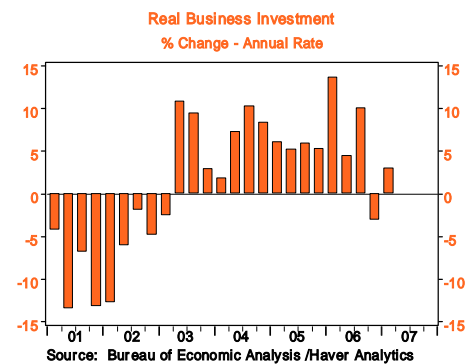
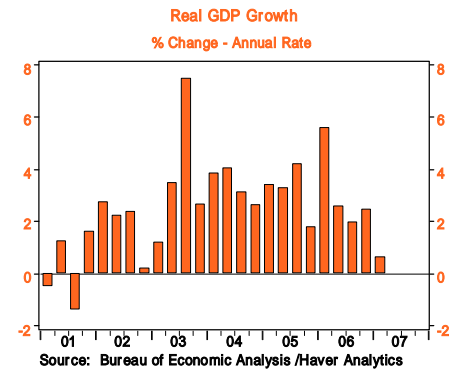


## 1ST QUARTER GDP (PRELIMINARY)

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

- The government revised first quarter real GDP growth to 0.6% at an annual rate, versus the 1.3% rate originally reported last month. The revised 0.6% rate is the weakest growth rate since 2002. The consensus expected 0.8%.
- Inventories and trade accounted for all the downward revision to GDP growth. Inventory reductions lopped 1.0 percentage point off GDP growth, versus an originally reported 0.3 points. The trade deficit also exerted a 1.0 point drag on GDP growth, versus an originally reported 0.5 points. Housing was a drag of 0.9 points, less than the full point originally estimated.
- Personal consumption was revised up to a 4.4% growth rate from an originally reported 3.8%. Business investment in equipment, software, and structures was revised up to 2.9% from 2.0%.
- The GDP price index rose at a 4.0% rate, the fastest increase since 1991. Nominal GDP growth – real GDP plus inflation – grew at a 4.7% rate.



**Implications:** We already knew the first quarter had weak GDP growth and today's report does not change that. However, the reasons why GDP growth was revised lower bolster our view that the economy will grow at a 3%+ rate in Q2 and beyond. Inventories cut GDP growth by more than one percentage point in the last quarter of 2006 and another percentage point in Q1, leaving substantial room for faster production ahead. Meanwhile, the negative trade effect in the first quarter was largely attributable to a spike in the March trade gap that should narrow in the second quarter, in inflation-adjusted terms. Note that personal consumption and business investment, combined, grew at a 4.2% rate in Q1, the fastest in a year. Our concern is inflation. The GDP deflator grew at a 4% rate in Q1, the fastest since 1991. In other news, initial claims for unemployment insurance remained at a low 310,000 last week and continuing claims for jobless benefits fell by 52,000.

<b>1st Quarter GDP</b> <i>Seasonally Adjusted Annual Rates</i>	<b>Q1-07</b>	<b>Q4-06</b>	<b>Q3-06</b>	<b>Q2-06</b>	<b>4 Quarter Change</b>
<b>Real GDP</b>	<b>0.6%</b>	2.5%	2.0%	2.6%	1.9%
<b>GDP Price Index</b>	<b>4.0%</b>	1.7%	1.9%	3.3%	2.7%
<b>Nominal GDP</b>	<b>4.7%</b>	4.1%	3.9%	5.9%	4.6%
<b>PCE</b>	<b>4.4%</b>	4.2%	2.8%	2.6%	3.5%
<b>Business Investment</b>	<b>2.9%</b>	-3.1%	10.0%	4.4%	3.5%
<b>Structures</b>	<b>5.0%</b>	0.9%	15.7%	20.3%	10.2%
<b>Equipment and Software</b>	<b>2.0%</b>	-4.8%	7.7%	-1.4%	0.8%
<b>Contributions to GDP Growth (p.pts.)</b>	<b>Q1-07</b>	<b>Q4-06</b>	<b>Q3-06</b>	<b>Q2-06</b>	<b>4Q Avg.</b>
<b>PCE</b>	<b>3.0</b>	2.9	2.0	1.8	2.4
<b>Business Investment</b>	<b>0.3</b>	-0.3	1.0	0.5	0.4
<b>Residential Investment</b>	<b>-0.9</b>	-1.2	-1.2	-0.7	-1.0
<b>Inventories</b>	<b>-1.0</b>	-1.2	0.1	0.4	-0.4
<b>Government</b>	<b>0.2</b>	0.6	0.3	0.2	0.3
<b>Net Exports</b>	<b>-1.0</b>	1.6	-0.2	0.4	0.2

Source: Commerce Department