LPL RESEARCH
WEEKLY ECONOMIC COMMENTARY

July 22, 2019

A CONSUMER-DRIVEN QUARTER

John Lynch *Chief Investment Strategist, LPL Financial*
Barry Gilbert, PhD, CFA *Asset Allocation Strategist, LPL Financial*
Callie Cox, *Senior Analyst, LPL Financial*

KEY TAKEAWAYS

Consumer activity rebounded strongly in the second quarter.

Still, GDP likely expanded at the slowest pace in three years as other sectors dragged on growth.

We're encouraged by the strength in consumer spending, but economic growth needs to be broader.

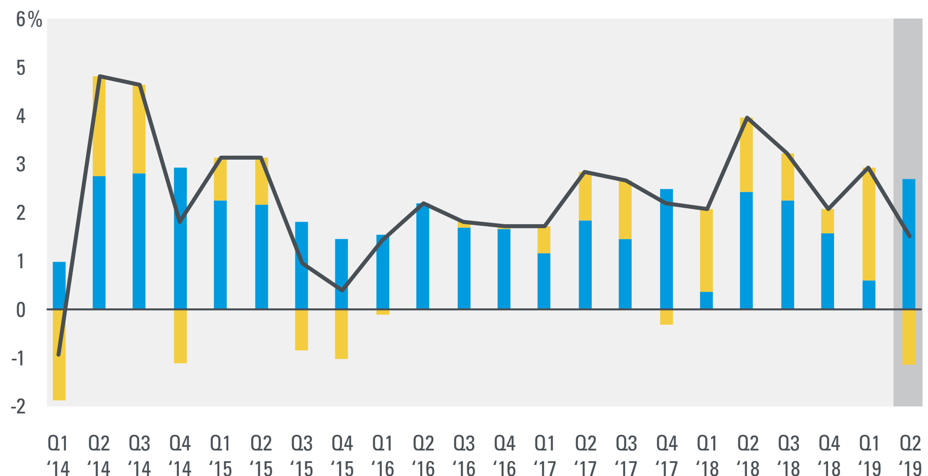
U.S. economic growth lately has been squarely on consumers' shoulders. Consumer spending likely added about 2.8% to second quarter gross domestic product (GDP), according to the Federal Reserve (Fed) Bank of Atlanta's GDP forecasting model. At that rate, the consumer's contribution to GDP would be the highest for any quarter since the end of 2014.

Still, when the GDP report is released July 26, we may see that overall growth last quarter was 1.6%, the slowest since the beginning of 2016. Consumer activity has meaningfully lifted growth, but projections show other parts of the economy withered. The makeup of growth has been unusual year to date, a product of trade uncertainty that has plagued the global economy for more than a year now [Figure 1].

THE STRONG CONSUMER

Recent data has hinted toward a rebound in consumer activity. Our best view of consumer spending's contribution to economic growth is through control group retail sales, a kind of core reading that excludes some categories. Control group

1 CONSUMERS LIKELY CARRIED THE U.S. ECONOMY IN 2nd QUARTER



Source: LPL Research, Federal Reserve (Fed) Bank of Atlanta, Bureau of Labor Statistics 07/18/2019
Q2 2019 is projected GDP data from the Fed Bank of Atlanta's GDPNow Model

Member FINRA/SIPC
LPL Financial

sales have risen for four straight months, the longest streak since the end of 2017. Month-over-month growth in control group sales averaged 0.6% in the second quarter, one of the highest quarterly averages in this economic cycle.

Consumer spending has been primarily supported by a strong U.S. labor market. U.S. companies have added jobs for 105 straight months, by far the longest streak on record. Claims for unemployment benefits have been contained, wages have grown at a healthy 3% clip, and the unemployment rate remains near a cycle low. Fiscal stimulus enacted in 2018 provided an extra boost of income for the consumer through lower tax rates and added tax credits.

Other short-term catalysts have propelled consumer activity as well. Oil prices are historically low after a steep sell-off late last year, allowing consumers to allocate more income from gas purchases to discretionary spending. Consumer activity was also weak in the first quarter (thanks to trade tensions and a record-long government shutdown), so we expected to see a rebound in the second quarter solely from pent-up demand.

THE DETRACTORS

The U.S. consumer provided a solid base for GDP growth in the second quarter, but it did not get much help from other sectors in the economy. Business investment, housing, government spending, trade, and inventories are collectively expected to drag down GDP by about 1.2%, according to Atlanta Fed projections. Output from trade and inventories alone likely stripped around 1.5% from GDP, almost negating their 1.7% boost to growth in the first quarter.

Most importantly, U.S. businesses need to step up at this point in the cycle. We've been watching for a pickup in capital expenditures (capex) growth, especially after fiscal stimulus' implementation. Year-over-year growth in nonresidential fixed investment has averaged 3.9% in this cycle, the second-lowest rate among all expansions since 1970. We saw a healthy pickup in business spending in the first half of 2018, but that momentum fizzled as U.S. companies sidelined expansion plans in the face of increasing trade and political uncertainty.

Business investment is especially crucial for growth prospects as the personal income boost from fiscal stimulus wanes over the next few years. Higher capex leads to higher productivity, which directly feeds into higher economic output. Productivity also promotes healthy inflation as it keeps employer costs in check.

All the fundamental pieces are in place for a resurgence in capex, but the chilling effect of uncertainty remains. We think some trade uncertainty will dissolve with meaningful progress in U.S.-China trade talks, but only if the policy outlook also stabilizes and businesses believe it's safe to plan long-term projects. Once there is more clarity on trade, we expect capex to pick up again as companies take advantage of fiscal incentives, record cash piles, and low borrowing costs.

CONCLUSION

We're maintaining our GDP forecast of 2.25–2.5% growth in 2019, which implies some moderation from the 3% pace we saw in the first quarter. Even if growth trends lower than our forecast this year, it's important to remember that annual GDP growth has averaged only 2.3% in this expansion. Average growth is satisfactory at this point in this cycle, but the underlying details show the economy has yet to reach its full potential.

We're encouraged by strength in consumer spending, especially in the face of global headwinds. Still, we believe capital expenditures will need to rebound as the cycle matures to extend the expansion. A U.S.-China trade deal would be an important first step. ■

Member FINRA/SIPC

LPL Financial

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

The economic forecasts set forth in this material may not develop as predicted.

Investing involves risk including loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

Securities and advisory services offered through LPL Financial (LPL), a registered investment advisor and broker-dealer (member FINRA/SIPC). Insurance products are offered through LPL or its licensed affiliates. To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL is not an affiliate of and makes no representation with respect to such entity.

If your advisor is located at a bank or credit union, please note that the bank/credit union is not registered as a broker-dealer or investment advisor. Registered representatives of LPL may also be employees of the bank/credit union. These products and services are being offered through LPL or its affiliates, which are separate entities from, and not affiliates of, the bank/credit union. Securities and insurance offered through LPL or its affiliates are:

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by Any Government Agency | Not a Bank/Credit Union Deposit

RES-48751-0719 | For Public Use | Tracking #1-874803

Member FINRA/SIPC

LPL Financial