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First Trust

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Monday Morning Outlook

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How Can We Be So Optimistic About Growth?

Our forecast for the second half of this year and all of next year is that real (inflation-adjusted) economic growth is going to average more than 4% at an annual rate, well above the consensus, which expects below-trend growth of about 2%.

To be more precise, we are forecasting that real GDP grows at a 3.5% rate in the second half of 2009 and 4.5% next year. But, in all truth, we are much more confident about the overall 4%+ figure for the full 18-month period then about the exact growth rate for any particular quarter.

When we tell people this forecast, we often get looks as if we are out of our minds, and that's the polite response. So we're going to put all our cards on the table and show everyone exactly how we get to our bullish forecast. Get ready to be surprised at the modesty of many of our economic assumptions.

First, we project business inventories are going to end 2010 about $25 billion *lower* than they are right now. But with businesses no longer reducing stockpiles as forcefully as they have been in recent months, inventories will contribute 1.3 points to the real GDP growth rate. Second, we expect continued declines in the trade deficit, although not as quickly as in the last two years. The trade deficit was 5.4% of GDP in early 2007 and is now only about 2.2% of GDP. If the trade gap declines to 1.1% by the end of 2010, net exports can contribute 0.9 points to the real GDP growth rate.

Third, we expect home building to bottom later this year and rise in 2010, contributing 0.4 points to the real GDP growth rate. Housing starts are now only one-third of the long-term trend, justifiably so due to excess home inventories. But excess inventories have already dropped from about 4.5 million a few years ago to 2 million today. We think, realistically, it will take another three or four years to fully eliminate the excess. But this also means that over this time, the rate of housing starts is going to have to rise substantially just to get to normal, so that we don't have a housing shortage four years from now.

Fourth, for government, we assume government spending contributes its long-term average of 0.4 points to real GDP growth, despite massive stimulus spending. Fifth, despite our gut instinct that business investment in plant and equipment is going to turn around much faster, we assume an annualized rate of decline of 3.2%, which subtracts 0.3 points from the real GDP growth rate.

And last, we expect real consumer spending to rise at a relatively modest 2.1% annual pace, adding 1.5 points to the real GDP growth rate. To put this in perspective, we are forecasting that real consumption will be up at only a 0.6% annual rate from the end of 2007 through the end of 2010, the slowest three-year period for real consumer spending since World War II, including the early 1980s, when the jobless rate went up to almost 11%. It also means consumer spending drops to the lowest share of GDP since 2001.

Adding up all these factors leaves us with an average expected real GDP growth rate of 4.2%. And we get there with what we think are very conservative estimates on consumption and business investment. For the consensus forecast to remain at 2% real GDP growth, there must be some very, very pessimistic assumptions out there. We wonder what they are.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-13 / 1:00 pm	Treasury Budget – Jun	-$97.0 Bil	**-$97.0 Bil**		-$189.7 Bil
7-14 / 7:30 am	Retail Sales – Jun	+0.4%	**+0.5%**		+0.5%
7:30 am	"Core" Retail Sales – Jun	+0.5%	**+1.1%**		+0.5%
7:30 am	PPI – Jun	+0.9%	**+1.1%**		+0.2%
7:30 am	"Core" PPI – Jun	+0.1%	**+0.1%**		-0.1%
9:00 am	Business Inventories – May	-0.8%	**-0.9%**		-1.1%
7-15 / 7:30 am	CPI – Jun	+0.6%	**+0.7%**		+0.1%
7:30 am	"Core" CPI – Jun	+0.1%	**+0.2%**		+0.1%
7:30 am	Empire State Mfg Index – Jul	-5.0	**0.0**		-9.4
8:15 am	Industrial Production – Jun	-0.6%	**-0.5%**		-1.1%
8:15 am	Capacity Utilization – Jun	67.9%	**67.8%**		68.3%
7-16 / 7:30 am	Initial Claims - Jul 11	554K	**555K**		565K
9:00 am	Philly Fed Survey – Jul	-5.0	**-4.5**		-2.2
7-17 / 7:30 am	Housing Starts - Jun	0.528 Mil	**0.548 Mil**		0.532 Mil