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Trend setters

What is the OBR's forecast for trend productivity growth, and why it matters so much for the Budget

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The Budget in November is likely to reveal a significant deterioration in the outlook for the public finances, requiring the Government to raise taxes in response. A key reason for this is what the Office for Budget Responsibility will assume about how fast the economy can sustainably grow. It has been eight years since this judgement was significantly changed. Having waited a long time to revisit this key assumption, the most recent data, if anything, suggest there has been some good news on productivity growth. In this Spotlight, we unpack what this judgement means for the fiscal forecast, arguing that a growth downgrade is overdue, based on long-standing trends, rather than any news since March. Any such downgrade is likely to have a smaller impact on the fiscal rules than widely thought, due to the shortening in the fiscal rules assessment horizon (from five to four years) at the Budget. Looking ahead, the OBR should revisit this assumption more regularly, in a more transparent and predictable way.

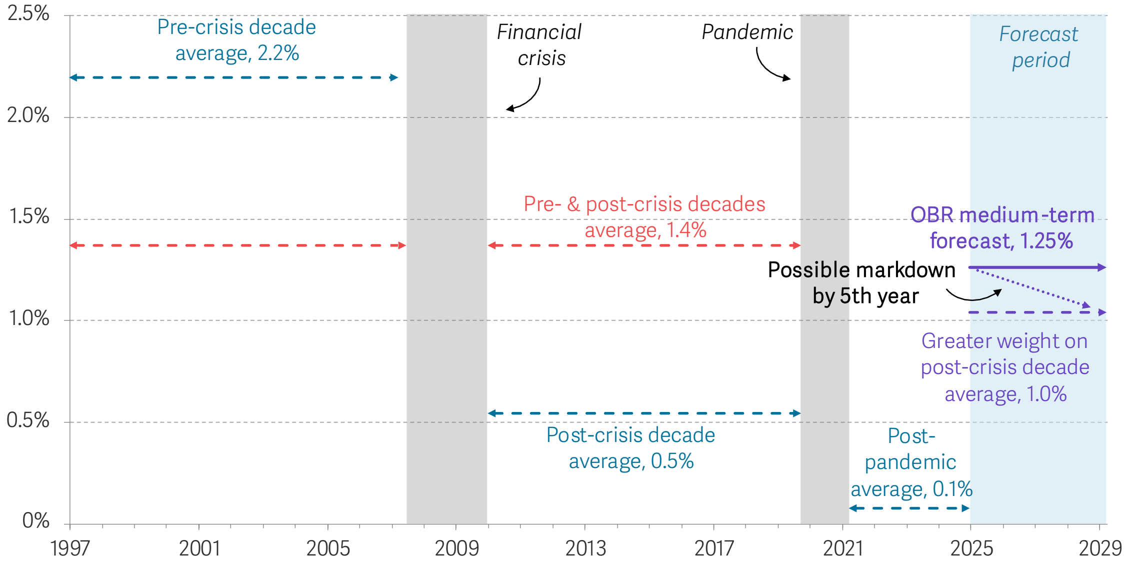
The forecast for trend productivity growth is *the* key judgement for the OBR at the upcoming Budget

The Office for Budget Responsibility's (OBR) forecast for tax and spending will, given the Chancellor's 'non-negotiable' fiscal rules, determine how much policy change is needed this autumn. Policy 'U-turns' and higher government borrowing costs will also contribute to a more difficult fiscal outlook. But looming over all this will be the OBR's forecast for how quickly the economy can grow. This will be a key determinant of tax receipts in 2029-30 – the year that the Government says the current budget must be in surplus.[1] Specifically, the pace at which the OBR expects trend labour productivity to grow – the ability for workers to sustainably produce more, and hence generate more tax revenues, from an hour's work – is always a key driver of the fiscal position.

In its March 2025 forecast, the OBR assumed that productivity growth would pick up to its trend level of around 1.25 per cent a year by the end of the forecast (Figure 1). The OBR has rationalised this as roughly halfway between what we saw in the decade before the 2008 financial crisis (when it averaged 2.2 per cent), and the decade afterwards (an average of 0.5 per cent).[2] Average productivity growth in the OBR forecast is 1 per cent, because it takes some time for the sunlit uplands of the medium-term to be reached. In the end, both the medium-term and the path to get there will matter (see Box 1 for more on the difference between trend and cycle).

