MEGA *Trends* 10

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Economic Growth in 2025 and Beyond?

Why skills and productivity remain a prickly subject for the UK

Economic Growth
A national priority

The pandemic is behind us, and the economy shows signs of recovery. And that means that economic growth is firmly on the agenda: while it has always been important, growth has now become a central point of discussion for UK politicians across the political spectrum.

In October 2023, Liz Truss famously declared: “I have three priorities for our economy: growth, growth and growth.” Likewise, Rishi Sunak promised in January of this year that “we will grow the economy, creating better-paid jobs and opportunity right across the country.”

And most recently, in her budget speech, Rachel Reeves announced that “the only way to drive economic growth is to invest, invest, invest,” stressing that “today’s budget marks an end to short-termism”. So, what is the difference between short-term and long-term growth measures, and how does this difference affect you?

If growth is going to be the focus of the economy for the next few years, let’s take a closer look at what we mean by it. In this Mega Trends, we will unpick the two forms of economic growth in the context of the UK’s stagnant growth of the last few years. What does stagnant growth – and the efforts to tackle it – mean for your business and the wider labour market?

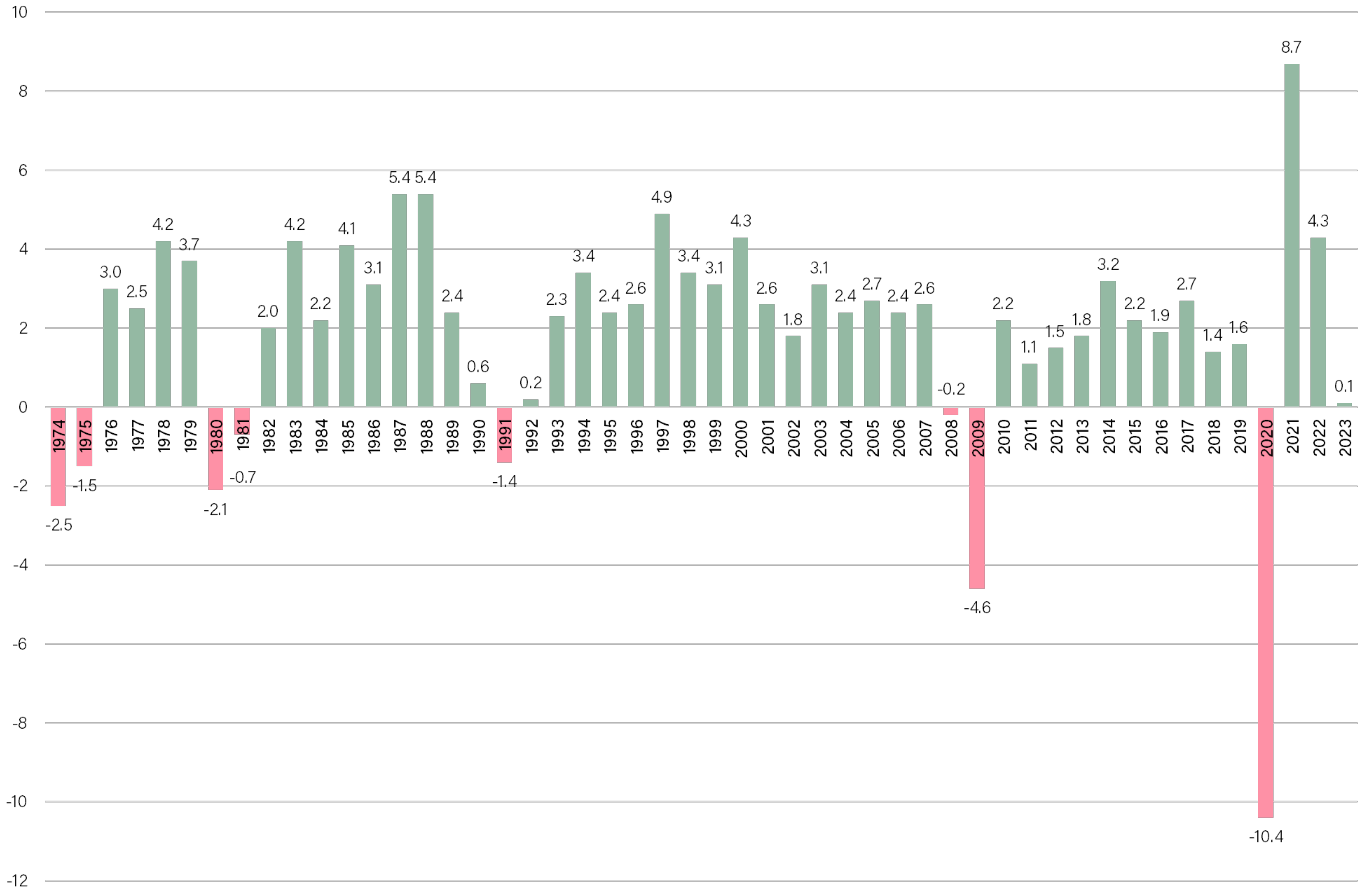
To understand today's debate around growth, we need to look back at the last few years.

