

The Last Hurrah?

Most investors we talk to think the US is already in a recession or that a recession will start by the end of 2022. We think they're wrong on both counts.

Yes, we are fully aware that the reports on real GDP growth for the first two quarters of the year were negative. But, as economists, we are also aware that the GDP reports will be revised once a year for the next several years and are confident they will ultimately show positive growth. Why? Because the unemployment rate has dropped, payrolls have grown at a very rapid pace, and industrial production continues to climb.

Don't get us wrong; we're not "recession deniers." We think a recession is coming because monetary policy will have to get tight enough to bring inflation back down and a monetary policy tight enough to do that is also likely to drag the economy into a recession. We're just not there yet. We expect a recession to start in the second half of 2023, with some risk of it starting in either the first half of 2023 or first half of 2024.

In the meantime, as set out below, our calculations show economic growth at a 3.0% annual rate for the third quarter, which is probably going to be the fastest growth we see for any quarter from now until the next recession is done.

Consumption: "Real" (inflation-adjusted) retail sales outside the auto sector declined at a 1.4% annual rate in Q3 while sales of autos and light trucks slipped at a 0.4% rate. However, it looks like real services, which makes up most of consumer spending, should be up at a solid pace. Putting it all together, we estimate real consumer spending on goods and services, combined, increased at a modest 1.0% rate, adding 0.7 points to the real GDP growth rate (1.0 times the consumption share of GDP, which is 68%, equals 0.7).

Business Investment: We estimate a 5.8% annual growth rate for business equipment investment, a 7.4% gain

in intellectual property, and no change in commercial construction. Combined, business investment looks like it grew at a 5.6% rate, which would add 0.7 points to real GDP growth. (5.6 times the 13% business investment share of GDP equals 0.7).

Home Building: Amid higher mortgage rates and buyer skittishness, residential construction looks like it fell at a 16.5% annual rate. A decline at a 16.5% rate would subtract 0.8 points from real GDP growth. (-16.5 times the 5% residential construction share of GDP equals -0.8).

Government: Remember, only direct government purchases of goods and services (not transfer payments like unemployment insurance) count when calculating GDP. We estimate these purchases – which represent a 17% share of GDP – grew at a 0.6% rate in Q3, adding 0.1 point to real GDP growth. (0.6 times the 17% business investment share of GDP equals 0.1).

Trade: Exports remain very close to all-time highs in Q3 while imports have declined sharply, in part a reflection of businesses with too much inventory cutting back on foreign purchases. That means a smaller trade deficit. At present, we're projecting net exports will add 2.7 points to real GDP growth, although a report on the trade deficit in September, which arrives on Wednesday, may alter that forecast.

Inventories: Inventories look like they grew at a slower pace in the third quarter than they did in Q2, suggesting a drag of about 0.4 points on the growth rate of real GDP. However, just like with trade, a report out Wednesday may alter this forecast.

Add it all up, and we get 3.0% annual real GDP growth for the third quarter. An economic storm is coming. The sun is still shining today, but, with almost all the net growth in Q3 coming from the trade sector, the clouds are forming on the horizon.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-26 / 9:00 am	New Home Sales – Sep	0.580 Mil	0.620 Mil		0.685 Mil
10-27 / 7:30 am	Initial Claims – Oct 24	220K	213K		214K
7:30 am	Q3 GDP Advance Report	2.3%	3.0%		-0.6%
7:30 am	Q3 GDP Chain Price Index	5.3%	5.2%		9.0%
7:30 am	Durable Goods – Sep	+0.6%	+0.8%		-0.2%
7:30 am	Durable Goods (Ex-Trans) – Sep	+0.2%	+0.2%		+0.3%
10-28 / 7:30 am	Personal Income – Sep	+0.4%	+0.5%		+0.3%
7:30 am	Personal Spending – Sep	+0.4%	+0.4%		+0.4%
9:00 am	U. Mich Consumer Sentiment- Oct	59.7	59.5		59.8