Figure 1 **Productivity growth has fallen sharply since the financial crisis and flatlined post-pandemic**

Measures of past and forecast productivity growth (output per hour worked): UK, Q1 1997 to present (Q1 2025)



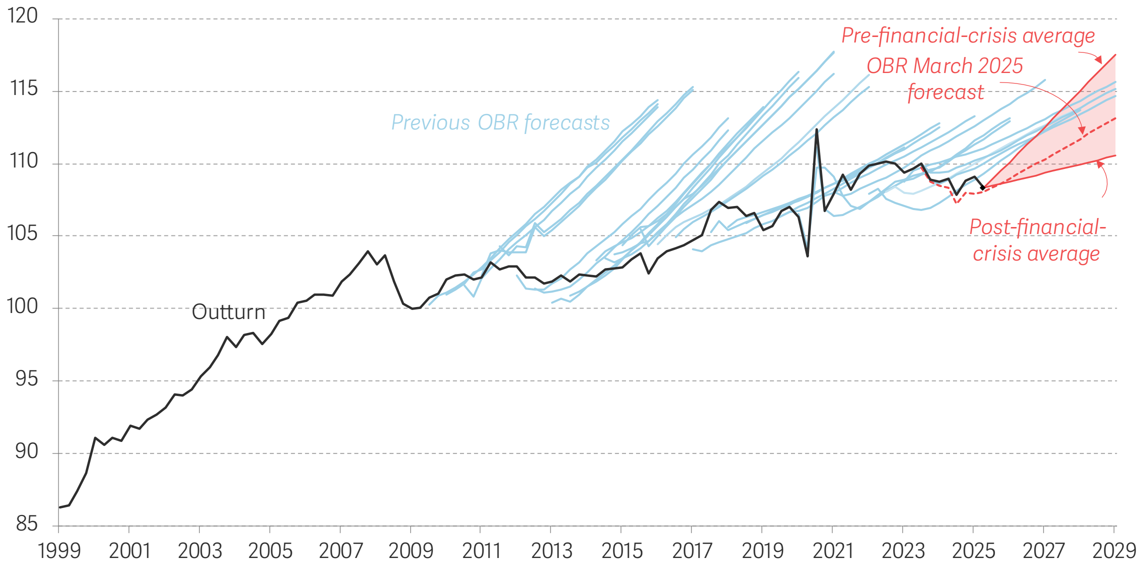
Notes: We have defined the pre-crisis decade from Q2 1997 to Q2 2007, the post-crisis decade as Q2 2010 to Q4 2019, and the post-pandemic period from Q1 2021 to present (Q1 2025). The pre-crisis/pre-pandemic average is the simple average of the pre-crisis and post-crisis decade while the weighted average places more emphasis (70 per cent) on the post-crisis decade.

Source: RF analysis of OBR March 2025 Economic and Fiscal Outlook, ONS Labour Market Statistics.

Medium-term trend productivity growth of around 1.25 per cent remains much higher than what is assumed by most other forecasters, including the Bank of England.[3] It's also much faster than the 0.1 per cent we have seen since the pandemic. And as the economy has continually underperformed its pre-financial crisis growth rate, the OBR has been repeatedly disappointed by productivity outturns (Figure 2).

Figure 2 **The OBR has been consistently disappointed by productivity growth**

Productivity growth (output per hour worked), OBR forecasts and outturns, index (Q1 2009 = 100): UK



Notes: Pre-financial crisis average is taken from Q2 1997 to Q2 2007; and the post-financial crisis average is taken from Q2 2010 to Q4 2019.
Source: RF analysis of ONS, National Accounts & Labour Market Statistics; and OBR, Economic and Fiscal Outlook, various.

