First Trust
Monday Morning OUTLOOK
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Robust Growth Continues

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Economic growth continued at a robust rate in the third quarter, supporting the case for both a continued bull market in stocks and further rate hikes from the Fed.

While we might make minor adjustments when we get Thursday's data on durable goods, international trade, and inventories, right now our model forecasts real GDP expanded at a 3.6% annual rate in Q3. If so, the real economy grew at a 3.1% pace in the past year, a roughly 50% acceleration from the 2.1% growth rate that defined the Plow Horse Economy from mid-2009 through early 2017. It's clear that cutting tax rates and slashing red tape have boosted economic growth. And there is room to run. We don't see a recession coming for at least the next two years, and potentially much longer.

But that won't stop the pessimists, who are likely to assert that inventories artificially boosted Q3 growth. Yes, it's true that the pace of inventory accumulation was fast, but that simply makes up for the unusually large drop in inventories in the second quarter. A similar story holds true for net exports, which will be an unusually large drag on growth in Q3 after pushing growth higher in Q2. In other words, inventories and trade are just swapping the roles they played in Q2.

Here's how we get to our 3.6% real growth forecast:

Consumption: Automakers reported car and light truck sales declined at a 4.8% annual rate in Q3. Meanwhile, "real" (inflation-adjusted) retail sales outside the auto sector grew at a 4.4% annual rate. Most consumer spending is on services, however, and real service spending looks like it climbed at about a 3.0% annual rate. Putting it all together, it looks like real personal consumption (goods and services combined), grew at a 3.1% annual rate, contributing 2.1 points to the real GDP growth rate (3.1 times the consumption share of GDP, which is 68%, equals 2.1).

Business Investment: Another quarter of solid growth in business investment, with our estimates showing equipment growing at an 8.5% annual rate, commercial construction growing at a 3% rate, and intellectual property growing at a 4.5% pace. That would mean total business investment grew at a 6.0% rate in Q3, which should add 0.8 points to real GDP growth. (6.0 times the 14% business investment share of GDP equals 0.8).

Home Building: Residential construction slowed in Q3, although we think the home building recovery that started back in 2011 will revive in the quarters ahead. For now, it looks like real residential construction declined at a 2.6% annual rate in Q3, which would subtract 0.1 point from the real GDP growth rate. (-2.6 times the residential investment share of GDP, which is 4%, equals -0.1).

Government: Public construction projects soared in Q3 while military spending slowed modestly. As a result, it looks like real government purchases rose at a 1.2% annual rate, which would add 0.2 points to the real GDP growth rate. (1.2 times the government *purchase* share of GDP, which is 17%, equals 0.2).

Trade: At this point, we only have trade data through August. Based on what we've seen so far, net exports should subtract 1.8 points from the real GDP growth rate. However, an advance glimpse at September trade figures arrives Thursday, which could shift this key estimate.

Inventories: We're also working with incomplete figures on inventories. But what we do have suggests companies accumulated inventories at a rapid clip in Q3, making up for last quarter's reductions. This should add 2.4 points to the real GDP growth rate.

Add it all up, and we get 3.6% annualized growth. Not every quarter is going to be as fast as the last two – remember, real GDP grew at a 4.2% annual rate in Q2 – but we still expect an average growth rate of 3%+ for both 2018 and 2019. More growth, in turn, means higher profits, which should help send the stock market higher as well.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-24 / 9:00 am	New Home Sales – Sep	0.625 Mil	**0.627 Mil**		0.629 Mil
10-25 / 7:30 am	Initial Claims – Oct 20	213K	**210K**		210K
7:30 am	Durable Goods – Sep	-1.4%	**-0.9%**		+4.4%
7:30 am	Durable Goods (Ex-Trans) – Sep	+0.4%	**+0.5%**		0.0%
10-26 / 7:30 am	Q3 GDP Advance Report	3.4%	**3.6%**		4.2%
7:30 am	Q3 GDP Chain Price Index	2.1%	**1.7%**		3.0%
9:00 am	U. Mich Consumer Sentiment- Oct	99.0	**99.0**		99.0