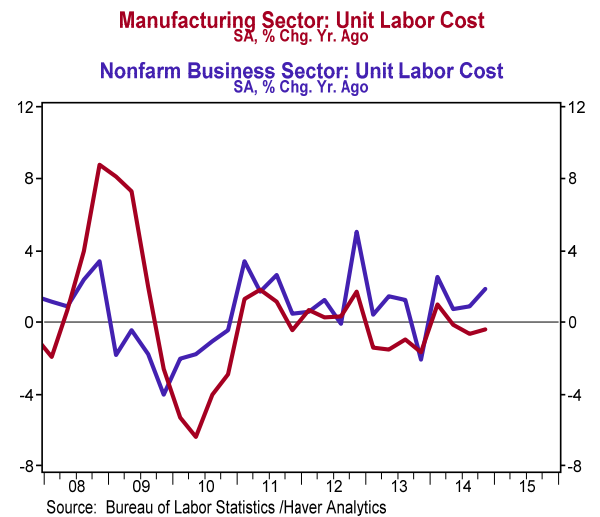
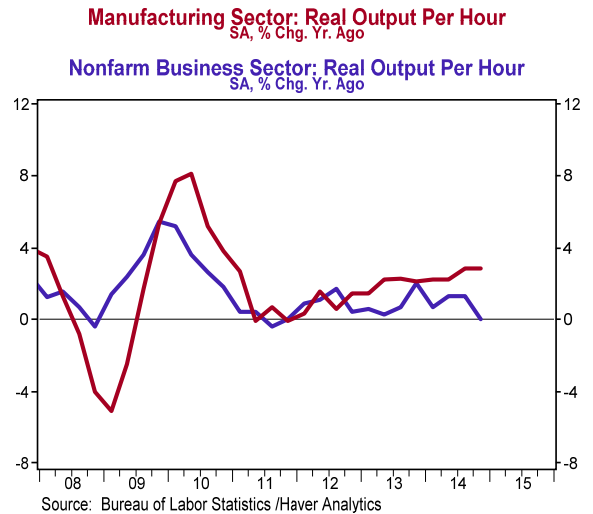


Q4 Productivity (Preliminary)

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- Nonfarm productivity (output per hour) declined at a 1.8% annual rate in the fourth quarter, versus a consensus expected gain of 0.1%. Nonfarm productivity is unchanged versus last year.
- Real (inflation-adjusted) compensation per hour in the nonfarm sector was up at a 2.1% annual rate in Q4 and is up 0.7% versus last year. Unit labor costs rose at a 2.7% rate in Q4 and are up 1.9% versus a year ago.
- In the manufacturing sector, productivity was up at a 1.3% annual rate in Q4, much faster than among nonfarm businesses as a whole. The quicker gain in manufacturing productivity was due to faster growth in output along with slower growth in hours. Real compensation per hour was up at a 2.8% annual rate in the manufacturing sector, while unit labor costs increased at a 0.2% rate.

Implications: Please feel free to take all the government's productivity numbers with a huge grain of salt. For reasons we explain below, we don't think the official productivity figures are capturing the dynamism of the US economy. According to the official data, nonfarm productivity declined at a 1.8% annual rate in Q4. Output continued to increase at a healthy clip, but hours climbed at the quickest pace since 1998, so output *per hour* declined. Productivity is unchanged from a year ago, but we suspect the government is underestimating output in the increasingly important service sector, which means growth and productivity are higher than the official data show. (For example, do the data fully capture the value of smartphone apps, the tablet, the cloud,...etc.?) We believe the figures from the government miss the value of these improvements, which 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 is up 2.8% in the past year. From 1973 through 1995, overall productivity growth averaged 1.5% per year. 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, decline in labor force participation, and faster growth in wages should create more pressure for efficiency gains, while the technological revolution continues to provide the inventions that make those gains possible. Overall, for 2015-16, we look for faster productivity growth than in the past two years.



Productivity and Costs (% Change, All Data Seasonally Adjusted)	Q4-14	Q3-14	Q2-14	Q1-14	Y to Y % Ch. (Q4-14/Q4-13)	Y to Y % Ch. (Q4-13/Q4-12)
Nonfarm Productivity	-1.8	3.7	2.9	-4.5	0.0	2.0
- Output	3.2	6.3	5.5	-2.4	3.1	3.7
- Hours	5.1	2.5	2.5	2.1	3.1	1.6
- Compensation (Real)	2.1	0.2	-3.8	4.6	0.7	-1.3
- Unit Labor Costs	2.7	-2.3	-3.7	11.6	1.9	-2.1
Manufacturing Productivity	1.3	3.2	3.7	3.2	2.8	2.2
- Output	5.7	4.8	7.3	1.6	4.8	3.2
- Hours	4.3	1.5	3.4	-1.6	1.9	1.0
- Compensation (Real)	2.8	0.3	-4.8	6.9	1.2	-0.7
- Unit Labor Costs	0.2	-1.7	-5.4	5.5	-0.4	-1.7

Source: US Department of Labor