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Data Watch

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Q2 PRODUCTIVITY (PRELIMINARY)

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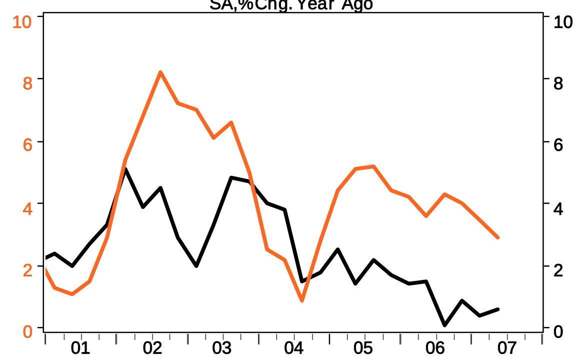
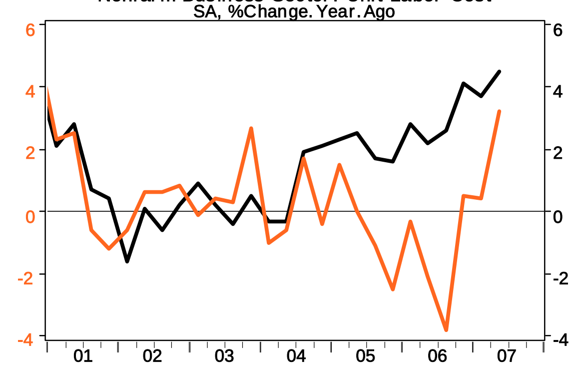
- Non-farm productivity (output per hour) increased at a 1.8% annual rate in the second quarter, slightly less than the 2% rate the consensus expected. Non-farm productivity is up 0.6% versus a year ago.

- Real (inflation-adjusted) compensation per hour in the non-farm sector declined at a 2.0% annual rate in the second quarter but is up 2.4% versus a year ago. Unit labor costs increased at a 2.1% rate in the second quarter and are up 4.5% versus a year ago.

- In the manufacturing sector, second quarter growth rates for productivity (1.6%), compensation (2.8%), and unit labor costs (1.2%) were all lower than for the non-farm sector as a whole. However, versus a year ago, the manufacturing sector is still beating the non-farm business sector in productivity (2.9% versus 0.6%) and compensation (6.2% versus 5.2%).



Source: Bureau of Labor Statistics /Haver Analytics



Source: Bureau of Labor Statistics /Haver Analytics

Implications: Productivity growth was mediocre in the second quarter but will probably be revised higher next month because real GDP growth will probably be revised upward. More output means more output per hour. Perhaps more importantly, productivity has only grown at a 1.2% annual rate in the past three years. It is possible that the large increases in federal spending and regulation over the past several years are starting to weigh on the economy. However, at this point, we are not convinced that this represents a permanent slowdown from the acceleration in productivity growth in the late 1990s and the early part of this decade. A similar slowdown occurred in the mid-1990s. Productivity growth in Q2 was the fastest since early 2006 and we expect further productivity acceleration in the year ahead as output growth revives. Also, we are not concerned by the increase in unit labor costs. Labor compensation is still a relatively small share of income (as opposed to corporate profits). For labor's share of income to return toward its normal level, unit labor costs have to rise faster than inflation. However, the Fed will be troubled by rising labor costs, supporting our view that a rate cut is nowhere in sight.

Productivity and Costs *(% Change, All Data Seasonally Adjusted)*	Q2-07	Q1-07	Q4-06	Q3-06	Y to Y % Ch. *(Q2-07/Q2-06)*	Y to Y % Ch. *(Q2-06/Q2-05)*
Nonfarm Productivity	**1.8**	0.7	1.8	-1.6	0.6	1.5
- Output	**4.2**	0.3	2.6	0.8	2.0	3.6
- Hours	**2.3**	-0.3	0.8	2.4	1.3	2.0
- Compensation	**3.9**	3.7	12.2	1.3	5.2	3.8
- Unit Labor Costs	**2.1**	3.0	10.3	2.9	4.5	2.2
Manufacturing Productivity	**1.6**	1.7	2.0	6.5	2.9	3.6
- Output	**3.5**	0.9	-2.1	4.8	1.7	5.4
- Hours	**1.8**	-0.8	-4.0	-1.6	-1.2	1.8
- Compensation	**2.8**	6.8	14.2	1.4	6.2	1.3
- Unit Labor Costs	**1.2**	5.0	12.0	-4.8	3.2	-2.1
Durable Goods Productivity	**4.7**	1.6	2.7	9.3	4.5	6.3
Nondurable Goods Productivity	**-1.9**	1.2	1.0	2.4	0.6	1.1

Source: US Department of Labor