CALDERONE HUDSON GROUP

550 W. Merrill St. | Suite 100
Birmingham, Michigan 48009
248.430.8060

CHG Economic Report – 2nd Quarter CHG GDP Forecast

Key Takeaways

- *Consumer spending continues subpar growth as Americans use more money to service debt and deal with higher prices.*
- *Net investment is anticipated to grow given uptick in investments in rolling stock, aircraft deliveries, and manufacturing.*
- *Residential investment slowdown is concerning.*
- *American consumers and companies continue to rely heavily on foreign products; annualized trade deficit well over $1 trillion.*
- *Slower growth significantly increases likelihood of Fed rate cut.*

Economy Grade

B-

Higher interest rates are necessary to fight inflation and appear to be working in the direction of providing a soft landing. However, slower consumer spending suggests risks remain.

Rate Cut Probability
70%

Recession Probability
38%

On July 25th, the Bureau of Economic Analysis will release a 2nd quarter GDP that likely shows America's economic activity continues a pattern of slow growth. We hate to say it – "we told you so."

Predictable Slow Growth

As illustrated below, the CHG model and the Atlanta Fed project sub-2% growth for the second successive quarter with the CHG model predicting a steeper drop from Q1 2024 than the Atlanta Fed. With short term rates holding steady near 5.25%, slower consumer spending and overall economic underperformance should not be a surprise; in fact, CHG predicted meager growth for the 2nd quarter back in February. Projected contributions to 2nd quarter GDP are as follows:

Component	CHG	Atlanta Fed	Prior Qtr.
Personal Consumption	1.882%	1.500%	1.223%
Residential Investment – Structures	0.000%	-0.150%	0.538%
Non-Residential Investment – Structures	-0.185%	-0.120%	0.013%
Non-Residential Investment – Equipment	0.497%	0.520%	0.015%
Intellectual Property Investment	0.266%	0.340%	0.523%
Net Exports	-1.197%	-0.750%	-0.619%
"Core GDP"	1.261%	1.340%	1.693%
Change in Inventory	0.130%	0.950%	-0.530%
Government Spending	0.272%	0.420%	-0.018%
Total	1.663%	2.710%	1.145%

As illustrated above, CHG is forecasting a smaller increase in inventory build than the Atlanta Fed as manufacturing activity continues to slow as indicated by lower to muted growth in the three major industrial production indices. Similarly, leading indicator data suggests muted growth in residential investments (as higher mortgage rates dampened home builder confidence) and net exports as U.S companies increased their import of capital goods by more than $3 billion. Further analysis on each GDP components follows.

Personal Consumption

Surprising Uplift

Despite continued inflation, American consumer spending is anticipated to increase, with CAG expecting a 1.86% annualized increase in personal consumption in the second quarter vis-à-vis the first quarter (1.1% contribution to GDP see **Chart 1**). This marks the first increase in three quarters as the Fed continues to battle inflation with higher interest rates. American investment in cars appears to have increased significantly, leading indicator data suggests new vehicle consumption increased quarter over quarter by 14.2%. Similarly. spending on services appears to have increased 2.5% quarter over quarter while growth in non-automotive goods approximates 2.6% quarter over quarter.

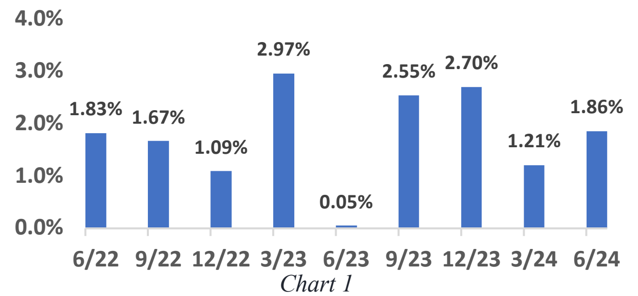

Chart 1

The increase in consumer spending is surprising given that consumers continue to struggle with a heavy debt load (see **Chart 2**). American debt to overall income remains at a record high, despite high interest rates. Further, though inflation has moderated, at 3.3% from May ’23 through May ’24 and an annualized quarterly rate of 2.8%, it remains above the target rate of 2%. Given that none of these conditions will be alleviated in the near term, we anticipate continued slow growth in personal consumption.

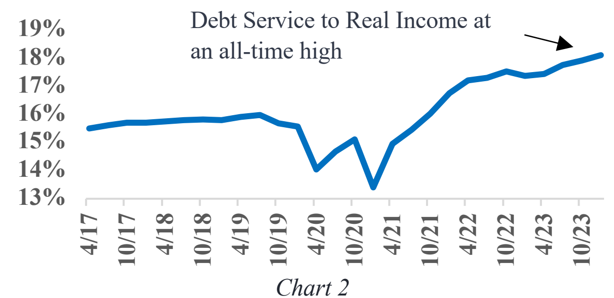

Chart 2

Residential Investment – Structures

Reversal of a Positive Trend

Residential investment appears to be flat, if not declining (See **Chart 3**) halting three consecutive quarters of strong growth. Through May, construction of single and multi-family homes was little changed quarter over quarter at 0.05% with a 0.3% increase in single family home construction being offset by a 0.7% decline in multi-family home construction. Further, advanced retail sales of home improvement and building material declined for the third consecutive quarter.

