First Trust DATAWATCH

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Q3 Productivity (Preliminary)

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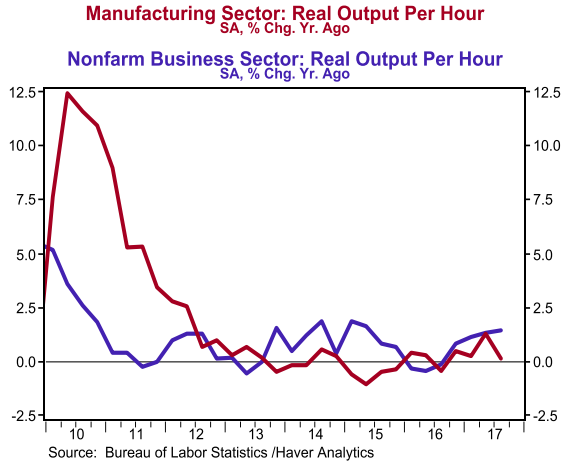
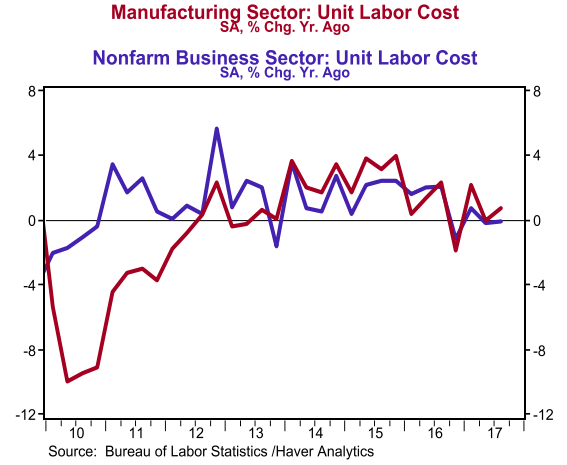
- Nonfarm productivity (output per hour) increased at a 3.0% annual rate in the third quarter, faster than the consensus expected gain of 2.6%. Non-farm productivity is up 1.5% versus last year.
- Real (inflation-adjusted) compensation per hour in the non-farm sector increased at a 1.5% annual rate in Q3 but is down 0.6% versus last year. Unit labor costs rose at a 0.5% rate in Q3 and are down 0.1% versus a year ago.
- In the manufacturing sector, productivity declined at a 5.0% annual rate in Q3. The decline in manufacturing productivity was due to slower growth in output and increased hours worked. Real compensation per hour fell at a 1.1% annual rate in the manufacturing sector, while unit labor costs rose at a 6.2% annual rate.





Implications: Nonfarm productivity rose at the fastest pace in three years during the third quarter, as output rose much quicker than hours. Despite the nice gain, productivity is up at a modest 0.7% annual rate in the past two years. But we think government statistics underestimate actual productivity growth. There are many examples, in every area of the economy, but the service sector is particularly hard to measure. Want to talk face to face with someone in Europe? You no longer need to get on a flight, just Facetime them, for free! The benefits to consumers and businesses have been huge, but the figures from the government miss much of the value of these improvements, because many of these amazing technologies are free, and anything free, no matter how much it improves everyday life, isn't directly included in output, which means it's much harder to measure productivity. Still, even on the manufacturing side, where it's easier to measure output per hour, productivity is up only 0.1% in the past year. This is due in part to the hurricanes, which hit the manufacturing sector particularly hard, driving down manufacturing productivity at a 5.0% rate in Q3, the fastest pace of decline since 2009. As we have seen in other data series, the storm impacts have subsided and activity is making up lost ground in Q4, and we expect manufacturing productivity to rebound in Q4 as well. Despite slower productivity growth in recent years, we think the long-term trend is still strong, a result of the technological revolution that began in the 1980s. We anticipate an acceleration in productivity growth over the coming years, with a potential boost if tax and regulatory reform comes out of Washington. The declining unemployment rate 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. In other news this morning, new claims for jobless benefits declined 5,000 last week to 229,000. Continuing claims fell 15,000 to 1.88 million. These figures are consistent with our forecast that tomorrow's official report will show nonfarm payrolls up 320,000 in October, a sharp rebound from the hurricane-related 33,000 decline in September. Investors should expect another solid month in November, which means it's almost certain the Federal Reserve will raise short-term interest rates in December. In other recent news, automakers sold cars and light trucks at an 18.1 million annual rate in October, a decline of 2.6% from the torrid pace in September, but well above consensus expectations and up 1.2% from a year ago. The pace of sales should remain unusually strong through year end due to vehicles destroyed in Hurricanes Harvey and Irma. However, sales for all of 2017 should still be slightly below the pace of 2016 and should move lower in 2018. Don't get worried when this happens; it's not a negative sign for the economy overall, just a shift by consumers from the auto sector to other kinds of purchases.

Productivity and Costs *(% Change, All Data Seasonally Adjusted)*	Q3-17	Q2-17	Q1-17	Q4-16	Y to Y % Ch. *(Q3-17/Q3-16)*	Y to Y % Ch. *(Q3-16/Q3-15)*
Nonfarm Productivity	**3.0**	1.5	0.1	1.3	1.5	-0.1
- Output	**3.8**	3.9	1.8	2.2	2.9	1.6
- Hours	**0.8**	2.4	1.6	1.0	1.4	1.7
- Compensation (Real)	**1.5**	2.1	1.7	-7.3	-0.6	0.8
- Unit Labor Costs	**0.5**	0.3	4.8	-5.7	-0.1	2.1
Manufacturing Productivity	**-5.0**	3.4	0.2	2.0	0.1	-0.4
- Output	**-2.1**	2.8	2.3	1.8	1.2	-0.1
- Hours	**3.1**	-0.6	2.1	-0.2	1.1	0.3
- Compensation (Real)	**-1.1**	2.7	1.2	-7.1	-1.1	0.7
- Unit Labor Costs	**6.2**	-1.0	4.2	-6.1	0.7	2.3

Source: US Department of Labor

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