

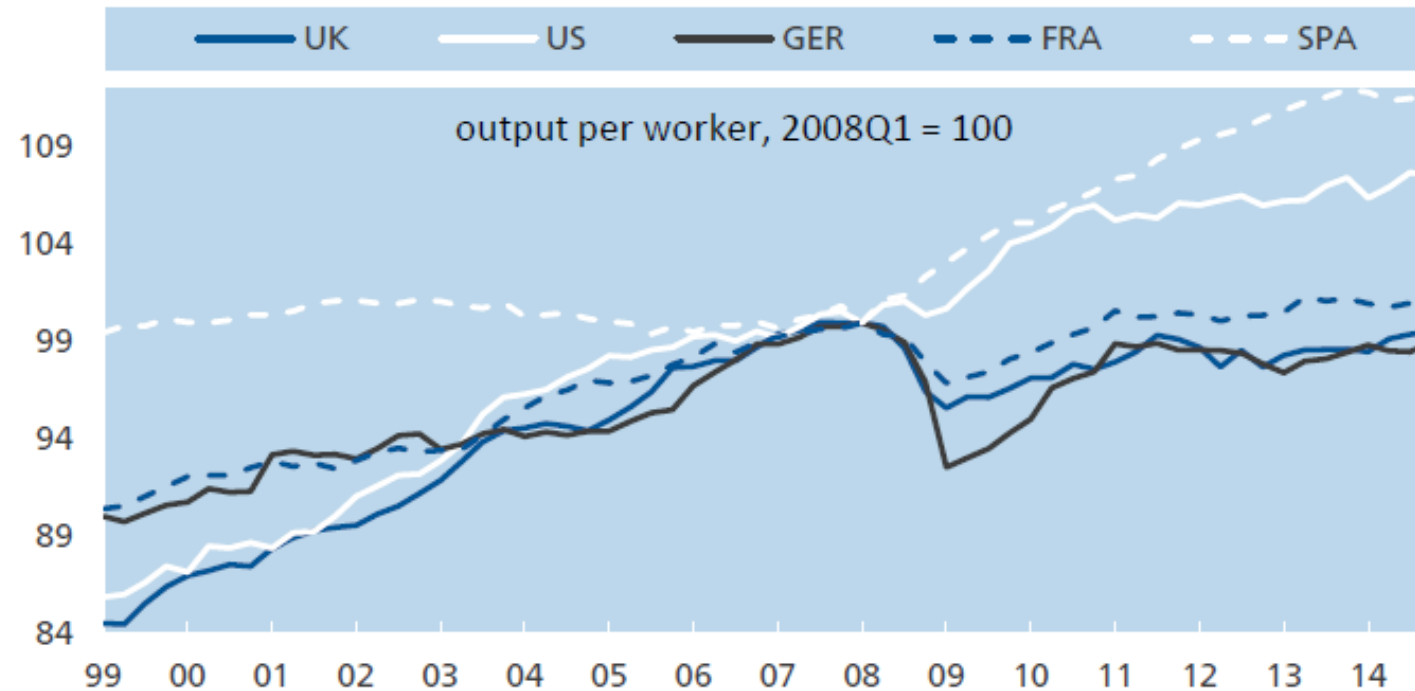
# **“Oh Productivity, Wherefore Art Thou Productivity?”**

