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TRENDMACRO LIVE!

On Q2 GDP

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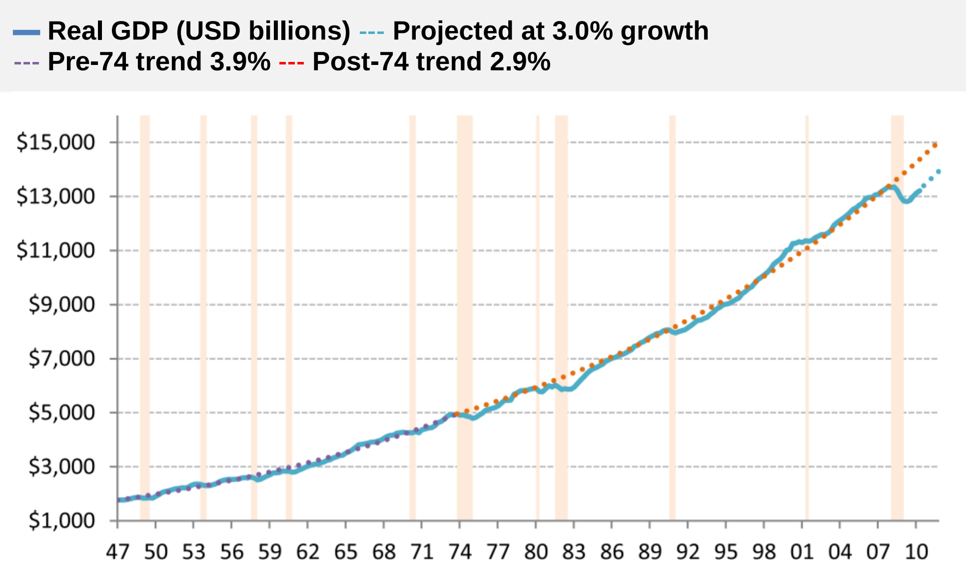
The recession was worse than we knew, making this recovery even more "expansionless."

Don't take too much comfort about this morning's report of lackluster Q2 real GDP growth of 2.4%, just because Q1 was at the same time revised up from 2.7% to 3.7%. In reality, production in Q1 was revised *down* by $100 billion. The only reason Q1 growth looks *better* is because Q4 2009 production was revised down even more, by $131 billion.

In fact, every quarter for the last three years was revised lower, but the expansion quarters in 2007 were revised down less than the recession quarters in 2008 and 2009. This moves the high-water mark for output from Q2 2008 to Q4 2007 (where the NBER had dated the cycle peak all along). The trough is still Q2 2009. Before, from peak to trough, output fell 3.8%. With the revisions, it fell 4.1%. The recession was worse than we thought.

This implies that output is further below the trend level than we thought. And this morning's Q2 data shows *growth* below trend, too, so we are falling further below the trend *level* (please see the chart below). This is a material consideration because the further the economy is below trend, the



Source: Bureau of Economic Analysis, TrendMacro calculations

Update to strategic view

US MACRO: It's an "expansionless recovery" for sure, based on this morning's Q2 GDP data. Revisions of the last three years show the previous expansion to have been greater than previously thought, and the recession to have been deeper. That means tepid 2.4% growth leaves us even further below trend than we thought.

FED FUNDS: The Fed operates in an "output gap" framework, so this morning's 2Q GDP data, and revisions -- which show output even further below trend than previously understood -- entrenches the Fed more deeply in a posture of "no exit" from extremely easy policy.

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more rapidly you would expect it can expand. Yet there is no expansion here at all, merely recovery -- the "expansionless recovery." We're falling behind: as the US population grows, and the potential labor force grows along with it, languishing below trend puts the economy further and further from the goal of full employment.

All that said, let us not fail to point out two bright spots in this morning's numbers. These contribute to our belief that while we are falling behind in an overall sense, nevertheless the economy is surely no longer in recession, and there's no sign here of a "double dip" as far as we're concerned.

- Disposable personal income grew at a 4.4% annual rate. Most of this growth was achieved substantively, through increases in wages and salaries. Only 30% was achieved through growth in transfer payments. This indicates that as income-supports from the 2009 "stimulus" bill dwindle, even the small gains we've seen in employment are boosting overall income.
- The 19.1% growth in fixed investment -- housing, commercial real estate, and equipment and software -- explains almost all the growth in Q2 (2.24% out of 2.4%). This is the sector of the economy where the contraction was the steepest during the recession, falling two quarters ago to an all-time historic low as a percentage of GDP. So it is the best candidate for "V-shaped" recovery, and it is encouraging to see some signs of life here.

Bottom line

It's an "expansionless recovery" for sure, based on this morning's Q2 GDP data. Revisions of the last three years show the previous expansion to have been greater than previously thought, and the recession to have been deeper. That means tepid 2.4% growth leaves us even further below trend than we thought. The Fed operates in an "output gap" framework, so this morning's 2Q GDP data, and revisions -- which show output even further below trend than previously understood -- entrenches the Fed more deeply in a posture of "no exit" from extremely easy policy.

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Recommended Reading

Seven Faces of The Peril
James Bullard
Preprint, Federal Reserve Bank of St. Louis *Review*
September-October

The Perils of Taylor Rules
Jess Benhabib, Stephanie Schmitt-Grohe and Martin Uribe
Journal of Economic Theory 96, 2001

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