GDP Distortions

As recently as two years ago, more than 70% of Americans thought the US economy was still in recession. We’re not sure what that figure is today – maybe pollsters are too busy with the election – but we’d bet it’s still very high.

Those who think we’re still in recession are wrong; the US economy has been growing for seven years. But we understand why they feel that way, given the huge increase in the size of government under the past two presidents and the resulting Plow Horse economic growth, averaging 2.1% per year since the recovery started. Increases in the size of government, including more government spending, more regulation, and the hidden control of private resources through health insurance rules, have sapped the economy’s ability to generate higher standards of living as fast as in previous decades.

However, some analysts are blowing last Friday’s GDP report way out of proportion. Yes, the economy grew at only a 1.2% annual rate in the second quarter, falling short of a consensus expected 2.6%. And yes, the growth rate in the first quarter was revised down to only 0.8%. None of this is good.

But an economy with a growth trend right around 2% is bound to have periods that are slower offset by periods that are stronger. The economy grew 3% in the year ending in mid-2015, so what we’ve seen in the past four quarters (an average growth rate of 1.2%) has just returned us to the Plow Horse trend. Inventories alone have subtracted 0.6 points from the real GDP growth rate in the past year. That just leaves more room for future growth. Real consumer spending rose at a 4.2% annual rate in Q2, suggesting the drag from inventories is about to turn into a boost, as firms restock shelves.

Some analysts are concerned about business investment, which has dropped in each of the past three quarters and is only up 8.5% since the prior peak in early 2008. But that includes commercial construction, like brick-and-mortar retail stores that are going out of style. Business investment in structures is still 20% below the peak in early 2008; by contrast, the rest of business fixed investment, including both equipment and R&D is up 19%, and that’s despite lower energy prices.

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Traditionally, investors have thought of productivity growth as something that comes from more investment. A worker with a better machine produces more. But in today’s economy, productivity looks like it’s increasingly coming from how efficiently we use the labor and capital we already have in place. The official government data on productivity don’t show that, at least not yet. But how else can we explain the boom in profits? Corporate profits are up 47% since early 2008.

The Plow Horse economy has plenty to complain about. But let’s stick to fixing government policy, not distorting data to try to make the economy look even worse than it is.