Jeremy Batstone-Carr, Chief Global Economist

*June 2016*



# The productivity slowdown

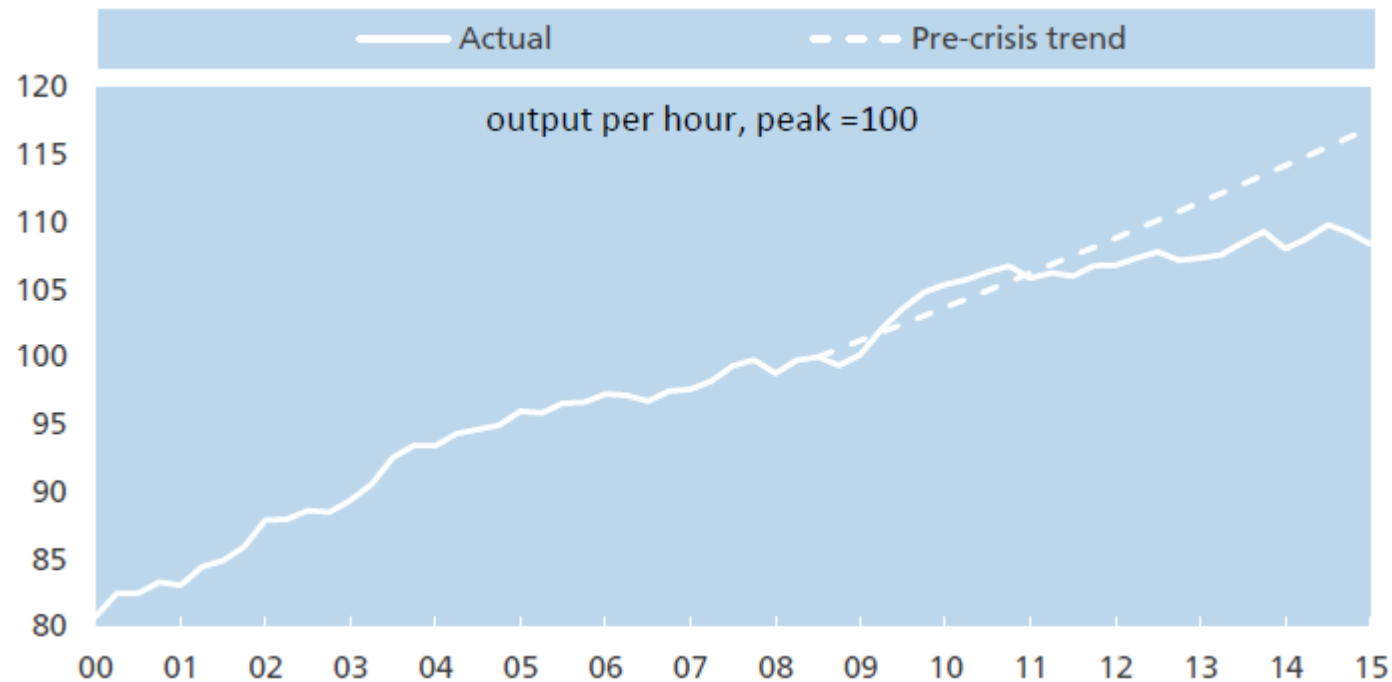


- Productivity crash
- Tech wreck
- Deflation rules

# Productivity Crash

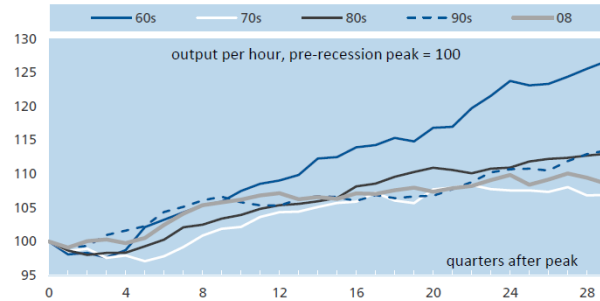
*Productivity: measures how much output an economy produces per unit of labour input (either per worker or per hour worked)*

- A vital element of trend / potential growth
- The deterioration has been common across most developed economies



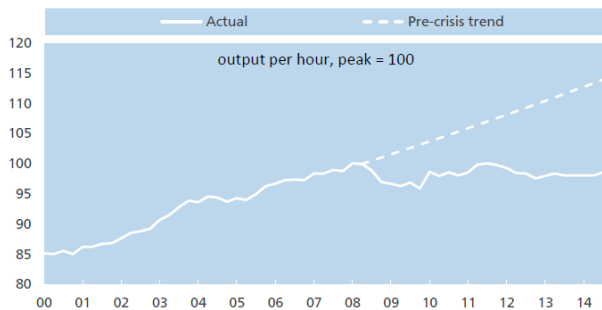
# Is the productivity slowdown cyclical or structural?

- Cyclical forces were blamed at first

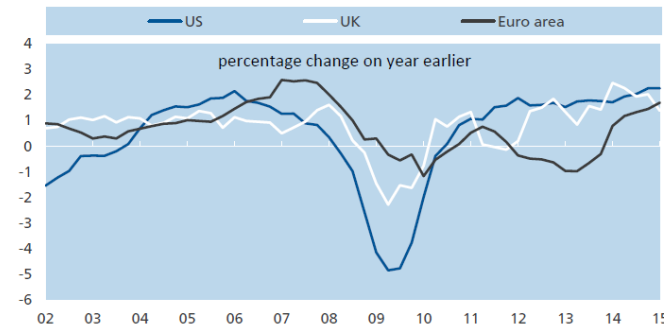


Source: US Bureau July 2015

- In contrast, the UK and Eurozone companies were slower to reduce their workforce



Source: ONS July 2015



Source: National Statistics July 2015

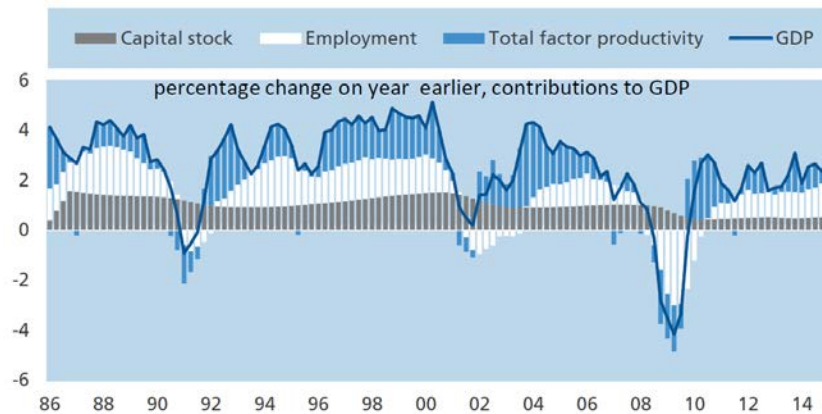
# Seven years after the financial crisis and no improvement in sight

