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U.S. productivity growth moderates, but trend still strong

KEY TAKEAWAYS

- Slower U.S. productivity growth in Q4 pushes up ULC, consistent with stalling disinflation.
- U.S. layoff plans and jobless claims still subdued, as the labor market remains healthy.
- Germany's machinery orders surge, suggesting possible light at the end of the tunnel.

U.S. productivity growth moderates, but trend still strong

U.S. nonfarm productivity increased at a slower-than-expected 1.2% annualized rate in Q4, as both output growth and hours worked moderated. On a y/y basis, productivity was up 1.6% and has eased over the course of 2024. Nevertheless, the 5-year productivity trend, which smooths over the short-term cyclical fluctuations and the y/y base effects, was little changed at 2.0%, markedly stronger than pre-pandemic, and basically in line with the long-run historical mean.

Strong productivity in this expansion has been the defining characteristic of American exceptionalism versus other developed economies. It faces, however, a potential downside risk from a loss in comparative advantage due to a surge in protectionism. Even so, we still expect steady U.S. productivity growth over the next decade, driven by AI and other technological advancements, as well as U.S. energy independence, as discussed in the *2025 NDR Capital Market Assumptions*.

Productivity trend is stronger than pre-pandemic

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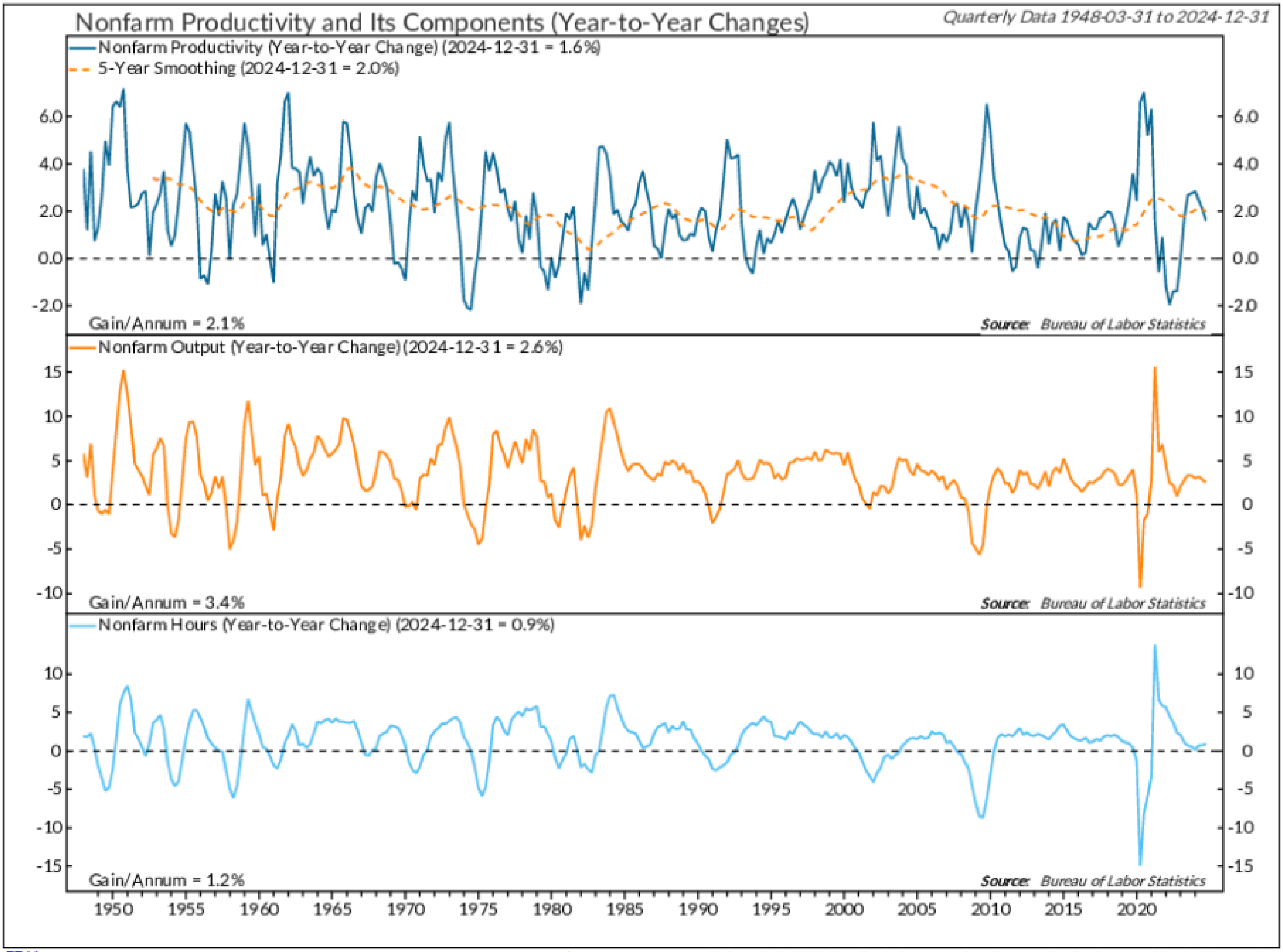

