

TRENDMACRO LIVE!

## On Q2 2011 GDP -- and On the Debt Ceiling Deadlock, Volume 3

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Debt ceiling action moves to the Senate as we learn this recovery is weaker than we knew.

**First, a word about the debt ceiling drama.** [John Boehner's bill](#) didn't pass the House last night. But as we said yesterday, it was irrelevant anyway, and a negative market reaction to its failure could present an interesting speculative opportunity (see ["On the Debt Ceiling Deadlock, Volume 2"](#) July 28, 2011). That's because pass or don't pass, the action would have moved to the Senate today and over the weekend. If anything, the failure of Boehner's bill yesterday improves Senate negotiations by highlighting the large extent of adjustments to Harry Reid's plan that will be required to pass the House. As bleak as it seems, we continue to expect a good resolution -- the deeper the crisis, the more the incentive for both sides to stand down.

**Now, a few very quick thoughts on [this morning's Q2 2011 GDP report](#).**

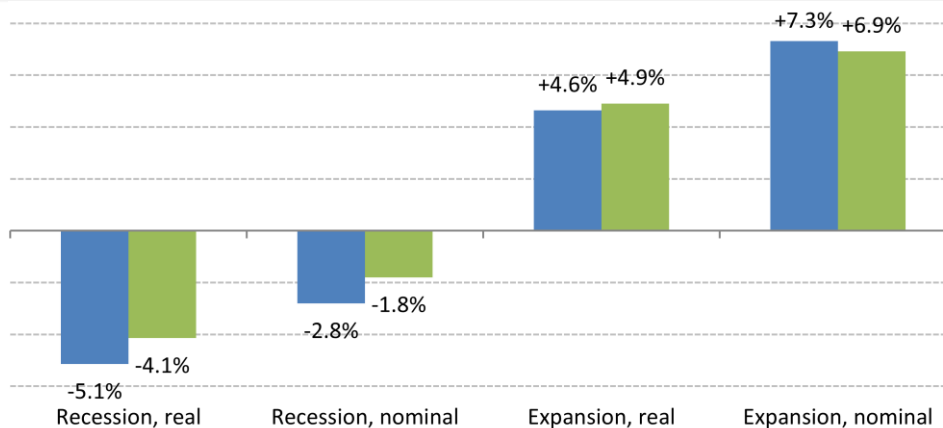
- In our view there was nothing particularly surprising about Q2's poor real growth number -- 1.3% at a seasonally adjusted annual rate.
- What was surprising was the revisions (please see the chart below). Of immediate interest, Q1 was revised down from an

### Update to strategic view

**US MACRO, US FED:** The failure of the Boehner bill in the house is an irrelevancy. The action would have moved to the Senate anyway, with the search for a solution all the more highly motivated. Today's GDP report told us what we already knew, that the economy is in a soft-spot. But the revisions were surprising -- showing the Great Recession to have been far worse than we knew, and the recovery far weaker. The difference? Mostly higher inflation than previously thought, which at the margin could inhibit the Fed from further QE.

**Cumulative change in GDP in Great Recession, and recovery to 2Q-11**

■ Revised ■ Pre-revision



Source: BEA, TrendMacro calculations

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already poor 1.7% SAAR to a mere 0.4%. This soft-spot is softer than we knew.

- Also surprising was the revisions to data going back to 2003, showing the Great Recession in a new and uglier light. Previously, from Q4 2007 peak to Q2 2009 trough, the Great Recession had been reported as a 4.1% drop in real output. That was revised to 5.1%.
- The recovery from the Q2 2009 trough now looks weaker, too. Its first year was actually revised higher, from 3.0% to 3.3%. But the subsequent three quarters, through Q1 2011, were revised lower, from 1.9% to 1.3%. Overall, the recovery was revised from a 4.9% gain to a 4.6% gain.
- With a deeper recession and a weaker recovery, real GDP remains as of Q2 2011 below the Q4 2007 peak -- previously, real GDP had been reported as making new all-time highs as of Q4 2010. No longer. *What was already the slowest recovery in the history of the data has gotten even slower.*
- There are many competing factors that explain the change. But we note that one of the most important is inflation -- which was revised sharply higher for the recovery period. As a result, *nominal* output was revised higher, too.
- In nominal terms the Great Recession was revised to appear worse -- from a drop of 1.8% to a drop of 2.8% -- the same downward revision seen in real terms.
- But while in real terms the *recovery* was revised to appear worse, in nominal terms it was revised to appear better -- from a gain of 6.9% to a gain of 7.3%.
- At the margin, this may be a factor in inhibiting the Fed from implementing more quantitative easing in response to the present soft-spot (see ["FOMC Preview: In Praise of Ben Bernanke"](#) June 22, 2011). According to these revisions, we may have been at less risk of a deflationary spiral than the Fed had previously thought.

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### Bottom line

The failure of the Boehner bill in the house is an irrelevancy. The action would have moved to the Senate anyway, with the search for a solution all the more highly motivated. Today's GDP report told us what we already knew, that the economy is in a soft-spot. But the revisions were surprising -- showing the Great Recession to have been far worse than we knew, and the recovery far weaker. The difference? Mostly higher inflation than previously thought, which at the margin could inhibit the Fed from further QE. ►