- Stronger demand has been met by rising employment



Source: US Bureau, Eurostat July 2015

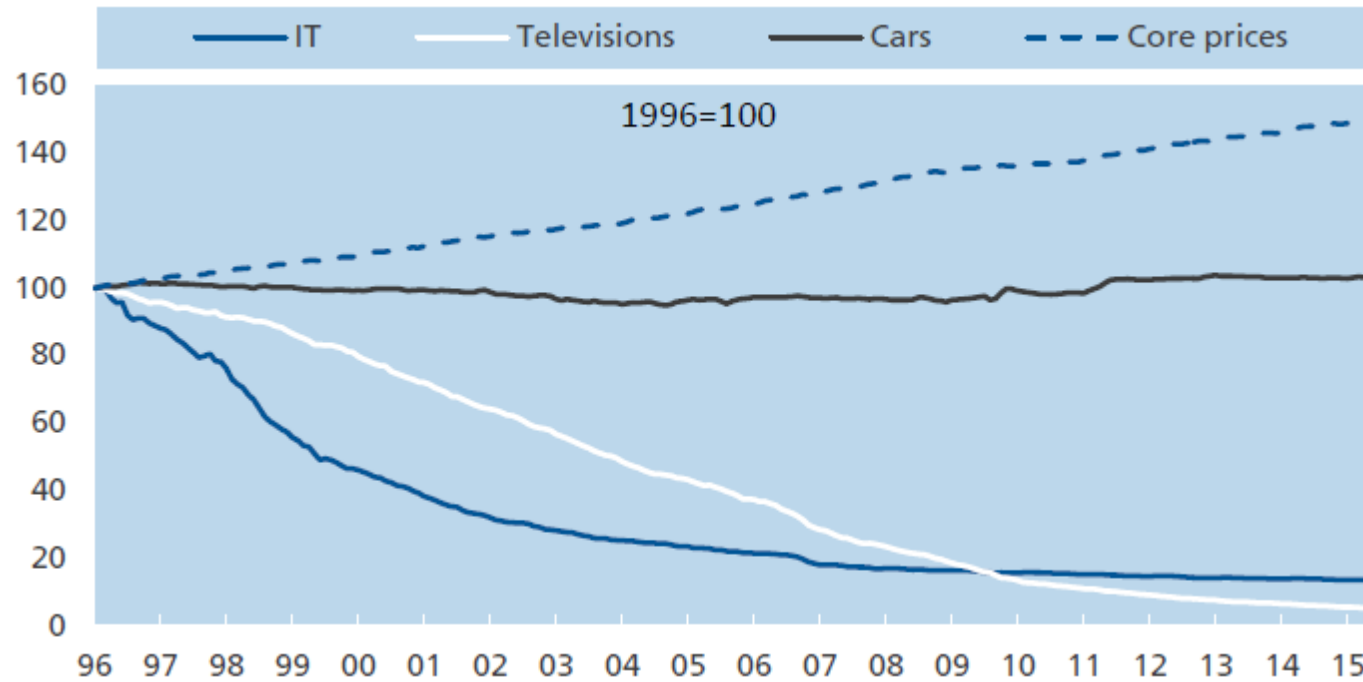
- Output per hour has slowed in the US



Source: US Bureau, BLS July 2015

# Tech Wreck

- Cyclical justifications give way to other explanations
- Data recording
- IT distortions

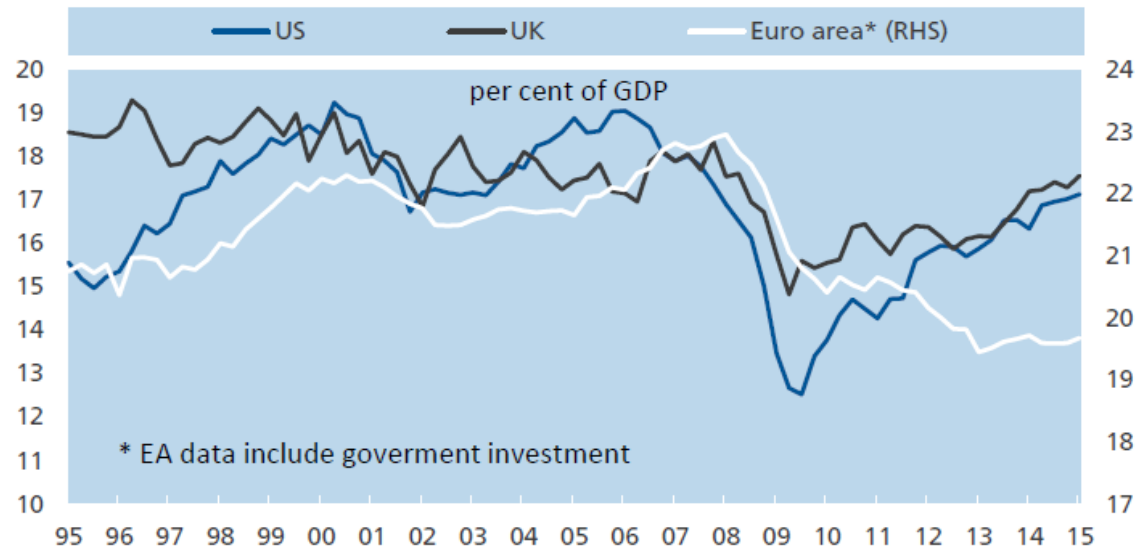


# Productivity “mega-trend”

- Statistical failings a response to pessimistic analysis
- IMF / Federal Reserve / Robert Gordon
  - Productivity slowdown pre-dates the crisis period
  - Output per hour is now back on 1973-1995 trend
  - Gordon is even more pessimistic