As pandemic lockdowns ended and the economy came back to life, there was huge growth in the UK economy. But that was a short-lived reaction to the newfound freedom of post-pandemic life. Over the last 12 months, we have seen a dramatic shift to *stagflation*: economic growth shrank to almost nothing – well below 1% - despite high levels of inflation.

But what are we aiming for when it comes to levels of growth?

Economists generally agree that annual growth of 2-3% per year is sustainable and reasonable – and growth that exceeds this can lead to inflationary pressure. Over the last 40 years, the UK has generally achieved that on average – but in the last few years, that has changed.

The last 50 years of economic growth: GDP per capita year-on-year growth



Two types of growth: *Intensive and extensive growth*

So, the UK needs to generate growth. But the way we attempt to create growth matters, because there are two kinds of growth: intensive growth and extensive growth – and they aren't equally beneficial in the long term.

- **Intensive growth** is created by more efficient use of inputs and increasing productivity. That means doing more with the same amount of effort, capital, energy, and materials.

- **Extensive growth** is created by increasing the number of inputs: using more land and getting more people into the labour force.

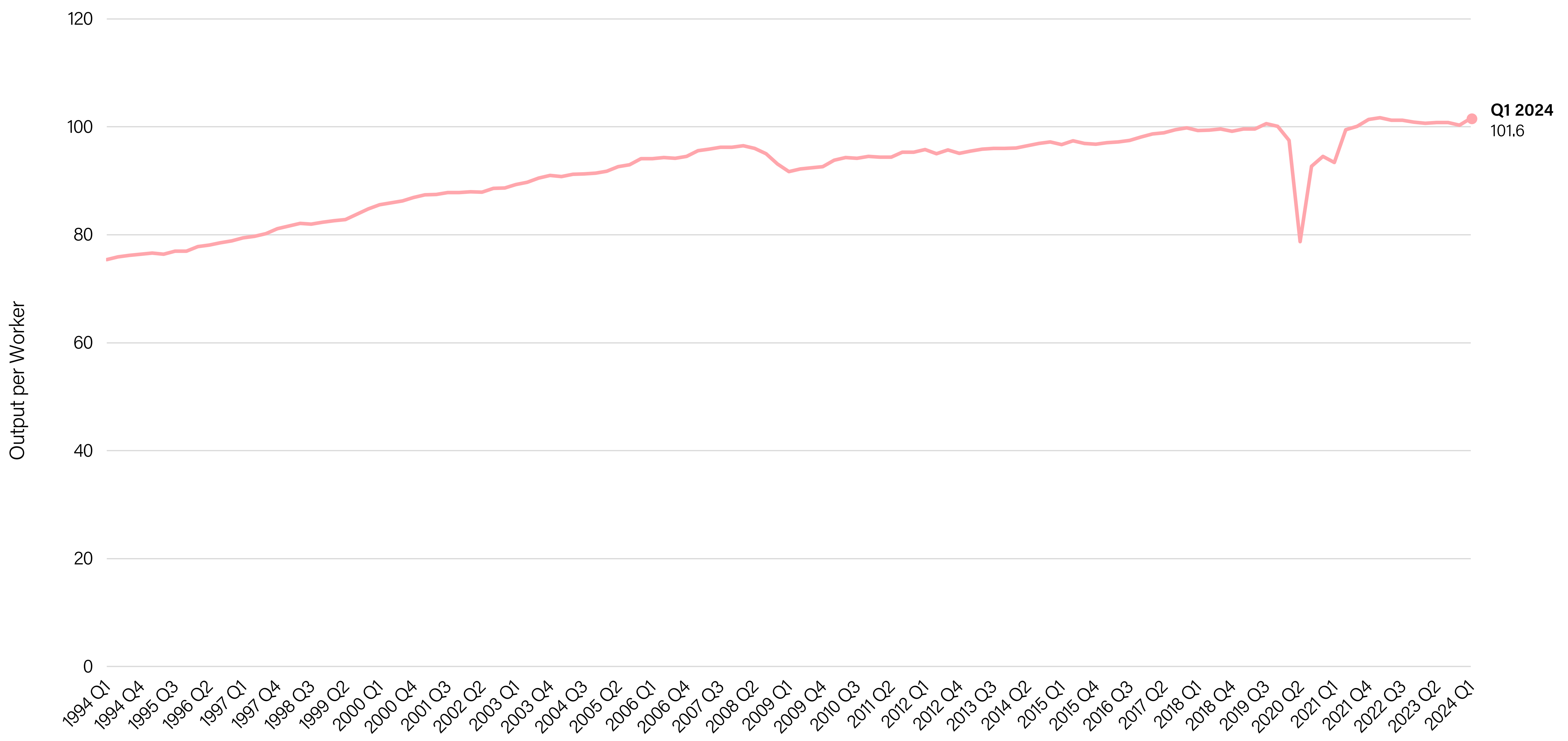
Historically, the UK has focused on building extensive – rather than intensive – growth. In other words, it has relied on bringing more people into the economy instead of increasing productivity in the current workforce. And this can become a problem when we run out of people that are able to join the workforce. In other words, extensive growth is riskier in the long term.

