

## The Economic Surge

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Paul Krugman, Larry Summers and Bob Gordon have some ‘splainin to do. Where’s that “secular stagnation?”

Since 2009, they, along with many others, have said the US economy is stuck at 2% real growth. Their theory got traction after 2009, as the U.S. saw what we called a Plow Horse Economy.

But, we never believed slow growth was permanent. The real problem was the size of government – too much spending, too much regulation and excessively high tax rates were holding the economy back. We believed the idea of “secular stagnation” was another Keynesian red herring, designed to hide the damage government was doing and fool people into accepting slow growth as something that couldn’t be fixed.

But after cutting tax rates and regulation, Friday’s GDP report demolished their theory. Real GDP grew at a 4.1% annual rate in the second quarter, and is up 2.8% in the past year. And although some analysts pointed out that net exports were an unusually large boost in Q2, they ignored that inventories were an unusually large drag (the largest drop since late 2009). As a result, our initial forecast for real GDP growth in Q3 is 4.5%, even faster than was just reported for Q2.

So now some of the same people who said the economy couldn’t grow any faster are saying that the acceleration in

growth is just temporary, due to tax cuts. While we certainly agree that tax cuts boost growth, we think the change is more than temporary, particularly due to the cut in the corporate tax rate and the move to full expensing of plant and equipment. Not only has real GDP growth picked up, “potential” GDP growth has accelerated, as well.

Potential growth is a term economists use to mean how fast the economy would grow if the unemployment rate remains steady. We calculate it by using “Okun’s Law,” named after economist Arthur Okun, President Lyndon Johnson’s chief economist. Okun’s Law 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 rate declines of recent years shows that potential GDP growth has picked up. From mid-2010 thru mid-2017, Okun’s Law said potential real GDP grew at just a 0.6% annual rate. But in the past year, potential GDP has risen to 2.0%, and signs suggest it’s moving higher.

Maybe this is a statistical fluke that will fade away over the coming years, but it sure looks like something changed a year ago. Deregulation and tax cuts are boosting growth, and the Keynesians are back to the drawing board.

| Date/Time (CST) | U.S. Economic Data             | Consensus   | First Trust        | Actual | Previous    |
|-----------------|--------------------------------|-------------|--------------------|--------|-------------|
| 7-31 / 7:30 am  | Personal Income – Jun          | +0.4%       | <b>+0.4%</b>       |        | +0.4%       |
| 7:30 am         | Personal Spending – Jun        | +0.4%       | <b>+0.4%</b>       |        | +0.2%       |
| 8:45 am         | Chicago PMI                    | 62.0        | <b>64.0</b>        |        | 64.1        |
| 8-1 / 9:00 am   | ISM Index – Jul                | 59.3        | <b>59.5</b>        |        | 60.2        |
| 9:00 am         | Construction Spending – Jun    | +0.3%       | <b>+0.2%</b>       |        | +0.4%       |
| Afternoon       | Total Car/Truck Sales – Jul    | 17.0 Mil    | <b>16.8 Mil</b>    |        | 17.4 Mil    |
| Afternoon       | Domestic Car/Truck Sales – Jul | 13.2 Mil    | <b>12.9 Mil</b>    |        | 13.3 Mil    |
| 8-2 / 7:30 am   | Initial Claims – Jul 28        | 220K        | <b>218K</b>        |        | 217K        |
| 9:00 am         | Factory Orders – Jun           | +0.7%       | <b>+0.2%</b>       |        | +0.4%       |
| 8-3 / 7:30 am   | Non-Farm Payrolls – Jul        | 192K        | <b>185K</b>        |        | 213K        |
| 7:30 am         | Private Payrolls – Jul         | 190K        | <b>183K</b>        |        | 202K        |
| 7:30 am         | Manufacturing Payrolls – Jul   | 25K         | <b>16K</b>         |        | 36K         |
| 7:30 am         | Unemployment Rate – Jul        | 3.9%        | <b>3.9%</b>        |        | 4.0%        |
| 7:30 am         | Average Hourly Earnings – Jul  | +0.3%       | <b>+0.2%</b>       |        | +0.2%       |
| 7:30 am         | Average Weekly Hours – Jul     | 34.5        | <b>34.5</b>        |        | 34.5        |
| 7:30 am         | Int’l Trade Balance – Jun      | -\$46.5 Bil | <b>-\$46.5 Bil</b> |        | -\$43.1 Bil |
| 9:00 am         | ISM Non Mfg Index – Jul        | 58.6        | <b>58.8</b>        |        | 59.1        |