First Trust Portfolios Canada
Monday Morning OUTLOOK

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Mirror-Image Quarters and Iran

Looking back on it, the first quarter of the year was a complete anomaly. Real GDP *declined* at a 0.2% annual rate, and the left side of the political spectrum said this proved current policies were a disaster.

But industrial production *expanded* at a 4.5% annual rate in the very same quarter, the fastest growth rate for any quarter since 2021. The quarterly decline in real GDP was a figment of tariff-induced front-running. Excluding the surge in imports, economic activity continued to grow.

Now comes the first quarter's mirror image. The Atlanta Federal Reserve Bank's GDPNow model is currently projecting that real GDP is growing at a 3.4% rate in Q2. Believe it or not, that may be an underestimation.

The Atlanta Fed model assumes that the trade deficit in Q2 is smaller than in Q1 (back when consumers and businesses were "front-running" Liberation Day tariffs) but is still larger than it was in Q4 last year. That's possible, but we think the more likely outcome is that the Q2 trade deficit is smaller than in Q4 to make up for the surge in Q1. And if we are right about that, real GDP could be up at a 5.0%+ annual rate in Q2.

Some people (on the right side of political spectrum) are already calling this The Trump Boom. Yet, as we said, it's in the mirror, and guess what? Data on industrial production are pointing in the opposite direction. We are currently estimating that overall industrial production will be up at only about a 1.0% annual rate in Q2 and that manufacturing excluding autos will show growth of near zero.

Meanwhile, overall retail sales were 0.3% lower in May than at the end of last year, without factoring in higher prices. If we factor in overall consumer price inflation, retail sales are down 1.2%.

In other words, the data are so choppy that discerning a true trend from the first six months of the year is virtually impossible. Averaging the two quarters leaves us closer to trend growth. But emerging weakness in many areas (outside of trade) means we are not out of the woods on recession risk. To gauge underlying growth, we track "core" GDP—consumer spending, business investment, and homebuilding—excluding volatile swings from trade, inventories, and government. In Q2, core GDP looks to be growing near the slowest pace for any quarter since 2022

Monetary policy has been tight enough to reduce the rate of inflation in the past couple of years, with the past four months especially slow. The year-over-year changes to the CPI in the next few months are not likely to show additional improvement, because last year's monthly data was weak. Pay attention to three-month and six-month trends this year, not the year-over-year changes.

Chairman Powell is still selling the story that tariffs are inflationary, despite a lack of evidence. The Fed will use the year-over-year CPI readings in the next few months to say they were right, this is why it is important to look at annualized rates for this year, not year-ago comparisons.

While the Federal Reserve may be wrong, it is still transparent. So, because of the wrong-headed belief that tariffs cause inflation, there will likely be no cut in short-term rates until September. But a monetary policy tight enough to slow inflation is certainly tight enough to slow the economy. As this becomes evident, cuts will be forthcoming.

In the meantime, some investors are worried about the situation in the Middle East. The way we look at it, actions taken by any country that make it less likely Iran develops nuclear weapons and mechanisms to deliver them are a good thing.

True, in the short term, Iran may threaten oil traffic in the Straits of Hormuz. But many countries have an interest in being able to buy and sell oil using that passage, including Iran itself and its allies. China, for example, would not like to see a major spike in oil prices.

The US, in spite of the drawdown in the strategic petroleum reserve, has much less to lose, even in the short-run. If Iran tries to force oil prices higher, expect the rig count in the US to soar.

Our biggest concern would be a policy shift toward getting US "boots on the ground" in Iran, which could end up being very costly and require a political coalition of support on Capitol Hill that shifts legislative priorities away from extending the 2017 tax cuts and reducing government spending in the years ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-23 / 9:00 am	Existing Home Sales – May	3.950 Mil	**4.020 Mil**	4.030 Mil	4.000 Mil
6-25 / 9:00 am	New Home Sales – May	0.693 Mil	**0.722 Mil**		0.743 Mil
6-26 / 7:30 am	Initial Claims – Jun 21	245K	**245K**		245K
7:30 am	Durable Goods – May	+8.5%	**+14.0%**		-6.3%
7:30 am	Durable Goods (Ex-Trans) – May	0.0%	**+0.1%**		+0.2%
7:30 am	Q1 GDP Final Report	-0.2%	**-0.2%**		-0.2%
7:30 am	Q1 GDP Chain Price Index	+3.7%	**+3.7%**		+3.7%
6-27 / 7:30 am	Personal Income – May	+0.3%	**+0.3%**		+0.8%
7:30 am	Personal Spending – May	+0.1%	**+0.1%**		+0.2%