

## GDP Rebounds in Q2

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The US economy rebounded in the second quarter from the supposed decline in real GDP in Q1. We say “supposed decline” in Q1 because the government has had persistent problems seasonally adjusting GDP, tending to underestimate growth in the first quarter each year while overestimating growth in the middle two quarters.

Taking our own models at face value suggests real GDP grew at a 2.4% annual rate in Q2, very close to the consensus of 2.5% and exactly the same as the 2.4% generated by the Atlanta Fed’s [GDPNow Model](#).

But forecasting real GDP growth in Q2 is tougher than normal. Every year, the July report includes revisions going back quarter-by-quarter the past several years and the government says this year’s revisions should fix some of the seasonal adjustment problems.

If the government completely fixed the seasonal issues, it’d probably say real GDP growth was near 1.5% in Q1 and a 2.4% forecast for Q2 would make sense. But we doubt the government is going to fix all the data problems right away. Instead, a partial fix is more likely, which means the -0.2% reported in Q1 gets revised to around +0.5% and Q2 is reported at 2.8%.

One way to avoid the adjustment problem and find the trend is to look at real GDP compared to the same quarter two years before. By that measure, the economy has been growing at a 2.4% annual rate, which is why we call it a Plow Horse.

Below is our “add-em-up” forecast for Q2 real GDP.

**Consumption:** Auto sales rose at a 12.4% annual rate in Q2. But “real” (inflation-adjusted) retail sales outside the auto sector were up at a 1.4% annual pace in Q2, and services, which make up more than 2/3 of personal consumption, grew at about a 1.8% rate. So it looks like real personal consumption of goods and services, combined, grew at a 2.6% annual rate in Q2, contributing 1.8 points to the real GDP growth rate (2.6

times the consumption share of GDP, which is 69%, equals 1.8).

**Business Investment:** Business equipment investment looks like it was unchanged in Q2. But commercial construction rebounded sharply from weather-related problems in Q1, growing at a 22% pace, while R&D probably grew around its trend of 5%. Combined, we estimate business investment grew at a 6% rate, which should add 0.8 points from the real GDP growth rate (6.0 times the 13% business investment share of GDP equals 0.8).

**Home Building:** Residential construction looks unchanged in Q2 after surprising growth in Q1 despite the weather. That means it neither added to nor subtracted from GDP (0 times the home building share of GDP, which is 3%, equals 0.0).

**Government:** Both military spending and public construction projects rebounded in Q2, suggesting real government purchases rose at a 2.8% rate in Q2, which would add 0.5 percentage points to real GDP growth (2.8 times the government *purchase* share of GDP, which is 18%, equals 0.5).

**Trade:** At this point, the government only has trade data through May, but the data so far suggest the “real” trade deficit in goods has gotten a little bigger. As a result, we’re forecasting that net exports are a drag of 0.1 point on the real GDP growth rate.

**Inventories:** At present, we have even less information on inventories than we do on trade, but what we have suggests companies piled up inventories at a slightly slower pace than in Q1. We’re forecasting inventories subtracted 0.2 points from real GDP in Q2.

Put it all together, and we get 2.8% as a forecast for Q2, consistent with our view that the Plow Horse economy remains alive and well. More important for investors, is that the report should keep the Fed on track to start raising rates in September.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-27 / 7:30 am	Durable Goods – Jun	+3.2%	<b>+4.7%</b>	<b>+3.4%</b>	-2.2%
7:30 am	Durable Goods (Ex-Trans) – Jun	+0.5%	<b>+0.6%</b>	<b>+0.8%</b>	0.0%
7-28 / 9:00 am	Consumer Confidence – Jul	100.0	<b>99.6</b>		101.4
7-30 / 7:30 am	Initial Claims - Jul 26	270K	<b>272K</b>		255K
7:30 am	Q2 GDP Advance Report	2.5%	<b>2.8%</b>		-0.2%
7:30 am	Q2 GDP Chain Price Index	1.5%	<b>1.4%</b>		0.0%
7-31 / 8:45 am	Chicago PMI	50.9	<b>49.9</b>		49.4
9:00 am	U. Mich Consumer Sentiment- Jul	94.0	<b>93.5</b>		93.3