First Trust
Monday Morning OUTLOOK

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Strong Growth in Q2

Another quarter for consumers to rely on massive stimulus payments, extremely loose monetary policy, and the continued re-opening of the US economy combined to push real GDP up at a very rapid pace in the second quarter, with the federal government preparing to release its initial estimate of economic growth on July 29.

At present, we are estimating that real GDP grew at an 8.3% annual rate in Q2, an acceleration from the 6.4% growth rate in Q1 and, with the exception of the massive surge in output in the third quarter of 2020, which offset the massive plunge in production in Q2 of 2020, the fastest growth rate for any quarter since the early 1980s.

Remember, though, that much of the recent rapid growth we've seen is really just a "sugar high." Look for economic growth to slow in the second half of the year, and then even more so in 2022.

In the meantime, it's important to recognize that although rapid growth is welcome, that the economic glass remains half empty. Yes, real GDP likely hit a new all-time high. Yes, if our estimate is correct, real GDP will be up 0.7% annualized versus the last quarter of 2019, which is when we hit the previous peak in quarterly real GDP.

However, in the absence of COVID-19, the economy almost certainly would have grown faster than that pace in the meantime, which means that, even at an all-time high, real GDP *is still smaller than it would have been if COVID had never happened*.

Note, also, that as the economy emerges from the COVID disaster, changes in international trade flows and inventories can have an outsized effect on GDP numbers. A day before the government releases the GDP report it will release some preliminary figures for trade and inventories in June, which may alter our forecast.

In the meantime, an 8.3% growth rate is our best estimate and here's how we get there:

Consumption: Car and light truck sales rose at a 3.7% annual rate in Q2, while "real" (inflation-adjusted) retail sales outside the auto sector soared at a 12.7% annual rate. We only have reports on spending on services through May, but it looks like real services spending should be up at a rapid rate, as Americans got back toward normal (think recreation, restaurants, bars,…etc.). As a result, we estimate that real consumer spending on goods and services, combined, increased at a 9.8% annual rate, adding 6.7 points to the real GDP growth rate (9.8 times the consumption share of GDP, which is 68%, equals 6.7).

Business Investment: The second quarter should continue the pattern of recovery, led by investment in business equipment. Investment in intellectual property should also gain, as usual, and we may eke out a small gain in commercial construction, as well. Combined, business investment looks like it grew at a 7.6% annual rate, which would add 1.0 points to real GDP growth. (7.6 times the 13% business investment share of GDP equals 1.0).

Home Building: Residential construction continued to grow in Q2, although not as quickly as in recent prior quarters, a reflection of higher construction costs and less labor availability. Look for faster growth in this sector in the year ahead as excessive jobless benefits run out. We estimate growth at a 2.1% annual rate in Q2, which would add 0.1 point to the real GDP growth. (2.1 times the 5% residential construction share of GDP equals 0.1).

Government: It's hard to translate government spending into GDP because only direct government purchases of goods and services (and not transfer payments like extra unemployment insurance benefits) count when calculating GDP. We estimate federal purchases grew at a 1.1% annual rate in Q2, which would add 0.2 points to real GDP growth. (1.1 times the 18% government purchase share of GDP equals 0.2).

Trade: Faster economic growth in Q2 brought a larger trade deficit (at least through May), a by-product of a faster recovery in the US than in Europe. At present, we're projecting net exports will subtract 0.2 points from real GDP growth in Q2.

Inventories: Inventories look like they fell again in Q2 as businesses with supply-chain issues had to dip into inventories to meet strong consumer demand. However, inventories didn't fall as rapidly as they did in Q1, and in the arcane world of GDP accounting, that means inventories will make a *positive* contribution to growth in Q2, which we are estimating at 0.5 points.

Add it all up, and we get 8.3% annualized real GDP growth for the second quarter, very high by historical standards, but representing an economy that is still smaller than it would have been in the absence of COVID.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-20 / 7:30 am	Housing Starts – Jun	1.590 Mil	**1.590 Mil**		1.572 Mil
7-22 / 7:30 am	Initial Claims - Jul 18	350K	**364K**		360K
9:00 am	Existing Home Sales – Jun	5.900 Mil	**5.800 Mil**		5.800 Mil