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The Palos Perspective

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A Macro Market View by Hubert Marleau

Economic Power Results from Productivity

Productivity growth (output per hour worked) is a key driver of business activity because it allows an economy to expand progressively without creating annoying inflation.

So far, a lot of the discussion around productivity has been theoretical, with little focus on empirical evidence and with inputs rather than outcomes as the centre of attention. The theory of sustained growth through creative destruction is connected supposedly to technological advancements, breakthrough innovation, cheap energy, and transformative entrepreneurs that have a symbiotic relationship with R&D workers, to the extent that they are willing to risk huge sums of money on capital expenditures against prospective paybacks in the event of success, in the form of profits made by selling the product and/or service to a broad and enormous market - the bigger the better - or by reducing cost-to-income ratios with operating efficiencies.

The fact of the matter is that gains from AI are now becoming visible, with significant improvements showing up in either sales per employee, profit per worker, or both. In the last few weeks, Walmart, J.P Morgan, John Deere, SAP, Rolls-Royce, Grainger, Bank of America, PayPal and many others have reported publicly that their volume of business has risen, and so have their profit margins. Interestingly, it appears that a broad range of industries with low margins and heavy labour intensity - where huge opportunities lie - are adopting robots equipped with AI and AI models using "distillation" to produce cheap and powerful agents. According to Satya Nadella, the CEO of Microsoft, AI is bound to diffuse furiously and broadly because it is built on the rails of cloud mobile, bringing surplus growth throughout.

Indeed, recent data shows business productivity rose 4.9% in Q3 2025, following several quarters of superior growth - a surge that is still going on. A week ago, the Bureau of Labor Statistics reported another nice surprise when it revealed that new orders for non-defence capital goods made a new all-time high in November, rising 0.3% after a previous report of 0.5% advance in October, moving its path above long-term average. Capex is the precursor of growth and new orders are the precursor of capex. Put simply, the benefits are starting to pop up in traditional statistics.

It looks to me as if we might, indeed, be in a new productivity super cycle that has arrived without fanfare, like the one that characterised the second half of the 1990s. It's based on the "Jevons Paradox," the "Value of Time" and the "Substitution Effect": first as production mechanizes, when prices tend to fall, which in turn increases demand and, by ricochet, growth; secondly, as chores automate, where more time can be allocated to other things; and thirdly, as a replacement for slowing population growth. AI is like electricity: it's omnipresent and bound to become the underlying dynamics of the economy, thereby countering shaky geopolitics, rising public debt and dollar debasement, while boosting corporate profitability, supporting wage gains and increasing competition.

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