# Impact of the financial crisis

- Weak investment post-crash

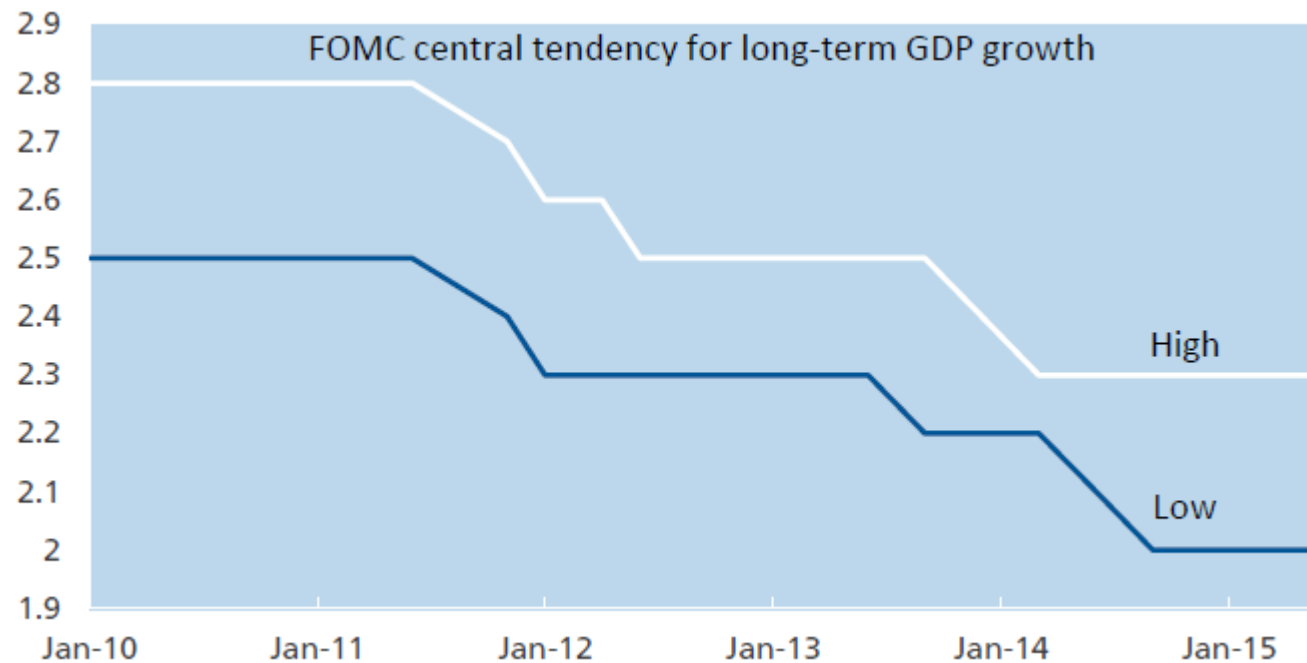


- Economists identify various channels
  - a) Bursting of the bubble in housing and finance
  - b) Low investment
  - c) Impaired resource allocation
  - d) Regulation



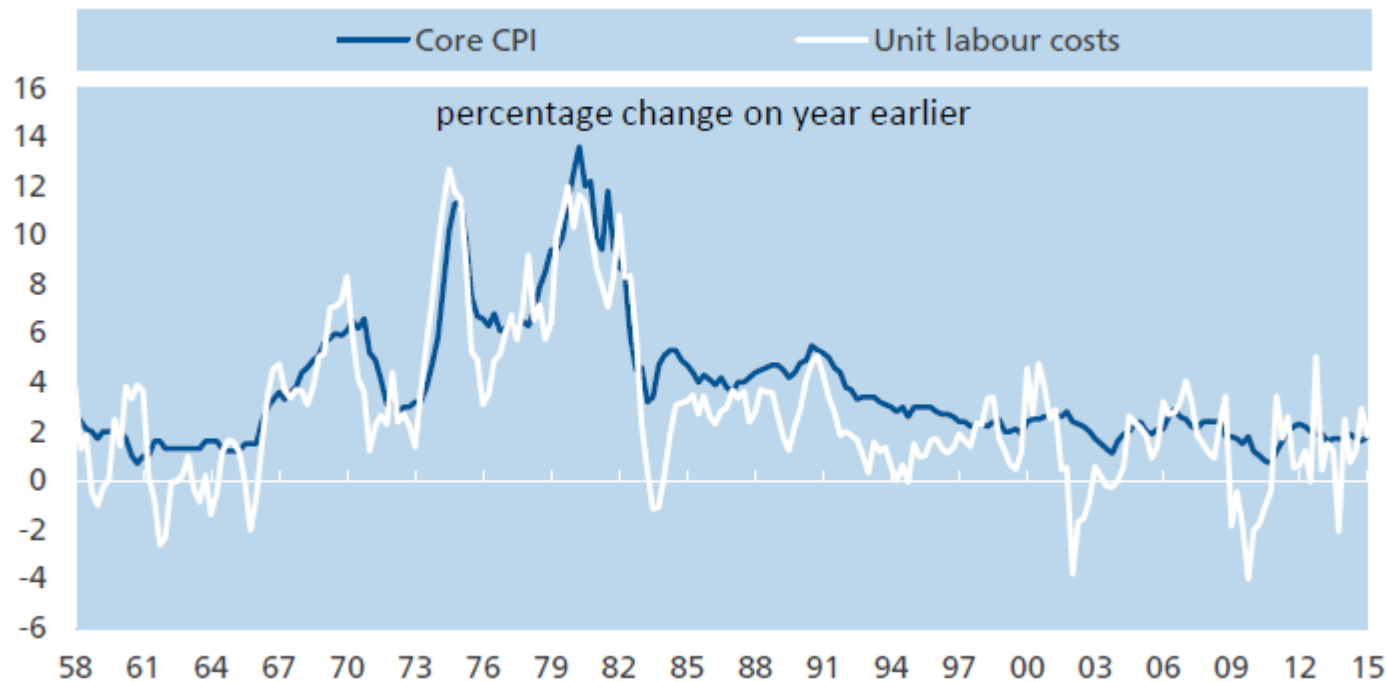
# Deflation rules

- Uncertainty as to whether the productivity slowdown is cyclical or structural has created a dilemma for central banks
- The FOMC has already lowered its long-term estimate of GDP growth significantly



