# ECONOMIC UPDATE

REGIONS

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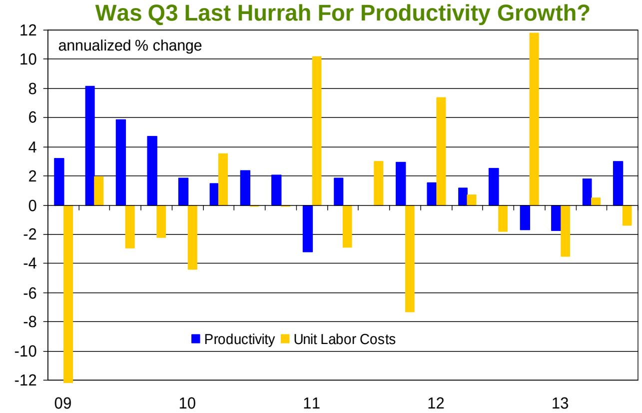
## Q3 Productivity And Costs: Strong Q3 Can't Mask Weak Trend

- Nonfarm labor productivity <u>increased</u> at an annualized rate of 3.0 percent in Q3.
- Unit labor costs <u>fell</u> at an annualized rate of 1.4 percent.
- On an 8-quarter moving average basis, productivity is rising at a rate of 1.19 percent and unit labor costs are rising at a rate of 0.99 percent.

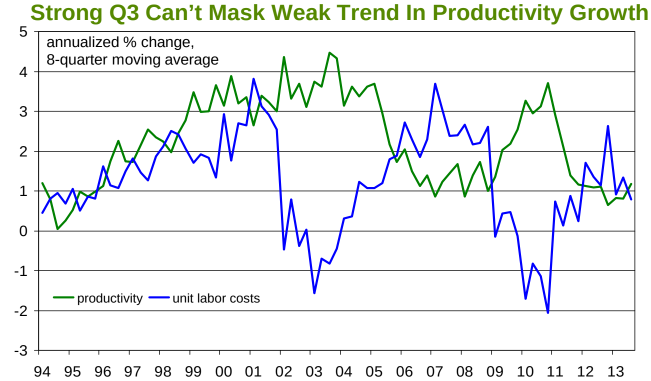
Worker productivity in the nonfarm business sector rose at an annual rate of 3.0 percent in Q3, an upward revision from the original estimate of 1.9 percent. With the upward revision to worker productivity, unit labor costs, the ratio of hourly compensation to labor productivity, were revised sharply lower, now reported to have fallen at an annual rate of 1.4 percent compared to the initial estimate of a 0.6 percent decline (annual rate). Reflecting the steep upward revision to real GDP growth, total output in the nonfarm business sector is now reported to have risen at an annualized rate of 4.7 percent in Q3 compared to the initial estimate of 3.7 percent growth. Aggregate hours worked rose at an annual rate of 1.7 percent, while compensation per hour rose at an annual rate of 1.6 percent, though on an inflation adjusted basis hourly compensation fell at an annual rate of 1.0 percent in Q3.

Was Q3 Last Hurrah For Productivity Growth?



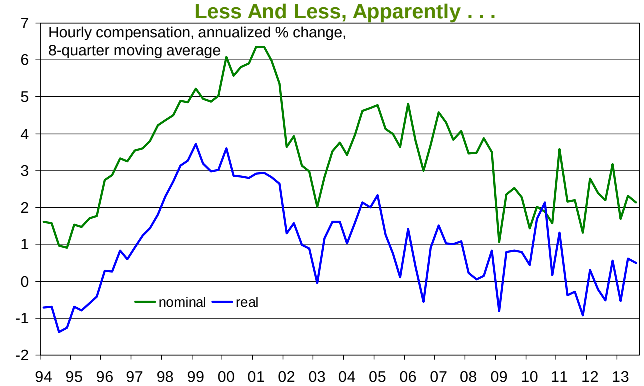

The rate of productivity growth in Q3 is the fastest since Q4 2009, when worker productivity was rising sharply as is typically the case as the economy is emerging from recession. The data on worker productivity and unit labor costs, however, can be volatile on a quarter-to-quarter basis. As such, we prefer to look at the longer-term trends, with an 8-quarter moving average being our preferred lens through which to view the productivity and cost data. On this basis, productivity growth is far less impressive than implied by the jump recorded in Q3, as seen in the middle chart opposite. The longer-term trend rate of productivity growth is closer to 1 percent. The faster rate of productivity growth seen coming out of the Great Recession is, as noted above, consistent with patterns seen in past cycles, as in the early stages of recovery firms typically rely on boosting output via productivity gains from current workers. As recoveries mature and give way to expansion, firms then begin to add hours and take on additional workers, which push recorded productivity growth lower. What is atypical about the current cycle, however, is the handoff from productivity growth to hiring has taken so long, and indeed is by no means near being complete given how tepid overall growth has been over the course of the current cycle. Still, the silver lining here is, with productivity growth having settled into a slow trend rate, the faster rate of GDP growth we and most other analysts expect for 2014 would necessitate a stepped up rate of hiring.

Strong Q3 Can't Mask Weak Trend In Productivity Growth




Given the degree of slack that remains in the labor market, however, even should firms sustain a faster rate of hiring it will take some time before that translates into meaningful growth in labor compensation which, as seen in the bottom chart, remains exceptionally slow. From the prospective of firms, this means increased hiring need not result in immediate compression of profit margins, but for workers the bottom line result is not so positive. Moreover, a longer term puzzle is whether true underlying productivity growth is reflected by the rapid growth seen from the mid-1990s through 2005 or the tame growth seen over the past several quarters. This has implications for not only the economy's "potential" (i.e., noninflationary) rate of growth but also for growth in worker compensation. It will take time for an answer to emerge, but clearly the implications are significant.

You Load 16 Tons And What Do You Get?
Less And Less, Apparently . . .





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