First Trust
Monday Morning OUTLOOK

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Temporary Tepid Growth for Q2

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

This Friday, the government will release its initial estimate of real GDP growth in the second quarter, and the headline is likely to look soft. At present, we're projecting an initial report of growth at a 1.8% annual rate.

If our projection holds true, we're sure pessimistic analysts and investors will latch onto the slowdown from the 3.1% growth rate for the first quarter, implying that we're back to slower Plow Horse growth for good. They will argue nothing has substantially changed since Trump took office, despite tax cuts and deregulation.

It's true that an annualized growth rate of 1.8% would be the slowest pace since the first quarter of 2017. But, as we will explain below, growth in the second quarter was likely held down temporarily by businesses returning to a more sustainable pace of inventory accumulation following the rapid pace of inventory building in the second half of 2018 and first quarter of this year. Excluding inventories – focusing on what economists call final sales – we estimate that real GDP grew at a 3.1% annual rate in Q2.

We also like to follow what we call "core GDP," which is real growth in personal consumption, business investment, and home building, combined. Core GDP looks like it grew at a 4.1% annual rate in the second quarter, the fastest pace in a year. In other words, while the economy may not be booming like the mid-1980s or late-1990s, the underlying trend remains quite healthy, and certainly much better than the Plow Horse period from mid-2009 through early 2017.

Here's how we get to our 1.8% real growth forecast for Q2:

Consumption: Automakers say car and light truck sales grew at a 2.8% annual rate in Q2 while "real" (inflation-adjusted) retail sales outside the auto sector grew at a 3.9% rate. Combined with some less up-to-date figures on consumer spending on services, real personal consumption (goods and services combined) looks to have grown at a 4.0% annual rate, contributing 2.7 points to the real GDP growth rate (4.0 times the consumption share of GDP, which is 68%, equals 2.7).

Business Investment: Reports on durable goods shipments and construction suggest all three components of business investment – equipment, commercial construction, and intellectual property – rose in the first quarter. A combined growth rate of 5.1% adds 0.7 points to real GDP growth. (5.1 times the 14% business investment share of GDP equals 0.7).

Home Building: After five straight quarters of contraction, it looks like home building – a combination of new housing as well as improvements – increased at a 2.6% annual rate in Q2. Expect more gains in the quarters ahead as home builders are still constructing too few homes given population growth and the scrappage of older homes. In the meantime, a 2.6% pace translates into a boost of 0.1 point to real GDP growth. (2.6 times the 4% residential construction share of GDP equals 0.1).

Government: Looks like a relatively large 2.3% increase in real public-sector purchases in Q2, which would add 0.4 points to the real GDP growth rate. (2.3 times the government purchase share of GDP, which is 17%, equals 0.4).

Trade: Net exports' effect on GDP has been very volatile in the past year, probably because of companies front-running - and then living with - tariffs and (hopefully) temporary trade barriers. Net exports added 0.9 points to the GDP growth rate in Q1, but should subtract an almost equal 0.8 points in Q2.

Inventories: Inventories are a potential wild-card, because we are still waiting on data on what businesses did with their shelves and showrooms in June. We get a report on inventories on Thursday, the day before the GDP report arrives, which may change our final GDP forecast. In the meantime, it looks like the pace of inventory accumulation got back to more normal levels in Q2, which should temporarily subtract 1.3 points from real GDP growth.

Add it all up, and we get 1.8% annualized real GDP growth. Don't let this tepid headline number spoil your day; the trend remains strong where it matters most, and prospects are bright for the US economy.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-23 / 9:00 am	Existing Home Sales – Jun	5.330 Mil	**5.240 Mil**		5.340 Mil
7-24 / 9:00 am	New Home Sales – Jun	0.660 Mil	**0.638 Mil**		0.626 Mil
7-25 / 7:30 am	Initial Claims - Jul 22	218K	**217K**		216K
7:30 am	Durable Goods – Jun	+0.7%	**+0.8%**		-1.3%
7:30 am	Durable Goods (Ex-Trans) – Jun	+0.2%	**+0.2%**		+0.4%
7-26 / 7:30 am	Q2 GDP Advance Report	1.8%	**1.8%**		3.1%
7:30 am	Q2 GDP Chain Price Index	2.0%	**1.9%**		0.9%