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In Q4, unit labor costs (ULC), or labor costs in excess of productivity, rose at a 3.0% annualized rate, the most in three quarters, although slightly less than expectations. On a smoothed y/y basis, ULC were up 2.6%, accelerating modestly in 2H 2024. The pace is stronger than pre-pandemic and suggests that the path to the Fed's 2% inflation target will be slow.

ULC growth implies core inflation > 2%

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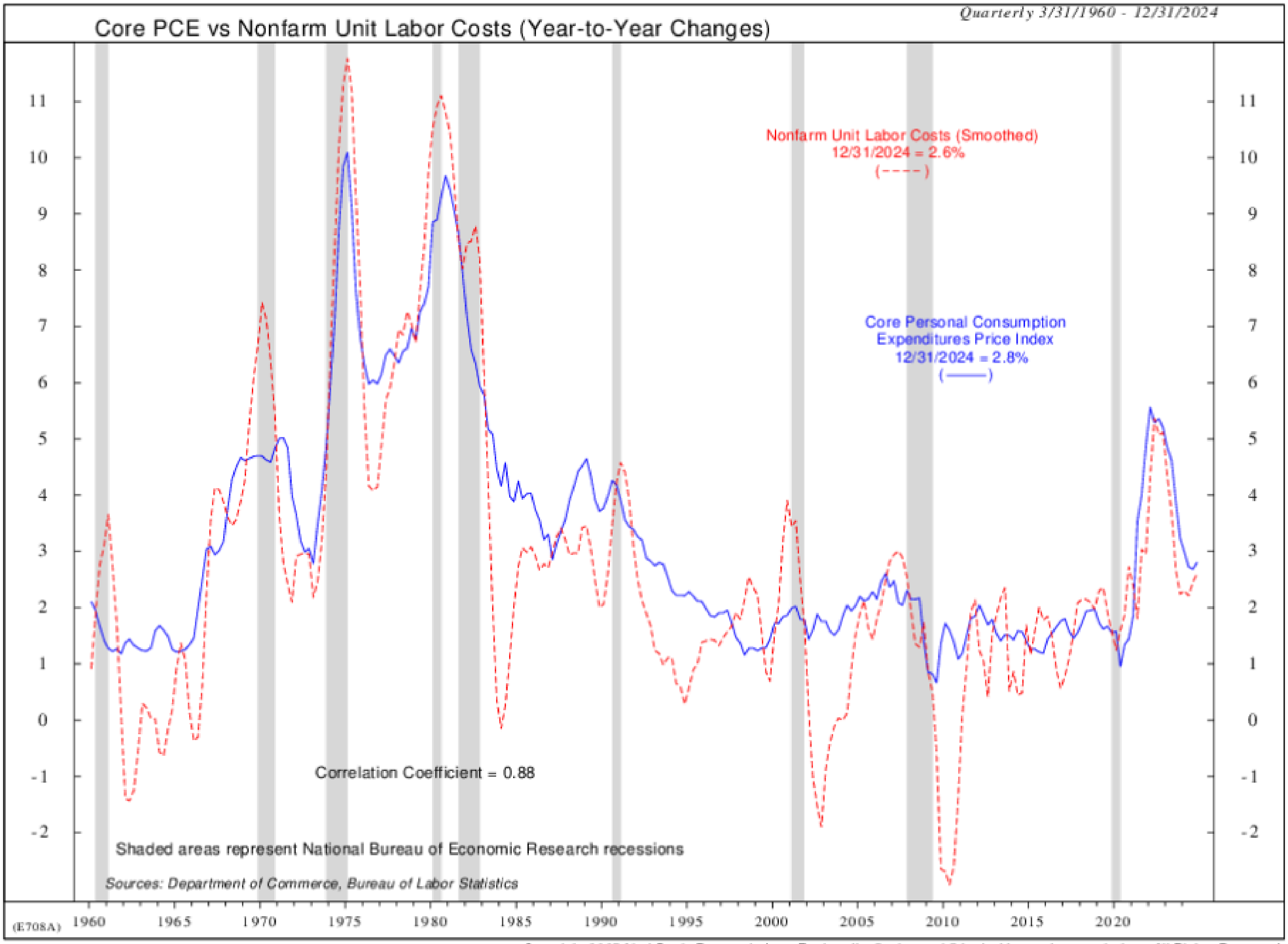

