

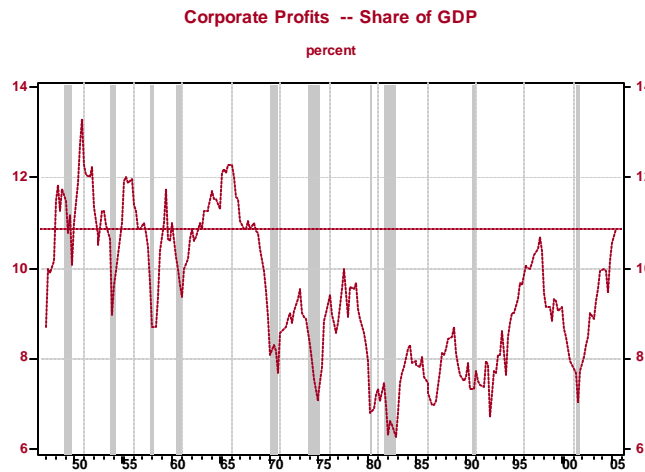


November 9, 2005

Shares of Corporate Profits And Labor Compensation – A Quick Overview

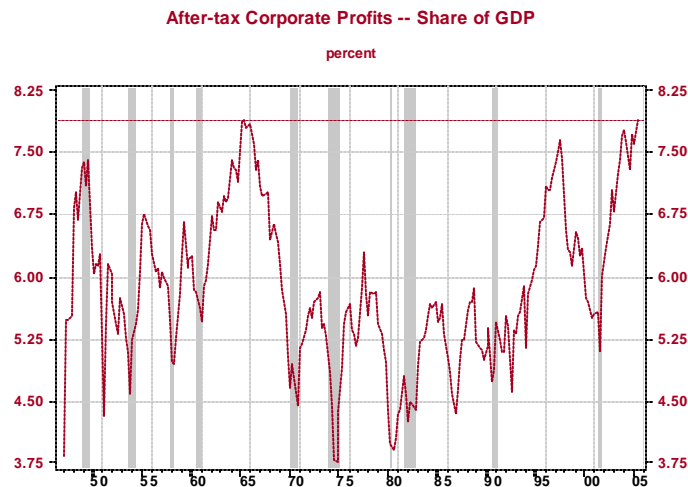
The share of corporate profits as the current expansion ages is growing steadily. It is noteworthy that before tax corporate profits made up 10.89% of GDP in the second quarter of 2005 (see chart 1). (Data for the third quarter will be published on November 30.) The share of corporate profits in GDP comparable to this level was last reported for the second quarter of 1968 when it was 10.99%.

Chart 1



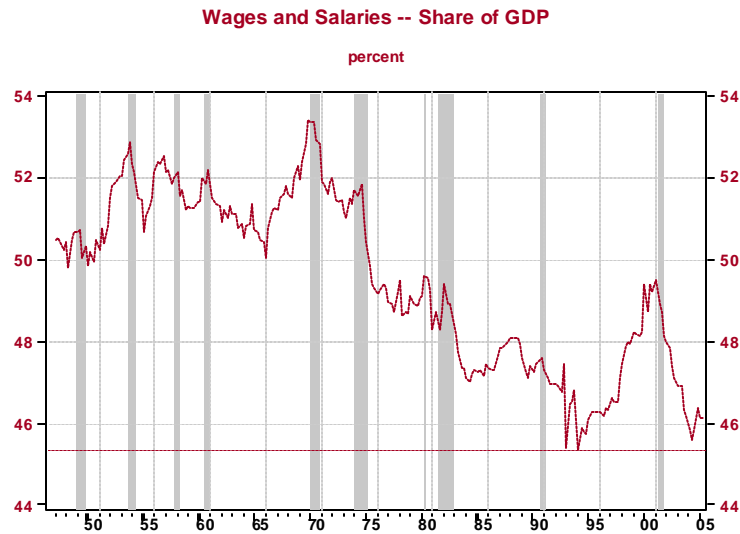
As a proportion of GDP, after-tax corporate profits in the second quarter (7.877%) were close to the record high mark of 7.894% set in the second quarter of 1965 (see chart 2).

Chart 2



The productivity surge is often cited as the reason for soaring corporate profits. Although productivity grew in the first quarters of 2005, there is a deceleration underway after the robust performance during 2002-2004. In a free market, profits are competed away. Corporate profits of the second-half of 2005 will indicate if the share of corporate profits in GDP declined or it held up. As corporate profits continued to advance, labor's share dropped after the onset of the current expansion. Labor's share of the economic pie shows a small improvement in recent quarters (see chart 3). The share of wages and salaries in GDP dropped to a record low in the first quarter of 1994 (45.36%), followed by an upward trend for several years. Wages and salaries made up 46.13% of GDP in the third quarter, after a low of 45.9% in 2004, which was close to the record low of 45.4%. The inclusion of China and India in the global market place is cited as the reason for the decline of labor's share.

