First Trust
Monday Morning OUTLOOK

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January Surge Kept Q1 Positive

The US economy is being tugged in two different directions right now. On the positive side we have the lingering effects of the massive stimulus of 2020-21, the renormalization of the service sector after COVID Lockdowns, and, as always, the entrepreneurial and innovative spirit of the American people. On the downside we have the early stages of a drop in the money supply that started last year and too much government spending.

The problem with forecasting the economy right now is we have never been in this position before, where an unprecedented two-year surge in the money supply (plus massive temporary transfer payments) were closely followed by a dive in the money supply unlike anything we've seen in decades.

Eventually, we believe the balance of these forces will tilt the US economy into a recession. However, largely due to a temporary surge in consumer spending in January, Real GDP growth remained positive in the first quarter. As we set out in a Monday Morning Outlook two months ago, January came in strong due to odd factors like unusually warm weather, a big Social Security cost-of-living adjustment, and seasonal-adjustment issues due to the timing of COVID stimulus payments in 2020-21.

As we set out below, we think the economy grew at a 2.3% annual rate in Q1, although we may tweak this forecast slightly in the next ten days based on reports on housing, inventories, and international trade.

In addition, we think the second quarter will likely be weaker than Q1, and very possibly negative. The ISM Manufacturing index has been below 50 for five straight months and, at 46.3, is at a level often (although not always) associated with a recession. Manufacturing production is down 1.1% from a year ago. The ISM Services index is barely north of 50. Continuing unemployment claims are up 37% from six months ago. Retail sales are down in four of the past five months, the lone exception being the January surge.

Don't look for Real GDP growth to remain positive much longer. But, in the meantime, our calculations show economic growth at a 2.3% annual rate for the first quarter.

Consumption: "Real" (inflation-adjusted) retail sales outside the auto sector grew at a 1.7% annual rate in Q1 while sales of autos and light trucks surged at a 29% rate and it looks like real services, which makes up most of consumer spending, should be up at a moderate pace. Putting it all together, we estimate that real consumer spending on goods and services, combined, increased at a robust 4.3% rate, adding 2.9 points to the real GDP growth rate (4.3 times the consumption share of GDP, which is 68%, equals 2.9).

Business Investment: We estimate a 5.1% growth rate for business investment, with gains in intellectual property and commercial construction leading the way. A 5.1% growth rate would add 0.7 points to real GDP growth. (5.1 times the 13% business investment share of GDP equals 0.7).

Home Building: Residential construction is still absorbing the pain of higher mortgage rates and looks like it fell at a 13.0% rate, which would subtract 0.5 points from real GDP growth. (-13.0 times the 4% residential construction share of GDP equals -0.5).

Government: Only direct government purchases of goods and services (not transfer payments) count when calculating GDP. We estimate these purchases – which represent a 18% share of GDP – were up at a 1.7% rate in Q1, which would add 0.3 points to the GDP growth rate (1.7 times the 18% government purchase share of GDP equals 0.3).

Trade: Looks like the trade deficit expanded in Q1, as imports rose faster than exports, thanks to re-opening in China and better growth in Europe than many expected. We're projecting net exports will subtract 0.4 points from real GDP growth.

Inventories: Inventories look like they grew slower in Q1 than in Q4, suggesting a subtraction of about 0.7 points to the growth rate of real GDP. Look for continued slower inventories in 2023, which could be a significant drag on economic growth later this year.

Add it all up, and we get a 2.3% annual real GDP growth rate for the first quarter, juiced by a temporary spike in consumer spending in January that is unlikely to be repeated.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-17 / 7:30 am	Empire State Mfg Survey – Apr	-18.0	-18.9	10.8	-24.6
4-18 / 7:30 am	Housing Starts – Mar	1.400 Mil	**1.400 Mil**		1.450 Mil
4-20 / 7:30 am	Initial Claims – Apr 15	240K	**240K**		239K
7:30 am	Philly Fed Survey – Apr	-19.7	**-19.3**		-23.2
9:00 am	Existing Home Sales – Mar	4.500 Mil	**4.500 Mil**		4.580 Mil