JUNCTURE WEALTH STRATEGIES

On1Page: Understanding GDP Growth Rates

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Since the beginning of the year, inflation rates have fallen and at least part of the blame has been placed on the "slowing U.S. economy" which grew "only 1.2%" during the first quarter of 2017. The perception that the U.S. economy is slowing is likely based more on "statistical noise" rather than actual economic reality. Due to many factors such as seasonal weather patterns, agricultural crop cycles, annual bonuses/tax refunds, "back to school" purchases, holiday shopping seasons, etc., comparing a quarter's GDP output to a prior quarter's is problematic as these time specific economic events are not repeated throughout a given year. Yet, that is how GDP growth rates are reported in the broader media, and as a result, perceptions about GDP growth rates are oftentimes flawed and overly volatile.

U.S. GDP Growth Rates – "Sequential Quarters" (left) & "Year-on-Year" (right)

<u>Comparing 1st Quarter Apples to Last Year's 1st Quarter Apples, Not Last Quarter's Oranges</u>

The above chart on the left is presenting U.S. GDP Growth in the manner most reported by media outlets which compares the most recent quarter to the prior quarter. The U.S. Bureau of Economic Analysis applies many statistical techniques to try and "normalize" the quarterly data so that, despite the aforementioned seasonal events, the quarterly data is properly adjusted to remove those distortions. Despite these efforts, some distortion is unavoidable and this "noise" is then amplified by "annualizing" the quarterly change to arrive at an annual rate. The above chart on the right is using the same data as the chart on the left, but the annual rates of growth are calculated by comparing the most recent quarter to the same quarter of the prior year which not only keeps most of the seasonal factors consistent between the two data points, but it also removes the need to annualize the rate of change. The difference in approach can result in very different interpretations: (using the data on left) "The U.S. economy has decelerated from 4-5% growth during the summer of 2014 to a recent low of 1.2% which is over a 60% decline from the 3.5% rate we saw just two quarters ago! Why in the world is the Federal Reserve raising interest rates!!!" or (using the data on the right) "The U.S. economy is growing at a steady 2% rate for the second quarter in a row after having accelerated from the sub-2% rates we saw in the 4th quarter of 2015 and the first half of 2016. This steady, if not improving, growth environment supports the notion that the U.S. Federal Reserve should continue its efforts to normalize its monetary policy."

As the saying goes: "There are three kinds of lies: lies, damned lies, and statistics", but in the case of the analyzing U.S. GDP growth rates, it is probably best to abide by the advice "keep it simple". By comparing a quarter to the same quarter of the prior year you avoid much of the reliance on statistical techniques needed to "clean" the data and, to the extent that distortions remain, you aren't amplifying the noise by annualizing. The U.S. economy, while not operating at an optimal level, is also not decelerating at a rapid pace. The rise in inflation has taken a "breather" for the past few months, but we feel it is likely that both the rate of GDP growth and inflation will once again begin an upward trend during the remainder of this year, but neither at a rate that would trigger a more aggressive tightening effort by the Federal Reserve than what we have already seen.

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