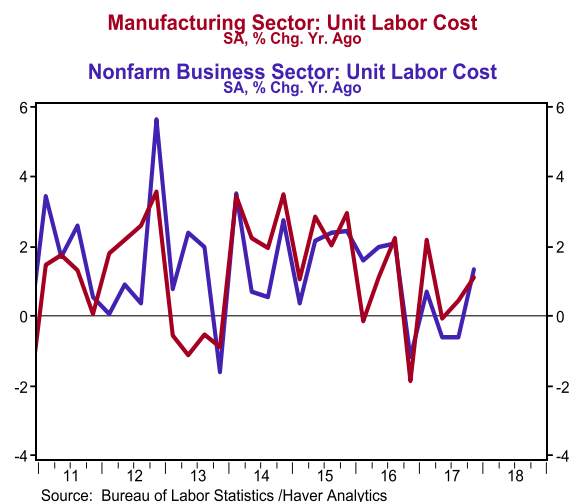
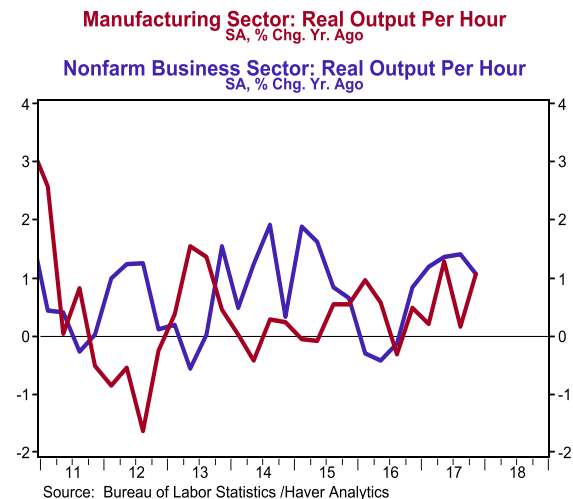


Q4 Productivity (Preliminary)

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- Nonfarm productivity (output per hour) declined at a 0.1% annual rate in the fourth quarter, coming in below the consensus expected increase of 0.7%. Nonfarm productivity is up 1.1% versus last year.
- Real (inflation-adjusted) compensation per hour in the nonfarm sector declined at a 1.8% annual rate in Q4 but is up 0.3% versus a year ago. Unit labor costs rose at a 2.0% annual rate in Q4 and are up 1.3% versus a year ago.
- In the manufacturing sector, productivity rose at a 5.7% annual rate in Q4. The large gain in manufacturing productivity was due to faster growth in output. Real compensation per hour was down at a 1.8% annual rate in the manufacturing sector, while unit labor costs fell at a 3.7% rate.

Implications: Productivity growth slipped slightly in the fourth quarter after a robust gain in Q3. The reason for the 0.1% annualized decline in Q4 was growth in hours worked climbing faster than output, so output *per hour* declined. Still, measured productivity has accelerated, up 1.1% from a year ago, versus a 0.8% gain in the year ending Q4 2016. We expect a further acceleration in 2018. Companies have increased business investment, which should generate more output per hour. Meanwhile, the tight labor market should encourage firms to find more efficient ways to produce. However, we think government statistics still underestimate actual productivity growth. The figures from the government miss the full value of technological advances, such as all those free smartphone apps so many people carry around in their pockets. Items that are free, no matter how much they improve everyday life, aren't directly included in output, which means they're not included in productivity either. This means our standard of living is improving faster than the official reports show. In other recent news, the ADP Employment index says private payrolls increased 234,000 in January. Meanwhile, initial jobless claims fell 1,000 last week to 230,000; continuing claims rose 13,000 to 1.953 million. Plugging these figures into our models suggests tomorrow's official report will show a gain of 180,000 in nonfarm payrolls. That may seem odd, but in recent years the initial reports on January payrolls have usually come in below the initial ADP report. On the housing front, the national Case-Shiller index says home prices rose 0.7% in November and are up 6.2% from a year ago, an acceleration from the 5.3% gain in the twelve months ending in November 2016. In the past year, price gains have been led by Seattle and Las Vegas. Pending home sales, which are contracts on existing homes, rose 0.5% in December after a 0.3% gain in November. These reports suggest existing home sales, which are counted at closing, will rebound in January.



Productivity and Costs (% Change, All Data Seasonally Adjusted)	Q4-17	Q3-17	Q2-17	Q1-17	Y to Y % Ch. (Q4-17/Q4-16)	Y to Y % Ch. (Q4-16/Q4-15)
Nonfarm Productivity	-0.1	2.7	1.5	0.1	1.1	0.8
- Output	3.2	4.0	3.9	1.8	3.2	2.1
- Hours	3.3	1.2	2.4	1.6	2.1	1.2
- Compensation (Real)	-1.8	0.6	0.6	1.7	0.3	-2.1
- Unit Labor Costs	2.0	-0.1	-1.2	4.8	1.3	-1.2
Manufacturing Productivity	5.7	-4.9	3.6	0.2	1.1	0.5
- Output	7.3	-1.6	2.9	2.3	2.7	0.5
- Hours	1.5	3.5	-0.6	2.1	1.6	0.0
- Compensation (Real)	-1.8	-1.8	2.6	1.2	0.0	-3.1
- Unit Labor Costs	-3.7	5.4	-1.2	4.2	1.1	-1.9

Source: US Department of Labor