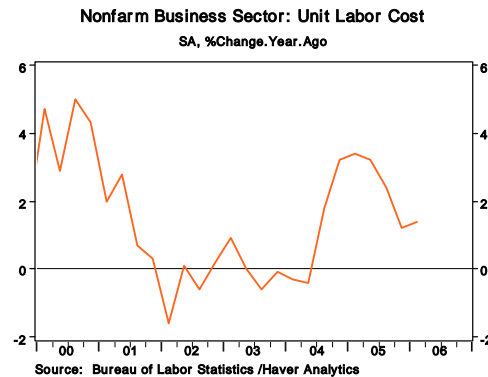
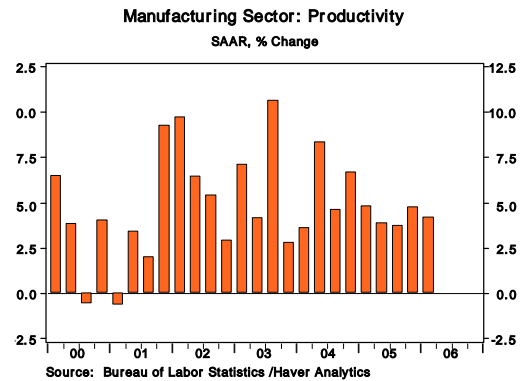
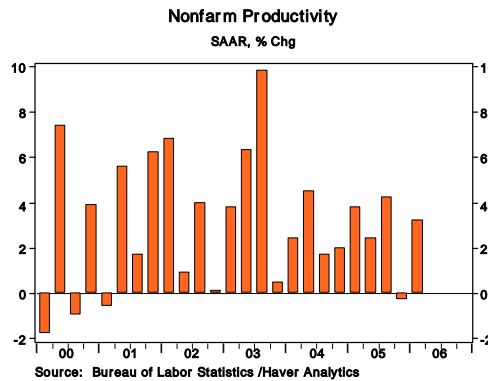


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## Q1 PRODUCTIVITY

- Non-farm productivity increased at a 3.2% annual rate in the first quarter. Non-farm productivity is up 2.4% in the past year.
- Manufacturing productivity continues to outpace the gains in the rest of the economy, growing an annualized 4.2% in Q1. Manufacturers have increased productivity by 4.1% in the past year as they adapt their business models to utilize new technology and compete in a global economy.
- Non-farm unit labor costs increased a more-than-expected 2.5% at an annual rate in the first quarter. Manufacturing unit labor costs fell 2.6% at an annual rate in Q1 and slid 1.1% in the past year.

**Implications:** The productivity boom continues. Non-farm productivity jumped an annualized 3.2% in Q1 after a hurricane-related slowdown pulled productivity down an annualized -0.3% in Q4. Productivity gains continue to be an important force driving this economic expansion. The ability of US companies to produce more with less is increasing wealth and making US companies more competitive on the global stage. Despite these massive gains in productivity, unit labor costs are on the rise. Unit labor costs rose 2.5% in Q1, much higher than the consensus expected. The fact that unit labor costs are rising, even with productivity surging, is a sign of the massive amounts of money the Fed has added to the economy. Productivity can only hold back inflation for so long. Eventually a neutral monetary policy is needed. As a result, we view it as a bullish sign that the Fed seems poised to stamp out inflation by continuing to lift the fed funds rate. Inflation is a much greater threat to this expansion than a few more rate hikes by the Fed. Separately, initial claims for unemployment rose to 322,000 last week, the highest level since November 2005. The four-week moving average rose to a 2006-high of 315,250. This bulge in initial claims was unexpected amidst other data showing the economy on a tear. While the rise is somewhat disturbing, initial claims remain at a very low level and we expect claims to fall back to 300,000 or below in the weeks ahead.



<b>Productivity and Costs</b> (% Change, All Data Seasonally Adjusted)	<b>Q1-06</b>	<b>Q4-05</b>	<b>Q3-05</b>	<b>Q2-05</b>	<b>YOY % (Q1-06/Q1-05)</b>	<b>Prior YOY % (Q1-05/Q1-04)</b>
Nonfarm Productivity	3.2	-0.3	4.2	2.4	2.4	2.2
- Output	5.8	1.5	4.7	4.4	4.1	4.1
- Hours	2.5	1.8	0.4	2.0	1.7	1.9
- Compensation	5.7	2.7	5.5	1.3	3.8	4.0
- Unit Labor Costs	2.5	3.0	1.2	-1.0	1.4	1.8
Manufacturing Productivity	4.2	4.7	3.7	3.9	4.1	4.5
- Output	5.8	9.4	2.6	1.2	4.7	5.5
- Hours	1.6	4.6	-1.0	-2.5	0.6	1.0
- Compensation	1.5	1.2	5.6	3.6	3.0	2.1
- Unit Labor Costs	-2.6	-3.3	1.8	-0.2	-1.1	-2.2
Durable Goods Productivity	3.8	9.9	6.5	4.0	6.0	5.0
Nondurable Goods Productivity	4.4	-1.9	0.7	4.2	1.8	4.5

Source: US Department of Labor

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