Economic Indicator — August 7, 2025

Productivity: Through the Ups and Downs, Firm Trend

Summary

Output per hour worked increased at a 2.4% annualized rate in Q2, bouncing back from the prior quarter's decline and helping to keep the underlying trend in nonfarm labor productivity growth solid. Unit labor costs rose at a 1.6% annualized rate and the four-quarter moving average is up 2.2% over the past year. As such, the still solid pace of nominal compensation growth remains unlikely to be the force that keeps inflation meaningfully above the Fed's 2% inflation target.

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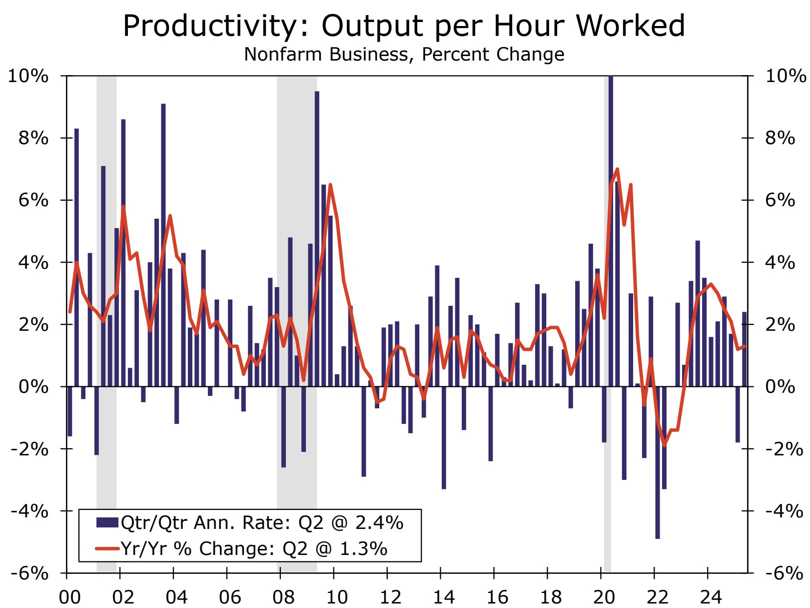
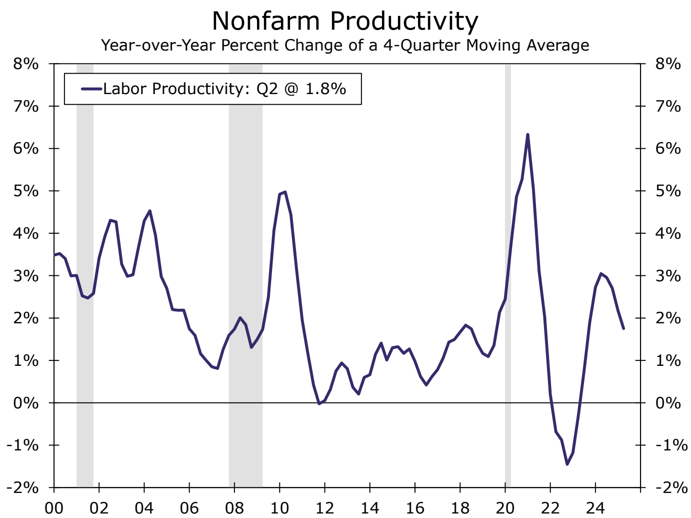


Source: U.S. Department of Labor and Wells Fargo Economics

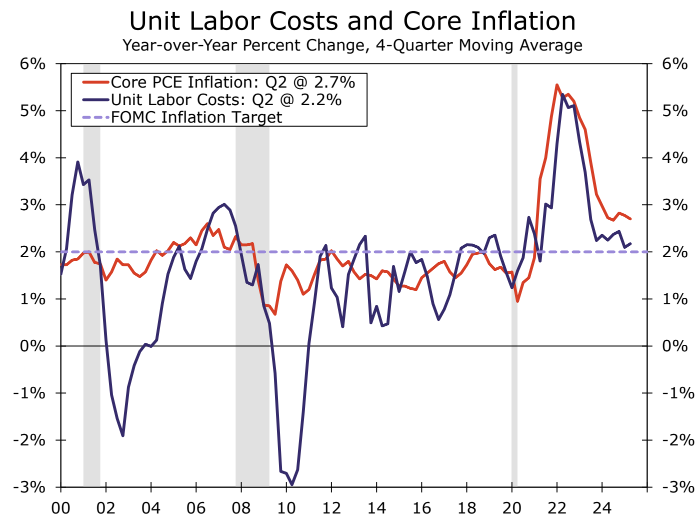
Q2 Productivity Rebound Keeps Unit Labor Costs Friendly for Inflation

Amid lingering concerns about inflation and more recent worries of economic activity wobbling, the firm trend in labor productivity is a welcome bright spot. Output per hour worked increased at a 2.4% annualized rate in the second quarter, bouncing back from the prior quarter's decline (chart). The rebound was underpinned by a sharp recovery in output growth (+3.7% annualized) that outpaced a 1.3% annualized gain in hours worked. While a solid outturn, output has been more volatile than usual due to massive swings in trade flows, which has distorted readings of productivity recently.

Smoothing with a four-quarter moving average, nonfarm labor productivity is up 1.8% year-over-year (chart). This pace matches its average annualized increase since the end of 2019 and is notably stronger than the past cycle's average of 1.5%. With workers more productive, firms have generally enjoyed increased profitability and employees have seen real earnings growth. Solid productivity growth also provides firms the flexibility to absorb higher costs of production without needing to mark up their selling prices to the same degree, which could help to counterbalance the inflationary impulse from tariff-related price pressures today.



Source: U.S. Department of Labor and Wells Fargo Economics



Source: U.S. Department of Labor and Wells Fargo Economics

The second quarter's rebound in productivity growth coincided with a strong gain in labor costs. Hourly compensation rose at a 4.0% annualized rate, a bit firmer than the separately reported and less volatile Employment Cost Index. Over the past year, hourly compensation is up 3.9%, running ahead of its pre-pandemic (2010-2019) average of 2.5%. Despite the strength in nominal compensation growth, the labor market's inflationary impulse has been quelled by the solid trend in productivity growth. Unit labor costs (ULCs), which can be thought of as the productivity-adjusted cost of labor, rose at a 1.6% annualized rate in Q2 and the four-quarter average is up 2.2% over the past year (chart). As such, the still-solid pace of nominal compensation growth remains unlikely to be the force that keeps inflation meaningfully above the Fed's 2% inflation target, thanks to the firm trend in productivity.

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