THE DANA VIEWPOINT

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Mom, Where Does GDP Come From?

This is probably not a question that is frequently heard by parents. If it were, it would probably be just as disconcerting as the more common, “Where do babies come from?” If your child asks about GDP (Gross Domestic Product), you probably have a budding economist on your hands, and potentially a Nobel Prize winner as well. What we should really want to know is where does GDP growth come from? One of the problems we face both in the U.S. and around the world is the stubbornly slow recovery following the 2008 recession. This has been a problem in the EU, China, Japan, Russia, and India, as well as the U.S. In all of these countries, the rebound in growth post-recession has been uniformly smaller than in almost all other recovery periods, despite the unprecedented monetary expansion facilitated by the major central banks. GDP in the U.S. has averaged about 2.2% over the last six years during the not so great recovery that has followed the ‘Great Recession’.

A look at the formula for calculating GDP can give us clues on how to boost growth. The formula is C+I+G+X, (consumption plus private investment plus government spending plus net exports). When policy makers talk about government stimulus, they are in favor of increasing G. Those that talk of capital gains tax cuts hope to increase I. Those that talk of income tax rebates or cuts are trying to increase C. Those that want lower corporate tax rates here are trying to increase I and X.

The economic writer Jude Wanniski once said, “All growth is the result of risk taking.” In order for something to be consumed, we must create it first. The formula makes it easy to see that a dollar can be used for consumption or investment, not both. It is also important to think of investment in terms of time, not just money. A good education certainly costs money, but it also costs time, and is an investment in an individual’s future earnings potential . One of the best indicators of long term success is the ability to postpone gratification. Successful entrepreneurs certainly know this, and it is demonstrated in their drive to put in long hours and reinvest most of their earnings and revenue back into their ventures during the growth phase. Established business owners also know one way to offset an increase in taxes is to reduce investment in their business by the amount of the tax increase; this certainly isn’t good for growth.

Demographics are also a part of the GDP growth picture. Many developed economies are aging, and there are a greater number of retirees as a percent of the population. Most economies that are not replacing their workforce as their population ages have slower growth rates. Japan is a good multi-decade example of this sluggish growth trend. Here in the U.S., we are faced not only with an aging population, but a decreasing

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percentage of working age population that is actually working full time. It would be refreshing if our politicians spent at least some time discussing solutions for these problems. Tax, monetary, and educational policies all can have an effect on GDP, and finding a way to educate and employ those who are not taking full advantage of their human capital should be a priority for all of us.

The S&P 500 is now up 4% year to date, as we continue what seems to be one of the most hated bull markets. GDP (see above) is projected to come in above 3% in the third quarter, and that would be a refreshing rebound from the 1% growth rates recorded over the last few quarters. The recovery in the price of crude oil should continue to help profits in that sector, and the S&P energy sector index is now up over 13% year-to-date. The Fed is the little engine that can't (raise rates), and that is probably for the better. There are few signs of inflation and growth is sluggish, so why give investors something else to worry about? We would be happy if the Fed started reducing their bond buying by ending their program of reinvesting the proceeds from maturities in their portfolio.

As we send the kids back to school, we have to say goodbye to the long summer days and hello to fall. This is one of our favorite times of the year, with crisp mornings, changing leaves, and fall football. We are still celebrating the Wisconsin Badgers strong start in their opening game at Lambeau Field, let's hope the Packers do as well!

Random Thought for September 2016: There is now well over $10 trillion in worldwide sovereign debt that trades at a negative yield. Bill Gross made an interesting point in his last newsletter - if you hold negative yielding debt, is it an asset or a liability?

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