

Third Quarter Real GDP – 3.8%!

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While the Sunday morning talk shows discuss the number of Civil War monuments that can dance on the head of a pin...and a rare Eclipse grabs focus...investors might be shocked at how the economy has accelerated.

Although we still have more than a month left in the third quarter, and many more pieces of data to come, as of August 16th the Atlanta Fed's "GDP Now" model, which tracks and estimates real GDP growth, says the economy is expanding at a 3.8% annual rate in Q3. If correct, that would be the fastest pace for any quarter since 2014.

We usually take forecasts this early with a grain of salt. After all, a lot can happen over the remainder of the quarter. And, on some prior occasions, the Atlanta Fed has projected rapid growth for a quarter mid-way through, only to ratchet back the forecast by quarter-end to a more pedestrian Plow Horse growth rate near 2%. But, in this particular case, we think the pick-up is real. In fact, our own internal forecast suggests the exact same growth rate of 3.8%.

One thing more pessimistic analysts are focusing on is that "inventories" are adding about 1% to the third quarter growth rate. It looks like businesses are stocking shelves at a more normal pace after the lull in the first half of the year. Excluding this inventory boost, First Trust models have real GDP growing at a 2.4% annual rate in Q3, while the Atlanta Fed model has it at 2.8%.

It's hard to remember that the original report for Q1 real GDP was less than 1% growth. That report worried many investors, and doom and gloom stories abounded. But the foundation for continued economic growth remains in place.

It's true that the US is unlikely to see tax cuts or real tax reform (or both!) anytime this year. And this will make sustaining GDP growth at a 3.8% rate very difficult. But we expect favorable changes in tax policy by early next year. All that said, the best news is any threat of growth-harming tax hikes remains virtually nil.

Meanwhile, the one area of clear improvement in economic policy under President Trump has been regarding regulation. The issuance of new rules that slow growth has

basically stopped, while harmful old rules are getting rolled back or being reviewed for reform. This alone can help push growth up by ¼ to ½ percentage point on an annual basis.

In addition, monetary policy remains very loose. Short-term interest rates are still well below "normal" and there are over \$2 trillion in excess reserves in the banking system. We still expect another rate hike this year, and it seems clear that the Fed will begin slowly reducing the size of its bloated balance sheet. Assuming the Fed starts balance sheet normalization on October 1st, their \$4.4 trillion-dollar balance sheet would shrink by a measly 0.7% by year-end. This takes the Fed from running a super-easy monetary policy to a very, very easy monetary policy. In other words, any threat from tight money is remote.

Trade protectionism was the biggest threat to the economy as the new Trump Administration took office, but so far, there's been a great deal more rhetoric than action on this front. We remain confident that President Trump realizes a true lurch into protectionist policies would risk a drop in the stock market and would make it harder to meet his goal of faster economic growth. Protectionist promises are much easier to break (or just ignore), when the unemployment rate is moving toward 4%. Instead, expect the president to pivot toward trying to get better enforcement of intellectual property rights from China and an open market in oil and gas exports.

We constantly warn investors that one quarter, or one month, of economic data is meaningless. So far, the Plow Horse has not morphed into a thoroughbred. However, good news tends to lead to more good news and momentum is building.

Better economic growth means better profit growth and better profit growth will help push stocks higher. Our 2017 end-of-year forecast of 2,700 for the S&P 500 and 23,500 for the Dow Jones Industrial Average remains in place. Risks to growth remain low, and the chance of an acceleration remains positive as third quarter data is suggesting.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-23 / 9:00 am	New Home Sales – Jul	0.610 Mil	0.608 Mil		0.610 Mil
8-24 / 7:30 am	Initial Claims – Aug 19	237K	238K		232K
9:00 am	Existing Home Sales – Jul	5.550 Mil	5.420 Mil		5.520 Mil
8-25 / 7:30 am	Durable Goods – Jul	-6.0%	-6.8%		+6.4%
7:30 am	Durable Goods (Ex-Trans) – Jul	+0.4%	+0.3%		+0.1%