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Q1 Productivity (Final)

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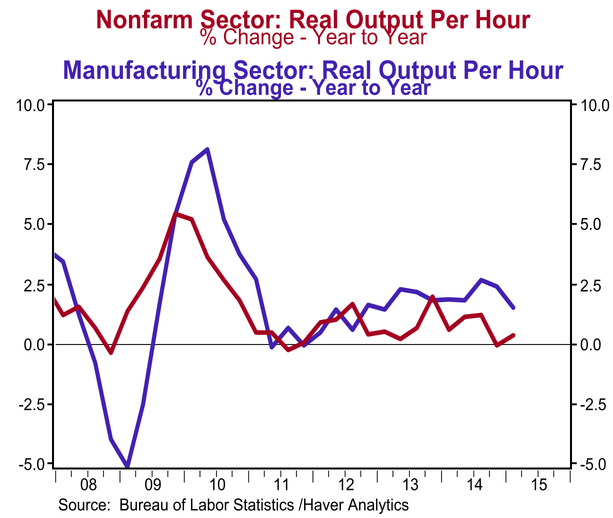
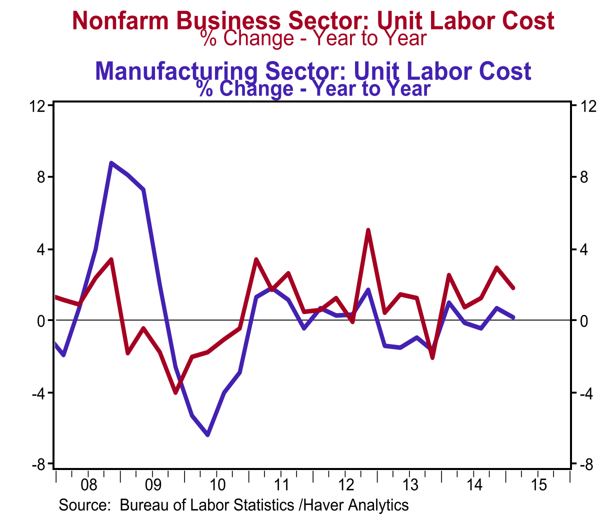
- Nonfarm productivity (output per hour) declined at a 3.1% annual rate in the first quarter, revised lower from last month's -1.9% estimate. Nonfarm productivity is up 0.3% versus last year.

- Real (inflation-adjusted) compensation per hour in the nonfarm sector increased at a 6.5% annual rate in Q1 and is up 2.2% versus last year. Unit labor costs rose at a 6.7% rate in Q1 and are up 1.8% versus last year.

- In the manufacturing sector, productivity declined at a 1.0% annual rate in Q1, a smaller dip than among nonfarm business as a whole. The slower decline in productivity growth compared to the nonfarm sector as a whole was due to a slower decline in output along with a decline in hours. Real compensation per hour was up in the manufacturing sector (5.5%) and unit labor costs rose at a 3.4% annual rate.





Implications: No surprise here. Productivity growth in the first quarter was revised lower, consistent with last week's downward revision to real GDP. According to the official data, nonfarm productivity declined at a 3.1% annual rate in Q1. Output declined 1.6%, while hours climbed 1.6%, so output *per hour* fell. The key part of today's report was that unit labor costs – how much companies have to pay workers per unit of output – increased at a 6.7% annual rate in the first quarter and are up at a 2.2% annual rate in the past two years, signaling the kind of compensation pressure that will get the attention of the Keynesians at the Federal Reserve. That's why we still think the Fed will seriously consider raising short-term rates at the meeting in two weeks. The official measure of productivity is up 0.3% from a year ago, but we suspect the government is underestimating output in the service sector, which means economic growth and productivity are higher than the official data show. Remember when you had to look in separate places for the weather, directions, business contacts, email, news, taxis… the list goes on and on. Now all you have to do is reach into your pocket, or for some, look at your watch. We believe the figures from the government miss the value of these improvements, which means our standard of living is improving faster than the official reports show. Still, even on the manufacturing side, where it's easier to measure output per hour, productivity is up only 1.5% in the past year. This is consistent with overall productivity growth of 1.5% on average per year from 1973 through 1995. However it's slower than the 2.1% average per year since 1995. In spite of the problems with measurement, we anticipate faster productivity growth over the next few years as new technology increases output in all areas of the economy. The declining unemployment rate and faster growth in wages should create more pressure for efficiency gains, while the technological revolution continues to provide the inventions that make those gains possible. Overall, for 2015-16, we look for faster productivity growth than in the past two years. In other news this morning, new claims for jobless benefits declined 8,000 last week to 276,000. Meanwhile, continuing claims fell 30,000. These are the very last inputs into our payroll models, which suggests tomorrow's employment report will show a nonfarm gain of 240,000 for May, another month of solid improvement in the labor market.

Productivity and Costs *(% Change, All Data Seasonally Adjusted)*	Q1-15	Q4-14	Q3-14	Q2-14	Y to Y % Ch. *(Q1-15/Q1-14)*	Y to Y % Ch. *(Q1-14/Q1-13)*
Nonfarm Productivity	**-3.1**	-2.1	3.9	2.9	0.3	0.6
- Output	**-1.6**	2.6	6.3	5.5	3.2	2.4
- Hours	**1.6**	4.9	2.4	2.5	2.8	1.8
- Compensation (Real)	**6.5**	4.2	1.7	-3.3	2.2	1.7
- Unit Labor Costs	**6.7**	5.6	-1.0	-3.7	1.8	2.5
Manufacturing Productivity	**-1.0**	0.0	3.4	3.7	1.5	1.9
- Output	**-1.1**	4.4	4.9	7.3	3.8	2.4
- Hours	**-0.1**	4.4	1.4	3.4	2.3	0.5
- Compensation (Real)	**5.5**	5.1	1.0	-4.2	1.8	1.5
- Unit Labor Costs	**3.4**	4.2	-1.3	-5.4	0.2	1.0

Source: US Department of Labor