

## Q2 Productivity (Final)

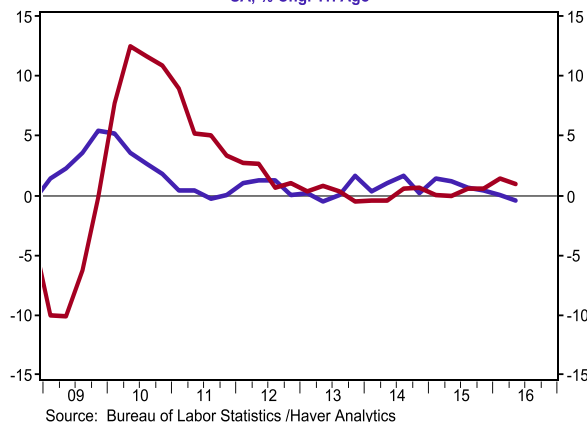
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- Nonfarm productivity (output per hour) declined at a 0.6% annual rate in the second quarter, revised slightly lower from last month's estimate of -0.5%. Nonfarm productivity is down 0.4% versus last year.
- Real (inflation-adjusted) compensation per hour in the nonfarm sector rose at a 1.1% annual rate in Q2 and is up 1.1% versus last year. Unit labor costs rose at a 4.3% annual rate in Q2 and are up 2.6% versus a year ago.
- In the manufacturing sector, the Q2 growth rate for productivity (-0.4%) was slightly better than among nonfarm businesses as a whole. The slower decline in productivity growth was due to a decline in hours in that sector. Real compensation per hour was up in the manufacturing sector (+3.7%), and unit labor costs rose at a 6.7% annual rate.

**Implications:** Consistent with last week's slight downward revision in the growth rate for Q2 real GDP, productivity growth was also revised slightly lower from -0.5% annualized growth to -0.6%. The largest change in today's report was an upward shift in labor costs, which jumped at a 4.3% annual rate from the prior estimate of 2.0%. The revision can be traced back to the Q2 GDP report as well, which showed a large \$44.2 billion upward revision to worker pay. The increase supports the case for the Federal Reserve raising rates sooner rather than later. Productivity has been weak – down 0.4% from a year ago following a tepid 1.2% gain the year before. In fact, the past few years have seen productivity improvements noticeably slower than the average gain of 2.1% since 1996. However, we do not think the productivity revolution has come to an end and actual productivity growth is much stronger than what the government reports. (For example, do the data fully capture the value of new technologies like smartphone apps, the tablet, the cloud,...etc.?) The benefits to consumers and businesses have been huge, but the figures from the government miss the full value of these improvements, many of which are free to consumers. Overall, for the rest of the year and into 2017-18, we look for faster productivity growth than in the past two years. In other news today, initial unemployment claims increased 2,000 last week to 263,000, the 78th consecutive week below 300,000. Meanwhile, continuing claims rose 14,000 to 2.159 million. Yesterday, the ADP report said private payrolls were up 177,000 in August. Plugging these figures into our models suggests nonfarm payrolls will be up about 165,000 for the month. That's slower than the trend in the past year as well as the consensus forecast of 180,000. But August payroll growth is usually revised up after the first report, so the Fed should not use a below-consensus payroll report as a reason to postpone rate hikes. On the housing front, the national Case-Shiller index increased 0.2% in June and is up 5.1% from a year ago. Price gains in the past year have been led by Portland, Seattle, Denver, and Dallas. Expect a similar price gain in the year ahead as housing inventories remain unusually lean.

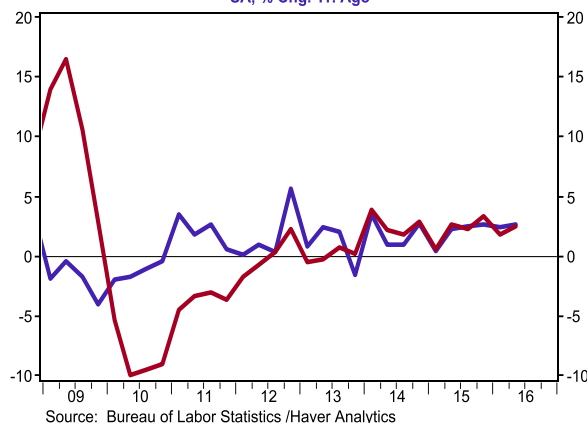
**Manufacturing Sector: Real Output Per Hour**  
SA, % Chg. Yr. Ago

**Nonfarm Business Sector: Real Output Per Hour**  
SA, % Chg. Yr. Ago



**Manufacturing Sector: Unit Labor Cost**  
SA, % Chg. Yr. Ago

**Nonfarm Business Sector: Unit Labor Cost**  
SA, % Chg. Yr. Ago



<b>Productivity and Costs</b> (% Change, All Data Seasonally Adjusted)	<b>Q2-16</b>	<b>Q1-16</b>	<b>Q4-15</b>	<b>Q3-15</b>	<b>Y to Y % Ch.</b> (Q2-16/Q2-15)	<b>Y to Y % Ch.</b> (Q2-15/Q2-14)
<b>Nonfarm Productivity</b>	<b>-0.6</b>	-0.6	-2.4	2.0	-0.4	1.2
- Output	1.1	0.7	0.8	1.8	1.1	3.7
- Hours	1.7	1.4	3.3	-0.2	1.5	2.5
- Compensation (Real)	1.1	-0.6	2.3	1.5	1.1	3.5
- Unit Labor Costs	4.3	-0.3	5.7	0.8	2.6	2.3
<b>Manufacturing Productivity</b>	<b>-0.4</b>	1.3	-1.1	3.7	0.9	0.0
- Output	-0.8	0.6	-0.5	1.9	0.3	1.2
- Hours	-0.4	-0.8	0.6	-1.7	-0.6	1.2
- Compensation (Real)	3.7	-4.5	7.4	3.0	2.3	2.6
- Unit Labor Costs	6.7	-6.0	9.5	0.7	2.5	2.6

Source: US Department of Labor