First Trust
Monday Morning OUTLOOK
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Better Signs

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A few key economic reports have taken a turn for the better, boosting expected real GDP growth in the second quarter and pointing to an upward revision to first quarter growth.

Retail sales grew 0.5% in May, very close to consensus expectations, and were revised up substantially for prior months. Pairing this data with other recent reports, it now looks like real GDP in Q1 will be revised up to a 3.3% annualized growth rate from the prior estimate of 3.1%.

More important than the Q1 revisions, it now looks like real GDP is growing at a 2.0% annual rate in the second quarter. That may not sound great, but it's a big improvement from the 0.9% estimate the Atlanta Fed's "GDP Now" model was signaling in early May. Moreover, this comes despite Q2 growth likely being held down by inventories. Both our estimate and the Atlanta Fed's estimate of real GDP growth *excluding inventories* (also known as Final Sales growth) is running 3.0%+ in Q2. Fed, take note. With Final Sales this strong, the underlying economy is doing well.

Moreover, with inventories likely to rebound in months ahead, we expect total real GDP growth will come in near 3.0% in 2019 (Q4/Q4), well above the Fed's consensus projection in March of 2.1%. In other words, Fed forecasts have been overly pessimistic and will likely affect rate cut thinking.

Despite what the data show, some analysts continue to price in recession, and the bond market seemingly agrees. The tepid May 75,000 increase in US payrolls bolstered pessimism, but other employment data don't support this fear. The highest frequency data on jobs are unemployment claims, and those don't signal a problem at all. Initials claims came in at 222,000 last week, while the four-week moving average was 217,000, both very low levels. Moreover, the US currently has 1.6 million more job openings than unemployed people.

It's true that consumer and producer prices increased only 0.1% in May, but in the past three months consumer prices are up at a 3.3% annual rate while producer prices are up at a 3.5% pace.

At the close on Friday, the futures market in federal funds showed a 21% chance the Fed will cut rates this Wednesday, and an 86% chance of a rate cut by the meeting in late July. All told, the futures market is pricing in two or three rate cuts for 2019. We think these expectations are way out of line with the fundamental strength of the economy. The Fed is not tight. They don't need to cut rates, and we don't think they will cut rates this week, or even this year.

As the summer goes on, we expect evidence will continue to show that the economy isn't slipping into recession. Why? We think the Trump Administration is either (a) going to forge a trade deal with China or, (b) in the absence of a deal with China, move toward freer trade with other countries and regions (Japan, South Korea, the EU,…etc.) to help organize an effort to get China to conform to normal trade rules.

Our best guess is that the "dot plot" from the Fed, which shows the projected path of short-term interest rates, will look much different than it did in March. Back then, it showed about one-third of policymakers thought rates would be higher by year end, while none thought rates would be lower. Look Wednesday for a dot plot showing some policymakers forecasting higher rates by year end, some lower, but most showing no change at all. That's what we think will actually happen in 2019, too.

For all the issues the US economy faces, it has some pretty strong winds at is back. Corporate tax rates have been cut, boosting incentives for investment. The federal funds rate is still well below nominal GDP growth, and the Fed still has $1.4 trillion in excess reserves in the banking system. In other words, monetary policy is not an impediment to entrepreneurs or businesses. Finally, the federal government is reducing regulation, not increasing it.

Meanwhile, home building has plenty of room for further growth, and households have both low debts relative to assets and low debt service relative to incomes. Banks are in strong financial shape, while the rest of Corporate America has debts that are below normal relative to assets.

None of this means the US economy will grow forever. It won't. But too many analysts and investors are needlessly fearful of a recession starting soon. We don't see one this year or in 2020. Beyond that, forecasts are merely guessing. Appetite for risk should improve from here. Smart investors should get in front of it.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-17 / 7:30 am	Empire State Mfg Survey – Jun	11.0	**9.3**	-8.6	17.8
6-18 / 7:30 am	Housing Starts – May	1.240 Mil	**1.240 Mil**		1.235 Mil
6-20 / 7:30 am	Initial Claims – Jun 15	220K	**218K**		222K
9:00 am	Philly Fed Survey – Jun	10.7	**15.1**		16.6
6-21 / 9:00 am	Existing Home Sales – May	5.260 Mil	**5.470 Mil**		5.190 Mil