SMBC SMBC Group

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GDP: Speed vs. Accuracy

We get the first snapshot on Q3 economic output tomorrow. The consensus of economists projects 4.3% Q3 real GDP growth. The Atlanta Fed's GDPNow forecast is even higher at 5.4%. Several observations are worth noting.

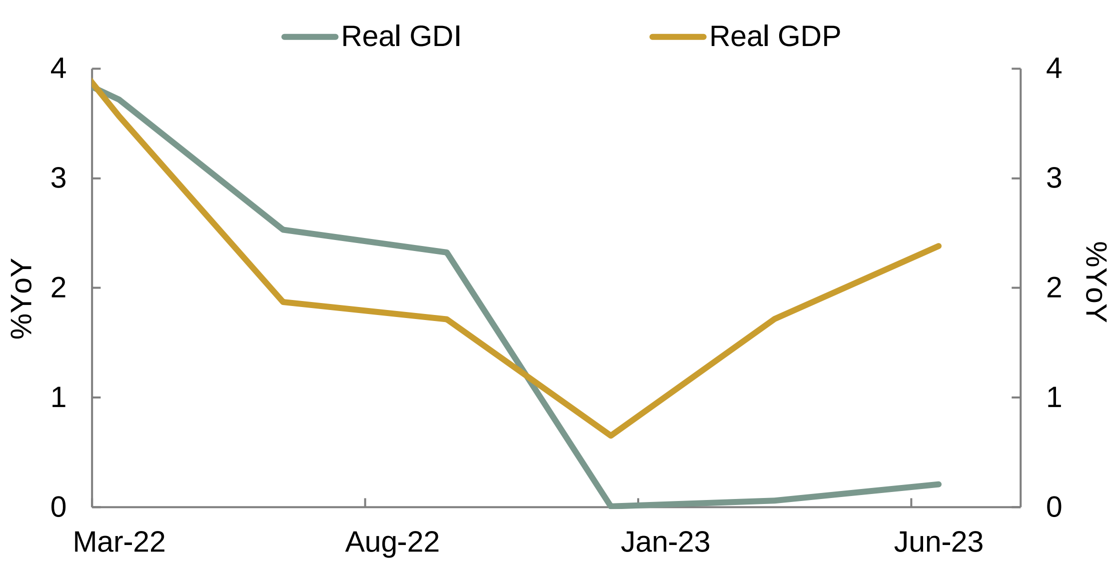
One, **real GDP is prone to substantial revision**. According to Bureau of Economic Analysis (BEA) calculations, one standard deviation on revisions is worth one full percentage point. That is large. But our calculations show that the revisions are almost twice that amount near economic inflection points. In fact, it is not unusual for the economy to have a growth fillip right before peaking. It has occurred ahead of four out of the last six recessions, with real GDP on average printing a solid, 3%-plus figure.

Two, **three-quarters of the expected Q3 splurge in output is coming from the consumer**. But given households' high relative share of durable goods spending, and the fact that financing is harder to get and more expensive, a big slowdown should be in the offing. And many consumers once again have student loan payments to make. That is a big tax hike that could be worth upward of $160B per annum.

Three, **GDP is essentially a lagging indicator.** It tells us (imprecisely, given the revisions) where the economy was last quarter. But it does not tell us where the economy is going. For that, we need to look at leading indicators of the economy, such as the treasury yield curve. While bear steepening, the curve has been inverted since July 2022 and is thus sending an ominous economic signal.

Fourth, and maybe more importantly, **the income side of the economy has been telling us something entirely different than the product side of the economy** from which the GDP figures are derived. Presently, there is a near record large gap (known as the statistical discrepancy) between the income and product sides of the economy.

As we can see in the chart below, **real gross domestic income (GDI) has barely been grown over the past few quarters** while real GDP appears to be accelerating. Why focus on GDI? Because income is based on tax revenues, and businesses and households do not pay tax on phantom income. Arguably, this makes the GDI data more accurate than the GDP data. The reason investors focus more on the latter is partly because the product data are timelier.



Sources: BEA, Haver, SMBC Nikko

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