

## Slow in Q2, But No Recession

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We estimate real GDP grew at only a 0.9% annual rate in Q2. The Plow Horse Economy hit a tough spot, but it hasn't hit the wall. In Q1-2011, real GDP grew at just 0.4% at an annual rate, but then accelerated again.

In other words, this is not the end of the world. It's not a recession. The economy is still growing. It could grow faster if the US made better public policy choices. Under both President Bush and Obama, government spending grew. Our Plow Horse has had a heavy load to pull. In economic terms, potential GDP is lower, while unemployment is higher, than it would have been without the growth in government spending.

We expect real GDP to pick up in the second half of the year, with the improvement tilted toward the fourth quarter. In other words, we do not expect either a surge or collapse in economic data to influence the election in November. What the voters see is what they get: pockets of entrepreneurial brilliance offset by the weight and uncertainty of government spending, regulation, and taxes.

Here's our "add-em-up" calculation of real GDP growth in Q2, component by component.

**Consumption:** Auto sales fell at a 12% annual rate in Q2, while "real" (inflation-adjusted) retail sales ex-autos declined at a 2.1% rate. However, services make up about 2/3 of personal consumption and they grew in Q2. So far, it looks like real personal consumption of goods and services combined, grew at a 1.1% annual rate in Q2, contributing 0.8 points to the real GDP growth rate. (1.1 times the consumption share of GDP, which is 71%, equals 0.8.)

**Business Investment:** Business investment in equipment and software and commercial construction grew at an annualized 4% rate in Q2. This should add 0.4 points to the real GDP growth rate. (4 times the business investment share of GDP, which is 10%, equals 0.4.)

**Home Building:** Residential construction is headed for its fifth straight positive contribution to real GDP. The growth is still led by apartment buildings, but single-family construction is also on the mend, and the pessimists can no longer say it's a temporary blip from unusually mild winter weather. Home building appears to have grown at about a 13% annual rate in Q2. This translates into 0.3 points for the real GDP growth rate. (13 times the home building share of GDP, which is 2.3%, equals 0.3.)

**Government:** Military spending continues to decline and state/local government construction is still under pressure from budget cuts. On net, real government purchases shrank at about a 0.5% rate in Q2, which should subtract about 0.1 percentage points from real GDP growth. (-0.5 times the government purchase share of GDP, which is 20%, equals -0.1.)

**Trade:** At this point, the government has only reported trade data through May. On average, the "real" trade deficit in goods has grown compared to the Q1 average. Also, in the last few years, seasonal adjustment factors for oil have made the Q2 trade deficit look larger in the GDP accounts than in the monthly Census data. As a result, we're forecasting the trade sector subtracted 0.7 points from the real GDP growth rate.

**Inventories:** As always, inventories are the wild card. We only have "real" inventory figures through April, when they were up at a solid pace. Nominal inventories were up at a moderate pace in May and we're assuming another moderate gain in June. This should generate a very small addition of 0.2 points to the real GDP growth rate in Q2.

Add-em-up and you get 0.9% real GDP growth for Q2. It's nothing to write home about – just another Plow Horse report. For now, despite all kinds of stumbling blocks, the US economy just keeps plodding along.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-25 / 9:00 am	New Home Sales– Jun	0.370 Mil	<b>0.363 Mil</b>		0.369 Mil
7-26 / 7:30 am	Durable Goods – Jun	0.4%	<b>-0.9%</b>		1.3%
7:30 am	Durable Goods (Ex-Trans) - Jun	0.1%	<b>-0.7%</b>		0.7%
7:30 am	Initial Claims – Jul 21	380K	<b>376K</b>		386K
7-27 / 7:30 am	Q2 GDP Advanced	1.4%	<b>0.9%</b>		1.9%
7:30 am	Q2 GDP Chain Price Index	1.6%	<b>1.6%</b>		2.0%
8:55 am	U. Mich Consumer Sentiment	72.0	<b>73.0</b>		72.0