Economic Analysis

Productivity Plunged in 1Q15 While Labor Costs Rose

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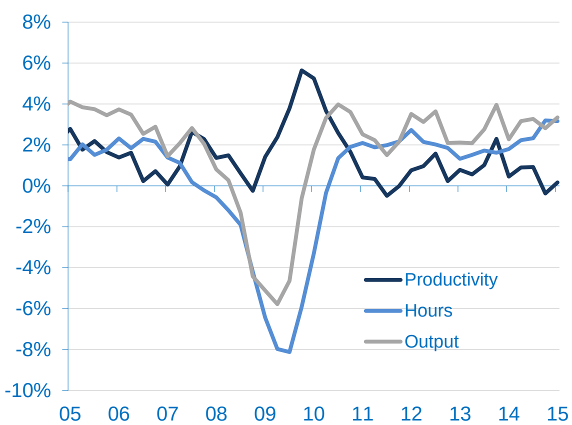
- **Productivity declined for the second consecutive quarter, dropping 3.1% in 1Q15**
- **Unit labor costs and compensation increased, signaling tightening labor market**
- **We expect stronger productivity growth in upcoming quarters**

Nonfarm business sector productivity, defined as real output per hour of all persons, was revised down to -3.1% QoQ SAAR in 1Q15, following a 2.1% decrease in the previous quarter. This marks the first time since mid-2006 that productivity growth has held below zero for two consecutive quarters. On a YoY basis, productivity was slightly positive, but only because of the even bigger drop (-4.7% QoQ SAAR) seen in 1Q14. Given what we already know about the weak start to 2015, this downward revision is not so surprising. Furthermore, the series is volatile and often undergoes significant revisions for each quarter. On a positive note, the underlying details point to increased compensation and hours worked, suggesting that businesses are preparing themselves for periods of higher output when demand picks up again.

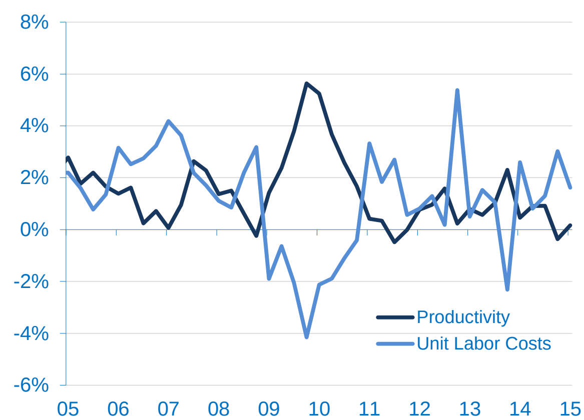
Interestingly, although real output fell 1.6% QoQ SAAR, hours worked increased 1.6%. Unit labor costs, defined as the price of labor per single unit of output, surged 6.7%. This is primarily due to a rise in compensation per hour, which increased for a third consecutive quarter, up 3.3% in 1Q15. Real compensation per hour jumped a massive 6.5%, the strongest increase since 4Q12. This adds to other signs of higher wage growth that we have seen as of late, including the Employment Cost Index, and it likely points to further progress as the labor market continues to tighten gradually. Employers could be hiring more labor to prepare for stronger expected demand in the near future, which may be contributing to current weakness in output and productivity.

Chart 1
Productivity, Hours, and Output (YoY % Change)



Source: BLS & BBVA Research

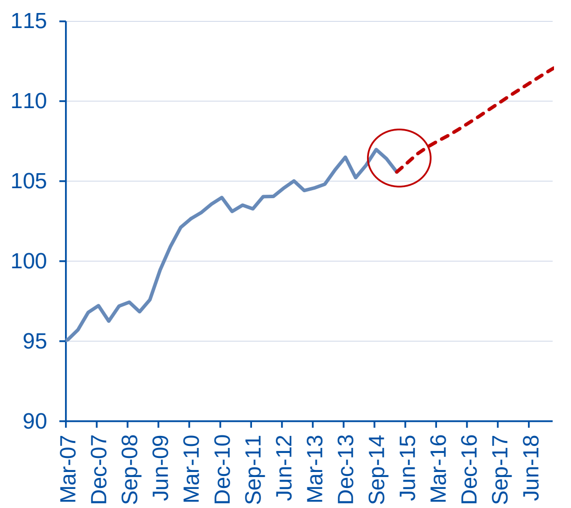
Chart 2
Productivity and Unit Labor Costs (YoY % Change)



Source: BLS & BBVA Research

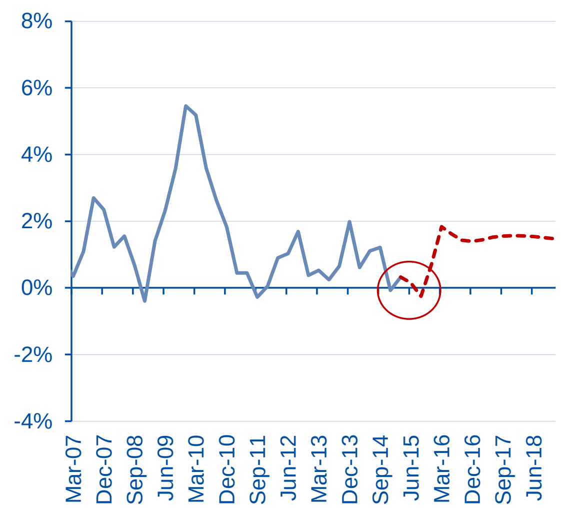
Overall, post-recession productivity remains disappointing, with few strong gains and much slower annual growth since the financial crisis. However, it is important to remember that much of the pre-crisis productivity growth of the 1990s and early 2000s stemmed from significant technological innovation that is unlikely to be repeated in such a drastic manner any time soon. Still, we should be seeing stronger productivity than what we have now, particularly if we are headed back to an environment of 3.0% real GDP growth or higher in the coming years. Assuming that output picks up throughout the rest of this year, and hours worked remain steady, then we should see stronger productivity growth throughout the next few quarters. However, we will continue to monitor the ongoing volatility in this series. For instance, we are likely to see a slightly negative YoY figure for the third quarter given that productivity reached an all-time high in 3Q14 that has not been touched since.

Chart 3
Nonfarm Business Sector Productivity Forecasts (SA, 2009=100)



Source: BLS & BBVA Research

Chart 4
Nonfarm Business Sector Productivity Forecasts (YoY % Change)



Source: BLS & BBVA Research

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