First Trust
Monday Morning OUTLOOK
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The Q1 Curse Strikes Again

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Remember the recession of 2011, or 2014, or 2015?

Each of those years started out with either a contraction or anemic first quarter economic growth. But despite these slowdowns, the US economy didn't fall into recession. Instead, it was just more Plow Horse growth.

Since the end of the recession in mid-2009, real GDP has grown at a 2.1% annual rate. The average annualized growth rate across 2011, 2014, and 2015? You guessed it: 2.1%. In other words, first quarter weakness was meaningless.

Keep this in mind when you hear the US barely grew in the first quarter of 2016. It may have even shrunk. The first quarter curse is an ongoing problem where the government has trouble seasonally-adjusting the economic data, making the first quarter look artificially slow, but making the remaining quarters look artificially fast.

You don't need to look much further than the labor market to see that the US is not in a recession. Payrolls grew 209,000 per month in Q1 and initial jobless claims averaged the lowest for any quarter since the early 1970s. As a result, we expect a pickup in the pace of GDP growth through the rest of 2016.

To cut through the noise, we like to focus on "core" GDP. By subtracting the volatile, less growth-oriented, categories (Government, Inventories, and International Trade) from GDP, a clearer picture of trends in investment and consumer spending emerges. That measure appears to have grown at a 1.2% annual rate in Q1, which means it was up a respectable 2.6% in the past year. This is part of the reason we think real GDP will continue to grow at a Plow Horse pace and may even accelerate over the next couple of years.

Below is our "add-em-up" forecast for Q1 real GDP.

Consumption: After surging late last year, auto sales fell at a 14.6% annual rate in Q1. But "real" (inflation-adjusted) retail sales ex-autos rose and services, which make up more than 2/3 of personal consumption, probably helped push overall real consumer spending on goods and services combined to a 1.8% growth rate, contributing 1.2 points to the real GDP growth (1.8 times the consumption share of GDP, which is 69%, equals 1.2).

Business Investment: Investment in equipment looks like it fell at about an 8% annual rate in Q1, led lower by the energy sector, while commercial construction declined at about a 3% rate. But R&D likely offset some of the decline, so overall business investment fell at about a 3% annual rate, subtracting 0.4 points from the real GDP growth rate. (-3 times the business investment GDP share, which is 13%, equals -0.4).

Home Building: The home building recovery continued in Q1. Residential construction looks to have grown at a 6% annual rate, which should add 0.2 points to the real GDP growth rate (6 times the home building GDP share, which is 3%, equals 0.2).

Government: An increase in public construction probably offset a large decline in military spending in Q1, suggesting real government purchases rose at a 0.4% rate, which would add 0.1 percentage points to real GDP growth (0.4 times the government *purchase* share of GDP, which is 18%, equals 0.1).

Trade: At this point, the government only has trade data through February, 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 0.6 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 slightly slower pace than in Q4. As a result, we're forecasting inventories subtracted 0.1 points from real GDP in Q1.

Put it all together, and we get a 0.4% forecast for real GDP growth in Q1. But, with the components that make up the "core" adding a total of 1.0 points, and those components making up roughly 85% of total GDP, the growth rate for those core components appears to be a slightly more respectable 1.2%. Sorry for the extra math, but if 85% of GDP grows at a 1.2% rate, then the contribution to overall GDP growth is 1.0 points.

None of this is to excuse the state of the economy. Even if statistical quirks are behind problems in the first quarter, government bean-counters aren't responsible for bad policies that have kept the economy from reaching its true growth potential. Hopefully, that will change in November. In the meantime, investors should expect more Plow Horse growth ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-19 / 7:30 am	Housing Starts – Mar	1.166 Mil	**1.187 Mil**		1.178 Mil
4-20 / 9:00 am	Existing Home Sales – Mar	5.280 Mil	**5.260 Mil**		5.080 Mil
4-21 / 7:30 am	Initial Claims Apr 16	265K	**262K**		253K
7:30 am	Philly Fed Survey – Apr	8.9	**14.8**		12.4