These repeated disappointments have prompted the OBR to successively revise, in general downwards, its medium-term forecast of trend productivity from the pre-financial crisis trend. The single largest markdown occurred in November 2017, when the OBR knocked 0.6 percentage points from its final-year forecast compared to its March 2017 forecast (see Figure 3). This reflected the OBR's shift in judgement towards placing greater weight on post-crisis trends in productivity.[4] Further downward revision followed in March 2020, when the OBR reduced its final year productivity growth estimate by 0.1 percentage points, due to continued weak productivity growth and the economic effects of Brexit.[5]

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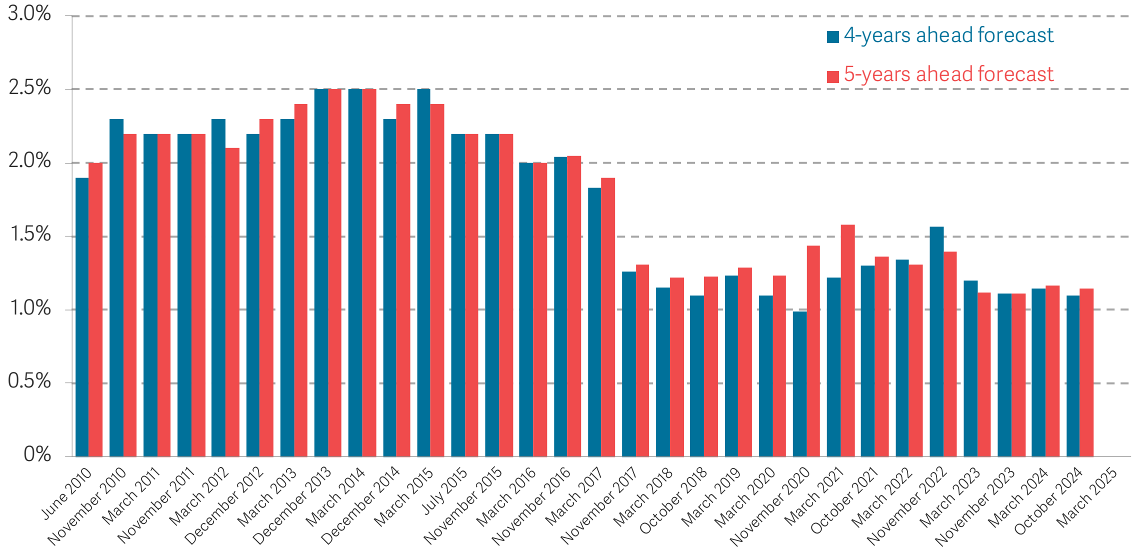
Figure 3 **Outside the pandemic, the OBR last made a big change to its medium-term productivity judgement in 2017**

Forecasts of productivity growth (output per hour worked) in the fourth and fifth year of OBR Economic and Fiscal Outlooks: UK



Source: RF analysis of OBR Historical Official Forecasts Database.

It is being widely reported that the OBR is considering another downwards revision to trend productivity growth in November. A downgrade of 0.2 percentage points to annual productivity growth would be enough to leave a £14bn hole in the public finances in 2029-30, a smaller number than many have discussed.[6] This is smaller because the horizon at which the fiscal rules will be judged – that is, in 2029-30 – will now be the fourth, rather than fifth, year of the forecast, so the impact of lower growth has less time to build. But make no mistake, this is still big money: it's equivalent to around 2p on the basic rate of Income Tax, or around twice last year's entire prisons budget. If growth stays low in the fifth year of the forecast and beyond, the gap would grow by roughly £4 billion a year.

Did someone say *good news*?

So far, so depressing. But let us give you something we're not used to these days – some qualified *good news* on productivity.

