

May 14, 2007

Monday Morning Outlook

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The Economic Rebound Is Already Underway

US Real GDP grew just 1.3% at an annual rate in the first quarter of 2007. That estimate, like all initial GDP estimates, was based on incomplete information.

Since then, new and revised data on retail sales, construction, international trade, and inventories have been released. Some of this new data for Q1 was stronger than the government statisticians expected, but most – like Friday’s report on retail sales – has been weaker. So, on May 31, the Commerce Department will release its first revision and real GDP growth for Q1 will likely fall below 1%.

However, by the time we see the revised estimate the second quarter will be two months old. And the data for the current quarter looks much stronger. The economy is pushing through the headwinds of housing, and working toward a 3% growth rate for real GDP in Q2, which would be the strongest since early 2006.

A look at each of the major components of GDP shows how this forecast is possible.

Personal Consumption: The monthly pattern of consumption through March as well as Friday’s data on retail sales suggest real consumption will grow at about a 1.6% rate in Q2. With consumption accounting for 70% of GDP, real PCE growth in Q2 will contribute about 1.1 percentage points to real GDP growth (1.1 equals 70% of 1.6).

Housing: Residential construction subtracted 1.2 points from real GDP growth in the second half of 2006

and 1.0 point in Q1. However, the rate of decline in the residential construction sector began to slow in Q1. This deceleration appears set to continue in Q2, suggesting that housing should be a smaller drag of about 0.6 points.

Business Investment: Shipments of capital goods and non-residential construction finished strong in the first quarter, suggesting business investment will add about 0.9 points to growth in Q2. To get this we (conservatively) assume shipments of capital goods are unchanged from April through June and non-residential building keeps growing at the same rate as it has grown in the past year.

Inventories: Businesses have stocked their shelves at a slower pace lately. Inventories were a drag on GDP growth of more than a percentage point late last year and by at least half a point in Q1. We look for this to reverse in Q2, adding about 0.7 points to GDP growth.

Trade: Before March, the trade gap had started to gradually shrink. We believe the jump in the March trade deficit (inflation-adjusted) was an outlier that will be reversed next month. A return to trend would add 0.5 points to GDP growth in Q2.

Government: In the past five years, on average, government spending has accounted for 0.4 points of GDP growth. We assume that trend will reassert itself.

Total: = 3.0%

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-15 / 7:30 am	CPI – Apr	+0.5%	+0.6%		+0.6%
7:30 am	"Core" CPI - Apr	+0.2%	+0.2%		+0.1%
7:30 am	Empire State Mfg Index - May	9.0	12.0		3.8
5-16 / 7:30 am	Housing Starts - Apr	1.480 Mil	1.486 Mil		1.518 Mil
8:15 am	Industrial Production - Apr	+0.2%	+0.2%		-0.2%
8:15 am	Capacity Utilization - Apr	81.5%	81.4%		81.4%
5-17 / 7:30 am	Initial Claims - May 12	310 K	320 K		297 K
9:00 am	Leading Indicators - Apr	-0.1%	+0.1%		+0.1%
11:00 am	Philly Fed Survey - May	3.0	4.6		0.2
5-24 / 7:30 am	Durable Goods - Apr	+1.0%	+1.6%		+3.7%
9:00 am	New Home Sales - Apr	0.875 Mil	0.854 Mil		0.858 Mil