

Plow Horse GDP Rebound in Q2

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Economist*

The 2.9% drop in real GDP during the first quarter was a fluke caused by a brutal winter and some one-off events. With much of the monthly data in for Q2, it looks like the US will see that drop almost completely reversed.

Normally, we would expect a bigger bounce as pent-up demand (lost to the weather) returned and added to growth already in train. But, not this time. In recent years, tax rates have been hiked, regulations have increased and government spending has expanded. All of these are a burden on the economy that creates slower potential growth.

As a result, while we expect a nice rebound in Q2 real GDP to 2.9% annualized growth, this still looks like a Plow Horse recovery.

This doesn't mean we won't see better growth rates in the years ahead. Monetary policy is loose – and will stay that way even when the Federal Reserve starts raising rates – corporate profits have been terrific, and housing will continue to rebound. Job creation has hastened, helping boost incomes and purchasing power.

However, the economy will remain disappointingly weak unless, and until, government policies change. Given current policies, this economic expansion will not be like the ones in the 1980s or 1990s. Not even close.

As we do every quarter, below is a component by component “add-em-up” forecast of Q2 real GDP – and how we get the 2.9% rebound from the Q1 economic pothole.

Consumption: Auto sales surged at a 26% annual rate in Q2 and “real” (inflation-adjusted) retail sales outside the auto sector grew at a 4% rate. But services make up about 2/3 of personal consumption and those were roughly unchanged. As a result, it looks like real personal consumption of goods and services combined, grew at a 1.9% annual rate in Q2, contributing 1.3 points to the real GDP growth rate (1.9 times the consumption share of GDP, which is 69%, equals 1.3).

Business Investment: Business equipment investment looks like it grew at a 12.5% annual rate in Q2, the fastest pace since 2011. Commercial construction looks like it grew at a 4% rate. Factoring in R&D suggests overall business investment grew at a 7.5% rate, which should add 0.9 points to the real GDP growth rate (7.5 times the 12% business investment share of GDP equals 0.9).

Home Building: Better weather brought more home building in Q2, although nothing close to a housing boom. We see a 6% annualized gain in home building in Q2 adding 0.2 points to the real GDP growth rate (6 times the home building share of GDP, which is 3%, equals 0.2).

Government: Public construction projects, which had been slowed by the weather in Q1, rebounded sharply in Q2. However, military spending continued to head down. On net, it looks like real government purchases grew at a 2% annual rate in Q2, which should add 0.4 percentage points to real GDP growth (2 times the government *purchase* share of GDP, which is 18%, equals 0.4).

Trade: At this point, the government only has trade data through May, and it doesn't look very good for US GDP. On average, the “real” trade deficit in goods has grown larger in Q2. As a result, we're forecasting that net exports subtracted 0.7 points from the real GDP growth rate.

Inventories: Companies cut the pace of inventory accumulation in Q1. But, with partial data only through May, it appears inventory accumulation is reaccelerating. That's a harbinger of better sales ahead and, for the time being, will add 0.8 points to the real GDP growth rate in Q2.

Nothing in the next GDP report is going to signal an economic boom. But, the dour forecasts of imminent recession which accompanied the reported drop in GDP over the winter months will be proven wrong. (Once again!) We aren't looking for a boom, but it sure looks like a solid Plow Horse piece of data is on its way.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-22 / 7:30 pm	CPI – Jun	+0.3%	+0.3%		+0.4%
7:30 am	“Core” CPI – Jun	+0.2%	+0.2%		+0.3%
9:00 am	Existing Home Sales – Jun	4.990 Mil	4.990 Mil		4.890 Mil
7-24 / 7:30 pm	Initial Claims Jul 19	310K	308K		302K
9:00 am	New Home Sales – Jun	0.475 Mil	0.459 Mil		0.504 Mil
7-25 / 7:30 pm	Durable Goods – Jun	+0.5%	+0.1%		-0.9%
7:30 am	Durable Goods (Ex-Trans) – Jun	+0.5%	+0.8%		0.0%