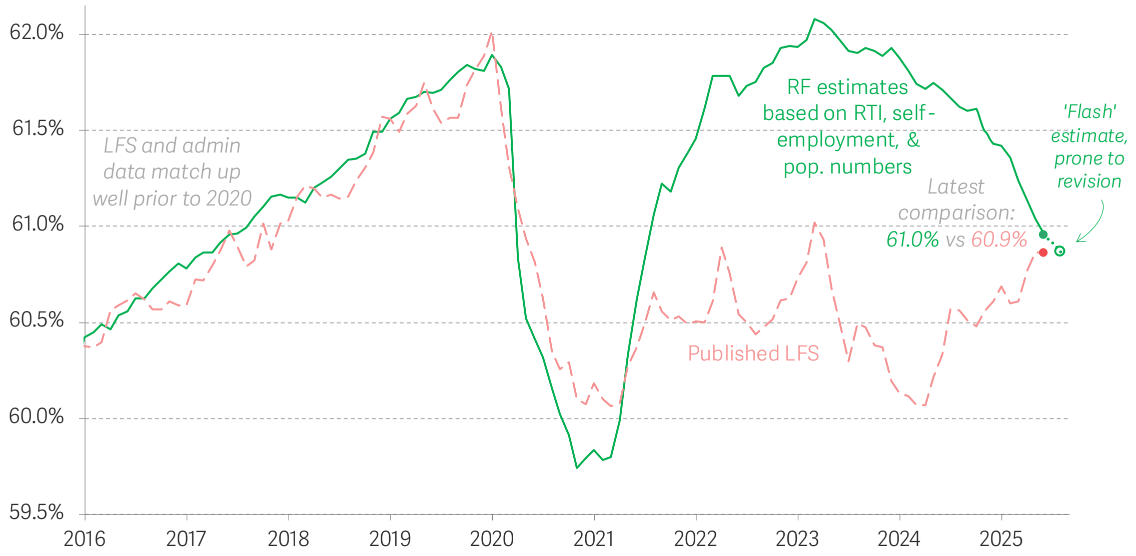
GDP rose by 1.4 per cent in the four quarters to Q2 2025, the latest quarter we have data for. That's not warp speed, but it's quite a bit faster than its average of 1.0 per cent in the past 20 years, and the fastest in the G7 in the first half of the year. The official ONS data says that total hours worked rose by 1.9 per cent over the four quarters to Q2 2025.

Labour productivity growth is the difference between the growth rates of output and the number of hours people worked to produce it. That would put productivity growth at a very depressing –0.5 per cent (yes, minus: British workers produced less per hour worked in the second quarter of this year than the second quarter of last year). Not quite as dismal as the -

0.7 per cent the OBR expected back in March, but a long way adrift of where the economy is supposed to be heading over the medium term.

But here's the thing: the official data on the growth in hours worked are wrong. They come from the Labour Force Survey (LFS), which has been plagued with a small and biased sample, especially since the pandemic. Happily, those problems are being fixed, and we think that the LFS is now broadly accurate when it comes to the number of people in work (see Figure 4). But the data wasn't right a year ago, and this means we can't trust the LFS when it says that employment has been rising strongly over the past year.

Figure 4 **Measured properly, the employment rate has been falling for two years**
Official and admin-based measures of the 16+ employment rate: UK