Similarly, home builder confidence, as measured by the Wells Fargo Housing Market Index, hit its lowest level since 2023 and has been in persistent decline since January of 2022. Home builder confidence appears unlikely to improve sans a reduction in interest rates given what appears to be a softening in new home sales. The seasonally adjusted annual rate of new home sales declined more than 0.7% in the second quarter vis-à-vis the first with May’s sales particularly sluggish at 611,000 units, only the second time the new housing SAAR has dipped below 620,000 units in the last fifteen months.

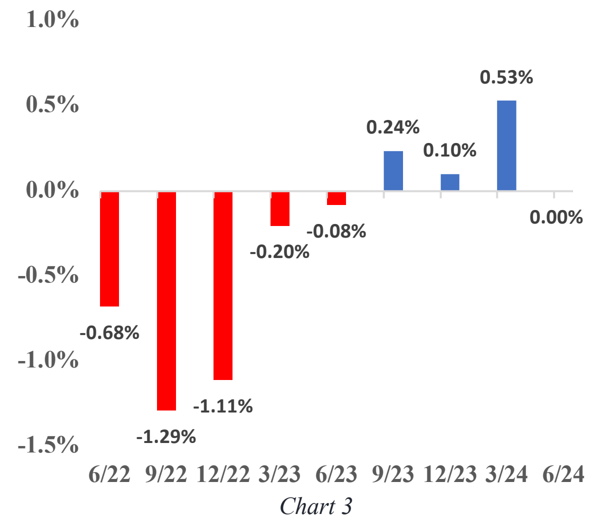

Chart 3

Non-Residential Investment – Structures

A Negative Trend Continues

Similar to residential investment, non-residential structural investment is likely to register flat to negative growth in the 2nd quarter (see **Chart 4**). Advanced data on non-residential construction spending shows a 0.7% decline quarter over quarter. Further, both oil / gas and mining industrial production each suggested investment contractions in their respective industries.

Eight of the 11 major non-residential construction categories showed quarter over quarter declines in activity with utilities surprisingly showing the largest quarter to date drop (0.9%). One bright spot in non-residential structural spending was manufacturing which is up 5.6% quarter to date.

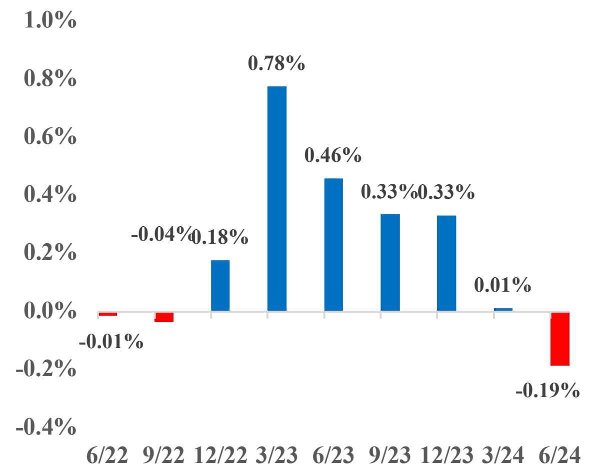

Chart 4

Non-Residential Investment – Equipment

Strong Truck and Aircraft Investments Stimulate Positive Growth

Despite a slight decline in core capex shipments (-0.5%), non-residential investment is forecasted to eke out a slight quarter over quarter gain (see **Chart 5**). Delivery of aircrafts is expected to increase 2% quarter over quarter while delivery of commercial trucks is anticipated to increase 4.5% quarter over quarter. Truck investments are anticipated to hit their highest SAAR since the second and third quarters of 2019.

The uplift in truck sales is likely a result of pent-up demand, the summer construction season, and residual effects of the Inflation Reduction Act. We anticipate this level of growth will subside in the coming quarters. That said, aircraft deliveries are likely to remain strong as Boeing begins to unwind its order backlog which reached a record at the end of March.

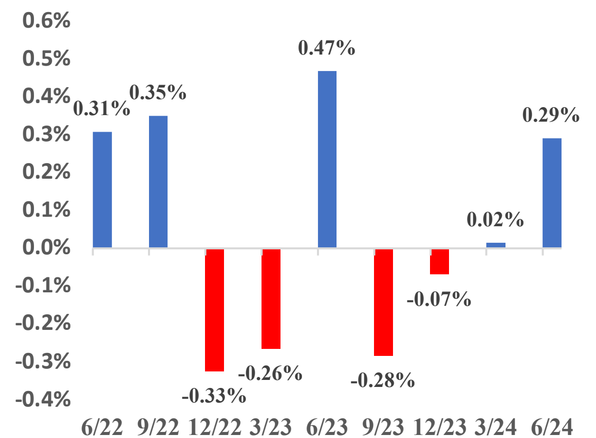

Chart 5

Net Exports

What Tariffs? U.S. Trade Deficit Continues to Grow

Since, 2014, the U.S. trade deficit has consistently trended up, with the trend taking brief respites immediately after tariffs before returning to form as (i) foreign nations develop mechanisms for circumventing the tariffs and (ii) domestic prices rise rendering the tariffs ineffective. The recent tariffs implemented by the Biden administration will likely be no different. Despite the extension of Trump era tariffs and with the addition of more tariffs, the monthly trade deficits in April and May hit their highest level since 2022. We anticipate a 1.8% increase in the trade deficit in the second quarter.

