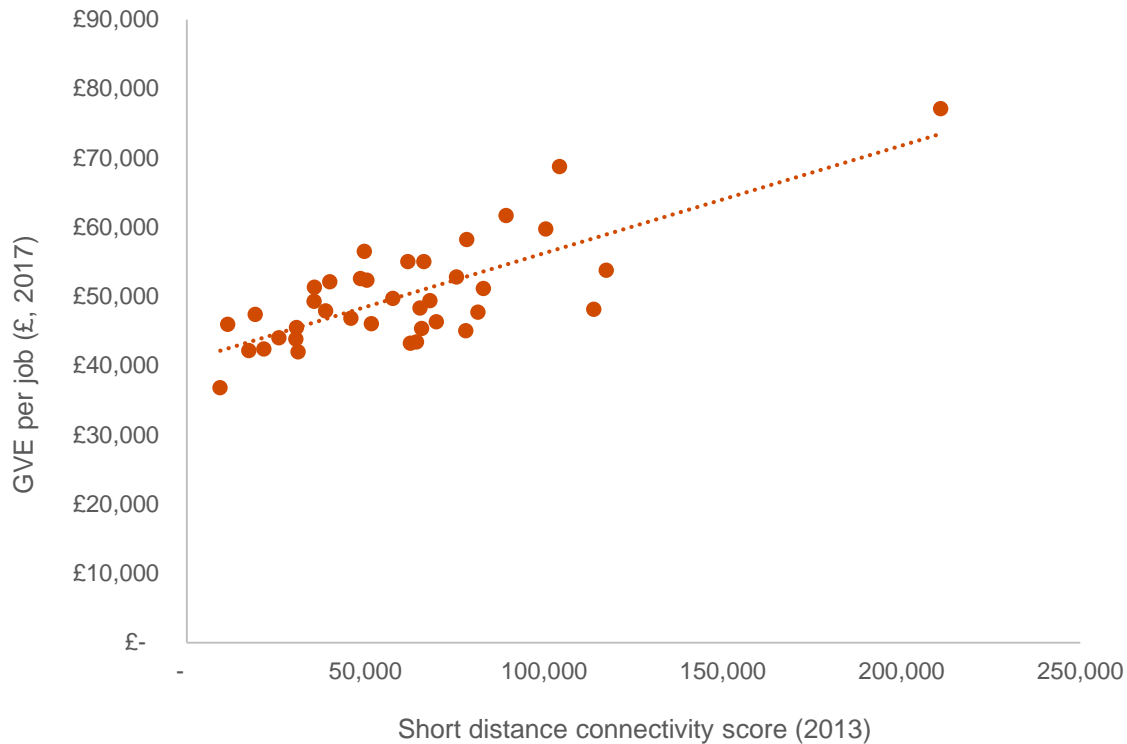
GVA per job vs educational qualifications, at the LEP level, 2017



Source: ONS, PwC analysis

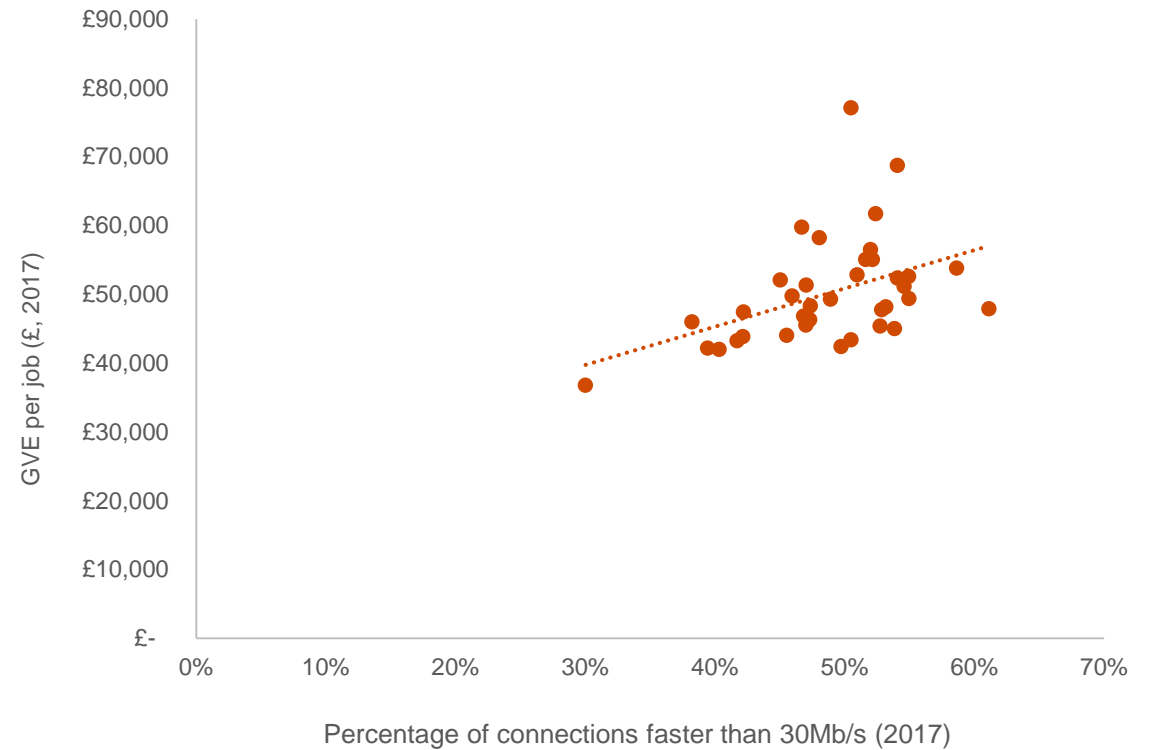
Better connectivity improves opportunities for collaboration, competition and innovation, so enhancing productivity (as supported by our analysis in charts below)