# Impact on central banks

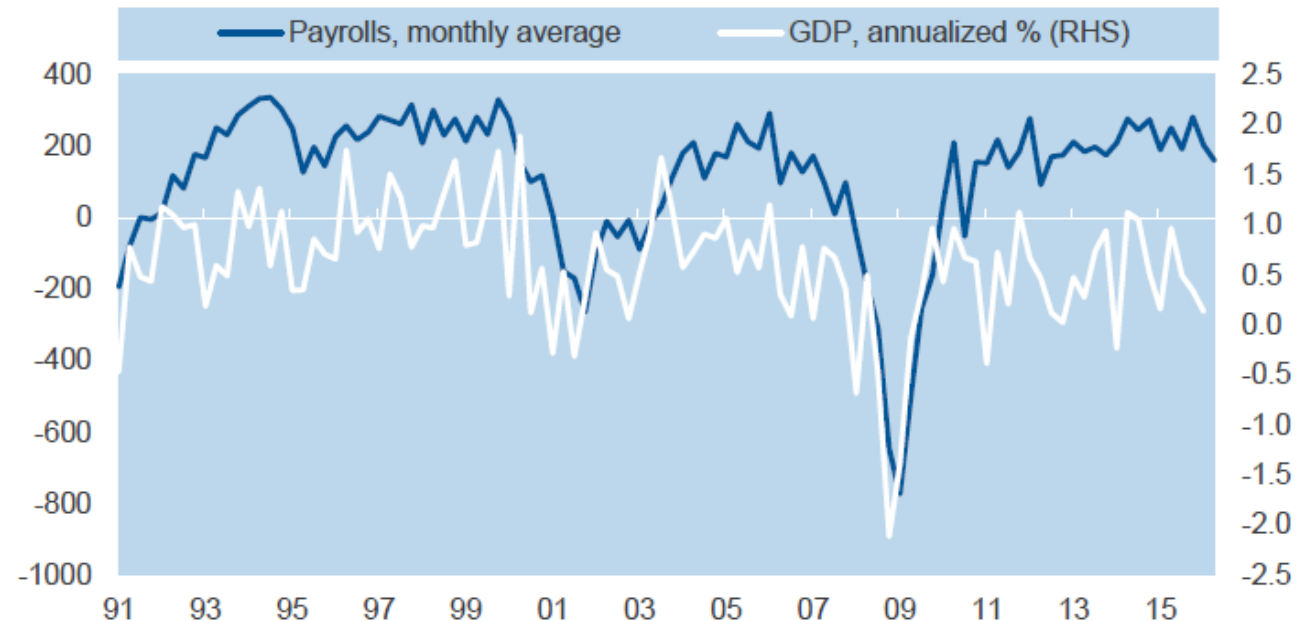
- Could structural concerns force a non-consensus policy tightening?
- Does the productivity slowdown presage a pick-up in future inflation?



- A deflating world
- Interim conclusion

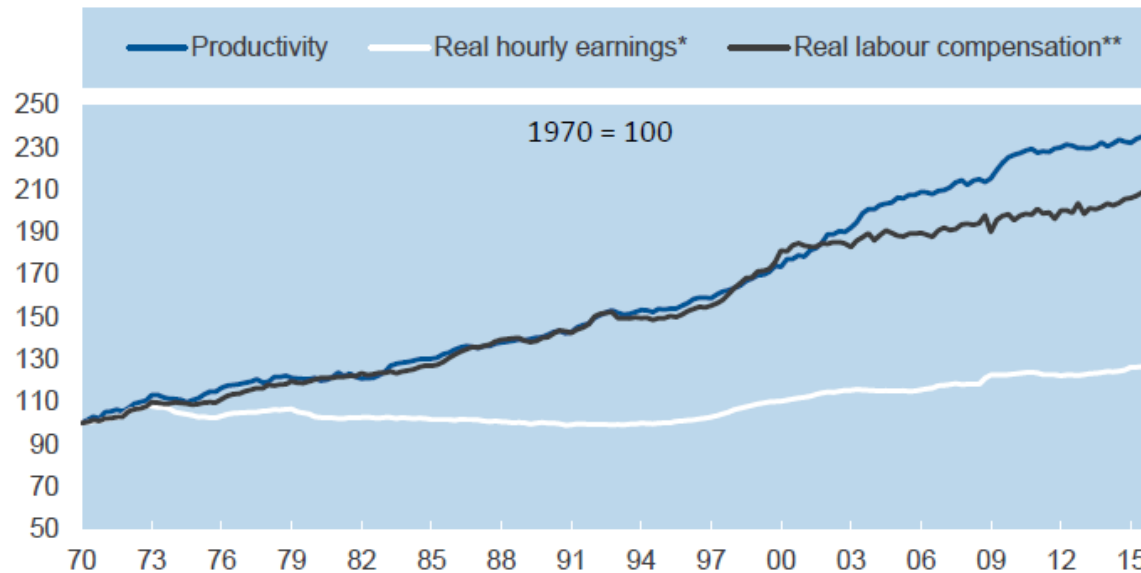
# Productivity and the financial markets

- Theories as to why productivity has slowed have not convinced investors
- Cyclical exaggeration
  - The recent experience exaggerates the issue
  - The US economy may strengthen over H2 2016
  - But structurally weaker productivity could have important implications for global financial markets



# The corporate response

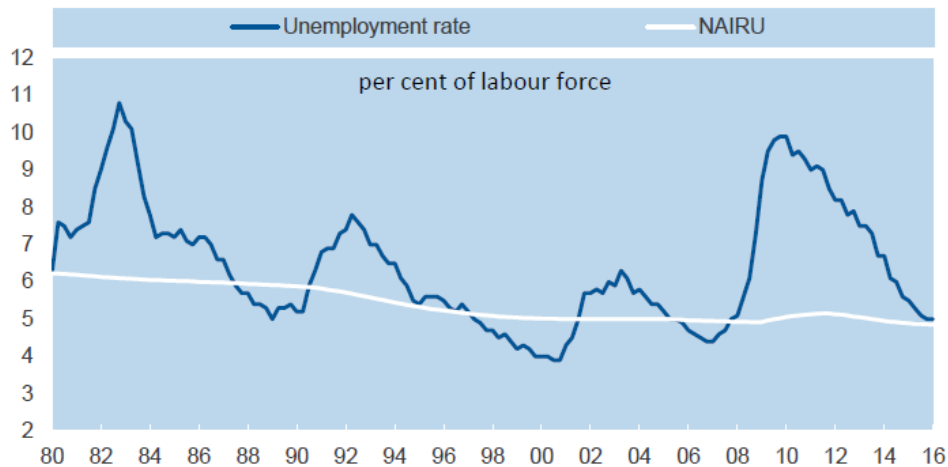
- Assuming that a large part of the slowdown is structural
- There will be an immediate impact on profit margins and wages



