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FIRST Trust ADVISORS L.P.

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Monday Morning Outlook

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GDP Revisions Suggest Healthy Growth Ahead

Real GDP grew at a 3.4% annual rate in the second quarter (4% excluding the housing sector). This is a significant acceleration from the relatively anemic 1.5% growth rate during the year ending in March. The 3.4% growth rate exactly matched our forecast from last week, although government spending was greater than we forecast and inventory accumulation was smaller.

Usually, when the economy slows to only 1.5% growth for a year it is about to slip into recession, already has slipped into a recession, or has just recently started to recover from a recession. This time was different because the economic slowdown was almost all concentrated in one sector: housing – which was operating under its own interest-rate driven dynamics. Outside of housing the economy grew 2.6% in the year ending in Q1, consistent with temporary slowdowns in previous business cycles.

Friday's GDP report was particularly important because it included revisions going back to 2004. Real GDP growth between 2004 and 2006 was revised down to 3.2% from the previously estimated 3.5%. Meanwhile, GDP inflation was revised upwardly to 3.1% from 2.9% for the same time period.

Other noteworthy revisions include a higher trajectory for personal income than previously estimated, primarily due to higher interest and dividend earnings. In turn, this extra income boosted the government's measure of the personal saving rate by 1.5 percentage points. Instead of a negative 1% personal saving rate between 2004 and 2006, it has been a positive 0.5%.

With higher incomes, our measure of consumer cash flow – the portion of after-tax income that consumers do not need to service their debts and other monthly obligations (mortgages, property taxes, rent, auto payments, credit card debt,…etc.) – has grown 3.4% (adjusted for inflation) in the past year. This makes us more confident that consumption growth will remain healthy.

Business investment and net exports will also be strong. Firms have plenty of cash to build out capacity. And, profit margins – although revised down for the past couple of years – remain very high. This gives companies an incentive to expand and entrepreneurs a reason to take risk. Meanwhile, the trade deficit is declining in response to past dollar depreciation and strong growth abroad.

Overall, we expect real GDP growth of around 3.5% over the next four quarters and close to 4% excluding housing.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-31 / 7:30 am	Personal Income - Jun	+0.5%	**+0.6%**		+0.4%
7:30 am	Personal Spending - Jun	+0.2%	**+0.1%**		+0.5%
7:30 am	Q2 Employment Cost Index	+0.9%	**+0.9%**		+0.8%
8:45 am	Chicago PMI - Jul	58.0	**64.0**		60.2
9:00 am	Construction Spending - Jun	+0.3%	**+0.2%**		0.9%
8-1 / 9:00 am	ISM Index - Jul	55.5	**56.1**		56.0
8-2 / 7:30 am	Initial Claims - Jul 28	309K	**308K**		301K
9:00 am	Factory Orders - Jun	+1.0%	**+1.1%**		-0.5%
8-3 / 7:30 am	Non-Farm Payrolls - Jul	130K	**60K**		132K
7:30 am	Unemployment Rate - Jul	4.5%	**4.5%**		4.5%
7:30 am	Average Hourly Earnings - Jul	+0.3%	**+0.3%**		+0.3%
7:30 am	Average Weekly Hours - Jul	33.9	**33.9**		33.9
7:30 am	Manufacturing Payrolls - Jul	-15K	**-20K**		-18K
9:00 am	ISM Non-Man. - Jul	59.0	**60.7**		60.7