GVA per job (2017) vs short-distance connectivity, at the LEP level (2013)



Source: ONS, PwC analysis

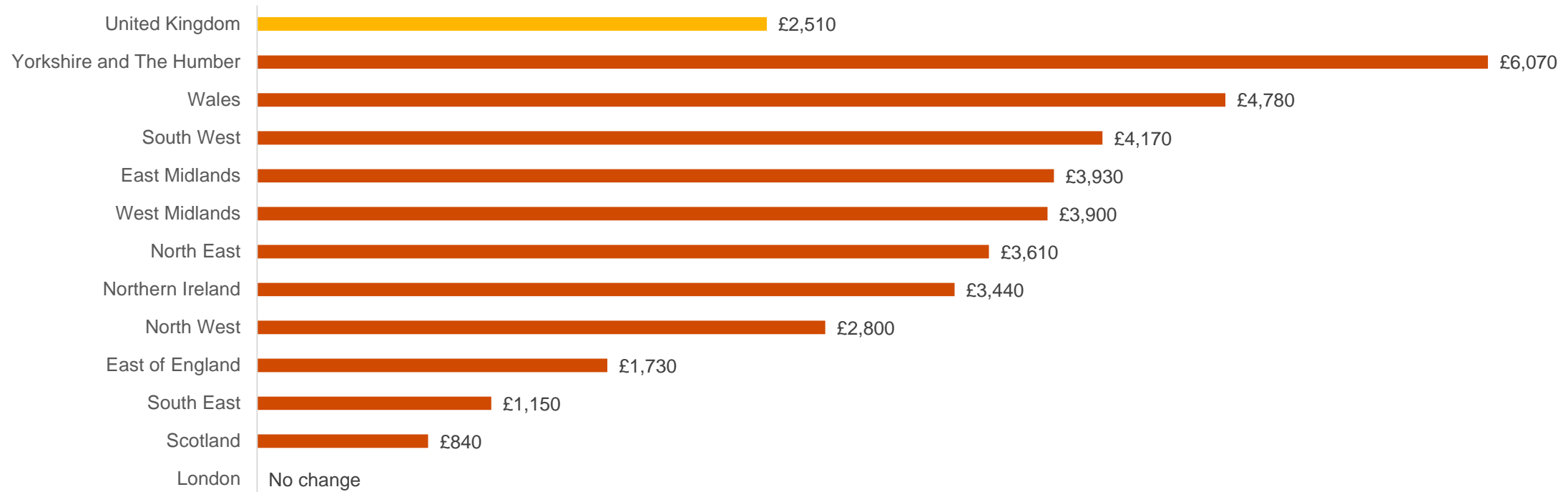
GVA per job vs digital connectivity at the LEP level (2017)



Source: ONS, PwC analysis

Closing half of the gap in regional productivity could boost GDP by over £80bn in total across the UK (averaging around £2,500 in terms of output per job)

Potential increase in GVA per job with regional productivity uplift, by NUTS1 region based on 2017 data



Source: ONS, PwC analysis

Summary: Regional productivity analysis and policy implications

1

Regional productivity gaps are large, and are growing over time, with the most productive LEP now more than twice as productive as the least productive LEP in 2017, compared to 1.8 times in 2002.

2

While differences in industrial structure can explain some regional productivity differences, other issues such as skills, connectivity and innovation appear more significant in general.

3

Investing to improve the quality and capacity of local infrastructure could help boost the connectivity of a place. LEPs should work in collaboration to strengthen intra-regional connectivity and access to economic hubs.

4

Policymakers and businesses need to focus on upskilling workers, particularly in areas such as self-management and leadership skills, as well as digital capabilities.

5

The economic prize from closing the gap is significant. If LEPs and countries that are currently performing below the UK average can halve this productivity gap, we estimate that it could lift UK GDP by around £83 billion (c.4%).

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