

## Q1 GDP Frozen, Q2 Thawed

**Brian S. Wesbury** – Chief Economist  
**Robert Stein, CFA** – Dep. Chief Economist  
**Strider Elass** – Economist

When it comes to forecasting near-term real GDP growth, there are parts of the economy that are easy to follow and then there parts of it that are tough.

The easy parts (with lots of timely information) are consumer spending, business investment, and home building. And despite one of the worst winters in multiple decades, this portion of the economy looks like it grew at a solid 2.5% to 3% annual rate in the first quarter, right in-line with the trend since the recession ended in mid-2009.

To get that kind of growth during this past brutal winter means the underlying fundamentals of the economy are gathering strength. Now that banks are more confident the Fed's balance sheet isn't going to shrink anytime soon, the M2 money supply and commercial and industrial loans are both accelerating. Meanwhile, the recovery in home building is still far from complete and low business and consumer debt obligations mean plenty of room for growth in purchases of big-ticket items.

The problem, at least as far as Q1 is concerned, is that the parts of GDP where we have less information look downright ugly. Government purchases, international trade, and inventories are set to be major drags on the economy in Q1. For some reason, these are the areas hit by the weather. As a result, our "add-em up" calculations suggest real GDP grew at only a 0.5% annual rate.

This doesn't mean the Plow Horse is headed for the glue factory. Far from it. Overall real GDP growth in Q1 may be weak, but it will rebound sharply in Q2.

Here's the first quarter, component by component:

**Consumption:** Auto sales were unchanged in Q1 and "real" (inflation-adjusted) retail sales outside the auto sector declined at a 1.1% annual rate. But services make up about 2/3 of personal consumption and, with strength there, it looks like real personal consumption of goods and services combined, grew at a 2.1% annual rate in Q1, contributing 1.4 points to the real GDP growth rate (2.1 times the consumption share of GDP, which is 68%, equals 1.4).

**Business Investment:** Business equipment investment looks like it grew at a 5% annual rate in Q1, about average for the past couple of years. Commercial construction looks like it grew at a 7% rate. Factoring in R&D suggests overall business investment grew at a 5% rate, which should add 0.6 points to the real GDP growth rate (5 times the 12% business investment share of GDP equals 0.6).

**Home Building:** Somehow, despite the weather, the housing rebound persevered through Q1. Even as weather held down starts, builders focused on finishing the homes near completion. We see a 10% annualized gain in home building in Q1 adding 0.3 points to the real GDP growth rate (10 times the home building share of GDP, which is 3%, equals 0.3).

**Government:** Public construction projects were slowed by weather in Q1 and military spending continued to head down. As a result, it looks like real government purchases shrank at a 1% annual rate in Q1, which should subtract 0.2 percentage points from real GDP growth (-1 times the government purchase share of GDP, which is 18%, equals -0.2).

**Trade:** At this point, the government only has trade data through February, but what we have doesn't look very good. On average, the "real" trade deficit in goods has grown larger in Q1. As a result, we're forecasting that net exports subtracted 0.4 points from the real GDP growth rate.

**Inventories:** Inventories surged in Q3 and Q4. Now, with partial data only through February, it appears companies were accumulating inventories much more slowly in Q1, subtracting 1.2 points from the real GDP growth rate.

Add-em-up and you get 0.5% for Q1.

If accurate, some investors will be ready to run for the hills and the short-sellers will be more than ready to chase them there. Don't fall for this weather-induced economic head-fake. The spring thaw has de-iced the Plow Horse and her pace will be much faster in Q2.

| Date/Time (CST) | U.S. Economic Data              | Consensus | First Trust      | Actual | Previous  |
|-----------------|---------------------------------|-----------|------------------|--------|-----------|
| 4-21 / 9:00 am  | Leading Indicators – Mar        | +0.7%     | <b>+0.7%</b>     | +0.8%  | +0.5%     |
| 4-22 / 9:00 am  | Existing Home Sales – Mar       | 4.550 Mil | <b>4.550 Mil</b> |        | 4.600 Mil |
| 4-23 / 9:00 am  | New Home Sales - Mar            | 0.450 Mil | <b>0.460 Mil</b> |        | 0.440 Mil |
| 4-24 / 7:30 am  | Initial Claims Apr 19           | 315K      | <b>310K</b>      |        | 304K      |
| 7:30 am         | Durable Goods – Mar             | +2.0%     | <b>+2.6%</b>     |        | +2.2%     |
| 7:30 am         | Durable Goods (Ex-Trans) – Mar  | +0.6%     | <b>+1.1%</b>     |        | +0.1%     |
| 4-25 / 8:55 am  | U. Mich Consumer Sentiment- Apr | 83.0      | <b>82.5</b>      |        | 82.6      |