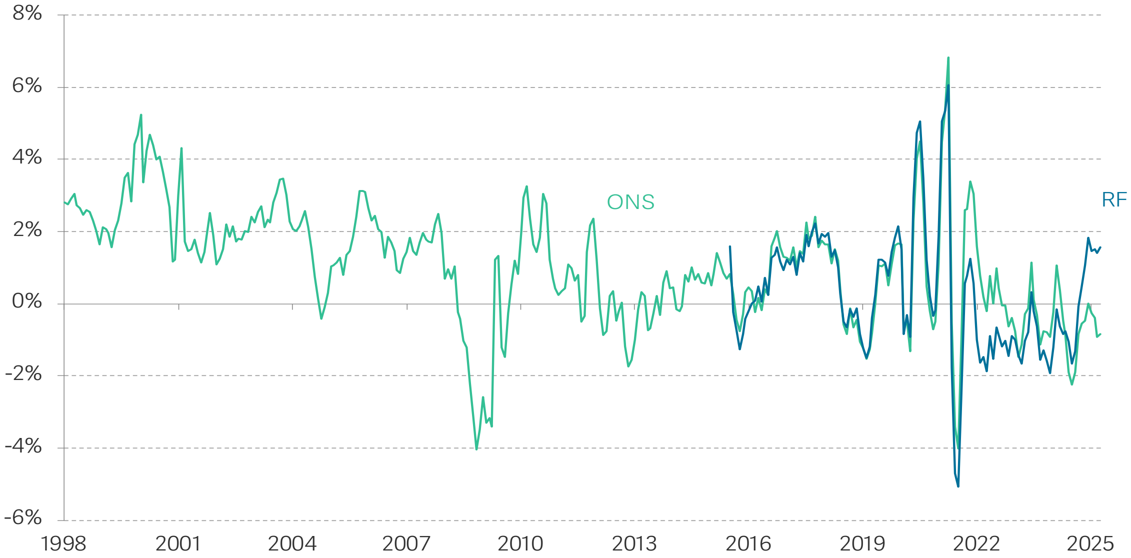


Source: RF analysis of ONS, Labour Force Survey; ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information; HMRC, Income of individuals with self-employment sources; ONS, National population projections: 2022-based.

Our own in-house measures of employment, leaning heavily on tax data, paint a very different picture. We think that the number of people in employment has been falling for around a year, and the employment *rate* for more than two years. In the grand scheme of things, this is bad news for the UK economy. But on the narrow question of measuring labour productivity, the extra output we have seen has been produced by fewer hours worked, mechanically pushing four-quarter productivity growth up to a heady 1.6 per cent in Q2 2025.

Figure 5 **Correcting for mismeasured labour inputs, recent productivity growth has been strong**

Annual productivity growth using official and RF measures of total hours worked: UK



Notes: Productivity measured as monthly gross value added (ONS code ED9T) and hours worked either the headline ONS number (YBUS) or ONS average hours multiplied by the RF estimate of employment. Growth rates measured as the change in the trailing 3-month average on the value a year earlier.
Source: ONS; RF analysis of ONS, National Accounts, Labour Force Survey; ONS/HMRC, Earnings and employment from Pay As You Earn Real Time Information; HMRC, Income of individuals with self-employment sources; and ONS, National population projections: 2022-based.

Zooming out, a forecast downgrade still makes sense

There's one more small bit of good news: revisions to the back data in the Blue Book suggests that growth was a little stronger in the recent past, nudging up past average productivity growth slightly. But before we get carried away and extrapolate these punchy growth rates into the future, a few words of caution are in order.

- First, the ONS has the level of employment about right, so stronger productivity growth in the recent past is the mirror of weaker growth further back. In other words, it doesn't change how terrible productivity growth has been overall since the pandemic.
- Second, productivity growth data is so erratic and prone to revision that one should not place much weight on any single year's numbers. This is why revisions to trend estimates are, rightly, rare.
- Finally, and most importantly, the further that the good old days recede into the rear-view mirror, the less weight you should place on them to make today's productivity forecast. We haven't seen productivity growth average more than 1 per cent over a five-year period (outside the pandemic) since 2008.

This is why, come November, a downgrade to the productivity forecast is both likely and sensible; even though the latest data on productivity is actually more positive than it was in March. When you realise you are off-track you have to course correct, even if everyone will ask why you didn't do it sooner.

Going forward, the OBR needs a better process for these crucial judgements

But aside from relying on press ~~leaks~~ speculation, it's far harder to say how big this downgrade will be, or should be. Nor is the OBR transparent about what triggers changes in medium-term growth assumptions. The number we currently have– halfway between the pre- and post-crisis decades' growth rates – *may* be reasonable, but it's not the only reasonable one, and it is becoming less reasonable as the pre-crisis 'good old days' recede further into the past, and the post-pandemic period continues to disappoint.

In a parallel universe with more headroom against the fiscal rules, this judgement would not matter as much. But until we get there, tax and spend decisions will depend heavily on this number. So the OBR should share more of its thinking with the public. It could, for example, review this judgement annually and publish conclusions ahead of the detailed forecasting process – an approach that would have few downsides.