And the pandemic brought this risk to a head. The COVID lockdown saw record numbers of workers leaving the workforce – becoming "economically inactive." Another risk of pursuing extensive growth – instead of tackling low productivity – is that it tends to deliver low-paid, low-skilled jobs that rely on consumer spending. It also requires a steady supply of people willing to work for low wages.

Improving productivity is a key part of boosting intensive growth. This is particularly important because the UK has struggled with long-term low productivity. From 2010 to 2022, the annual average growth in UK GDP per hour was just 0.5 per cent. Taking just the last few years, which have been dominated by the pandemic, high energy prices and inflation, as well as domestic and global political turmoil, the trend in productivity growth has not improved.

While a slowdown in productivity growth has been prevalent across most advanced economies, the UK has performed particularly poorly against our nearest economic comparators.

UK **Labour Productivity**: Output per Worker



So what?
Why fixing productivity matters

But what does this slowdown in productivity mean in real life? Well, if productivity doesn't improve, it could cause real problems in the near future, according to research from leading thinktank, the Productivity Institute:

"...if the current trend in productivity growth were to continue for the next two decades, it will not be possible to sustain current living standards, let alone deliver sustainability and improved well-being. For instance, even doubling the current productivity growth rate (from 0.5% to 1% a year) over the next 12 years will only be sufficient to achieve the same rate of GDP growth as in the past decade. To strengthen improvements in people's living standards in future, productivity growth would therefore have to more than double."
The Productivity Agenda (ESRC, 2023)

By focusing on upskilling, tech investment, and increased training, productivity should improve, along with an increase in high-quality jobs. But intensive growth is more difficult to achieve. It requires greater investment in skills and education. It can be difficult for individual businesses to make an impact in this space, and recent governments have avoided direct interventions that could increase intensive growth because of the costs involved.

Skills England *and a new focus on intensive growth?*

There are signals from the government that tackling the productivity challenge is going to be a focus going forward.

