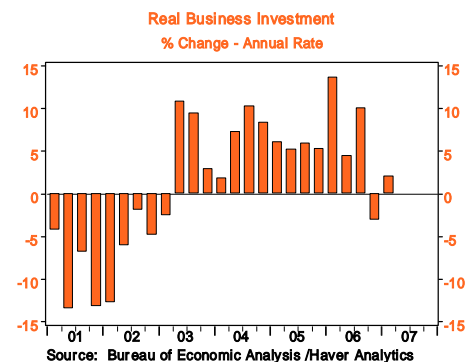
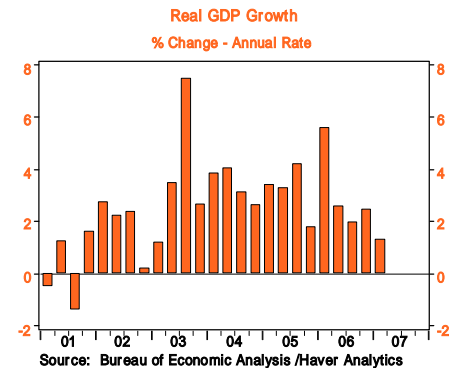


Chief Economist - Brian S. Wesbury
Senior Economist - Robert Stein, CFA
Economic Research Analyst - Trevor D. Scott

1ST QUARTER GDP (ADVANCE)

- The original estimate for first quarter real GDP growth is 1.3% at an annual rate, the weakest growth rate since early 2003. The consensus expected 1.8%.
- Housing lopped off 1.0 percentage point from the real GDP growth rate. Inventories and net exports exerted a combined -0.8 point drag on real GDP growth. A temporary drop in national defense spending subtracted an additional 0.3 points.
- Personal consumption plus business investment in equipment, software, and structures increased at a 3.6% annual rate.
- The GDP price index rose at a 4.0% rate in the first quarter, the fastest increase since 1991. Nominal GDP growth – real GDP plus inflation – grew at a 5.3% rate versus a consensus expected 4.8% rate.

Implications: Real GDP growth was slower than expected, but the weak components of today's report herald an acceleration of growth ahead. The decline in inventory accumulation gives firms more room to increase production in the next few quarters. The weakness in national defense spending should reverse as budget politics involving Iraq get clarified. Net exports will tend to boost GDP growth going forward, reflecting past depreciation of the dollar. Meanwhile, housing's drag on GDP should diminish and business investment should pick up given continued strong profits. Our concern is inflation. The Q1 spike in the GDP deflator, the largest in sixteen years, deserves the Fed's attention. In other news, the Employment Cost Index increased by 0.8% in the first quarter, slightly less than expected. Wages and salaries rose by 1.1%, the largest gain since 2000, but benefits rose only 0.1% due to an outright drop in benefit costs in the private sector. We believe the slowdown in benefit costs will support future hiring growth and wage gains.



1st Quarter GDP <i>Seasonally Adjusted Annual Rates</i>	Q1-07	Q4-06	Q3-06	Q2-06	4 Quarter Change
Real GDP	1.3%	2.5%	2.0%	2.6%	2.1%
GDP Price Index	4.0%	1.7%	1.9%	3.3%	2.7%
Nominal GDP	5.3%	4.1%	3.9%	5.9%	4.8%
PCE	3.8%	4.2%	2.8%	2.6%	3.4%
Business Investment	2.0%	-3.1%	10.0%	4.4%	3.2%
Structures	2.1%	0.9%	15.7%	20.3%	9.4%
Equipment and Software	1.9%	-4.8%	7.7%	-1.4%	0.8%
Contributions to GDP Growth (p.pts.)	Q1-07	Q4-06	Q3-06	Q2-06	4Q Avg.
PCE	2.7	2.9	2.0	1.8	2.3
Business Investment	0.2	-0.3	1.0	0.5	0.3
Residential Investment	-1.0	-1.2	-1.2	-0.7	-1.0
Inventories	-0.3	-1.2	0.1	0.4	-0.2
Government	0.2	0.6	0.3	0.2	0.3
Net Exports	-0.5	1.6	-0.2	0.4	0.3

Source: Commerce Department