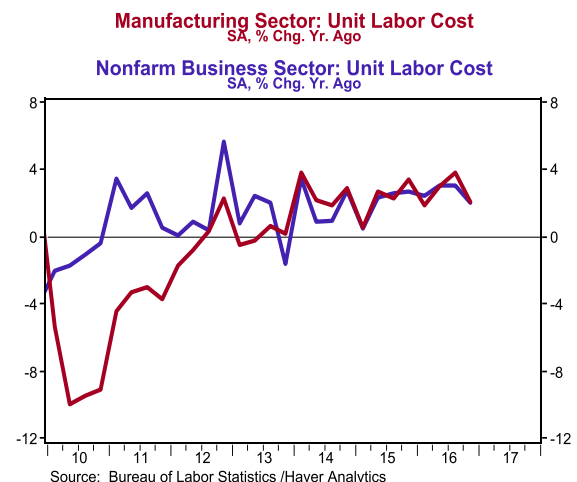
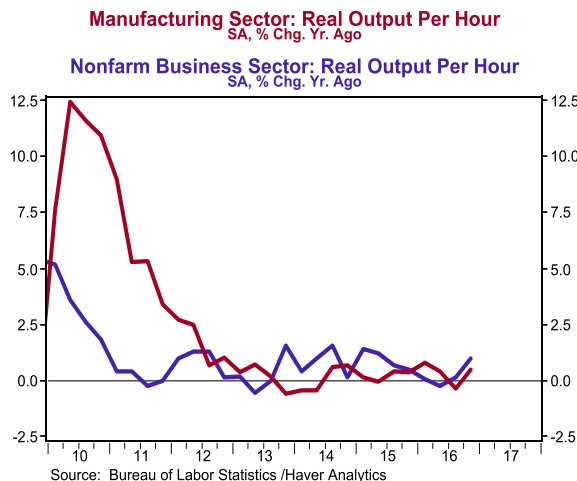


Q4 Productivity (Final)

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- Nonfarm productivity (output per hour) was unrevised at a 1.3% annual rate in the fourth quarter, coming in below the consensus expected 1.5% gain. Nonfarm productivity is up 1.0% versus last year.
- Real (inflation-adjusted) compensation per hour in the nonfarm sector declined at a 0.4% annual rate in Q4 but is up 1.2% versus last year. Unit labor costs rose at a 1.7% rate in Q4 and are up 2.0% versus a year ago.
- In the manufacturing sector, the 2.0% annual growth rate for productivity in Q4 was better than among all nonfarm businesses. The larger gain in manufacturing productivity growth was due to a decline in hours. Real compensation per hour was up in the manufacturing sector (0.9%) and unit labor costs rose at a 2.4% annual rate.

Implications: Hold off on productivity for a moment. The most important economic news this morning was the ADP index saying private payrolls increased 298,000 in February. Plugging this into our models suggests Friday’s official Labor report will show a nonfarm increase of 250,000 (versus a consensus 190,000), although we may tweak this forecast slightly based on tomorrow’s report on unemployment claims. If Friday’s report shows job gains anywhere north of 200,000 a rate hike next week is almost guaranteed, instead of just likely. Meanwhile, productivity growth in the fourth quarter was unrevised, consistent with last week’s unrevised real GDP. Output rose 2.4% at an annualized rate, stronger than the original 2.2% reading, but hours climbed as well, up 1.0% annualized from the original reading of 0.9%, so output *per hour* was unrevised. Productivity has been weak over the past few years, but we suspect part of the issue is the government underestimating output in the increasingly important service sector, which means economic growth and productivity are higher than the official data show. Have you used Google Maps lately? It will find the fastest route to your destination in real-time taking into account current traffic, weather, etc. And it’s all free! Need to purchase something? All you have to do is ask Alexa and it will be at your door within 48 hours, sometimes same day! As the economy becomes more and more friction-free due to new apps and technologies, productivity rises, but it does not get fully picked up in statistics because many of these benefits are free for consumers. And anything free, no matter how much it improves everyday life, isn’t directly included in output – which means they aren’t directly included in productivity either. In turn, this means our standard of living is improving faster than the official reports show. Note that on the manufacturing side, where it’s easier to measure output per hour, productivity was revised up substantially from an original reading of 0.7% annualized to 2.0% at an annual rate. Output was revised up while hours worked were revised lower. Manufacturing output is up 0.5% in the past year. Slower growth in the labor force, should put upward pressure on productivity growth. Less labor slack should make firms pursue efficiency gains more aggressively. In spite of the problems with measurement, we anticipate faster productivity growth over the next few years as new technology increases output in all areas of the economy. The declining unemployment rate and faster growth in wages should create even more pressure for efficiency gains, while the technological revolution continues to provide the inventions that make those gains possible.



Productivity and Costs (% Change, All Data Seasonally Adjusted)	Q4-16	Q3-16	Q2-16	Q1-16	Y to Y % Ch. (Q4-16/Q4-15)	Y to Y % Ch. (Q4-15/Q4-14)
Nonfarm Productivity	1.3	3.3	-0.1	-0.6	1.0	0.5
- Output	2.4	4.2	1.6	0.7	2.2	2.0
- Hours	1.0	0.8	1.7	1.4	1.2	1.5
- Compensation (Real)	-0.4	2.4	3.5	-0.7	1.2	2.8
- Unit Labor Costs	1.7	0.7	6.2	-0.3	2.0	2.7
Manufacturing Productivity	2.0	0.0	-0.9	0.9	0.5	0.3
- Output	1.6	0.7	-1.0	0.6	0.5	0.1
- Hours	-0.4	0.7	-0.1	-0.3	0.0	-0.2
- Compensation (Real)	0.9	2.4	4.9	-4.9	0.8	3.3
- Unit Labor Costs	2.4	4.1	8.5	-6.1	2.1	3.4

Source: US Department of Labor