Rising Productivity, Lower Labor Costs and Factory Weakness Increase Rate Cut Probability

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Improved second quarter labor productivity and a slowdown in labor costs further increases the likelihood of a September rate cut, while the Bank of England's first easing move in over four years adds additional pressure on the Fed.

Nonfarm productivity rose at an annualized rate of +2.3% in the second quarter, above the +1.8% median forecast and considerably higher than the revised +0.4% gain in Q1. On a year-over-year basis, productivity growth actually slowed from +2.9% to +2.7%, but it has now been *five consecutive quarters of solid increase.*

During the early days of the pandemic, labor productivity skyrocketed as Americans were forced to embrace new technologies. But those gains had ended by Q4 2020, turning alarmingly negative over a two-year period before staging the recent revival. An obvious solution for the too-lean U.S. labor force is enhanced productivity/technology, which in theory should reduce labor costs and by extension, overall inflation. Unit labor costs rose at a much cooler +0.9% annualized rate in Q2, down from +3.8% in the previous quarter.

In other news this morning, initial jobless claims climbed to 249k last week, *the highest number of Americans filing for unemployment benefits in nearly a year*, although much of the spike has been attributed to the annual auto factory retooling period.

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The ISM Factory survey indicated further softening in July. The composite manufacturing index slipped further into contraction territory at 46.8, the lowest since last November. (*Any number in this series below 50 indicates contraction.*) The employment index dropped from 49.3 to 43.4 as an increased number of purchasing managers expect to hire fewer workers in the coming months, while the new orders index fell from 48.5 to 47.4, hinting at still weaker factory growth in the coming months. There is still some lingering price pressure as the prices paid index crept up from 52.1 to 52.9.

Fed Chairman Powell told market participants yesterday that incoming economic data would determine future Fed actions. This morning's releases point to an easing move at the next FOMC meeting, while cuts already made by other central banks will raise the question of whether the Fed may have waited too long.

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The futures market is currently indicating quarter point reductions at each of the next four FOMC meetings.

Market Indications as of 9:48 A.M. Central Time

DOW	Down -322 to 40,521 (HIGH: 41,198)
NASDAQ	Down -105 to 17,494 (HIGH: 18,647)
S&P 500	Down -14 to 5,509 (HIGH: 5,667)
1-Yr T-bill	current yield 4.69%; opening yield 4.75%
2-Yr T-note	current yield 4.18%; opening yield 4.28%
3-Yr T-note	current yield 3.99%; opening yield 4.08%
5-Yr T-note	current yield 3.84%; opening yield 3.94%
10-Yr T-note	current yield 3.97%; opening yield 4.06%
30-Yr T-bond	current yield 4.26%; opening yield 4.32%