Chief economist's comment

How hard do workers work?

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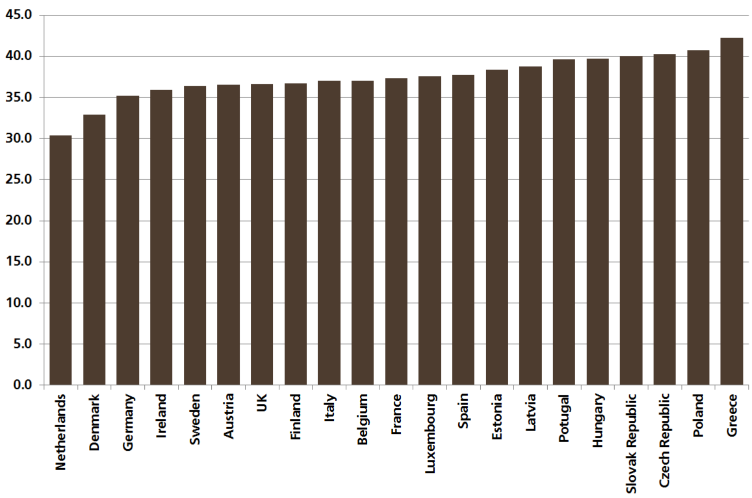
- How hard workers are working is important to investors.
- If a company's wage bill rises 5% but the workers work 10% harder, the shareholders are getting more for their money. This raises profit (equity relevant) and restrains price inflation (bond relevant).
- The low interest rates of recent years may have allowed some companies to continue in business, even though they have not been very productive. This holds down average productivity.
- There is evidence that, in each sector of the economy, strong companies have been a lot more productive than most of the sector. When a company is good, its productivity is likely to be very, very good.
- Investors should not focus too much on average productivity data, which may be distorted downwards by these developments.

The average German worker shows up for 35 hours per week. The average Greek worker shows up for 42 hours per week. A US citizen shows up at work for 38 hours, while Mexicans work 43 hours. Koreans work almost 44 hours a week. Does this mean that Koreans work the hardest? Not necessarily.

Average workweek in hours in the European Union



Source: OECD, as of 2016

The number of hours worked is not a very good economic indicator. The important question is how hard a worker works when at work. A long work day punctuated by regular tea breaks and hours surfing YouTube may not produce much that is of economic value.[1] A short work day of discipline and focus can produce higher output with fewer hours at the workplace. Hours worked is only part of the story. How hard a person can work matters as well.

How hard one works is what economists call "productivity." Productivity is an attempt to measure the economic value of what a worker does. Productivity will be influenced by the skills of the worker. If you are good at your job, you are likely to do more per hour worked. Productivity will be influenced by the quality of the tools available to the worker. A day spent shouting at a computer help desk in a vain attempt to get your laptop to work does not add much economic value. Productivity will also be influenced by the enthusiasm of the worker. A motivated worker will do more than a demoralized worker.

Productivity is hard to measure. It is also getting harder to measure as structural change and the rise of the service sector alter the economy. What is an economist's output worth? Obviously, the value of an economist's output is almost beyond price. It is hard to put a precise number on it. How many hours does an economist really work? Is it the eight hours a day of their contract? What about time spent thinking about economics at home? Surely that is work, even if it is not part of the hours in their contract? In a team environment, the productivity of one worker may also depend on the productivity of other workers.

Despite being hard to measure, how hard workers work is very important to an investor. If a company's wage bill rises 5%, but its workers work 10% harder, the company is getting a lot more for its money. Workers who work harder in this way produce bigger profits. As global labor markets get tighter, the question of whether workers are working harder becomes more important. This will determine profit and price inflation pressures. Profit matters to equities. Price inflation pressures matter to central bank policy and bond markets.

Normally, a company staffed by lazy workers will struggle to survive. Workers who do not work very hard will generally be high-cost, and this will eat away at profits. The very low interest rates of the last decade may have given lazy companies a lifeline. Research on large and medium-sized companies by the OECD suggests that low interest rates have let more lazy, unprofitable companies cling to life. A normal interest rate cycle would have killed off more of such companies. A lazy, unprofitable company has also clung to life for longer than in the past. A normal interest rate cycle would have killed these companies off far sooner.

More lazy, unprofitable companies clinging to life will drag average productivity lower. It also means that average productivity in an economy is less useful as a guide to how hard workers in good companies are working. OECD economists have found a productivity gap between leading companies and lagging companies, across all sectors of the economy. When it comes to productivity, those that are good are very, very good; those that are bad are mediocre. Since

2001, productivity growth in the top 5% of manufacturing companies has been almost five times that of the rest of the sector.

What does this mean? It means that average productivity – how hard workers work on average in an economy – is less and less useful to investors. An investor in a really good company should find that the workers are working harder, and that profits are better. Wage increases in a really good company need not produce higher price inflation, because hard work offsets the wage increase.

Conversely, low interest rates may have deluded investors in a lagging company. Average productivity will understate the laziness of the workers.

[1] This is not always true. Time spent surfing my YouTube videos may produce much economic value.

Appendix

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