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Q1 2016 Productivity And Costs: Trend Productivity Growth Remains Weak

- Nonfarm labor productivity fell at an annualized rate of 1.0 percent in Q1; unit labor costs rose at an annualized rate of 4.1 percent.
- On an 8-quarter moving average basis productivity is growing at a rate of 0.66 percent and unit labor costs are rising at a rate of 2.26 percent.

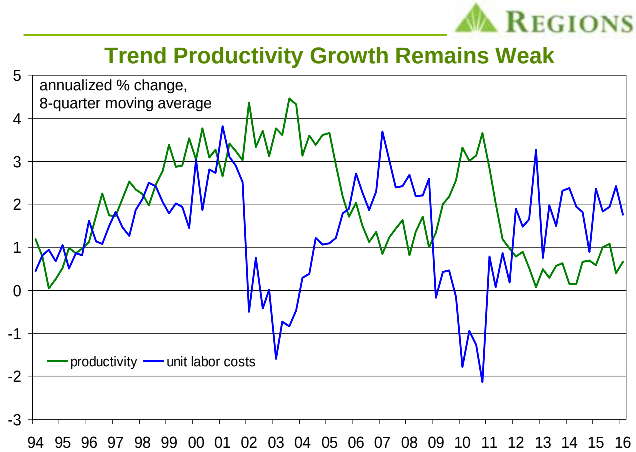
Labor productivity in the nonfarm business sector fell at an annualized rate of 1.0 percent in Q1 2016 while unit labor costs rose at an annualized rate of 4.1 percent. The decline in productivity was milder than had been anticipated but, as we routinely point out, the productivity data are extremely jumpy on a quarter-to-quarter basis. As such, our preferred basis of drawing out the underlying trend is to take the 8-quarter moving average of the quarterly growth rates, which is what we show in our top chart. On this basis, trend productivity growth is running at 0.66 percent while unit labor costs are rising at a trend rate below 2.0 percent.

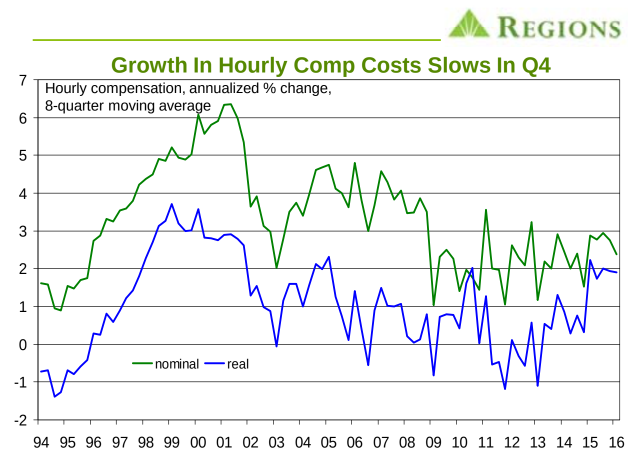
Data from the monthly employment reports show aggregate hours worked by private sector workers rose at an annual rate of 1.75 percent in Q1, while aggregate hours worked by the self-employed rose at an annual rate of 3.71 percent. On this basis, we had built a larger increase in aggregate hours worked into our forecast of a 2.4 percent decline in productivity, which proved to be well off the mark as aggregate hours worked as reported in the productivity data are reported to have risen by just 1.47 percent. Be that as it may, even with the smaller decline in productivity in Q1 the underlying trend remains weak. This is concerning as the rate of productivity growth is not only an important determinant of an economy's sustainable rate of noninflationary growth (or, the economy's "speed limit"), but also impacts corporate profit margins and the growth in workers' real wages over time. In terms of the economy's speed limit, the combination of anemic productivity growth and slower growth in the labor force is concerning, as this leaves us with a speed limit of just over one percent at present. Even with what has been restrained growth in labor costs, this is clearly weighing on corporate profit margins.

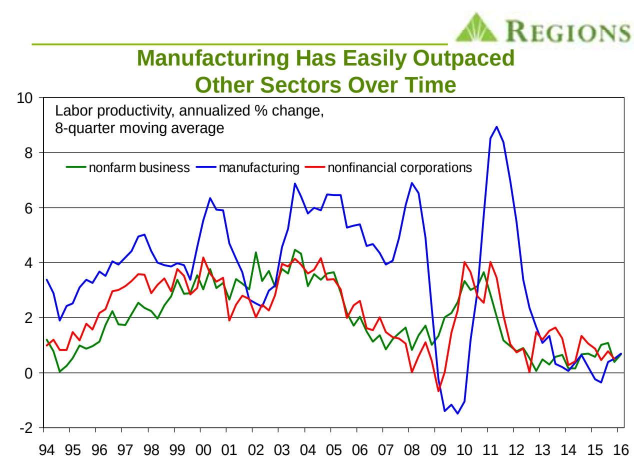
As seen in the middle chart, growth in hourly compensation remains fairly range bound, which is consistent with other measures of wage growth and a telling sign of the extent of slack remaining in the labor market. Still, workers are at least benefitting from what remains low inflation, as growth in real (i.e., inflation adjusted) hourly compensation hovers at the high end of the range that has prevailed for more than a decade. Of course, as inflation pushes higher over coming quarters growth in real hourly compensation will likely slow, though the extent to which this is the case will also depend on the extent to which tighter labor market conditions drive nominal compensation growth higher.

In light of the considerable rhetoric over the extent to which U.S. factory jobs are being "stolen" by "cheap" foreign labor we thought it worth highlighting, for those who can't be troubled to, you know, actually look at actual data, a trend that has prevailed for the past several decades. Though having run at a slower rate over the past few years, productivity in the manufacturing sector has outrun productivity growth in other sectors of the economy over time, and done so by a wide margin. This is more a function of technological advances and greater efficiencies in production processes. Sure, to some extent measurement issues are more problematic in the non-manufacturing portion of the economy, but it simply is not plausible to argue the persistent gap in productivity growth between these segments of the economy over the past several decades is purely a function of measurement issues. The broader point is that no matter how high one pushes up tariffs, that will do nothing to alter the primary cause of what for decades now has been declining employment in the factory sector.

We get that productivity may not be the most exhilarating of topics to discuss, but that makes it no less concerning that there seems to be so little understanding of the causes and consequences of the anemic trend rate of productivity growth. Our argument is that underinvestment on the part of businesses is the primary culprit behind lagging labor productivity growth. Instead of a serious discussion of the root causes and potential policy responses, we've been treated to shrill diatribes against global trade which, while no doubt attracting votes, do nothing to address the underlying issues.







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