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Q1 Productivity (Preliminary)

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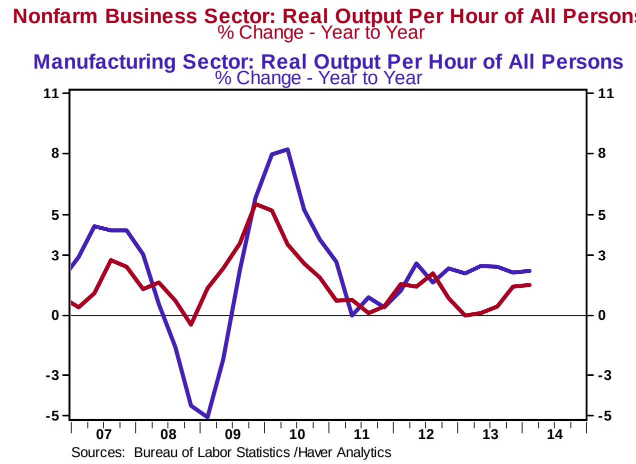
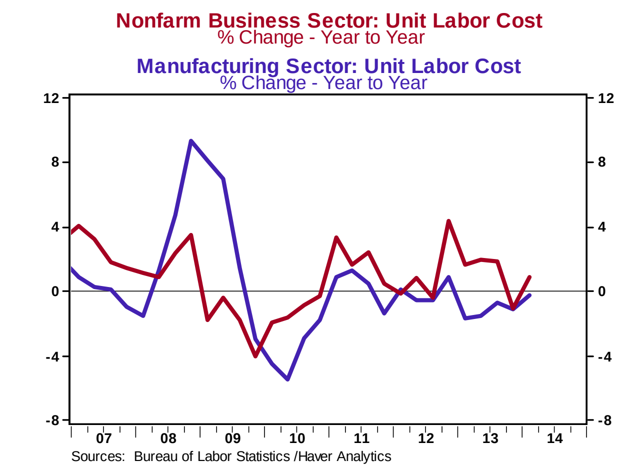
- Nonfarm productivity (output per hour) declined at a 1.7% annual rate in the first quarter versus a consensus expected decline of 1.2%. Nonfarm productivity is up 1.4% versus last year.

- Real (inflation-adjusted) compensation per hour in the nonfarm sector was up at a 0.5% annual rate in Q1 and is up 0.9% versus last year. Unit labor costs increased at a 4.2% rate in Q1 and are up 0.9% versus a year ago.

- In the manufacturing sector, productivity was up at a 3.3% annual rate in Q1, much better than among nonfarm businesses as a whole. The faster gain in manufacturing productivity was due to faster growth in output and a decline in hours. Real compensation per hour grew at a 1.4% annual rate in the manufacturing sector, while unit labor costs rose at a 0.1% rate.





Implications: After three consecutive quarterly increases, nonfarm productivity fell at a 1.7% annual rate in Q1. This was not due to falling production; output increased at a 0.3% rate. Instead, productivity declined because the number of hours worked increased much faster than output, which means output *per hour* declined. In spite of the decline in Q1, productivity is still up 1.4% from a year ago. More importantly, we think government statistics underestimate actual productivity growth. There are many examples, in every area of the economy, but the service sector is particularly hard to measure. Drivers used to buy road atlases, and then GPS devices to help them navigate; now they download free apps that are more accurate and provide optimal routes through real-time traffic patterns. Travelers used to guess, hit-or-miss, where to go for a meal. Now they can use free services to tell them what restaurants are close and provide reviews. 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. Sectors of the economy that are easier to measure show more rapid productivity growth. In manufacturing, productivity surged at a 3.3% annual rate in Q1 and is up 2.2% from a year ago. Yes, the surge in Q1 was, in part, due to a decline in hours, but manufacturing hours are up 0.2% in the past year. In spite of these problems with measurement, we anticipate faster productivity growth over the next few years as new technology increases output growth in all areas of the economy.

Productivity and Costs *(% Change, All Data Seasonally Adjusted)*	**Q1-14**	**Q4-13**	**Q3-13**	**Q2-13**	**Y to Y % Ch.** ***(Q1-14/Q1-13)***	**Y to Y % Ch.** ***(Q1-13/Q1-12)***
Nonfarm Productivity	**-1.7**	2.3	3.5	1.8	1.4	0.0
- Output	**0.3**	3.8	5.4	3.3	3.2	1.5
- Hours	**2.0**	1.4	1.9	1.5	1.7	1.6
- Compensation (Real)	**0.5**	0.6	-0.7	3.3	0.9	-0.1
- Unit Labor Costs	**4.2**	-0.4	-2.1	2.0	0.9	1.6
Manufacturing Productivity	**3.3**	1.3	0.5	3.7	2.2	2.0
- Output	**1.8**	4.7	1.7	1.5	2.4	3.2
- Hours	**-1.4**	3.4	1.1	-2.2	0.2	1.1
- Compensation (Real)	**1.4**	0.1	-1.5	2.4	0.6	-1.3
- Unit Labor Costs	**0.1**	0.1	-0.1	-0.8	-0.2	-1.7

Source: US Department of Labor