First Trust
Monday Morning OUTLOOK

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*
Andrew Opdyke, CFA – *Senior Economist*
Bryce Gill – *Economist*
Nate Gerze, CFA – *Economist*

630-517-7756 • www.ftportfolios.com December 29, 2025

Is Productivity Picking Up?

When it comes to interpreting the economy we put a premium on sobriety. One good piece of economic data doesn't mean a boom, nor does one bad report mean a bust. Sometimes a report with a good headline has details that aren't as strong; sometimes a report with bad headlines includes a silver lining that investors and other analysts overlook. Keeping that in mind, the most recent GDP report, combined with the fact that the stock market is on a tear, is causing a surge in optimism about underlying economic growth.

The economy grew at a 4.3% annual rate in the third quarter, the fastest growth for any quarter in the past two years. Moreover, given a continued decline in inventories in the third quarter, it looks like the fourth quarter will be solid, as well. In spite of the longest government shutdown on record, the Atlanta Fed's GDPNow model is tracking 3.0% real GDP growth for Q4.

But before we get into the reasons for optimism, let's start with the sobriety. Yes, a 4.3% growth headline is great, but there were plenty of caveats for the third quarter. We like to follow Core Real GDP, which includes consumer spending, business fixed investment, and home building, and excludes more volatile categories like government purchases, inventories, and international trade. Core Real GDP grew at a 3.0% annual rate in the third quarter and was up 2.6% versus a year ago. That's solid growth, not a boom.

Moreover, Real Gross Domestic Income (Real GDI), an alternative measure of the economy that is just as accurate as Real GDP, grew at a moderate 2.4% annual rate in Q3. An economic boom, that is not.

But here's why this report bolsters the case for optimism. If real GDP grows at a 3.0% pace in Q4, then it will be up 2.6% in 2025 (Q4/Q4) even though immigration policy has gone from de facto open borders in the prior four years to the strictest immigration enforcement since at least the early 1960s. In turn, if real GDP growth is solid even though it is no longer being artificially inflated by a surge in foreign-born workers, that suggests productivity growth (output per hour) is picking up. And that's important because productivity growth is the key to raising living standards over the long run.

From the economic peak in late 2007 before the Financial Panic of 2008-09 until the end of 2016, the economy grew at a pathetic 1.5% annual rate while productivity grew at a mediocre 1.4% annual rate. Since then, real GDP has grown at a 2.5% annual rate while productivity has grown at a 1.9% rate.

Many economists, investors, and pundits look at this improvement in economic growth, and the recent consensus-beating reports on the economy and see reasons to be bullish on the economy and stock market. It may be that the benefits of Artificial Intelligence are starting to take hold. In the meantime, the Trump Administration is cutting regulations, holding tax rates down, and canceling significant government-sponsored mal-investment into alternative energy. For the first time in a long time, the federal government cut discretionary spending this past fiscal year. A smaller, less intrusive government is good for growth.

But all of this potential good news can't be viewed in a vacuum. Maybe, just maybe, technology is improving things faster than the government can mess them up. And maybe, just maybe, a shift toward better government policy is pushing things along. But there are also many reasons to be skeptical of recent economic data. COVID era lockdowns, Quantitative Easing, and huge deficits have impacted the economy in ways few understand. And by every traditional measure the stock market is overvalued. In other words, while the underlying economy appears to be getting stronger, maybe it's just a mirage.

To put all this succinctly, while recent news seems very optimistic this doesn't guarantee we are on the cusp of an economic boom like that of the 1980s and 1990s. That boom coincided with significantly lower marginal tax rates, a tight money Fed and the end of the 1970s inflation, welfare reform, Medicare reforms, and a reduction in government spending as a share of GDP. And this happened while the demographic impact from Baby Boomers was at its peak.

At present, many Boomers are riding off into the economic sunset and the government is much bigger than it was in the 1990s, both in terms of spending and regulation. So, while many can view recent years, or even recent quarters, as evidence that the underlying economy is improving, we believe much more work is needed for a return to 1990s-like growth. Enjoy this holiday season! Next week we will share our outlook for 2026 and beyond.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-30 / 8:45 am	Chicago PMI – Dec	40.0	**37.8**		36.3
12-31 / 7:30 am	Initial Claims – Dec 27	218K	**216K**		214K