First Trust
Monday Morning OUTLOOK

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Economy Rising

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A solid 3.5% real GDP growth rate reported for Q3 wasn't enough to appease the doomsayers. They say inventories boosted growth and that can't last. Plus, they say, business investment was soft.

What the pessimists miss is that the surge in inventories in Q3 was a rebound from the unusual outright decline in Q2. Inventories subtracted 1.2 percentage points from real GDP growth in Q2 and then added 2.1 points in Q3. This was close to a mirror-image of what happened with net exports, which added 1.2 points in Q2 and then subtracted 1.8 in Q3.

Yes, real business investment grew at only a 0.8% annual rate in Q3, but we've had tepid quarters before, including as recently as the end of 2016, without signaling an impending recession. And don't be surprised if the recent figures get revised up in the next two months.

Meanwhile, evidence keeps building that something happened in 2017 that changed the nature of the economic recovery. "Potential" GDP growth continues to accelerate.

Potential growth is a term economists use to mean how fast the economy would grow if the jobless rate remains steady. We calculate it by using "Okun's Law," which says that for every 1% per year the economy grows faster than its potential rate, the jobless rate will drop by 0.5 points.

Working backward from the unemployment declines of recent years shows that potential GDP growth has picked up. From mid-2010 thru mid-2017, potential real GDP grew at just a 0.6% annual rate. But, since then, potential GDP has risen to a 2.2% annual rate. (It was 2.0% when we wrote about this topic three months ago.)

Faster potential growth undermines the Keynesian argument that it's just a demand-side boost from bigger budget deficits. What makes more sense is that reductions in tax rates and full expensing of business investments for tax purposes have enhanced incentives while less regulation encouraged business activity.

Right now, the biggest threat is the path of government spending, which shows no sign of slowing. If unaddressed, higher spending and unreformed entitlements (Medicare, Medicaid, and Social Security) may eventually convince entrepreneurs and investors that taxes will go up in the future, which could limit the economic benefits of last year's tax cuts.

And, while we are honest enough to admit that, we also think investors should not focus on that eventuality. Profits are rising and will likely continue to rise for at least the next 18 months. Moreover, if spending does undermine growth, it won't happen for years. The recent turmoil in markets is another buying opportunity.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-29 / 7:30 am	Personal Income – Sep	+0.4%	**+0.4%**	+0.2%	+0.4%
7:30 am	Personal Spending – Sep	+0.4%	**+0.4%**	+0.4%	+0.5%
10-31 / 8:45 am	Chicago PMI	60.0	**61.1**		60.4
11-1 / 7:30 am	Initial Claims – Oct 27	213K	**212K**		215K
7:30 am	Q3 Non-Farm Productivity	+2.2%	**+2.4%**		+2.9%
7:30 am	Q3 Unit Labor Costs	+1.1%	**+0.7%**		-1.0%
9:00 am	ISM Index – Oct	59.0	**59.1**		59.8
9:00 am	Construction Spending – Sep	+0.0%	**+0.4%**		+0.1%
afternoon	Total Car/Truck Sales – Oct	17.0 Mil	**17.2 Mil**		17.4 Mil
afternoon	Domestic Car/Truck Sales – Oct	13.1 Mil	**13.1 Mil**		13.3 Mil
11-2 / 7:30 am	Non-Farm Payrolls – Oct	193K	**190K**		134K1
7:30 am	Private Payrolls – Oct	190K	**184K**		121K
7:30 am	Manufacturing Payrolls – Oct	18K	**19K**		18K
7:30 am	Unemployment Rate – Oct	3.7%	**3.7%**		3.7%
7:30 am	Average Hourly Earnings – Oct	+0.2%	**+0.2%**		+0.3%
7:30 am	Average Weekly Hours – Oct	34.5	**34.5**		34.5
7:30 am	Int'l Trade Balance – Sep	-$53.7 Bil	**-$53.4 Bil**		-$53.2 Bil
9:00 am	Factory Orders – Sep	+0.5%	**+0.6%**		+2.3%