First Trust
Monday Morning OUTLOOK
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Solid 3.5% Growth in Q3

When real GDP growth barely budged in Q1 (0.4%) and sputtered in Q2 (1.3%), conventional wisdom became convinced that a recession was on its way. Many argued that unless the US "stimulated the economy" with more spending, temporary Keynesian tax cuts, or another round of quantitative easing, it was in for another recession.

We had a very different view. We suspected weakness in Q1 was overstated – after all, real GDI (gross domestic income) showed 2.4% growth in Q1. GDI and GDP are supposed to be equal. When they differ substantially, it is the income side that typically shows more accuracy. In other words, we think the weakness in Q1 will eventually get revised away.

That probably won't happen with Q2, when the economy grew at only a 1.3% annual rate. But we have always believed that weakness in Q2 was driven by disasters in Japan and the unusually violent tornado season in the South.

With the Fed accommodative, and productivity strong, we never believed the pessimistic narrative. Conventional wisdom has been wrong. With most monthly data in, it looks like real GDP grew at a 3.5% annualized growth rate in the third quarter of 2011.

Consumption: Auto sales are up at a 11.7% annual rate in Q3 while retail sales ex-autos are up at a 4.5% rate. Services, a major part of consumption, are not up as much, but it looks like real personal consumption – goods and services combined – probably climbed at a 2.1% annual rate in Q3, contributing 1.5 points to the real GDP growth rate. (2.1 times the consumption share of GDP, which is 71%, equals 1.5.)

Business Investment: Business investment in equipment and software appears to have grown at an annualized 14% growth rate in Q3. Meanwhile, commercial construction looks to be up at a 19% rate. Combined, these two components of non-residential investment grew at about a 15% rate, which should add about 1.5 points to the real GDP growth rate. (15 times the business investment share of GDP, which is 10%, equals 1.5.)

Home Building: Residential construction appears to have grown at about a 4% annual rate in Q3. This translates into 0.1 point for the real GDP growth rate. (4 times the home building share of GDP, which is 2%, equals 0.1.)

Government: Real government purchases expanded at about a 2.5% rate in Q3, which should boost the real GDP growth rate by about 0.5 percentage points. (2.5 times the government *purchase* share of GDP, which is 20%, equals 0.5).

Trade: We only have data through August, but the trade deficit is down so far in Q3 and we think this should add 0.3 points on the growth of real GDP.

Inventories: As always, inventories are a wild card. At this point, we only have data on inventories through August and *inflation-adjusted* numbers are only available through July. To be cautious with our real GDP estimate, we assume inventory accumulation slowed slightly from the pace in Q2, resulting in a drag of 0.4 points on the real GDP growth rate.

Add-em-up, and you get 3.5% real GDP growth for Q3, with an upside risk. Not only that, but we expect more solid growth in Q4 and beyond. Anyone who has forecast an imminent recession has some explaining to do.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-17 / 7:30 am	Empire State Mfg Index - Oct	-4.0	**0.0**	-8.8	-8.8
8:15 am	Industrial Production - Sep	+0.2%	**+0.2%**	+0.2%	+0.2%
8:15 am	Capacity Utilization - Sep	77.5%	**77.5%**	77.4%	77.4%
10-18 / 7:30 am	PPI - Sep	+0.2%	**+0.3%**		0.0%
7:30 am	"Core" PPI - Sep	+0.1%	**+0.2%**		+0.1%
10-19 / 7:30 am	CPI - Sep	+0.3%	**+0.3%**		+0.4%
7:30 am	"Core" CPI - Sep	+0.2%	**+0.2%**		+0.2%
7:30 am	Housing Starts - Sep	0.590 Mil	**0.585 Mil**		0.571 Mil
10-20 / 7:30 am	Initial Claims - Oct 15	400K	**405K**		404K
9:00 am	Philly Fed Survey - Oct	-9.3	**-12.5**		-17.5
9:00 am	Leading Indicators - Sep	+0.3%	**+0.3%**		+0.3%
9:00 am	Existing Home Sales - Sep	4.920 Mil	**4.820 Mil**		5.030 Mil