

No More Plow Horse

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We've called the slow, plodding economic recovery from mid-2009 through early 2017 a Plow Horse. It wasn't a thoroughbred, but it wasn't going to keel over and die either. Growth trudged along at a sluggish – but steady - 2.1% average annual rate.

Thanks to improved policy out of Washington, the Plow Horse has picked up its gait. Under new management, real GDP grew at a 3.1% annualized rate in the second quarter of 2017 and 3.2% in the third quarter. There were two straight quarters of 3%+ growth in 2013 and 2014, but then growth petered out. Now, it looks like Q4 clocked in at a 3.3% annual rate, which would make it the first time we've had three straight quarters of 3%+ growth since 2004-5.

Some say a government shutdown would make it tough to get another 3% quarter to start 2018, but we disagree. Yes, some “nonessential” government workers might pull back on their spending temporarily, but there's no historical link between government shutdowns and economic growth.

The economy grew at a 2.8% annual rate in late 1995 and early 1996 during the two quarters that include the prolonged standoff under President Clinton. That's essentially no different than the 2.7% pace the economy grew in the year before the shutdowns. The last time we had a prolonged standoff was in late 2013, under President Obama. The economy grew at a 4% rate that quarter, one of the fastest of his presidency.

Right now, taxes are falling, regulations are being reduced, and monetary policy remains loose. With these tailwinds, the acceleration of growth in 2017 should continue into 2018.

Here's how we get to 3.3% for Q4.

Consumption: Automakers reported car and light truck sales rose at a 16.4% annual rate in Q4, in part due to a surge after Hurricanes Harvey and Irma. “Real” (inflation-adjusted) retail sales outside the auto sector grew at a 6.6% rate, and growth in services was moderate. Our models suggest real personal consumption of goods and services, combined, grew at

a 3.9% annual rate in Q4, contributing 2.7 points to the real GDP growth rate (3.9 times the consumption share of GDP, which is 69%, equals 2.7).

Business Investment: Looks like another quarter of solid growth, with investment in equipment growing at about a 16% annual rate, and investment in intellectual property growing at a trend rate of 5%, but with commercial construction unchanged. Combined, it looks like business investment grew at an 8.8% rate, which should add 1.1 points to real GDP growth. (8.8 times the 13% business investment share of GDP equals 1.1).

Home Building: Given the major storms in Q3, we expected a larger pickup in home building than was realized in the fourth quarter. But it still grew at about a 2.6% annual rate in Q4, which would add 0.1 points to the real GDP growth rate. (2.6 times the home building share of GDP, which is 4%, equals 0.1).

Government: Both military spending and public construction projects were way up in the quarter, suggesting real government purchases up at a 2.7% annual rate in Q4, which would add 0.5 points to the real GDP growth rate. (2.7 times the government *purchase* share of GDP, which is 17%, equals 0.5).

Trade: At this point, we only have trade data through November. Based on what we've seen so far, it looks like net exports should subtract 1.2 points from the real GDP growth rate in Q4.

Inventories: We have even less information on inventories than we do on trade, but what we have so far suggests companies stocked shelves and showrooms at a slightly faster rate in Q4, which should add 0.1 points to the real GDP growth rate.

Some more reports on inventories and trade due this week could change our forecast slightly, assuming a shutdown doesn't interfere with the data schedule. But, for now, we get an estimate of 3.3%. The US economy is confirming the optimism behind the stock market rally.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-24 / 9:00 am	Existing Home Sales – Dec	5.70 Mil	5.690 Mil		5.810 Mil
1-25 / 7:30 am	Initial Claims – Jan 21	235K	241K		220K
9:00 am	New Home Sales – Dec	0.675 Mil	0.677 Mil		0.733 Mil
1-26 / 7:30 am	Q4 GDP Advance Report	3.0%	3.3%		3.2%
7:30 am	Q4 GDP Chain Price Index	2.3%	2.1%		2.1%
7:30 am	Durable Goods – Dec	+0.9%	+1.3%		+1.3%
7:30 am	Durable Goods (Ex-Trans) – Dec	+0.6%	+0.4%		-0.1%