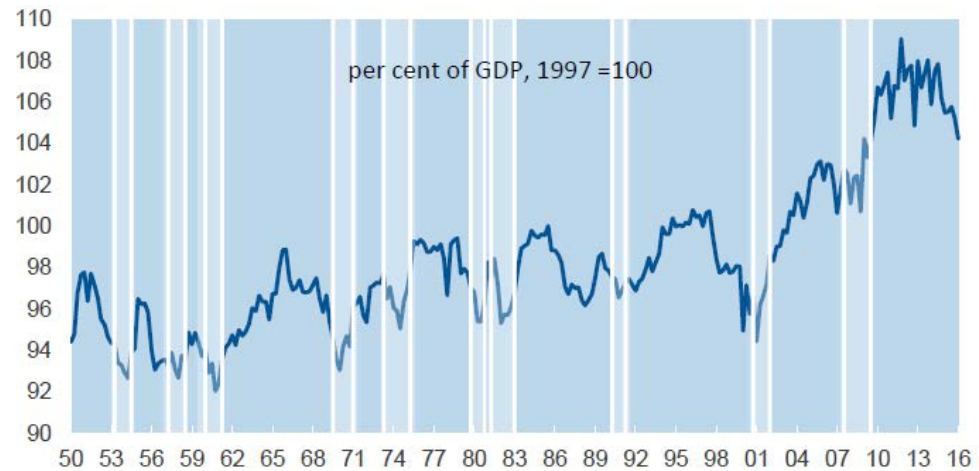
- Long-term trends
- Short-term response

# Profit margins and the cycle

- Is a US recession close at hand?
- Are profit margins pro-cyclical or counter-cyclical?



Source: OECD July 2015

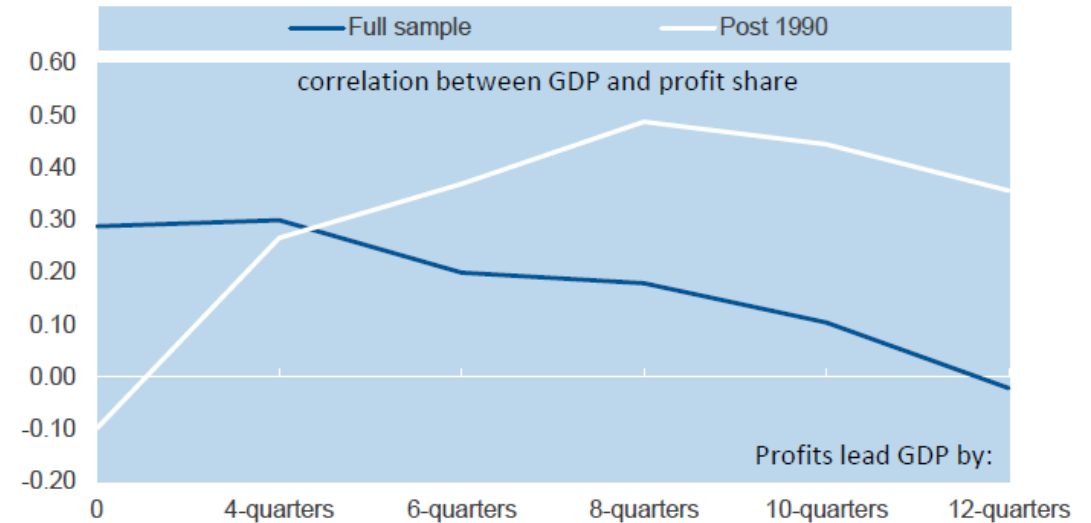
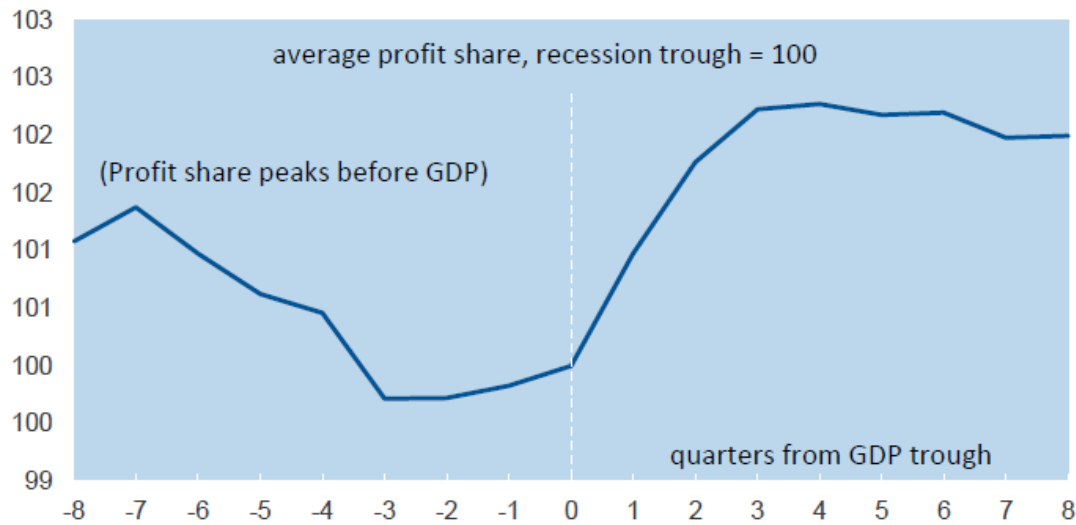


Source: Bureau of Economics Analysis July 2015

- How does one define margins?

