630-322-7756
www.ftportfolios.com

First Trust

Jul 21, 2008

Monday Morning Outlook

Brian S. Wesbury - Chief Economist
Robert Stein, CFA - Senior Economist

Growth Was Solid in Q2

Late next week the government will release initial estimates of real economic activity in the second quarter. Not long ago, in early April, when the quarter was just beginning, the consensus forecast for Q2 2008 real GDP growth was 0.0%, with as many economists predicting contraction as were predicting growth.

Now, three months later, the consensus is up to 2.2%. And no surprise - we are forecasting a 3% growth rate, more bullish than almost any other economist.

Yes, it is true that the home building and autos sectors have been hammered. But, it is not true that this weakness has spread. Outside those sectors, the economy is not just healthy but downright strong, reflecting relatively low tax rates and loose monetary policy.

Home building is still correcting from the excess liquidity of Alan Greenspan's final years, but home construction will likely turn up by early 2009. That same easy money boosted oil prices and sent a shock wave through the auto industry. But one of the big problems for auto manufacturers is that they have not made enough small cars in recent months. We expect auto sales to rebound as firms produce more small cars.

Many say it feels like a recession and predict negative growth. Then the data arrive, and show growth. The pessimists *then* say it doesn't matter because it's *"old"* news. After all, the quarter is already over and the evidence of recession will be clear by next quarter, they say.

Eventually, those forecasting recession are going to run out of time. The clock is already ticking and the economy remains resilient. Construction and auto related layoffs account for more than all the job losses in the past year. Initial unemployment claims remain below 400,000 and the financial sector appears to be bottoming.

Below we set out the components of real GDP that comprise our 3% forecast for Q2.

Personal Consumption: We already have full consumption data for April and May as well as auto sales and retail sales for June. The only piece missing is June services. We estimate real consumption grew at a 2.0% annual rate in Q2. With consumption accounting for 70% of GDP, real PCE will contribute 1.4 points to real GDP growth (1.4 equals 70% of 2).

Business Investment: Data through May show business investment in equipment and software was unchanged in Q2. However, business construction continued to boom, suggesting overall real business investment will grow at about a 6% annual rate in Q2. With business investment accounting for about 10% of GDP, this translates into 0.6 points for real GDP growth (0.6 equals 10% of 6).

Housing: Data on home building suggests a decline at about a 23% annual rate in Q2. Given that the sector makes up roughly 4% of GDP, this translates into a drag of 0.9 points on real GDP growth (0.9 equals 4% of 23).

Government: Federal defense spending and public construction at all levels of government were unusually strong, suggesting gov't spending accounts for 0.5 points worth of real GDP rather than the 0.3 or 0.4 trend.

Trade: The inflation-adjusted trade deficit has been shrinking rapidly. Even assuming no additional improvement in June, net exports will add about 2.0 points to real GDP growth.

Inventories: We assume businesses around the country reduced stockpiles at an annual rate of $37 billion, the largest reduction since the 2001 recession, resulting in a drag of 0.6 points to growth.

Second Quarter GDP: = 3.0%

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-21 / 9:00 am	Leading Indicators - Jul	-0.1%	**+0.0%**	-0.1%	+0.1%
7-24 / 7:30 am	Initial Claims - Jul 19	380K	**375K**		366K
9:00 am	Existing Home Sales - Jul	4.940 Mil	**4.930 Mil**		4.99 Mil
7-25 / 7:30 am	Durable Goods - Jul	-0.3%	**-0.7%**		+0.0%
7:30 am	Durable Goods (Ex-Trans) - Jul	-0.2%	**-0.4%**		-0.8%
9:00 am	New Home Sales - Jan	0.503 Mil	**0.508 Mil**		0.512 Mil
8:45 am	U. Mich. Consumer Sentiment	56.4	**56.0**		56.6