First Trust
Monday Morning OUTLOOK
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January 22, 2019

Solid Growth to Finish 2018

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Normally, the end of January sees the government's first estimate of real GDP growth for the fourth quarter. But with no end in sight for the shutdown, which has already seen numerous other data releases postponed – including figures on retail sales, international trade, inventories, construction, and durable goods - it's very unlikely the GDP report will arrive on time.

Our GDP model looks at each major component of GDP – consumer spending, business investment, home building – and adds those parts up to get the big picture of what happened to the economy in that quarter. But with less data to put into the model, that means less accuracy. In turn, that means we need to use not only our usual "add-em-up" framework, but also look at the economy from a "top-down" view as well. And that perspective suggests we did quite well in Q4.

For example, industrial production at factories, mines, and utilities grew at a 3.7% annual rate in the fourth quarter. That's important because industrial production measures "units" of output - in other words it's a measure of "real" output – and over the past nine years, there's been almost zero difference, on average, between the growth rate of industrial production and real GDP growth on a year-over-year basis.

And another reason to be optimistic is that the number of hours worked in the private sector increased 2.1% in the fourth quarter. Tack on some modest add-factor for productivity growth (the increase in output per hour) and we could easily be at a growth rate of 3.0%, at least for the private sector.

Maybe this is why the stock market is up despite the lack of data. Investors can see the economy is not falling off a cliff. In fact, it remains very close to the above-trend growth rate of the past year. Right now, we're estimating real GDP grew at a 2.5% annual rate in Q4, which would bring the growth rate for 2018 to 3.1% (comparing the fourth quarter to the fourth quarter of 2017), the fastest pace since 2005.

But don't expect everyone to hail this as good news. Some analysts are obsessed with the "second derivate" of GDP, which is just a fancy way of saying whether the growth rate is getting faster or slower, regardless of whether real GDP is still growing. So if we get a 2.5% growth rate for Q4, expect to hear about why this is really bad news because the growth rates in Q2 (4.2%) and Q3 (3.4%) were faster. The thinly-veiled idea is that the pace of growth is slowing, and that trend will continue until we find ourselves back in recession.

Don't buy it. A look back at quarterly GDP growth rates since 2009 shows this "second derivate" argument never worked. Real GDP slowed from quarter to quarter multiple times, but no recession occurred. Instead of over-using the phrase "second derivate," more analysts should get familiar with a more relevant phrase: "statistical noise." Growth on a quarterly basis always bounces around a trend, but it's the trend, not the bounces, that matter.

All that said, here's how we get to our 2.5% real growth forecast for Q4:

Consumption: Automakers say car and light truck sales rose at a 13.6% annual rate in Q4. Meanwhile, chain store sales soared, up 7.7% from a year ago in the last week of December. But most consumer spending is on services, where the data is sparse. We're estimating real personal consumption (goods and services combined) grew at a 4.0% annual rate, contributing 2.7 points to the real GDP growth rate (4.0 times the consumption share of GDP, which is 68%, equals 2.7).

Business Investment: Limited reports suggest equipment, commercial construction, and intellectual property growing at a 4.0% pace, which should add 0.6 points to real GDP growth. (4.0 times the 14% business investment share of GDP equals 0.6).

Home Building: Residential construction looks flat in Q4, which means it'll neither add to nor subtract from GDP growth for the quarter.

Government: Looks like a modest 0.8% increase in real public-sector purchases in Q4, which would add 0.1 points to the real GDP growth rate. (0.8 times the government purchase share of GDP, which is 17%, equals 0.1).

Trade: We only have data through October, but are guessing that net exports subtract 0.4 points from the real GDP growth rate.

Inventories: Again, reports are only through October, but it looks like a slowdown in inventory accumulation will trim 0.5 points from real GDP growth.

Add it all up, and we get 2.5% annualized growth. In the context of tax cuts and deregulation, look for this growth to keep pushing profits higher. The bull market is poised to push higher in 2019.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-22 / 9:00 pm	Existing Home Sales – Dec	5.240 Mil	**4.970 Mil**	4.990 Mil	5.330 Mil
1-24 / 7:30 am	Initial Claims – Jan 19	220K	**218K**		213K
1-25 / 7:30 am	Durable Goods – Dec	+1.5%	**+2.3%**		N/A
7:30 am	Durable Goods (Ex-Trans) – Dec	+0.2%	**+0.5%**		N/A

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.