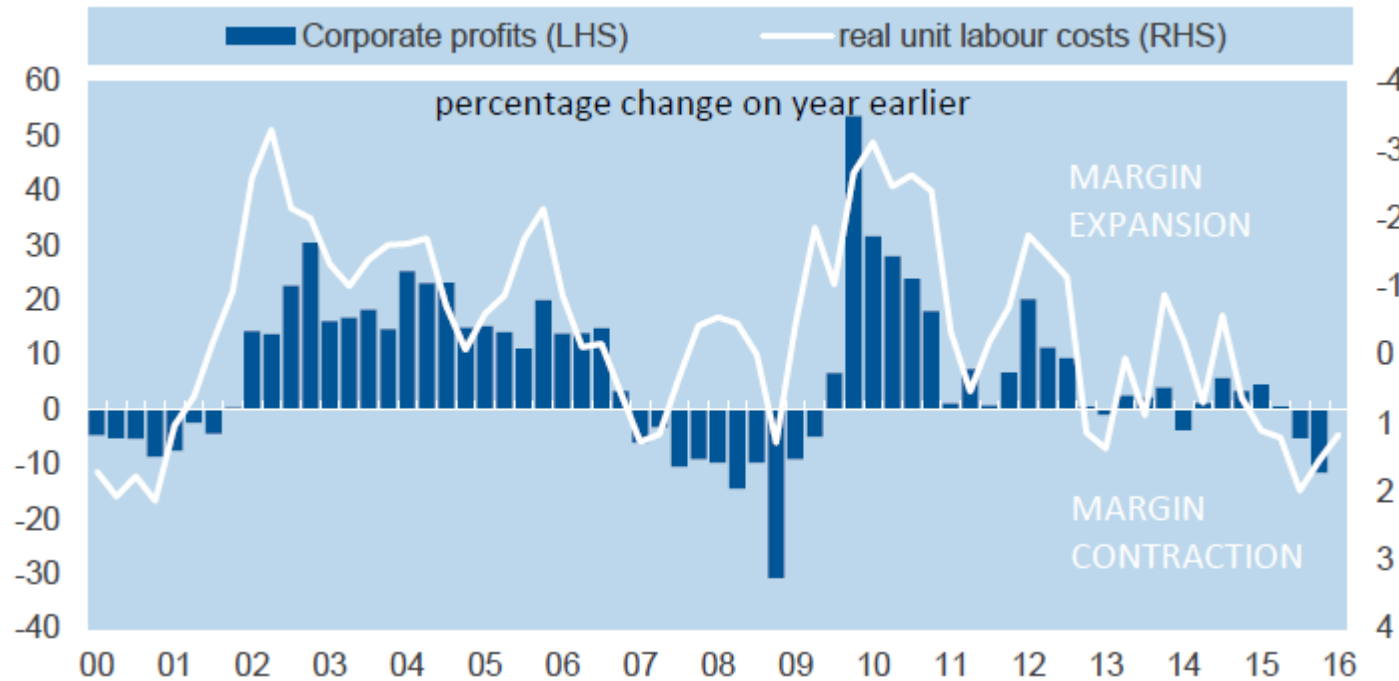
# Profit share around recessions

*US example 1950 - 2016*



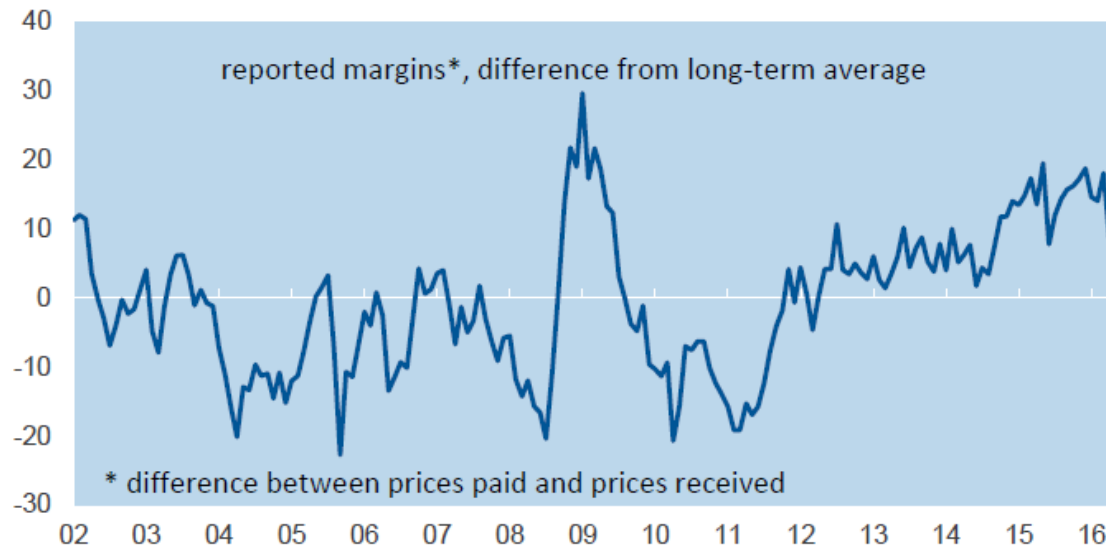
# Peak profits = recession

- The deterioration in US corporate earnings shows significant sectoral divergence
- But the last decade has not been “normal” for profit margins

