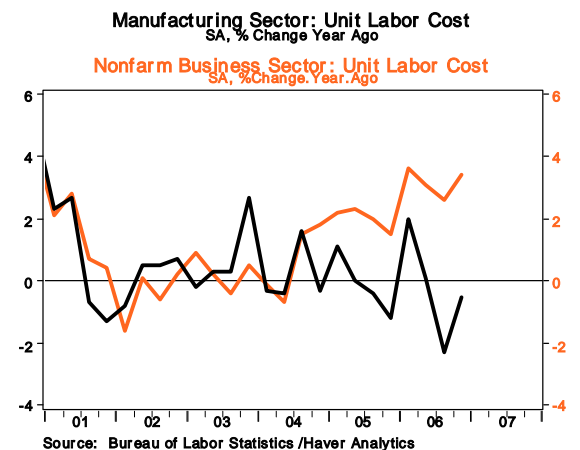
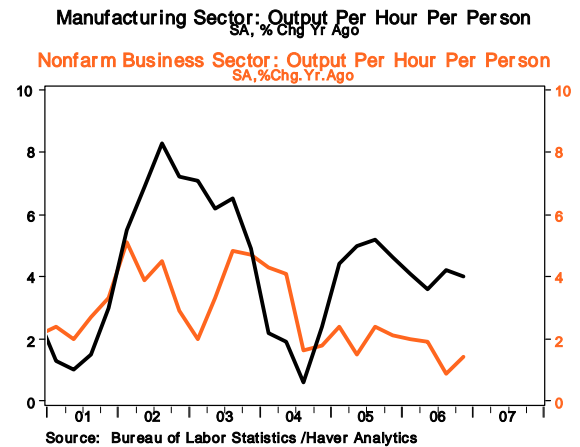


Q4 PRODUCTIVITY

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- Non-farm productivity (output per hour) increased at a 1.6% annual rate in the fourth quarter, a downward revision from the original estimate of 3.0% but slightly better than the consensus expected gain of 1.5%. Non-farm productivity increased 1.4% in 2006 (Q4/Q4).
- Real (inflation-adjusted) compensation per hour increased at a 10.5% annual rate, a combination of a nominal gain of 8.2% and falling energy prices that made inflation negative for the quarter. Unit labor costs – the gap between increases in compensation and output – increased at a 6.6% rate in the fourth quarter and were up 3.4% in 2006 (Q4/Q4).
- In the manufacturing sector, productivity growth was stronger (2.2%) and compensation gains less robust (7.1%), resulting in more moderate increases in unit labor costs (4.7%).

Implications: Today's downward revisions to fourth quarter productivity growth reflect revisions made last week to real GDP. Simply put, less total output means less output per hour. However, the long-term trend of higher productivity growth versus the 1990s remains intact. In the past two years, productivity growth is up at a 1.8% annual rate versus a 1% rate at the same point in the 1990s business cycle. Some analysts may be concerned about the fast rise in labor compensation costs but we are not. Much of the compensation gain in the fourth quarter is likely due to the accrual of large year-end bonuses. It appears that compensation is becoming more closely tied to firm profitability. This is an unambiguously positive development for the economy as a whole, but can also lead to greater volatility in unit labor cost data. The labor share of income in the overall economy remains relatively low, indicating there is still room for unit labor costs to expand without any major crimping of corporate profits or incentives for continued investment.



Productivity and Costs (% Change, All Data Seasonally Adjusted)	Q4-06	Q3-06	Q2-06	Q1-06	Y to Y % Ch. (Q4-06/Q4-05)	Y to Y % Ch. (Q4-05/Q4-04)
Nonfarm Productivity	1.6	-0.5	1.2	3.5	1.4	2.1
- Output	2.5	1.9	2.7	6.7	3.4	3.8
- Hours	0.9	2.4	1.5	3.0	2.0	1.6
- Compensation	8.2	0.6	-1.4	12.9	4.9	3.7
- Unit Labor Costs	6.6	1.1	-2.5	9.1	3.4	1.5
Manufacturing Productivity	2.2	5.9	3.8	4.1	4.0	4.6
- Output	-2.1	4.8	5.7	6.0	3.6	4.6
- Hours	-4.2	-1.1	1.9	1.9	-0.4	0.0
- Compensation	7.1	-0.2	-5.4	13.5	3.5	3.4
- Unit Labor Costs	4.7	-5.8	-8.8	9.0	-0.5	-1.2
Durable Goods Productivity	3.4	8.1	5.9	4.1	5.4	6.9
Nondurable Goods Productivity	0.8	2.7	2.2	3.8	2.4	2.6

Source: US Department of Labor

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