

Hey, Where is the Soft Patch?

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The current US recovery is probably the most ridiculed and disrespected we have seen in 31 years of economic forecasting. Conventional wisdom calls it a “sugar high,” it has evidently not reached “escape velocity” yet, and every piece of weaker than expected data is supposedly the beginning of the dreaded “double dip recession.”

Of course, none of this is true, but it fits a narrative – one that works for both sides of the aisle. Conservatives want to paint Obama as an economic fiasco. Liberals want to argue that “austerity” is killing us and “short-sellers” are spending billions trying to create another panic.

Yet, what we call, the Plow Horse Economy continues to plod along. The original negative 0.1% growth rate reported for Q4 was revised away, with annualized growth now showing a positive 0.4%. Then Q1-2013 was reported at an annualized 2.5% - can you say “more Plow Horse?”

With more data in now, the consensus among economists is that there will be no net revision to the original report for Q1. Our forecast is for a slight upward revision (to 2.6%) – which, in reality, is not statistically different than the consensus.

But don't take the lack of a major revision to the top-line number to mean no change at all. We're anticipating that changes to the “mix” of growth will bode better for the future, with less inventory accumulation and less government spending, while consumer spending and net exports are revised up.

Either way, the report will be looking in the rearview mirror and now – two-thirds of the way through Q2 – most investors are looking to the future.

And, right now, the consensus expects a “soft patch” is developing with real GDP growth slowing down to about 1.5% at an annual rate.

In contrast, we think the second quarter will end up like the first, with real GDP growth up at about a 2.5% rate once again. This is a change from the past two years when we warned ahead of time of a temporary soft patch around mid-year that would worry many analysts and investors. Back then, we said these soft patches would be short-lived. We expected ups and downs, but continued to forecast plow horse growth with no recessions. This time, we doubt we'll even get a real soft patch.

Consumer spending will likely be a little weaker in Q2 than it was in Q1. But, if recent estimates from auto analysts are right, consumption will be up about 2.5% annualized in Q2. Meanwhile, despite the sequester, government purchases are likely to be less of a drag in Q2 than they were in Q1. And, net exports have improved slightly.

The rest of GDP – business investment, home building, and inventories – should come in, combined, right about where it did in Q1. Nothing is for certain in economics, but we think the odds of getting growth of 3.5% seem just as high as 1.5% right now.

Just look at the labor market, where unemployment claims have moved down from Q1 and where early signs suggest another month of solid payroll growth in May. Consumer balance sheets are in great shape and equity prices are rising while the housing market solidifies its rebound. And, how about the energy sector, where US production is surging, making us less vulnerable to future price spikes?!!

The fundamentals of the expansion remain intact: monetary policy is loose, tax rates are still relatively low, entrepreneurs are innovating, and government spending is relatively in check. The expansion *could* be better, but current levels of disrespect and ridicule are way beyond the facts.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|-----------------|---------------------------------|-----------|--------------|-------------|----------|
| 5-28 / 9:00 am | Consumer Confidence – May | 71.0 | 70.8 | 76.2 | 68.1 |
| 5-30 / 7:30 am | Initial Claims May 25 | 340K | 337K | | 340K |
| 7:30 am | Q1 GDP Preliminary Report | 2.5% | 2.6% | | 2.5% |
| 7:30 am | Q1 GDP Chain Price Index | 1.2% | 1.2% | | 1.2% |
| 5-31 / 7:30 am | Personal Income – Apr | +0.1% | +0.2% | | +0.2% |
| 7:30 am | Personal Spending – Apr | 0.0% | 0.0% | | +0.2% |
| 8:45 am | Chicago PMI | 50.0 | 49.9 | | 49.0 |
| 8:55 am | U. Mich Consumer Sentiment- May | 83.7 | 83.7 | | 83.7 |