

TRENDMACRO LIVE!

## On Q3 GDP

Friday, October 29, 2010

Donald Luskin

The "Zarnowitz Law" has been repealed. After a record drop, the economy refuses to grow.

[This morning's advance Q3 2010 GDP report](#) shows the US economy mired in an "expansionless recovery," nowhere near the robust expansion it should be experiencing after the sharp recession of 2008-2009. Now five quarters from the trough, after a 4.2% drop in output, real GDP should have grown by 9.5% based on post-war historical precedent (please see the chart below). In reality it has only grown 3.5%. [Victor Zarnowitz](#), the great business cycle economist who died last year at age 90, didn't live to witness this refutation of the "law" named in his honor -- that the robustness of an expansion is a product of the depth of the previous recession, and that economists always underestimate the strength of recoveries. Fact: *this time is different*.

We are not experiencing a typical business cycle expansion because:

- This has not been a business cycle in the usual sense -- it has

### Update to strategic view

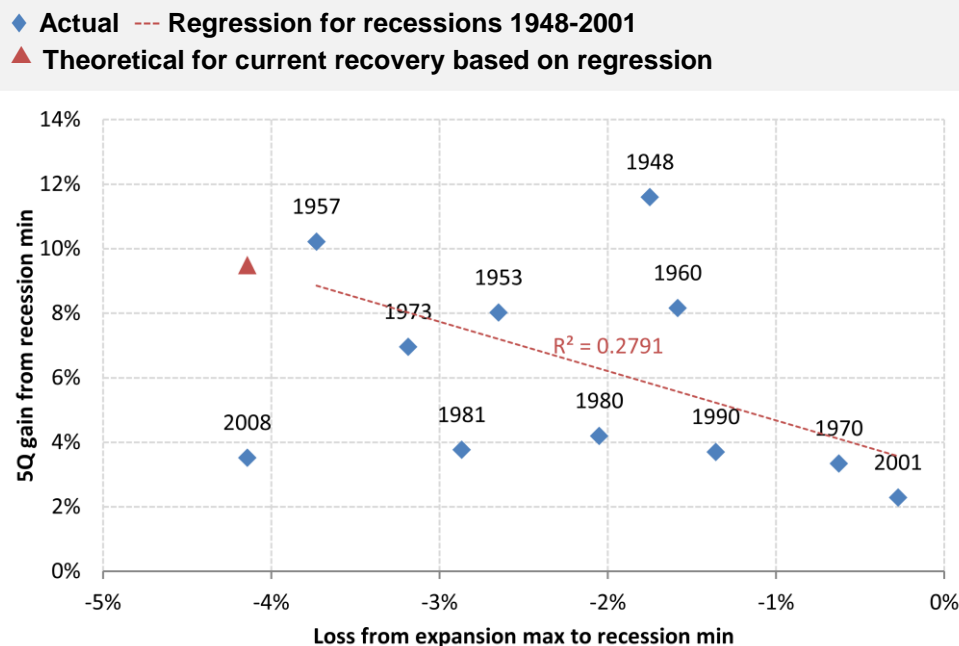
**US MACRO, FED FUNDS:** Q3 2010 GDP data this morning shows an ongoing "expansionless recovery." As the FOMC meets next week, it will debate QE2 against the backdrop of this data that portrays the economy acting like Fed is too tight. At the margin, this is a goad to a larger and more committed QE2.

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### Corrections

This morning's "Data Insights: GDP" contained two errors -- one chart had an incorrect label on one of its axes; and another chart was accidentally duplicated. [Please click here to download a corrected edition.](#)

In "[Sell On Good News](#)" (October 20, 2010), we stated that Blackrock is 34% owned by Bank of America. We should have made it clear that BofA holds 34% of the *capital stock* of Blackrock, but only 3.6% of its *common stock*.



Source: BEA, NBER, TrendMacro calculations

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been a systemic credit crisis (see ["So Much For The 'V'"](#) May 21, 2010).

- The fiscal policy response has been ineffective, and ongoing uncertainty about it is a drag on investment (see ["The Double-Dip Doomsday Machine"](#) September 21, 2010).
- The monetary policy response has been insufficient. The Fed is too tight (see ["Risk-On Hearts QE2"](#) October 14, 2010).

While sequential quarter real growth did improve to 2% in Q3 from 1.7% in Q2, there's really not a single truly strong element in this morning's report. Here are some of the features of the data that we found interesting (please see this morning's ["Data Insights: GDP"](#) for more details):

- Nominal disposable personal income grew 2.3% in the quarter at an annual rate, with wage growth the strongest component. As some elements of last year's stimulus linger and others roll off, rising taxes were a significant negative, but they were offset by rising transfer payments.
- Real output is still below the Q4 2007 peak, almost three years on, with the trend level 9.2% higher. Axiomatically, it is impossible to return to full employment without returning to trend.
- Fixed investment made a positive but small 0.10% contribution to growth. The capital goods sub-category -- that is, equipment and software -- contributed 0.80%, the largest positive contribution at that detail level. While investment in structures will likely languish in the aftermath of an historical building bubble -- capital goods is an area within fixed investment that is beginning to experience a classic Zarnowitz-type recovery off an unsustainably low base (please see the chart below).
- 1.79% growth in personal consumption expenditures almost

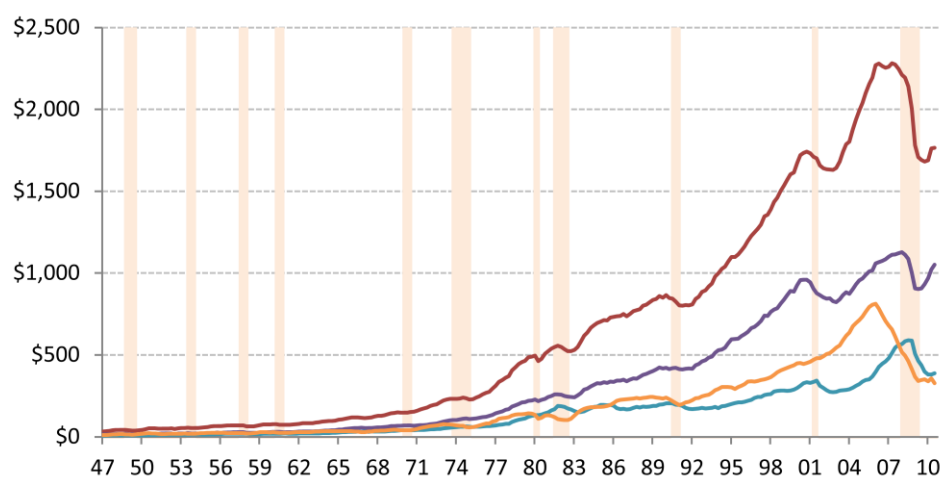
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Source: BEA, NBER, TrendMacro calculations

entirely explained the quarter's 2.0% overall growth, and the absolute level of consumption has made an all-time high. This is an utter refutation of the "new normal" thesis that a weak consumer will fail to get his share of growth (see ["The Consumer: QED"](#) April 16, 2010).

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**Bottom line**

Q3 2010 GDP data this morning shows an ongoing "expansionless recovery." As the FOMC meets next week, it will debate QE2 against the backdrop of this data that portrays the economy acting like Fed is too tight. At the margin, this is a goad to a larger and more committed QE2. ▶