First Trust
Monday Morning OUTLOOK
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More Plow Horse in Q2

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Forecasting economic growth for the second quarter of the year is always precarious. The reason is that the initial report on the second quarter is when the government goes back and makes revisions to GDP for the past several years. This time around, it's particularly iffy because the government – for the very first time – is going to start accounting in GDP for the value of R&D spending by companies.

Putting these obstacles aside, we've been calling the economy a Plow Horse for the last couple of years and, at the end of the month, it looks like we'll be getting yet another Plow Horse report for second quarter economic growth.

The data we are confident about are consumer spending, business investment, and home building. Combined, these parts of real GDP appear to have grown at a 1.6% annual rate in Q2. The other components of real GDP – the ones we are less confident about – inventories, government purchases, and trade should, on net, pull the overall economic growth rate down slightly, to 1.5%.

This a little bit slower than we had been expecting a couple of months ago, but we still anticipate an acceleration of growth later this year. So do private companies, which added 199,000 jobs per month to payrolls in Q2.

Once again, the reason we have a Plow Horse economy, and not a Race Horse economy, is that the huge increase in the size and scope of the federal government over the past several years is weighing on entrepreneurs. Still, it hasn't completely smothered innovation and risk-taking, and so we're left with plodding economic growth that would be so much faster if not for the burden of government.

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

Consumption: Sales of cars and light trucks were up at a 2% annual rate in Q2, while "real" (inflation-adjusted) retail sales ex-autos were up at a 1.5% rate. Services make up about 2/3 of personal consumption and they grew at about a 1.1% rate. So far, it looks like real personal consumption of goods and services combined, grew at a 1.3% annual rate in Q2, contributing 0.9 points to the real GDP growth rate. (1.3 times the consumption share of GDP, which is 71%, equals 0.9)

Business Investment: Business investment in equipment & software looks like it grew at a 2.7% annual rate in Q2 while commercial construction was down at a 3.4% pace. Combined, with equipment carrying a heavier weight than construction, they grew at a 1.2% pace, which should add 0.1 points to the real GDP growth rate. (1.2 times the business investment share of GDP, which is 10%, equals 0.1)

Home Building: The housing rebound continued in Q2, led by new home construction, and looks like it grew at an 11% annual rate. This translates into 0.3 points for the real GDP growth rate. (11 times the home building share of GDP, which is 2.7%, equals 0.3)

Government: Military spending shrank in Q2 (but less than in Q1) and state & local government construction projects appear to have picked up. On net, we estimate real government purchases grew at a 0.5% rate in Q2, which should add 0.1 percentage points to real GDP growth. (0.5 times the government *purchase* share of GDP, which is 19%, 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 substantially compared to the Q1 average. As a result, we're forecasting the trade sector subtracted 0.9 points from the real GDP growth rate.

Inventories: Inventory accumulation slowed substantially late last year, in part due to a drought in the farm sector. But inventory growth picked up in Q1 and we expect the rebound to continue in Q2, particularly when adjusted for what we think are (temporary) declining inventory prices for the quarter. As a result, we're assuming inventories add a full 1 percentage point to the real GDP growth rate in Q2.

Add-em-up and you get 1.5% real GDP growth for Q2. Once again, no economic boom, but no recession either. No one bets on a Plow Horse, but it does deserve respect.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-22 / 9:00 pm	Existing Home Sales – Jun	5.250 Mil	**5.280 Mil**	5.080 Mil	5.180 Mil
7-24 / 9:00 am	New Home Sales – Jun	0.485 Mil	**0.475 Mil**		0.476 Mil
7-25 / 7:30 am	Initial Claims Jul 20	340K	**340K**		334K
7:30 am	Durable Goods – Jun	+1.1%	**+3.3%**		+3.7%
7:30 am	Durable Goods (Ex-Trans) – Jun	+0.5%	**+0.6%**		+0.5%
7-26 / 8:55 am	U. Mich Consumer Sentiment- Jul	84.0	**84.0**		83.9