

Another Plow Horse Quarter

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Animal spirits are back!

Confidence surveys have soared since the election. The Conference Board's future expectations measure hit the highest level since 2003. The NFIB small business confidence index rose at its fastest pace ever. Other surveys are up, too.

But, it will take much more than animal spirits to lift economic growth from its sluggish pace of the past several years. Since mid-2009, real GDP has grown just 2.1% at an annual rate. We've been calling it a Plow Horse Economy, and have yet to find a better metaphor. But we didn't predict plow horse growth because of weak confidence numbers, we believed our thoroughbred high-tech economy has been weighed down by an overweight, overbearing jockey called Government.

To truly revive the economy on a lasting basis, we need better policies, not just more confidence. The new White House promises comprehensive corporate tax reform, a rollback of Obamacare, and more freedom to build energy infrastructure. These policies would lift growth and generate real, lasting, gains in confidence, too.

For the time being, though, we're stuck with the Plow Horse. Although we get some data later this week that may make us tweak our forecast – like the CPI and Industrial Production – it looks like real GDP grew at about a 2.2% annual rate in the last quarter of 2016, almost exactly the average 2.1% pace since mid-2009.

Here's how we get to our 2.2% forecast.

Consumption: Auto sales skyrocketed in Q4, growing at a 12.7% annual rate, while retail sales outside the auto sector rose at a 5.5% pace. But services grew much more slowly, so it looks like “real” (inflation-adjusted) personal consumption of goods and services, combined, grew at a 2.5% annual rate in Q4, contributing 1.7 points to the real GDP growth rate (2.5 times the consumption share of GDP, which is 69%, equals 1.7).

Business Investment: Business equipment investment grew at around a 4% annual rate in Q4 while commercial construction was flat. R&D probably grew near its trend of 5%. Combined, we estimate business investment grew at a 3.3% rate, which should add 0.1 points to the real GDP growth rate (3.3 times the 13% business investment share of GDP equals 0.4).

Home Building: Looks like residential construction rebounded in Q4 after declining in both Q2 and Q3, growing at about a 5% annual rate. Expect an acceleration in 2017 despite higher mortgage rates, as more jobs and higher incomes offset the effects of higher rates. In the meantime, a 5% growth rate will add 0.2 points to the real GDP growth rate. (5.0 times the home building share of GDP, which is 4%, equals 0.2).

Government: Military spending grew in Q4, but slowly, while public construction projects appear to have grown faster than usual. On net, we're estimating that real government purchases rose at a 1.1% rate in Q4, which would add 0.2 percentage points to real GDP growth (1.1 times the government *purchase* share of GDP, which is 18%, equals 0.2).

Trade: The third quarter included a slowdown in imports at West Coast ports due to the bankruptcy of a major international shipper. As a result, trade added substantially to real GDP in Q3. The end of that import problem will have the opposite effect on GDP in Q4. At this point, the government only has trade data through November, it looks like the “real” trade deficit in goods has grown rapidly in Q4. As a result, we're forecasting that net exports subtract 1.1 points from 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 are restocking shelves and showrooms in Q4. We're forecasting inventories add about 0.8 points to Q4 real GDP.

Put it all together, and we get a forecast of 2.2% for Q4, right in-line with the Plow Horse trend that we will hopefully leave behind in the next couple of years.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-17 / 7:30 am	Empire State Mfg Survey – Jan	8.5	10.0	6.5	7.6
1-18 / 7:30 am	CPI – Dec	+0.3%	+0.3%		+0.2%
7:30 am	“Core” CPI – Dec	+0.2%	+0.2%		+0.2%
8:15 am	Industrial Production – Dec	+0.6%	+0.6%		-0.4%
8:15 am	Capacity Utilization – Dec	75.4%	75.4%		75.0%
1-19 / 7:30 am	Initial Claims – Jan 16	252K	254K		247K
7:30 am	Housing Starts – Dec	1.187 Mil	1.200 Mil		1.090 Mil
7:30 am	Philly Fed Survey – Jan	16.0	22.2		19.7