Jobless claims and layoff plans still subdued

Initial claims for unemployment insurance rebounded 11,000 last week to a slightly higher-than-expected 219,000. But this is still within the low range since late 2021, as labor demand remains healthy.

Continuing claims in the previous week also rebounded, up 36,000 to 1.886 million, although the insured jobless rate was unchanged at 1.2%. While this signals that it takes a bit longer to find a job than earlier in this cycle, it is still consistent with continued low unemployment.

Separately, Challenger layoff announcements picked up somewhat in January to 49,795, but that was lower than a year ago. Additionally, the 12-month average edged down, reflecting a trend of fewer job cuts.

All-in-all, the two reports confirm that businesses are holding on to their staff, even though job creation and hiring have moderated, as evidenced by recent JOLTS reports and other employment indicators.

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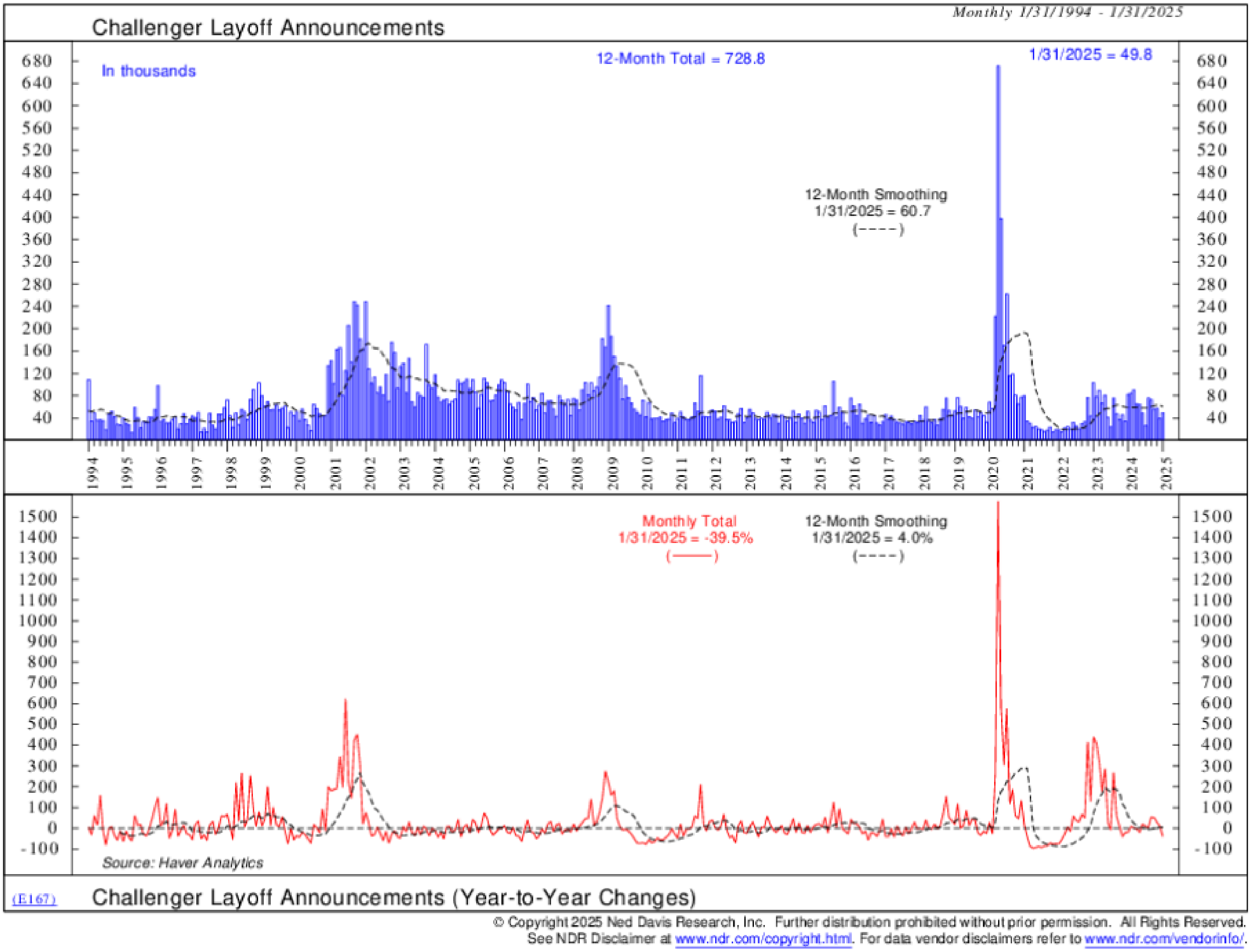

We project nonfarm payrolls will increase 125,000 in the January Employment Report tomorrow, which is below the current consensus of 170,000. Our estimate includes a notable downside effect on job growth from adverse weather (polar vortex, snowstorms, and wildfires). We will pay more attention to the household survey this month, which is less prone to weather distortions. We expect the unemployment rate to remain unchanged at 4.1%, in line with the consensus.

Germany's machinery orders surge, suggesting possible light at the end of the tunnel

In addition to some signs of life in Germany's PMIs for January, December's factory orders data, a leading indicator to manufacturing output, points to some further evidence of recovery. Orders surged a more-than-expected 6.9% from the prior month, led by a 14.6% jump in domestic orders, the most since July 2020 (indicating that this wasn't a result of foreign front-loading ahead of possible tariffs). While the trend in the y/y change of orders remains negative, the pace of decline has eased significantly, suggesting a modest recovery in Germany's economic growth.

Germany's economy has been in a long-term manufacturing-led rut, having experienced its second year of real GDP contraction in 2024. While the economy still faces downside risks associated with loss of competitiveness to China, the risk of U.S. tariffs, a quickly aging population, and prior dependency on Russia for its energy, adaptability to new energy sources and easier monetary policy may be pointing to a soft light at the end of the tunnel.

