

Spare Us the GDP Agony

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Senior Economist

Real GDP grew at a 2.6% annual rate in the fourth quarter, and while some analysts are overly occupied with this “slowdown” from the second and third quarter, we think time will prove it statistical noise. Even at 2.6%, the pace is a step up from the Plow Horse 2.2% annual rate from mid-2009 (when the recovery started) through early 2017.

Fourth quarter real GDP growth happened in spite of a huge decline in retail sales for December (itself suspicious and likely to be revised higher, as job growth and retailer reports painted a very different picture). Moreover, business investment grew at a 6.2% rate in Q4 and was up 7.2% in 2018, the fastest calendar growth for any year since 2011.

In 2018 as a whole, real GDP grew at the fastest pace for any calendar year since 2005. And what's even more impressive is that year-over-year real GDP growth has accelerated in every quarter since the beginning of 2017. The first quarter of 2017 was up just 1.9% from a year earlier while subsequent quarters showed four-quarter growth of 2.1%, 2.3%, 2.5%, 2.6%, 2.9%, 3.0% and now 3.1%. We expect Q1-2019 GDP to slow like many other Q1s in recent years, meaning this impressive streak may come to an end. But this too is just statistical noise, and the YOY trend should remain around 3%+ over coming quarters.

“Potential growth,” a measure of how fast the economy can grow when the unemployment rate is stable, has also improved. It's calculated using “Okun's Law,” which says that for every 1% per year the economy grows faster than its potential rate, the jobless rate will drop by 0.5 points.

Working backward from the unemployment declines of recent years shows that potential GDP growth has picked

up. From mid-2010 thru mid-2017, potential real GDP grew at just a 0.6% annual rate. But in 2018, with real GDP growth of 3.1% while the jobless rate dropped only 0.3 points, potential growth was 2.5%.

The worst part of the GDP story is the political gamesmanship of those who say real GDP only grew 2.9% in 2018. These data distorters are not looking at the size of the economy in the fourth quarter of 2018 compared to the fourth quarter of 2017; instead, they are comparing production through all of 2018 to production in all of 2017.

Here's why their method is misleading. Let's say that in the first quarter of Year 1 a company earns \$100 per share then earnings slip to \$99 in Q2, \$98 in Q3 and \$97 in Q4. Then, in Year 2, earnings start at \$97 per share in Q1, go to \$98 in Q2, \$99 in Q3 and finally back to \$100 in Q4. Overall, for two years earnings per share were flat. But that's because earnings growth was bad in Year 1 and good in Year 2. But the misleading method used by those saying the economy only grew 2.9% in 2018 would compare total earnings in Year 2 (\$394) to total earnings in Year 1 (\$394) and say the company had zero growth in Year 2! But that's nonsense. What matters in measuring Year 2 is how much earnings grew during the year, and in our example, that was 3.1% in Year 2.

As you can probably guess, this is a method favored only by academics, academic-style institutions like the IMF and World Bank, and political operatives trying to mislead. The truth is that tax cuts and deregulation have boosted growth, and will keep doing so as long as we stay on path.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-4 / 9:00 am	Construction Spending – Dec	+0.1%	+0.7%	-0.6%	+0.8%
3-5 / 9:00 am	New Home Sales – Dec	0.600 Mil	0.580 Mil		0.657 Mil
9:00 am	ISM Non Mfg Index – Feb	57.3	57.6		56.7
3-6 / 7:30 am	Int'l Trade Balance – Dec	-\$57.9 Bil	-\$57.9 Bil		-\$49.3 Bil
3-7 / 7:30 am	Initial Claims – Mar 2	225K	225K		225K
7:30 am	Q4 Non-Farm Productivity	+1.5%	+1.8%		+2.2%
7:30 am	Q4 Unit Labor Costs	+1.7%	+1.6%		+0.9%
3-8 / 7:30 am	Non-Farm Payrolls – Feb	183K	195K		304K
7:30 am	Private Payrolls – Feb	180K	187K		296K
7:30 am	Manufacturing Payrolls – Feb	10K	10K		13K
7:30 am	Unemployment Rate – Feb	3.9%	3.8%		4.0%
7:30 am	Average Hourly Earnings – Feb	+0.3%	+0.2%		+0.1%
7:30 am	Average Weekly Hours – Feb	34.5	34.5		34.5
7:30 am	Housing Starts – Jan	1.190 Mil	1.227 Mil		1.078 Mil