Chart 3

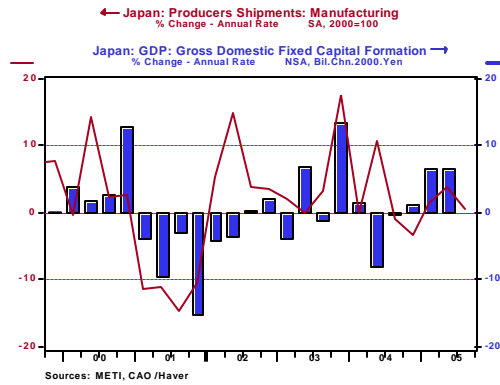
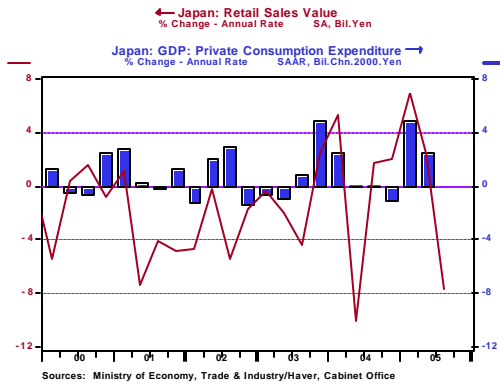


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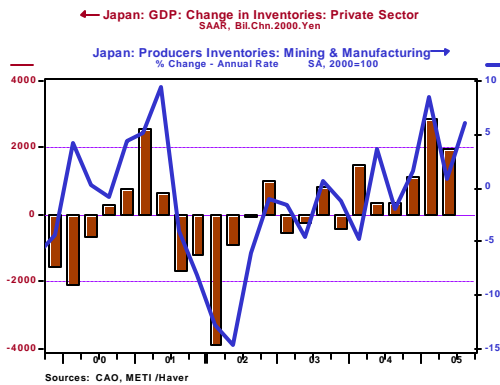
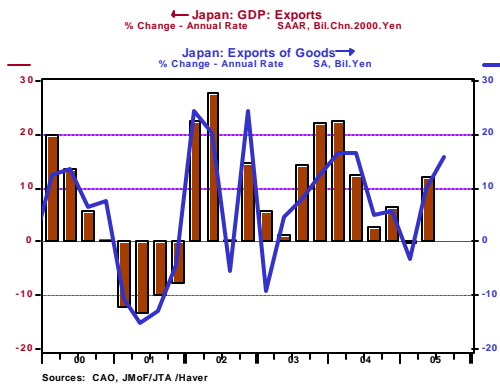
Japan: Numbers Change but the Forecast Remains the Same

The last week of economic indicators out of Tokyo have not matched the consensus in a number of cases, and with some of these numbers relating to the upcoming GDP release, it would only seem natural to do some last minute revising before placing our wager. However, we are holding firm to our belief that when the figures hit the Tokyo wire services on Friday morning (Thursday evening here in Chicago), our current forecasts will do just fine – keeping in mind that they're just forecasts.

There were two big reports recently that failed to meet expectations – retail sales and the closely-watched shipments figures – and made market-watchers a little edgy. The latest recovery has been based on the renewed vigor of private consumption and ongoing business expenditures, so any weak numbers relative to these two categories of GDP are taken seriously. We acknowledge the importance of these indicators as well, but it wouldn't be fair to examine these figures alone.



The two categories we use to offset other sour indicators are the usual standbys of the Japanese economy – trade and inventories. The first look at the Q3 trade data – compiled by the Ministry of Finance rather than the figures used for the national accounts – tells us that the summer quarter improved on an already-impressive Q2, and with imports not growing quite as fast, GDP will be aided more than expected by the net exports category. The difference won't be earth-shaking, but enough to counter a flat private consumption figure. Furthermore, the buildup of manufacturing inventories will offer some additional support against presumably-weak capital expenditure numbers. These offsets leave us standing firm at a 1.6% annualized increase for Q3 GDP – the same number we had been thinking about before all these reports tried to make our jobs difficult.



It is worth a final mention that our forecast represents growth at about half the rate seen in Q2 and well below the 5.8% figure posted for Q1 2005. While most analysts have factored this deceleration, we are a little concerned about the factors underlying this slowdown. In the past we have argued that Japan requires a healthy balance of exports of goods and domestic demand to spark the other driver of growth, business investment. While it would not be appropriate to establish a declining trend based on one quarter's-worth of data, it would also be careless to completely disregard the data. Looking forward, we will be paying special attention to indicators pertaining to those areas that have failed Japan in the past – retail sales, investment and so forth. If last quarter turns out to be nothing more than a pause between periods of strength then we will happily raise our forecasts, but for now we will look for warnings rather than relief.

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