

Please see below for a summary of our latest views:

- Productivity, or the lack of it, is the biggest single issue facing the UK economy. On this there is almost universal agreement. There is less agreement on the cause. Because productivity gains (or their lack) can be rather nebulous, the UK productivity puzzle often serves as a Rorschach test for a commentator's political leanings or pet theories. The left tends to attribute it to poor provision of childcare and underinvestment in skills and education. The right is more inclined to blame the rise of home working and a culture of dependency.
- Neither side's argument stands up well to counterfactuals; productivity growth in the US has been much better than the UK. Yet childcare is more expensive in the US than the UK (both in absolute terms as a % of household income). Likewise, rates of home working are similar between the two countries.
- The actual answer is much more mundane and not much of a puzzle. The UK ranks dead last among the G7 for gross fixed capital formation at about 18% of GDP annually. The range for the rest of the G7 is 20-25%. Of course, there are lots of other contributory factors, but this is by far the biggest. The situation was not helped by the uncertainty following the Brexit referendum.
- Essentially there are three main things that need to happen to address this lack of investment:
 - i. increase the size and scope of pools of savings available to invest in new capital formation;
 - ii. reduce the frictions to mobilising savings;
 - iii. increase the pool of projects available to invest in.
- Both the current and former governments deserve credit for their approach to i) (though more needs to be done). Local government pension funds have been pooled into larger pots better able to make larger more complex investments. Defined contribution funds look set to follow suit through mergers and have made commitments to increase their exposure to UK private assets. The current reforms stop short of mandating such investment which is a blessing: state directed investment has an unhappy history. Ultimately, the absolute rate of pension saving needs to rise.
- The record on ii) is mixed. Despite recent rises, corporation tax rates in the UK are low by international standards. Accelerated capital allowances create good incentives to invest, though the UK tax code has also become fiendishly long and complex. The UK is getting better at regulating to support investment; the current water regulatory settlement from 2025 to 2030 should see £100 bn invested by the UK's water industry.
- Probably the greatest failure of both public and private investment is found in iii). Nimbyism, red-tape, excessive bureaucracy and a sclerotic planning process all contribute to increasing the cost, uncertainty and time to deliver new projects.
- Whatever the progress on i) and ii), we are not optimistic that iii) will improve anytime soon.
- The investment conclusions are straightforward. First, we see no reason to believe that the 100-year running devaluation of sterling should come to an end so are likely to continue to hold significant non-sterling currency exposure. Second, the current real rates on government bonds in the UK are unsustainable. Over the long term they must fall. But the risk, in the near term – given the fiscal outlook for the UK and US – is that they rise. We share those concerns, so we are cautiously adding exposure to UK real rates, favouring the belly over the long end.