Northern Trust | Wayne Bowers: The Productivity Paradox – Five Factors to Consider

With a backdrop of continuing volatility and structural market issues taking center stage, it's difficult to sometimes see the genuine fundamental data that affects all economies. One such case is that of recent productivity figures, which may understate the true picture. Here's our five things to consider.

Do the figures show the full story? Official data shows a marked decrease in productivity across most developed markets from the turn of the century. When you look deeper, you see that in normal market cycles one would expect lower productivity accompanying higher inflation, as the result of production costs rising. Currently, this is not the case, as these lower inflation figures could be construed as casting doubt on the strength of productivity measures.

The ambiguity around productivity figures becomes more prevalent when you analyze the rise of corporate profit margins further. Just how are corporations able to sustain high profit margins in the face of slowing productivity growth? Well part of the answer is down to lower funding costs. Simply put, companies have been able to borrow at better rates, an outcome from the current low interest rate environment.

There have also been technological advances. Anecdotal stories are commonplace about companies able to slash costs through the use of automation to offset slowing revenues. The problem is that technological advancement mean there has been a shift from empowering the employee within their role, to potentially replacing them. This loss of earning power is also having a downward pressure on wage increases and demand.

Over the next five year period, we expect to see lower economic activity caused from government debt overhang and demographic changes in developed markets. These two factors will combine to force many baby boomers to focus on savings versus spending, as the state controls its debt burden by reducing benefits and assistance. This missing demand will further dampen growth development, supporting our continued view of lower for longer.

And finally, we have explained why we feel recent productivity figures are understating the situation. And we believe that they global economy could absorb increased demand. In a fast paced, media intensive financial environment, it's very easy to focus on the headline issues and recent market volatility. And yes, investors need to be aware of their effects. But fundamental data can show a surprisingly positive light on the situation.

Although low productivity measures may cause a cautionary stance, this may not affect corporate revenue growth, which may continue to improve, and thus, support a more constructive view on equity market risk.