German factory orders showing signs of recovery

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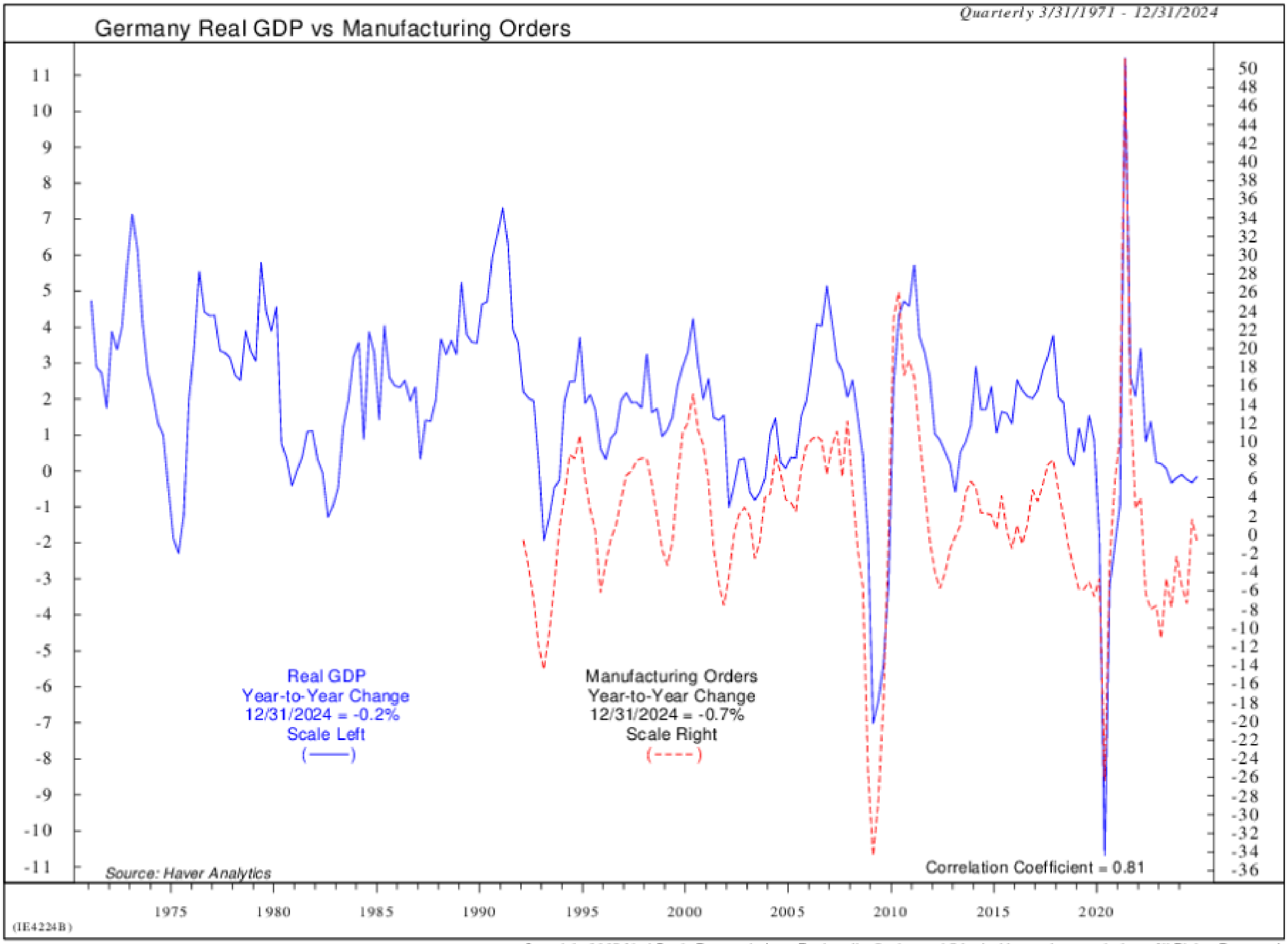

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