First Trust
Monday Morning OUTLOOK
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Q4: Sluggish Growth, No Recession

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The recent turmoil in the equity markets would make more sense if the US economy were headed for recession. But the economic data aren't cooperating.

Although initial jobless claims have trended up recently, plugging recent reports into our models suggests payrolls are still growing at about a 200,000 monthly rate, not even close to a recession. Meanwhile, existing home sales surged in December and "core" industrial production (manufacturing ex-autos) eked out a 0.1% gain as well.

Overall, Q4 was nothing great. As we explain below, we estimate real GDP grew at a 0.9% annual rate in Q4, consistent with the Plow Horse economic growth the economy has experienced ever since emerging from recession in mid-2009. Yes, 0.9% is on the weak side of the trend, but there have been six quarters with even weaker growth during the expansion. Moreover, the weakest part of GDP will be inventories, which should leave more room for future growth.

We like to focus on "core" GDP. By subtracting the volatile, and less growth-oriented, categories (Government spending, Inventories, and International trade) from GDP, a clearer picture of trends in investment and consumer spending emerge. That measure appears to have grown at a 1.9% annual rate in Q4, which means it was up a respectable 2.7% in 2015. This is part of the reason why we think, despite recent market turmoil, real GDP will rise 2.5%+ in 2016.

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

Consumption: Modest growth in auto sales and continued gains in services, which make up more than 2/3 of personal consumption, suggest real personal consumption of goods and services, combined, grew at a 1.9% rate in Q4, contributing 1.3 points to the real GDP growth rate (1.9 times the consumption share of GDP, which is 68%, equals 1.3).

Business Investment: Both business equipment investment and commercial construction look down slightly in Q4, probably led by the energy sector. But R&D probably grew enough to offset that damage, leaving overall business investment unchanged, with zero net effect on GDP.

Home Building: The home building recovery continued in Q4. Residential construction looks to have grown at a 9% annual rate, which should add 0.3 points to the real GDP growth rate (9 times the home building GDP share, which is 3%, equals 0.3).

Government: A surge in military spending probably more than offset a decline in public construction projects in Q4, suggesting real government purchases rose at a 1.0% rate, which would add 0.2 percentage points to real GDP growth (1.0 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 numbers so far suggest the "real" trade deficit in goods has gotten bigger due to weaker economies abroad. As a result, we're forecasting that net exports are a drag of 0.2 points on the real GDP growth rate.

Inventories: At present, we have even less information on inventories than we do on trade, but what we have suggests companies added to inventories at a much slower pace than in Q3. As a result, we're forecasting inventories subtracted 0.7 points from real GDP in Q4.

Put it all together, and we get a 0.9% forecast for real GDP growth in Q4. But, with the components that make up the "core" adding a total of 1.6 points and those components making up only 82% of total GDP, the growth rate for those core components appears to be healthy 1.9%. Sorry for the extra math, but if 82% of GDP grows at a 1.9% rate, then the contribution to overall GDP growth is just 1.6 points.

We've noticed more and more people are coming up with words to describe this slow growth economy – the snail, the six-cylinder car, plodding, and crawling. Why don't they just say "Plow Horse" because that's what it is.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-26 / 9:00 am	Consumer Confidence – Jan	96.5	**96.5**		96.5
1-27 / 9:00 am	New Home Sales – Dec	0.500 Mil	**0.510 Mil**		0.490 Mil
1-28 / 7:30 am	Initial Claims – Jan 23	281K	**287K**		293K
7:30 am	Durable Goods – Dec	-0.7%	**-2.9%**		0.0%
7:30 am	Durable Goods (Ex-Trans) – Dec	-0.1%	**0.0%**		0.0%
1-29 / 7:30 am	Q4 GDP Advance Report	0.8%	**0.9%**		2.0%
7:30 am	Q4 GDP Chain Price Index	0.8%	**1.0%**		1.3%
8:45 am	Chicago PMI – Jan	45.4	**44.3**		42.9
9:00 am	U. Mich Consumer Sentiment- Jan	93.0	**93.3**		93.3