In November 2024, following the summer General Election, the new government has finally published details of its plans to tackle what it calls a long-term industrial strategy. In a seven-point 'growth strategy', the Chancellor outlined plans for infrastructure investment and regional growth and, central to this, a new body responsible for addressing the productivity issue: "to improve economic prospects and skills we are creating **Skills England**, delivering our plans to Make Work Pay and tackling economic inactivity."

Skills England is the first government-related body to directly tackle skill development. Skills England explicitly describes its aims as relating to growth: it will "play a critical part in the government's mission to drive growth across the country, supporting people to get better jobs and improve their standard of living."

It does this by partnering with external organisations to provide training courses that specifically target occupations in demand like childcare, while conducting research that identifies where skills gaps exist. Skills England shows that our national conversation is moving from a general pursuit of growth – any growth – to a more discerning interest in which forms of growth will be most beneficial in the long term.

However, it will take time to see the long-term effects of this. **Despite the positive impact that schemes like this can make, the economy as it exists today continues to rely primarily on extensive growth**.

What the forecast means for you *Nine key labour market trends*

This shift towards facilitating intensive growth through upskilling is a welcome move, but as we move into the final quarter of this year and start to plan for 2025, the economy will continue to rely on extensive growth.

To help you plan ahead, we have collated data and projections from primary UK sources, such as the ONS and CBI. Here are the nine trends most likely to impact your hiring and retention strategies over the next year:

1. **Gradual increase in employment levels, especially in sectors tied to consumer spending**: The projected GDP growth of 1.0% in 2024 and 1.9% in 2025 suggests a moderate economic recovery. As the economy grows, businesses are likely to increase hiring to meet rising consumer demand, particularly in sectors like retail, hospitality, and services, which are more closely tied to consumer spending.
2. **Wages to stabilise or see modest increases**: As household real incomes rise and inflation decreases, real purchasing power improves. This could create upward pressure on wages, especially in consumer-facing sectors, as businesses compete to attract and retain workers. However, if productivity does not see significant improvements, wage growth may remain modest.
3. **Continued weakness in business investment-related sectors**: The forecast indicates a lack of confidence, which could result in restrained hiring or wage growth in sectors like manufacturing, construction, and professional services. Until business investment picks up in 2025, job creation in these sectors might remain subdued.

What the forecast means for you *Nine key labour market trends*

4. **Persistent productivity challenges**: With productivity still below the pre-pandemic level, there may be limited scope for significant wage increases across many sectors. Low productivity growth typically means that businesses are less willing or able to offer substantial pay raises, as output per worker remains low. This could also result in a greater focus on cost reduction, including cautious hiring and redundancies.
5. **Greater demand for skills development and training**: There's a need for further action to improve productivity. This could lead to an increased focus on skills development, training programs, and investment in digital transformation and innovation. Demand for workers with higher technical skills, digital literacy, and adaptability might increase as businesses try to boost productivity and competitiveness.
6. **Uneven experiences across regions and sectors**: The labour market impact may vary significantly across regions and sectors. Areas and sectors more reliant on consumer spending could see stronger job growth. Regions dependent on sectors such as manufacturing may see weaker job market dynamics while business investment remains low.

What the forecast means for you *Nine key labour market trends*

7. **Some sectors will continue to experience tight labour markets**: If consumer demand continues to rise and labour supply remains constrained (due to demographic trends, post-Brexit immigration changes, or other factors), certain sectors could experience labour shortages, leading to tighter labour market conditions in those areas, potentially pushing up wages. Those sectors under particular pressure are Health and Social Care, Hospitality, Technology, Construction and Manufacturing.
8. **Ongoing shift towards growth sectors**: As businesses aim to improve productivity, there may be growth in sectors like Technology, Digital Services, and Green Industries. These sectors are more likely to invest in innovative new technologies, potentially creating higher-quality, higher-wage jobs long term.
9. **Short-term uncertainties due to external factors**: Given the recent change in government and global geopolitical volatility, the macroeconomic outlook is subject to shocks. Changes to labour laws, tax policies, global economic and geopolitical trends and events will all impact the labour market.

Thank you!

If you want to develop a research-led, long-term plan for your brand and activations, get in touch with your ThirtyThree contact.

We look forward to hearing from you!

We'll be back in 2025 with another Mega Trends update.