Economic Analysis

3Q15 Productivity Reflects Slowdown in Output and Hours Worked

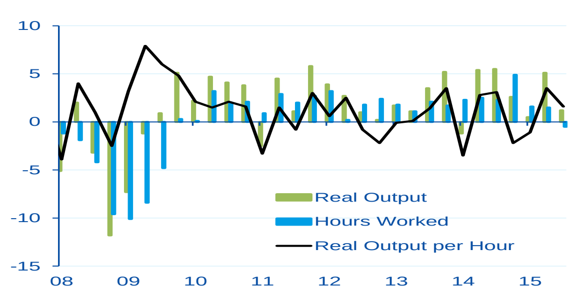
Kim Chase / Amanda Augustine

- **Real output per hour increased 1.6% QoQ SAAR following a 3.5% gain in 2Q15**
- **Hours worked declined for the first time since 3Q09, confirming slow demand conditions**
- **Productivity growth will remain below pre-crisis rates as GDP holds well below 3.0%**

Productivity growth for 3Q15 surprised to the upside, hitting 1.6% QoQ SAAR despite the fact that slow economic activity for the quarter had pushed consensus expectations to just 0.1%. Surprisingly, manufacturing productivity growth was at its highest level in four years, rising 4.9% and propelled primarily by durable goods manufacturing, which jumped 7.3%. However, the underlying details of the nonfarm productivity report reveal ongoing weakness in the economy and point to limited gains in the coming years. As expected, real output slowed significantly, up only 1.2% following a 5.1% boost in the second quarter, falling in line with the BEA's advance GDP report from late October. Hours worked, on the other hand, declined 0.5% for the first time since 3Q09. This reflects some of the lingering structural concerns in the labor market, with many workers still struggling to find enough hours for a full-time job. The fact that businesses have reduced worker hours is not a positive signal for economic confidence and foreshadows slow demand ahead. Also in line with this view is the lower-than-expected increase in unit labor costs, again suggesting that businesses are reluctant to shift into an expansionary mindset. The modest 1.4% gain in labor cost follows a 1.8% decline in 2Q15, adding to existing concerns on slow wage growth and supporting our expectations for very gradual interest rate hikes by the Fed.

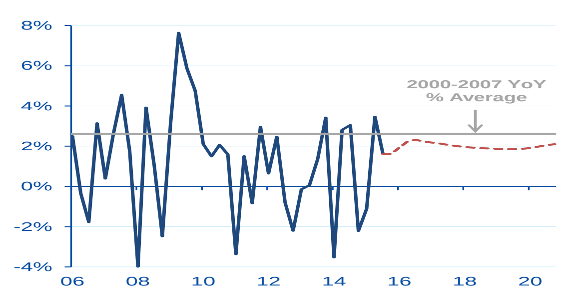
Although this report was stronger than expected, it does not necessarily imply that we are on a path towards strong and steady productivity growth. Volatility has been the name of the game for productivity growth throughout the recovery thus far, never quite gaining significant traction towards pre-recession growth rates. The post-crisis annual average of just 1.0% is far from the 2000-2007 average of 2.7% and suggests that we still have a long way to go before we can reach the economic strength seen before the recession. With both structural and cyclical factors in play, it is likely that productivity will remain low for the foreseeable future, fitting into this "new normal" economic environment of sub-3.0% GDP growth over the next few years.

Chart 1
Real Output per Hour (QoQ SAAR % Change)



Source: BLS & BBVA Research

Chart 2
Productivity Forecasts (QoQ SAAR % Change)



Source: BLS & BBVA Research

DISCLAIMER