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FIRST Trust ADVISORS L.P.

Jan 17, 2008 Economic Commentary

Cutting Our Q4 Growth Estimate to 1.5%

Before this week we had been estimating that fourth quarter real GDP grew at an annual rate of 2.5%. (*Economy Bends, But Does Not Break*; December 24, 2007). However, based on key GDP-component data released in this past week, we are revising this estimate to a slower and below-trend 1.5% growth rate.

The primary reason for the downward adjustment is inventories, which businesses accumulated at a slower rate in Q4. Excluding inventories from GDP leaves final sales, a measure of total demand in the economy. Our forecast suggests final sales grew at about a 2.5% annualized rate in Q4, a very respectable performance given today's dour mood. For the full-year of 2007, growth in real GDP will be 2.7% (Q4/Q4) and growth in final sales will be 2.8% - both near their 2006 rates.

We believe these data, while not as good as we once hoped continue to show the resilience of the US economy. We are not changing our outlook for 2008. Below-trend growth in the fourth quarter is payback for above-trend growth in Q2 and Q3. If anything, weak inventory accumulation in Q4 leaves more room for growth in the first quarter of 2008, bolstering our confidence that real GDP will grow at a 3% annual rate in Q1.

The table below lays out our "add-em-up" GDP estimate for the fourth quarter of 2007, with the actual growth rate and the contribution to overall GDP broken out.

Estimated Real GDP Growth

GDP Components	*% Change, Annual Rate*	*Contribution to GDP*
Consumption	2.4	1.7
Business Investment	8.5	0.9
Home Building	-20.0	-0.9
Government	2.5	0.5
Trade	NA	0.1
Inventories	NA	-0.8
Total	1.5	1.5

In the second table, contributions to GDP for Q2 and Q3 are listed for each category as well. Consumption and business investment have easily offset the drag from housing, and we expect that to occur in the fourth quarter as well. Trade was also a solid contributor to growth in the middle of 2007, but not as much in Q4. These trade data, along with the drag from inventories are the major reason for slower growth in the fourth quarter.

Contributions to Growth

GDP Components	*Q2*	*Q3*	*Q4 Estimate*
Consumption	1.0	2.0	1.7
Business Investment	1.1	0.9	0.9
Home Building	-0.6	-1.1	-0.9
Government	0.8	0.7	0.5
Trade	1.3	1.4	0.1
Inventories	0.2	0.9	-0.8
Total	3.8	4.9	1.5

In our view, this is unlikely to persist. The fall in the foreign exchange value of the dollar in the past several years suggests net exports will make a large positive contribution to real GDP growth in 2008. Meanwhile, inventory-to-sales ratios are extremely low, suggesting inventories will not be a significant drag on growth in the quarters ahead.

Finally, despite the doom and gloom about consumer and business spending trends, there has been little evidence that these sectors of the economy have slowed in any significant manner. And with monetary policy becoming extremely accommodative, it's hard to imagine any serious slowdown in 2008.

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