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ECONOMICS: US PERSPECTIVES

2Q GDP AND BENCHMARK REVISIONS: WILL PAST YEARS' GROWTH RATES BE REVISED HIGHER?

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Next week will see not only the first estimate for second-quarter GDP, but also revised figures for all quarters from the past three years. We expect the most recent quarter's aggregate growth rate to be near 3%, annualized—led by a large gain in consumer spending. GDP revisions for the past three years could prove noteworthy as well, as the income side of GDP accounts argue for upward revisions to real GDP growth from 2013 to 2015.

Robust Consumer Spending Drives Second-Quarter GDP

On July 29, the Bureau of Economic Analysis (BEA) will issue its first, or "advance," estimate for second-quarter real gross domestic product (GDP) growth. Based on preliminary incoming data, second-quarter GDP should show a growth rate in the range of 2.5% to 3% annualized. The strength in the quarter is centered in consumer spending.

Our estimate suggests that real consumer spending increased over 4% annualized, led by strong gains in spending on durable and nondurable goods. That strong consumer spending advance marks only the third time in the current cycle that it has topped the 4% mark for a quarter. Clearly, gains of this magnitude in consumer spending are a welcome development and indicate that the economic recovery remains youthful and on strong footing.

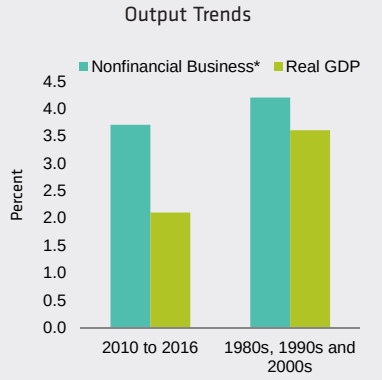
Modest gains in residential investment, exports and government spending will also contribute to the second quarter's growth rate. Nonresidential investment in structures will likely lag again, owing to the decline in the rig count in the energy sector. However, we expect this segment of the economy to be a contributor in the second half of the year.

Will BEA Unveil Noteworthy Revisions?

The BEA will also offer revised GDP estimates for the past three years, and those revisions could prove noteworthy. For example, there has already been a dramatic upward revision to the construction spending data, a key data component for the residential, nonresidential and government construction estimates. That revision alone should boost growth by one-fourth to one-half of a percentage point in some of the earlier years.

There's potential for other revisions as well. One reason to expect an upward revision is that, even based on currently published numbers, gross domestic income (GDI) has increased 2.4% per year versus the 2.1% gain in real GDP. A research paper published by the Federal Reserve staff in 2010 concluded that initial estimates in GDI predict revisions in GDP—but for the reverse order, they found no predictive evidence. Moreover, the output of the nonfinancial corporate sector, which is also based on income-sourced data, shows a much faster growth rate as well.

Display 1
Tale of Two Output Measures During Expansion Periods



Through June 30, 2016
*Nonfinancial corporate business sector
Source: Bureau of Economic Analysis and Haver Analytics

According to published data, real GDP has increased 2.1% on average since 2010, while the output growth measured by nonfinancial corporate business has increased 3.6% per year. While the output growth of the nonfinancial corporate sector tends to increase somewhat faster than real GDP during expansion periods, the 150-basis-point gap between the two output measures over the past six years is

unusually wide. In fact, the average spread between the output measures (GDP and nonfinancial corporate business) in the past three growth cycles (1983–1989, 1991–2000 and 2002–2007) was only 50 basis points (*Display 1*).

To be fair, it's difficult at this juncture to say conclusively whether GDP as currently measured is understated or not. But there's some hard evidence that points to an upward revision.

Perhaps more important, even after the new GDP estimates are released next week, it could take a few more years to fully and accurately capture the economy's growth rate. Indeed, history shows that it takes years for innovations and new services to be incorporated in the GDP methodology. A good example is the ATM: introduced in 1992, but not appearing in GDP figures until 1999.

Therefore, while the GDP figures might capture the attention of the financial markets for a day or two, we still think jobs data, and company profits and margins offer us more insight on the innovative ways and underlying growth trends in the economy. ■