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Q2 Productivity (Final)

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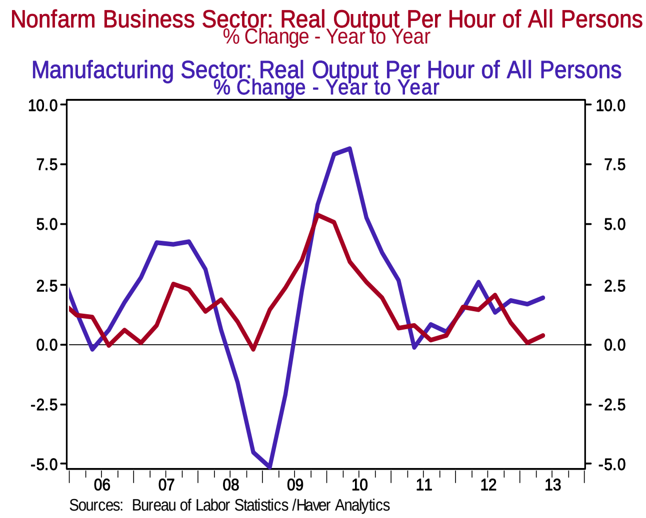
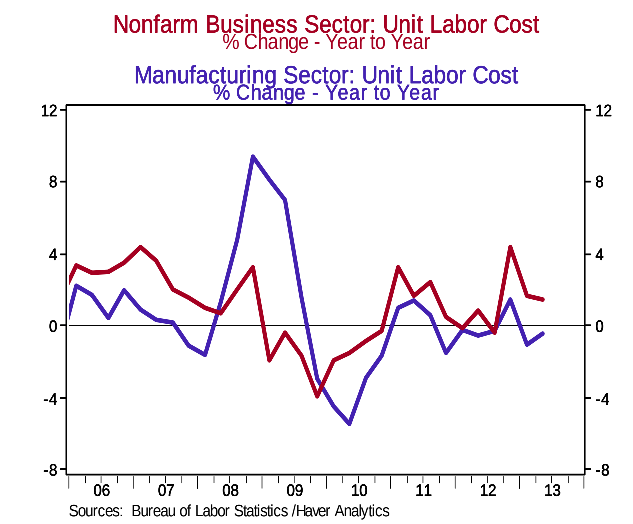
- Nonfarm productivity (output per hour) increased at a 2.3% annual rate in the second quarter, revised up from last month's estimate of 0.9%. Nonfarm productivity is up 0.3% versus last year.

- Real (inflation-adjusted) compensation per hour in the nonfarm sector rose at a 2.3% annual rate in Q2 and is up 0.3% versus last year. Unit labor costs were unchanged in Q2 but are up 1.5% versus a year ago.

- In the manufacturing sector, the Q2 growth rate for productivity (1.9%) was slower than among nonfarm businesses as a whole. The slower pace in productivity growth was due to a drop in output in that sector. Real compensation per hour was up in the manufacturing sector (+4.2%), and due to the decline in output, unit labor costs rose at a 2.3% annual rate.

Implications: Productivity growth in the second quarter was revised up sharply, to a healthy 2.3% annualized pace, largely due to upward revisions to GDP released last week. In the past three years, productivity is up at only a 0.8% annual rate, noticeably slower than the average gain of 2.3% since 1996. However, we do not think the productivity revolution has come to an end. It is not unusual for productivity to surge at the very beginning of a recovery and then (temporarily) slow down as hours worked increase more rapidly. This is exactly what we have seen. Since the end of 2008, productivity is up at a 1.9% annual rate, not too much different than the longer term trend. We would have to see productivity stagnate for at least another couple of years before being able to reach any conclusions about a structural downshift in its growth rate. For now, the long-term trend in productivity growth should remain healthy due to a technological revolution centered in computer, communications, and engineering advances. Manufacturing productivity, which is easier to measure than overall productivity, is still up at a 1.4% annual rate in the past three years. In other news this morning, the ADP employment index, which measures private sector payrolls, increased 176,000 in August, very close to consensus expectations. New claims for unemployment insurance declined 9,000 last week to 323,000; continuing claims for regular state benefits dropped 43,000 to 2.95 million. Plugging all these figures into our models, our final forecast for August payrolls is 148,000 nonfarm and 151,000 private. The official Labor Department report will be released tomorrow morning and our projections are below the consensus of 180,000 for both nonfarm and private. However, we also expect the initial report on August payrolls will be revised up substantially in later months. In other words, a below-consensus report tomorrow morning is not a reason for concern and shouldn't prevent the Federal Reserve from tapering quantitative easing.





Productivity and Costs (% Change, All Data Seasonally Adjusted)	Q2-13	Q1-13	Q4-12	Q3-12	Y to Y % Ch. (Q2-13/Q2-12)	Y to Y % Ch. (Q2-12/Q2-11)
Nonfarm Productivity	**2.3**	-1.7	-1.7	2.5	0.3	1.4
- Output	**3.7**	-0.3	0.7	4.1	2.1	3.5
- Hours	**1.4**	1.5	2.4	1.6	1.7	2.1
- Compensation (Real)	**2.3**	-6.6	7.5	-1.3	0.3	0.3
- Unit Labor Costs	**0.0**	-3.5	11.8	-1.8	1.5	0.8
Manufacturing Productivity	**1.9**	3.8	2.3	-0.3	1.9	2.6
- Output	**-0.6**	5.4	2.7	0.1	1.9	5.1
- Hours	**-2.4**	1.6	0.4	0.4	0.0	2.4
- Compensation (Real)	**4.2**	-2.1	1.9	-3.8	0.0	0.1
- Unit Labor Costs	**2.3**	-4.2	1.8	-1.5	-0.5	-0.6

Source: US Department of Labor