Datanote: U.S. Productivity, Q1

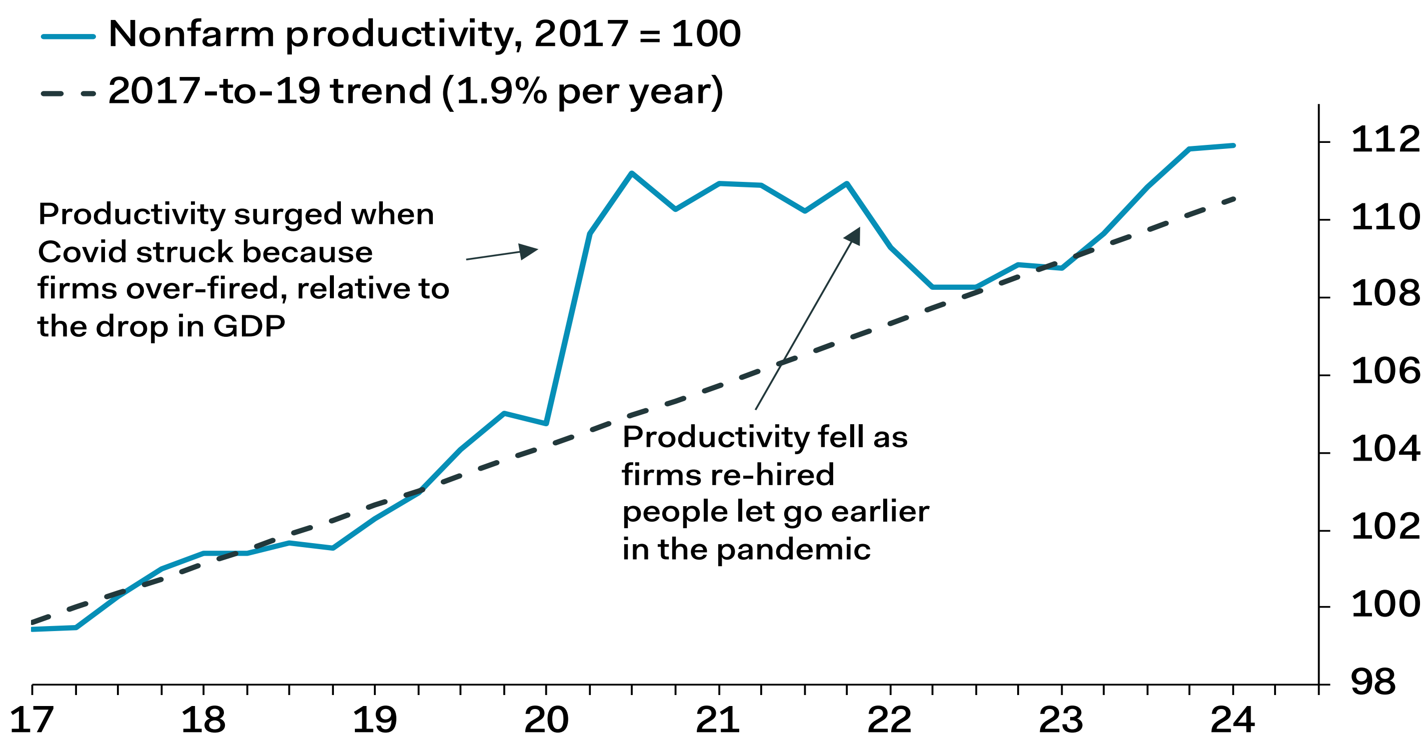
In one line: Still well above level implied by the pre-Covid trend.

- Q1 productivity rose at a 0.3% rate, slightly below the consensus, 0.5%.
- Unit labor costs rose at a 4.7% rate, above the consensus, 4.0%.

The subpar quarter-on-quarter rise in productivity in Q1 is well within the bounds of the usual volatility and follows a three quarter spurt over which growth averaged 3.8%. As a result, the underlying trend in productivity growth still looks very healthy; output per hour rose 2.9% year-over-year in Q1 and was 1.2% above the level it would have reached, if the 2017-to-19 trend—growth of 1.9% a year—had been sustained through the pandemic and afterwards.

Admittedly, the four-quarter average of year-over-year growth in real business investment in equipment, IP and software slowed to 1.9% in Q1—its lowest rate for three years—from 2.2% in Q4, suggesting that further productivity gains might be harder for firms to attain this year. Nonetheless, we remain upbeat about the medium-term outlook for productivity, not least because we expect the AI boom to continue apace.

