

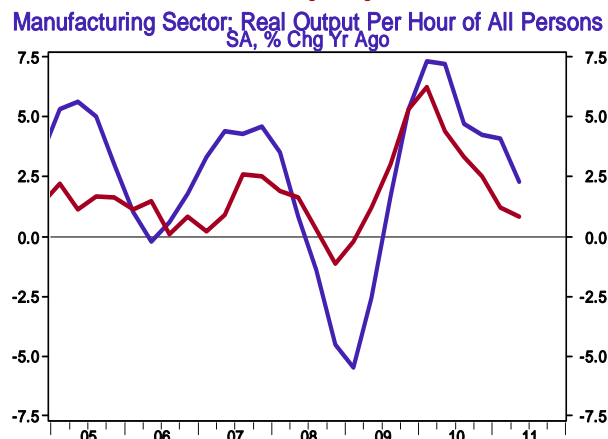
Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Senior Economist
Strider Elass – Economic Analyst
Andrew Hull – Economic Analyst

Q2 Productivity (Preliminary)

- Non-farm productivity (output per hour) fell at a 0.3% annual rate in the second quarter, beating consensus expectations of -0.9%. Non-farm productivity is up 0.8% versus last year.
- Real (inflation-adjusted) compensation per hour in the non-farm sector declined at a 2.1% annual rate in Q2, and is down 1.2% versus last year. Unit labor costs rose at a 2.2% rate in Q2 and are up 1.3% versus a year ago.
- In the manufacturing sector, the Q2 growth rate for productivity (-2.0%) was much lower than among non-farm businesses as a whole. The decline in productivity growth was due to rising hours, which rose more than output. Real compensation per hour was down in the manufacturing sector (-1.7%), and due to a slowdown in productivity growth, unit labor costs rose at a 4.4% annual rate.

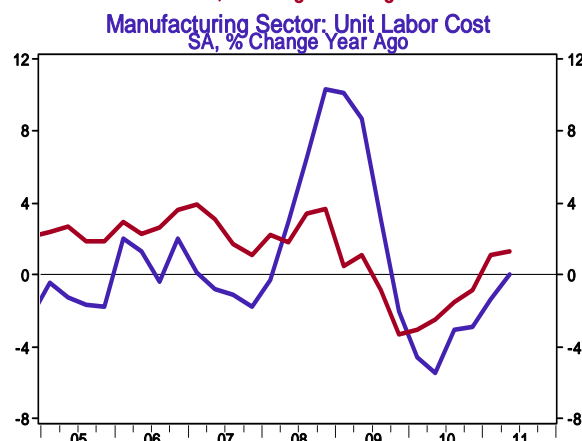
Implications: Productivity fell 0.3% at an annual rate in the second quarter, but came in better than the consensus expected decline of 0.9%. It's important to remember that when GDP growth slows (as it did in Q1 and Q2), so does productivity growth. Growth in hours worked came in at a healthy 2.0% annual rate in Q2, although real compensation per hour fell at a 2.1% rate. Oftentimes, once a recovery gets to the point where firms are vigorously increasing hours, the pace of productivity growth slows down. Productivity grew at a rapid 4.4% rate in the year ending in the second quarter of 2010. In the past four quarters, productivity has grown at a 0.8% rate. On the manufacturing side, productivity fell for the first time since the first quarter of 2009. This can be attributed to lower output mostly due to the earthquake that rocked Japan and caused parts shortages over here in the US. Unit labor costs (how much companies have to pay workers per unit of production) came in at the highest level since Q4 2008. Over the next few quarters productivity will start to increase again as the soft patch continues to dissipate and stronger growth in the economy resumes.

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



Sources: Bureau of Labor Statistics /Haver Analytics

Nonfarm Business Sector: Unit Labor Cost
SA, % Change Year Ago



Sources: Bureau of Labor Statistics /Haver Analytics

Productivity and Costs (% Change, All Data Seasonally Adjusted)	Q2-11	Q1-11	Q4-10	Q3-10	Y to Y % Ch. (Q2-11/Q2-10)	Y to Y % Ch. (Q2-10/Q2-09)
Nonfarm Productivity	-0.3	-0.6	2.2	2.1	0.8	4.4
- Output	1.8	0.9	3.8	3.5	2.5	4.2
- Hours	2.0	1.5	1.5	1.4	1.6	-0.3
- Compensation (Real)	-2.1	-1.0	-2.1	0.4	-1.2	0.1
- Unit Labor Costs	2.2	4.8	-1.6	-0.2	1.3	-2.5
Manufacturing Productivity	-2.0	4.2	4.9	2.1	2.3	7.2
- Output	0.6	7.8	3.8	5.6	4.4	7.5
- Hours	2.6	3.4	-1.0	3.4	2.1	0.2
- Compensation (Real)	-1.7	-2.1	-0.4	0.2	-1.0	-0.4
- Unit Labor Costs	4.4	-1.1	-2.5	-0.5	0.0	-5.5

Source: US Department of Labor