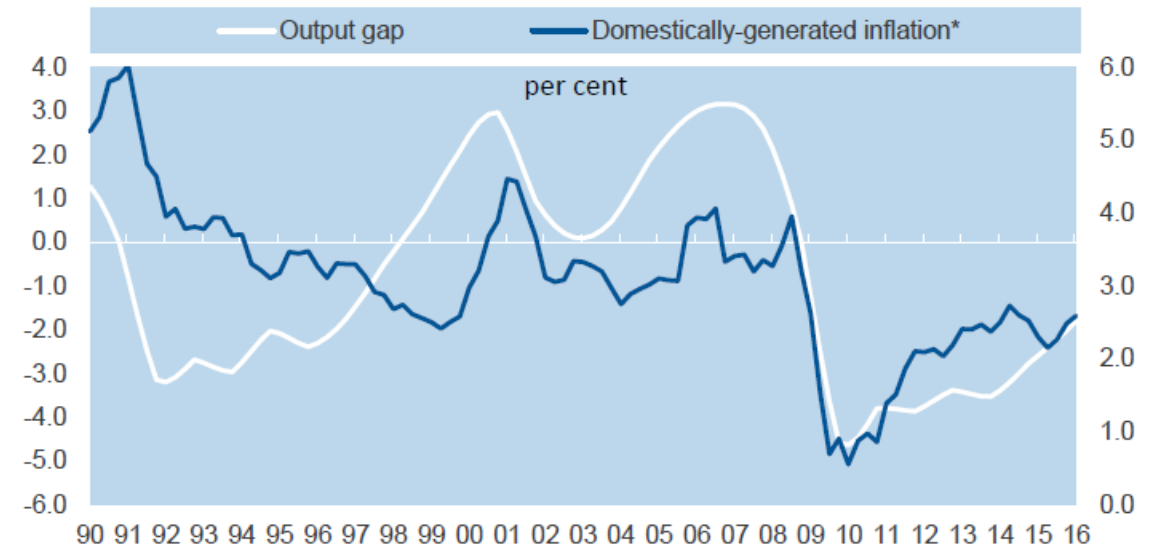


# Pricing power

- If companies do not lay off workers they must accept a margin squeeze or raise prices



Source: Average Regional ISM Surveys July 2015

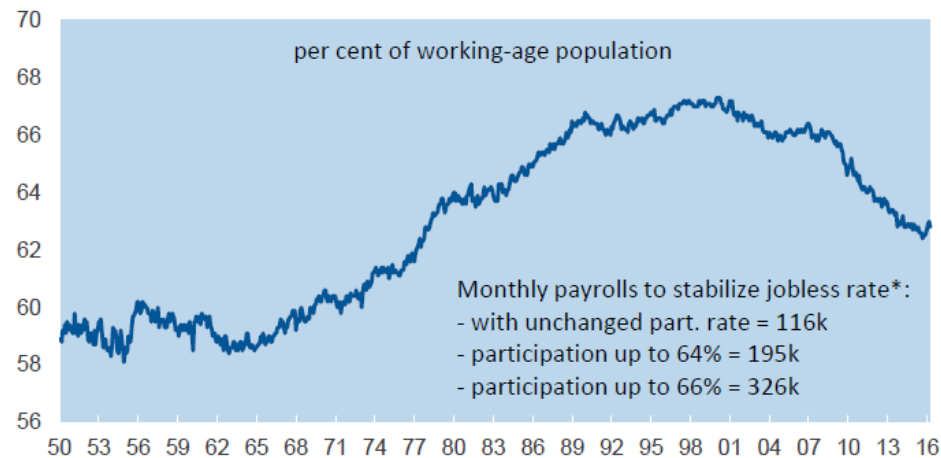


Source: OECD July 2015

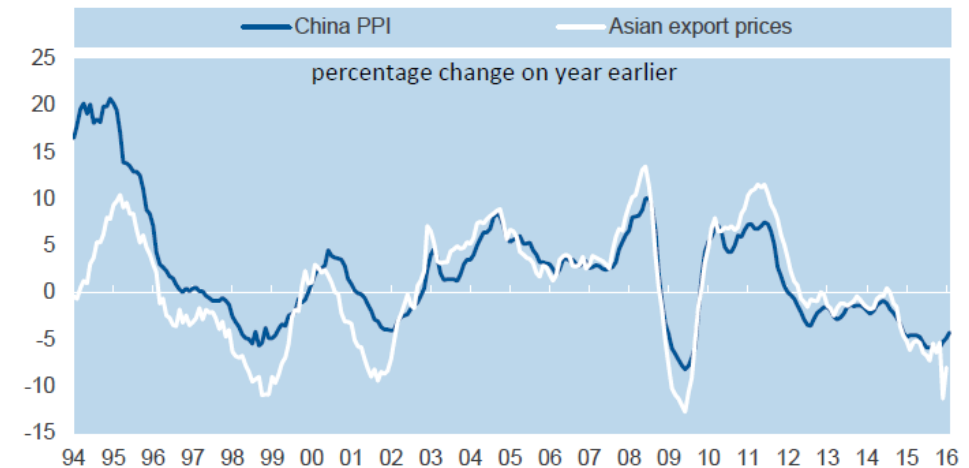


# Farewell Goldilocks

- We think companies will seek the middle road
  - Will lead to a less favourable market environment than in the recent past
  - Can Goldilocks be saved?
- A significant shift in labour force participation
  - Deflationary shock



Source: Bureau of Economics Analysis July 2015



Source: National Statistics July 2015

# Market conclusions

- Productivity has slowed, for whatever reason
- Persistently weak productivity threatens an end to the Goldilocks environment for investors
- The corporate sector will have to respond
- In a normal cycle one should expect both inflation and lower margins
- Goldilocks is doomed

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