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The "Good/Bad" Labor Report, Productivity Plunge Deepens

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Upon landing in JFK from an overnight flight from Tokyo yesterday, I immediately went to my smart phone for the employment report, first checking the unemployment rate (down to 4.9%) and the wage increase (up 0.5%). I said to myself, "that will take 200 points of the Dow," and indeed when I checked the equity markets, it did. I consider those two numbers key to the Fed's decisions, more so than the much-watched payroll numbers. Certainly, I was pleased that the participation rate inched up one tenth, but the unemployment rate is now at the lower limit of the Fed's "natural rate" and wages popped 0.5%, a far greater increase than productivity (see below), stoking the fears of a wage-induced cost-push inflation. Furthermore, the household figure was a startling 615k increase, on top of 485k increase last month; by that survey, 1.1 million jobs were created in the last two months! That is hardly the numbers one would expect if we were entering a recession. Furthermore the average hours worked increased one tenth to tie a cyclical high. To be sure, I still think the Fed defers in March, and the wage pop may be temporary, but one cannot deny that the growth of employment is far beyond what is being supplied "demographically". To be sure, Greenspan let the 1990s expansion go until the unemployment rate was in the low 4s before raising rates (and many argue he waited too long). But at the current rate of increase in jobs, that figure might be hit by late summer. We need to get a meaningful increase in the participation rate to prevent current job growth from eventually tightening the labor market to the point where it threatens inflation.

As readers of these letters well know, I have continued to emphasize the productivity collapse as a major macroeconomic issue. Last week's productivity data: A shocking 3% drop in Q4 productivity highlights my concern. And things are not getting better. Despite strong job growth in January, Q1 estimates of GDP growth are between 1.5% and 2%. This is barely equal to the trend productivity growth in the postwar period. In other words, 1.5% to 2% is how much we would expect GDP grow if there were zero increase in jobs and zero increase in hours worked. Is productivity really crashing, i.e., are workers producing less per hour than they used to, contrary to all historical trends? We need to get a much better handle of what is going on here.

As a political note, I was very pleased with the results of the Iowa caucuses. I have long regarded Rubio as the most attractive choice for Republicans, and the only one of the frontrunners who can defeat Hillary Clinton in November. In fact, the latest Quinnipiac poll has Rubio 7 points ahead of Clinton. A runner-up showing in New Hampshire would continue the momentum he is building.

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