Second Quarter GDP Was Great, But There Will Be No Encore Soon

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President Trump is rightly rejoicing about recent GDP numbers. But GDP is a lagging indicator – it tells us where the economy was in the past. And the economy isn't likely to do as well anytime soon.

The Bureau of Economic Analysis of the US Department of Commerce recently announced that the nation's estimated gross domestic product, which is the value of all goods and services produced in the nation, increased at a seasonally adjusted annual rate of 4.1 percent during the second quarter of this year. This is the largest gain since the third quarter of 2014. The revised GDP estimate for the second quarter, based on more complete data, will be released on August 29, 2018. Real GDP for the first quarter was revised slightly upward, to 2.2% from 2.0%.

President Trump is rightly rejoicing about these numbers. Yet, he forgot to mention that under President Obama, US GDP rose above 4.1% four times in four quarters, in 2009, 2012 and 2014.

Second quarter GDP was pushed up due to positive contributions from personal consumption expenditures (PCE), exports, nonresidential fixed investment, federal government spending, and state and local government spending. However, private inventory investment and residential fixed investment decreased.

While Trump stated, "We're going to go a lot higher than these numbers, and these are great numbers," I disagree. It is important to remember that GDP is a lagging indicator. It tells us where the economy was in the past. GDP does not tell us where we are now or where our economy is going in the future.

Unfortunately, a big reason for exports increasing in the second quarter was because US companies were hurrying to export ahead of retaliatory tariffs from other countries due to Trump having announced tariffs on Canada, China, Europe, and Mexico. It is unlikely that we will see such a rise in exports in the second half of this year unless Trump somehow were to take back his tariff threats.

Personal consumption expenditures, a big contributor to US GDP, is also likely to slow down as interest rates rise, which makes credit cards and any new loans more expensive for consumers. Moreover, anyone working in an export-supported job, especially in states in the Midwest and the South, are likely to spend less due to the uncertainty about their jobs, which are sensitive to Trump's tariffs.

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In addition, recent housing data are also indicating that second-quarter GDP performance is unlikely to be repeated at the same level in the coming quarters. For example, housing starts and home sales data should be a serious wake-up call for all US municipalities to create long-term financial models and plans to prepare for the economic and market downturn that is coming our way. Last week the Department of Commerce announced that housing starts tumbled to their lowest level in nine months; the 12% decline was much more than had been anticipated. Also worrisome is that permits for future construction declined for a third month in a row. Economist and Head of Analytics at Rutter Associates, Robert Selvaggio, explains that:

"Housing starts are a key leading indicator for the macroeconomy, because residential fixed investment represents about 20% of total US gross private domestic investment and the housing sector overall accounts for about 15% of total US GDP. Homebuilders do not start new projects when they fear an oncoming economic downturn, and potential homebuyers reduce their demands for new homes when they fear stock market and employment instabilities."

Also of concern is the fact that U.S. purchases of new homes fell in June to the slowest pace in eight months, while the median selling price declined to the lowest in more than a year. Additionally, the National Association of Realtors (NAR) reported existing home sales for June at 5.38 million homes seasonally-adjusted annualized (SAAR), which is the third month in a row that they declined. The NAR also revised May sales lower, to 5.41 million from 5.43 million. As a piece in Bloomberg News explains well, the housing market is slowing and in fact "may be headed for its worst slowdown in years."

According to the National Association of Business Economics June 2018 economics outlook survey, more than half of its economic forecaster survey respondents, 57, feel that "the balance of risks to real GDP growth through 2019 is weighted to the downside." This is in stark contrast to results in the March 2018 survey, which reflected more than 75% of the panel stating risks were largely weighted to the upside for 2018. I hope that anyone who opened champagne bottles over the weekend to celebrate the second quarter numbers enjoyed them. In the coming quarters, we will all have to be much more abstemious.

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