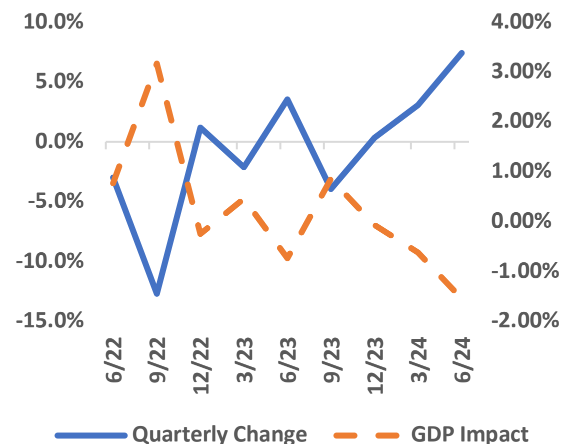

Chart 6

Net Exports (Continued)

What Tariffs? U.S. Trade Deficit Continues to Grow

CHG has been very critical of tariffs, suggesting they are a tax on the middle class, and consistently rejected them as a useful mechanism in managing trade imbalances. Further, after implementation of NAFTA 2.0, CHG declared Mexico and Canada the winners: this has proven true as the trade imbalance has increased $64 billion and $39 billion with Mexico and Canada, respectively, since 2020 (much of this is due to Chinese investment in these regions), while the Chinese trade deficit has only shrunk $29 billion. We expect these imbalances to continue in the foreseeable future.

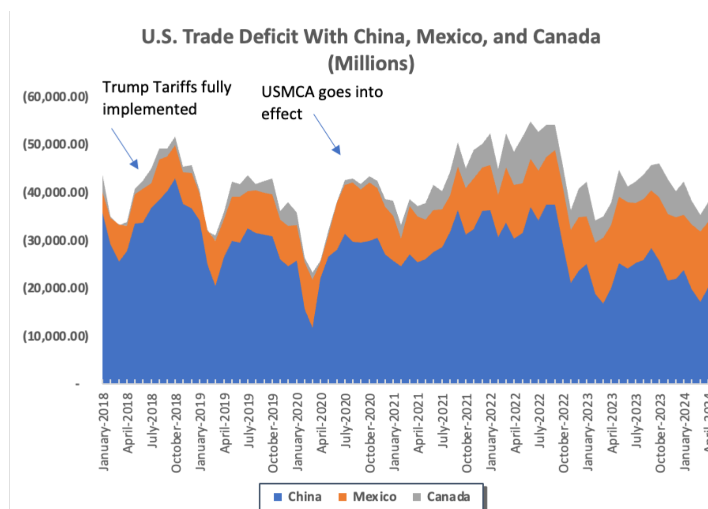

Chart 7

Other: Intellectual Property Investment, Governmental Spending, Change in Inventory

Historically, investment in IP has been tied to overall economic activity which is measured by the Chicago National Activity Index (CNAI) as well as the lagged activity in other components of GDP. CHG has modeled quarterly changes in IP investment vis-à-vis the CNAI and historical components of GDP; based on our model, despite recent softening in the CNAI, strength in U.S. investment over the past four quarters suggests another uptick in IP investments. Our projected 0.27% increase in quarter over quarter change in IP investment is consistent with that projected by the Atlanta Fed.

Similarly, both CHG (0.266%) and the Atlanta Fed are predicting an increase in governmental spending; a reversal relative to the first quarter drop in governmental spending. Seasonally adjusted outlays by the Treasury Department are trending toward a 3.8% seasonal increase in the second quarter versus the first.

Conversely, while the Atlanta Fed is suggesting U.S. inventories are climbing at a significant pace, contributing about 0.95% to GDP, CHG is currently forecasting a much lower increase in the stock build as we are yet to see advanced data supporting a more significant build.

Synopsis

The U.S. economy appears to be headed for another quarter of mediocre growth; even under the most optimistic scenario "core" GDP appears to be declining quarter over quarter and consumer spending, the key cog in the U.S. economic machine, appears set to remain in low growth mode. With inflation falling and advanced data suggesting a second consecutive quarter of uninspiring economic activity, the only question remaining is whether the Fed has seen enough signs of the economy moderating to begin cutting interest rates. Our belief is they have and rates will likely be cut at the September meeting. The markets appear to agree: based on current interest rate futures and their underlying options, the market probability of a rate cut appears to approximate 65% - 75%. Using our market proprietary model, we have assessed the market probability of a recession within the next 4 quarters at 38%.