

GDP, Strong Again

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

With all the focus on Europe in general and Greece in particular, it's important to keep in mind that the US economy continues to move forward. After real GDP dropped in the first quarter of last year, some analysts were predicting another recession. By contrast, we said the drop was due to unusually harsh winter weather and the economy would rebound quickly.

And rebound it did. Real GDP grew at a 4.6% annual rate in the second quarter and a 5% rate in the third. On Friday, the government will report its initial estimate for real GDP growth in Q4 and we think the economy grew at a 3.3% annual rate. If we're right, real GDP was up a Plow Horse 2.6% in 2014, slightly faster than the 2.3% pace the economy has averaged since the recovery started in 2009.

For 2015, we're forecasting 2.7%. Some analysts are lifting their forecasts based on plummeting oil prices and Europe's quantitative easing, while some might mark them down due to Greece. But these are all sideshows.

Lower oil prices may push up non-oil spending, but oil production will now expand more slowly. QE in Europe is not going to help boost growth; it'll just stuff European banks with as many useless excess reserves as US banks hold already. And our exports to Greece are less than 0.01% of US GDP.

Instead, investors need to focus on the fundamentals that drive the economy, which haven't changed. Monetary policy remains loose, tax rates are not going up (regardless of what President Obama said in his State of the Union address), and entrepreneurs are still innovating.

Below is our "add-em-up" forecast for Q4 real GDP.

Consumption: Auto sales increased at a 0.5% annual rate in Q4 while "real" (inflation-adjusted) retail sales outside the auto sector were up at a tepid 1.8% rate. But services make up about 2/3 of personal consumption and those were up at about a 4.5% rate. So it looks like real personal consumption of goods

and services combined, grew at a 3.8% annual rate in Q4, contributing 2.6 points to the real GDP growth rate (3.8 times the consumption share of GDP, which is 68%, equals 2.6).

Business Investment: Business equipment investment and commercial construction were both unchanged in Q4. Factoring in R&D suggests overall business investment grew at a 0.8% rate, which should add 0.1 point to the real GDP growth rate (0.8 times the 13% business investment share of GDP equals 0.1).

Home Building: A 9% annualized gain in home building in Q4 will add about 0.3 points to real GDP (9 times the home building share of GDP, which is 3%, equals 0.3).

Government: Public construction projects continued to increase in Q4 while military spending picked up as well. As a result, it looks like real government purchases grew at a 1.1% annual rate in Q4, which should add 0.2 percentage points to real GDP growth (1.1 times the government purchase share of GDP, which is 18%, equals 0.2).

Trade: At this point, the government only has trade data through November, but the data so far suggest the "real" trade deficit in goods has gotten a little smaller. As a result, we're forecasting that net exports add 0.1 point to the real GDP growth rate.

Inventories: After a weather-related lull in Q1, companies built inventories at a very rapid pace in Q2. Since, then that pace has neither slowed nor sped up further, meaning inventories are a net zero for GDP, neither adding nor subtracting.

The US government has expanded way too much in the past decade or so, which is why we have a Plow Horse economy rather than a Race Horse economy. But, even in this environment, the private sector still has room to grow. Not just in Q4, but in 2015 and likely beyond.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-27 / 7:30 am	Durable Goods – Dec	+0.4%	-0.2%		-0.9%
7:30 am	Durable Goods (Ex-Trans) – Dec	+0.6%	+1.1%		-0.7%
9:00 am	New Home Sales – Dec	0.450 Mil	0.462 Mil		0.438 Mil
9:00 am	Consumer Confidence – Jan	95.5	96.9		92.6
1-29 / 7:30 am	Initial Claims – Jan 24	300K	306K		307K
1-30 / 7:30 am	Q4 GDP Advance Report	3.1%	3.3%		5.0%
7:30 am	Q4 GDP Chain Price Index	0.9%	1.2%		1.4%
8:45 am	Chicago PMI – Jan	57.8	58.8		58.8
9:00 am	U. Mich Consumer Sentiment- Jan	98.2	98.5		98.2