Meanwhile, the Q1 jump in unit labor costs is chiefly the consequence of the temporary slowing in productivity growth. But 1.8% year-over-year growth in ULC is easily consistent with the inflation target and supports the Fed's view that the labor market has moved into better balance. Core CPI inflation will revert to the 2% target as soon as CPI rents for existing tenants catch up with the downshift in new tenant rent inflation, and the loosening of the labor market works through into lower non-rent services inflation.


Nonfarm productivity, 2017 = 100
2017-to-19 trend (1.9% per year)
Productivity surged when Covid struck because firms over-fired, relative to the drop in GDP
Productivity fell as firms re-hired people let go earlier in the pandemic
112
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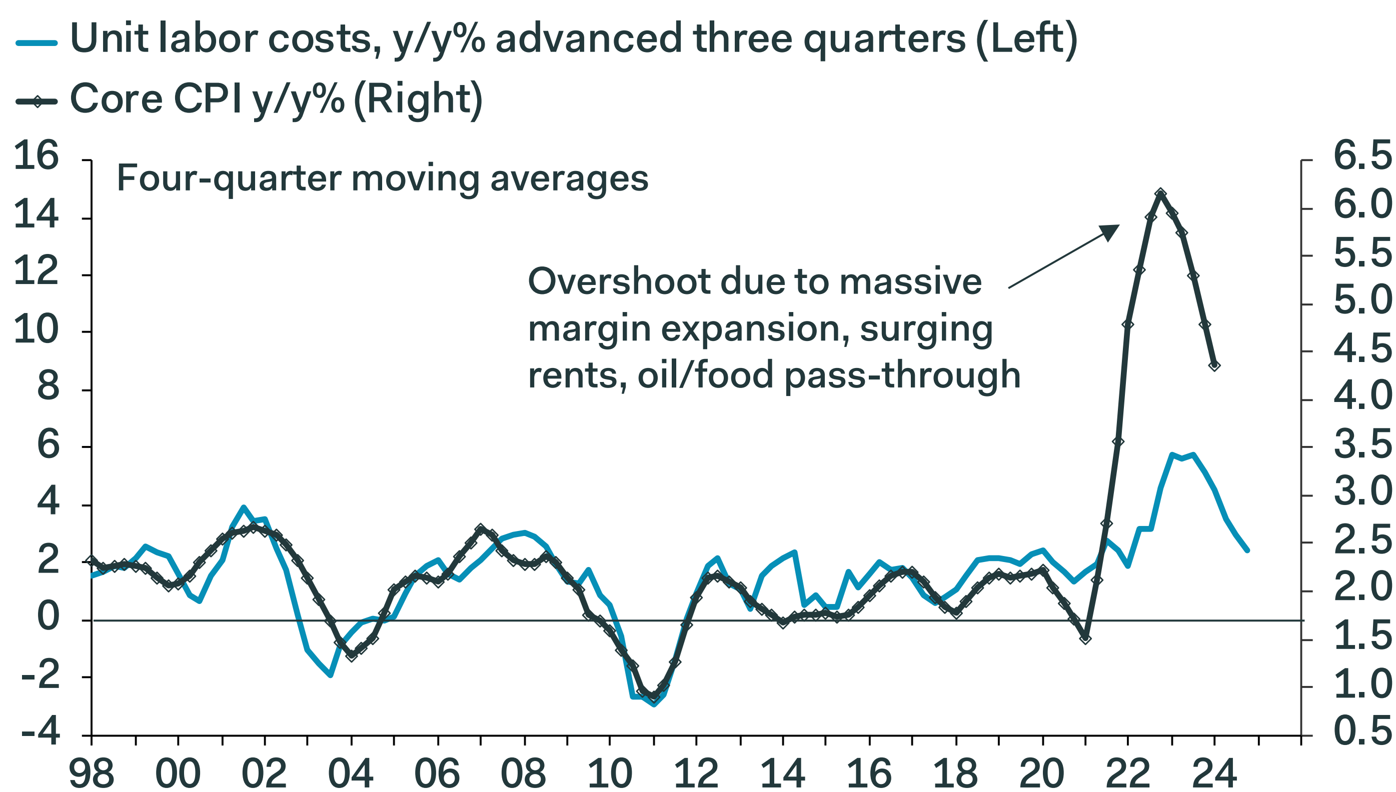
Unit labor costs, y/y% advanced three quarters (Left)
Core CPI y/y% (Right)
Four-quarter moving averages
Overshoot due to massive margin expansion, surging rents, oil/food pass-through
16
14
12
10
8
6
4
2
0
-2
-4
6.5
6.0
5.5
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