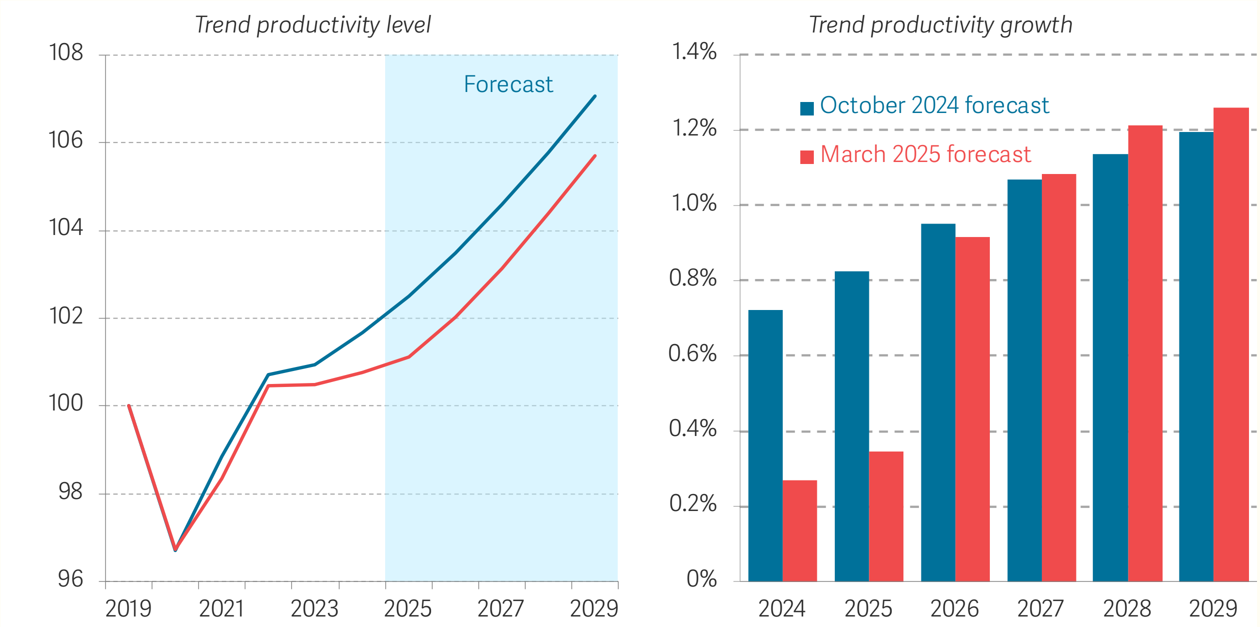
Box 1: The interpretation of trend productivity in the OBR forecast

Productivity isn't easy to measure – see above – but it is at least straightforward to define: hourly labour productivity is simply the ratio of GDP to hours worked. Beneath measured productivity, we can think of an underlying trend level which strips out various cyclical and temporary factors. The growth rate of this trend level will, in turn, be influenced by, but not identical to, the growth rate of productivity that the OBR expects over the medium term. The OBR may judge that productivity growth will take time to converge towards its medium-term trend rate, as it did back in March 2025 (see Figure 6).

The medium-term trend assumption – the subject of this Spotlight – is a key driver of expected growth over the forecast period. A lower medium-term trend assumption would, other things being equal, lead to a lower level of growth in each year. However, the level of trend productivity in the all-important fiscal year 2029-30 will also depend crucially on how quickly the OBR judges trend productivity growth to settle. Trend productivity growth is undoubtably an important assumption. But it doesn't just matter what that number is, but also how we get there.

Figure 6: **Even without changes to the trend productivity *level*, the growth *rate* over the horizon can change**

OBR forecast of trend productivity level (index 2019=100) and growth rate (per cent): UK



Source: OBR, March 2025 Economic and Fiscal Outlook.

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[1] The current budget balance is the difference between revenues and non-investment (or 'day-to-day') spending

[2] Paragraph 2.28, OBR, March 2025 Economic and Fiscal Outlook.

[3] Paragraph 2.64, OBR, March 2025 Economic and Fiscal Outlook.

[4] Paragraph 3.19, OBR, November 2017 Economic and Fiscal Outlook.

[5] Paragraph 2.32, OBR, March 2020 Economic and Fiscal Outlook.

[6] We derive the sensitivity of the current balance to trend GDP in the March 2025 Economic and Fiscal Outlook scenarios, take the average of the upside and downside scenarios, and then calculate the effect – expressed in £bn in 2029-30 - of a 0.8 percentage point downgrade in the level of trend productivity (a 0.2 percentage point downgrade for four years) by using these multipliers and the forecast for money GDP in 2029-30.