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MOODY'S ANALYTICS UK OUTLOOK 2014

STRONG GROWTH IN 2014 COULD SUFFER IN THE LONG TERM FROM PROLONGED LOW PRODUCTIVITY

LONDON, 25 April 2014 — Moody's Analytics, a leading independent provider of economic forecasting, has released its latest Outlook for the UK. According to the report, the UK's economy will grow by 2.5% in 2014, making it one of the best-performing in Europe.

The main drivers of UK growth this year will be household spending, followed by services, manufacturing and construction, notes Moody's Analytics. However, weak UK labour productivity, which lags behind its historical levels and those of other major European economies, could dampen the country's long-term outlook.

Moody's Analytics economist Melanie Bowler says, "The UK's labour productivity has been persistently weak since the 2008 financial crisis, both in historical terms and compared to other major European economies."

According to the report, a 7.2% fall in output in the year leading to early 2009, followed by strong employment gains from autumn 2011—the number of people employed hit a record high in early 2014—goes some way in explaining the weakness in U.K. productivity per hour worked.

The UK's lagging productivity has been concentrated in energy and financial services. Financial services in particular have lagged despite the sector's 12% fall in employment. This suggests that the industry's productivity weakness may be due to factors such as a lack of investment, a reduction in innovative products and processes, and more resources being devoted to business functions such as regulation.

In the UK's other main industrial sectors, manufacturing and construction, productivity has been better, which partially reflects sharp job cuts in these sectors, both of which have seen 16% falls in employment since the 2008 recession.

According to Ms. Bowler, "With construction starting to pick up strongly as the housing market recovers, productivity is likely to rise robustly unless labour shortages are quickly addressed. Productivity is also expected to improve in manufacturing but at a somewhat slower pace given lingering competitiveness concerns."

In the U.K.'s IT and professional services industries productivity gains are expected to continue despite ongoing hiring, since these sectors are proving particularly innovative.

Moody's Analytics expects the U.K. GDP to recover all the losses following the 2008 recession by mid-2014, but productivity will take longer to fully recover even though there are some signs of revival. Lingering weak productivity could undermine the longer-term outlook for the U.K. economy. "Persistently lower productivity growth would result in weaker wages and lower GDP. Weak wage growth is a key risk to the recovery in household spending, which accounts for more than 60% of UK GDP. Restrained household demand would in turn restrict business spending," says Ms. Bowler.

Uncertainty about the path of productivity combined with lingering spare capacity is a key reason for the Bank of England to hold interest rates low and maintain an expansionary monetary policy this year despite the strong growth forecast. According to Moody's Analytics, interest rates will not start rising from their current record low of 0.5% before mid-2015.

For more information, visit Moody's Analytics Dismal Scientist.

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