ECONOMIC UPDATE

REGIONS

February 6, 2020

Q4 2019 Labor Productivity And Costs: The Trend Is Still Our Friend. At Least For Now

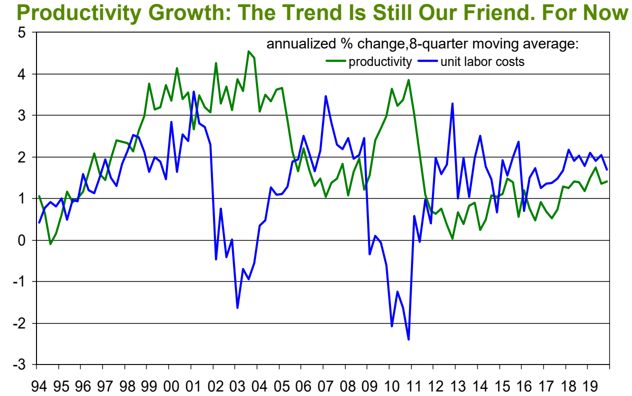
- Nonfarm labor productivity rose at an annualized rate of 1.4 percent in Q4; unit labor costs rose at an annualized rate of 1.4 percent.
- On an 8-quarter moving average basis productivity is growing at a rate of 1.4 percent and unit labor costs are rising at a rate of 1.7 percent.

Labor productivity in the nonfarm business sector rose at an annualized rate of 1.4 percent in Q4, less than the 1.6 percent growth the consensus expected and far less than the 2.7 percent growth our forecast anticipated. Unit labor costs, or, labor costs per unit of output, also increased at an annualized rate of 1.4 percent in Q4. For 2019 as a whole, labor productivity increased by 1.7 percent, the best annual growth since 2010, though still lagging longer-term historical norms, while unit labor costs increased by 2.0 percent. As we routinely note, we have little faith in measured productivity growth in any given quarter due to considerable measurement issues that tend to render growth in productivity and unit labor costs highly volatile from quarter-to-quarter – that out top chart, which shows 8-quarter moving averages, is so jumpy illustrates our point about the quarter-to-quarter changes. But, as these measurement issues tend to even out over time, we see value in looking at the trends in the data. In that sense, despite taking a hit over the second half of 2019, during which growth was well below the full-year average, productivity growth nonetheless continues to trend higher, which in turn has positive implications for wage growth and overall economic growth. That trend will most likely be derailed over the first half of 2020 if Boeing's production issues have the material adverse effect on real GDP growth we and most other analysts anticipate. The question then becomes whether the upward trend will resume over the latter half of this year and into 2021, or whether productivity growth will go back to drifting aimlessly within a fairly narrow range as was the case during the earlier years of the current expansion. We think it far too soon to answer that question, though the recent weakness in business investment is an unsettling sign, particularly to the extent that it lingers over coming months.

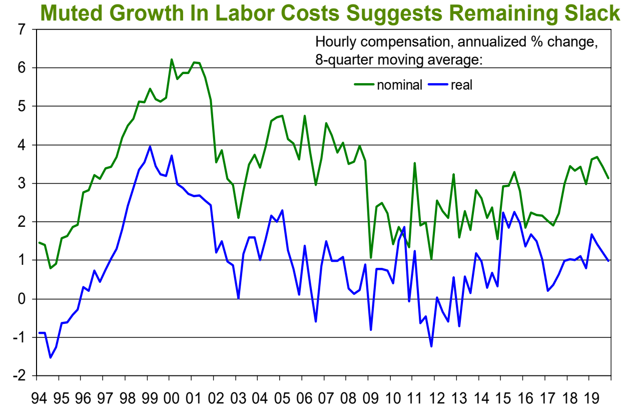
We know from the GDP data that real output in the nonfarm business sector grew at an annualized rate of 2.5 percent in Q4. Where the issues come into play in the productivity data is the measurement of aggregate hours worked, which includes those captured in the nonfarm employment data, nonfarm proprietors, and unpaid family workers. Though hours worked by those on nonfarm payrolls (captured in the monthly employment reports) account for far and away the largest block of hours measured in the productivity data, such is the quarter-to-quarter volatility in the latter two components that quarterly changes, particularly when annualized, can and do impact the aggregate hours worked number. This was clearly the case in the Q3 data when hours worked by unpaid family members increased at an annualized rate of better than 1,800 percent, leading to a decline in measured labor productivity. Our forecast of Q4 productivity growth assumed this increase would be unwound in Q4, and while this seems not to have been the case, we do not actually know at this point because the data on this series have yet to be released, though there has to be some estimate incorporated into the BLS's initial estimate of Q4 productivity growth. All of which amounts to nothing more than meaningless noise.

Our take is that productivity growth over 2H 2019 was understated thanks to implausibly fast growth in aggregate hours worked, and the flip side of this would be that growth in unit labor costs was overstated. Be that as it may, the hourly compensation measures reported in the productivity data are sending pretty much the same signal as are other measures of wage costs, such as the Employment Cost Index and the average hourly earnings metric, which is that growth in labor costs remains milder than would be implied by the headline unemployment rate. This suggests that labor market slack has not yet been fully pared down. Over time, productivity growth is an important driver of wage growth, and in that sense the fairly slow pace of wage growth seen over much of the current expansion has been consistent with the slow trend rate of labor productivity growth. This is one reason why the improvement in that trend rate of productivity growth seen in the quarters leading up to 2H 2019 was important. This also means that the question of whether the slower pace of productivity growth seen over the back half of 2019 was transitory noise in the data or the reversal of that improving trend is more than an academic question. Coming quarters will reveal the answer.

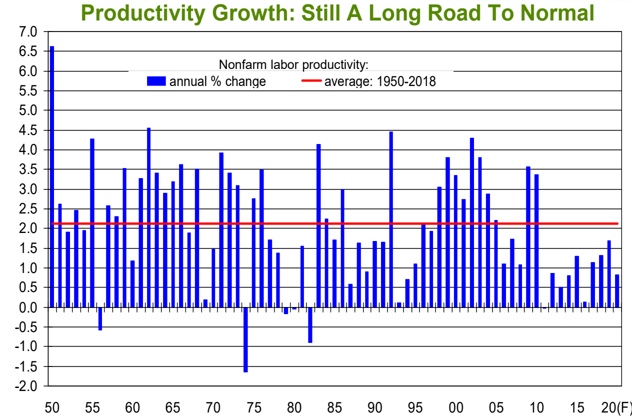
Productivity Growth: The Trend Is Still Our Friend. For Now



Muted Growth In Labor Costs Suggests Remaining Slack



Productivity Growth: Still A Long Road To Normal



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