



MORNING BRIEFING

August 14, 2018

Big Revisions, Small Net-Net

See the [collection](#) of the individual charts linked below.

(1) An old joke that remains relevant today. (2) Lots of offsetting benchmark revisions in real GDP that don't add up to much. (3) Shift to more first-half annual growth and less second-half growth. (4) BEA concedes that seasonally adjusting quarterly real GDP is hard to do. (5) Revisions give real tech spending and real imports (like cell phones) a boost. (6) Personal saving data revised up sharply. (7) Lots of components of personal income revised up sharply.

US Economy I: Same Old Real GDP Story. An accountant, an engineer, and an economist apply for the same job. The employer asks all three the same question in their respective interviews: "What does two plus two equal?" The accountant replies: "Four." The engineer says: "On average, four—give or take 10%." The economist gets up, locks the door, closes the shade, sits down next to the interviewer, and says: "What do you want it to equal?"

Reviewing the Bureau of Economic Analysis' (BEA) 7/27 "[2018 Comprehensive Update](#)" of the National Income and Product Accounts (NIPAs)—the 15th such NIPA revision—reminded us of that old joke. Remarkably, the macro narrative for real GDP didn't change much despite dramatic, albeit mostly offsetting, changes in the underlying components. Although real GDP on an annualized basis was basically unaffected, the quarterly flow of output shifted toward the first half of the years revised, on average. And while the annual real GDP growth trajectory didn't change much, the tone of the revisions was mostly positive. Technology investment and personal saving were revised higher, as we discuss below. But first, let's review some of the underlying changes to the top line of nominal and real GDP:

(1) *Level of GDP in the same ballpark.* The level of nominal GDP hasn't changed much at all ([Fig. 1](#)). It was revised from \$1.94 trillion during 2017 to \$1.95 trillion. Real GDP is now reported in 2012 dollars rather than 2009 dollars ([Fig. 2](#)). It rose to a record \$1.81 trillion last year.

(2) *Real GDP annual growth tweaked.* Along with the update, the BEA published a chart titled "Real GDP average growth rates" covering the "before" and "after" versions of real GDP over various economic cycles. For older decades, real GDP average annual growth rates stayed mostly the same as follows: from 1929-1944 at 5.1%, 1944-1973 at 3.1%, and 1973-1990 at 3.0% ([Fig. 3](#)). For the more recent periods, real GDP was revised slightly up to 3.1% from 3.0% for 1990-2007 and up to 1.5% from 1.4% for 2007-2017. The BEA also provided a chart titled: "Revisions to recent contractions and expansions." None of the contractions or expansions looked much different before and after the revisions. However, the contraction from Q4-2007 to Q2-2009 was a tad less bad than previously estimated. (See also the charts on page 2 and page 5 of the BEA's "[Results of the 2018 Comprehensive Update of the National Income and Product Accounts](#).")

(3) *Quarterly contours adjusted.* The revisions also show that output growth during the first half of the year tends to be a bit faster than initially estimated ([Fig. 4](#)). That's because the BEA made improvements to its seasonal adjustment (SA) methodology. Aware of the challenges of accurate SA,

the BEA announced that it would publish the raw non-seasonally adjusted real GDP data so that seasoned folks could apply their own methodology to adjust it. Reading between the lines, the quarterly SA data may not be so precise, which gives more weight to the y/y growth rates of real GDP. That's a point Debbie and I have been making for a while.

Nevertheless, the BEA's statisticians revised the quarterly real GDP growth rates (saar) going back to 2002. On average, the rates for 2002-2017 moved up for Q1s to 1.6% from 1.2%, and down for Q3s to 2.2% from 2.4%, while the average rates for Q2 and Q4 didn't change. Over 2012-2017, the average rates were revised up for Q1s by 0.5 percentage point (ppt) and Q2s by 0.1ppt, while Q3s and Q4s were revised down by 0.3ppt and 0.2ppt, respectively. (See the charts on pages 12 and 13 of the BEA's 2018 Comprehensive Update Results.)

(4) *Tech investment gains offset by higher trade deficit.* For 2007-2017, real GDP was revised up by only 0.05ppt, consisting of several offsetting adjustments: +0.12ppt for investment, +0.01ppt for exports, +0.01ppt for government spending, -0.02ppt for personal consumption expenditures, and -0.08ppt for imports. (See the chart on page 4 of the BEA's 2018 Comprehensive Update Results). Most of the revisions to investment and imports stemmed from improved technology deflation measures.

The BEA explained the reason for these revisions in its [“2018 Preview of the Comprehensive Update”](#): “Software, medical equipment, and communications equipment typically experience rapid innovation and are associated with state-of-the-art technologies. Such products present challenges when using standard matched-model techniques to construct quality-adjusted price indexes.” Notably, communications equipment includes cell phones, a key driver of the import revisions.

By the way, the revisions noted above were just a selection of important ones from the BEA's 2018 Comprehensive Update. See the Preview section for more details if you don't mind lots of statistical jargon. More explanations of the revisions, hopefully in plain English, will be available in mid-September, in the BEA's “September Survey of Current Business.”

US Economy II: Personal Saving at Record Low. Not! The 1/29 *WSJ* included a sobering [article](#) titled: “With Stocks Surging, Americans Are Saving at 12-Year Low.” The article's subtitle read: “Shift away from saving could leave consumers exposed if stocks or other assets take a sudden turn for the worse.” But don't worry, be happy: After the BEA's July revisions, a more appropriate subtitle for the article would be “Never Mind! Personal Saving Has Been Much Greater Than Previously Estimated.”

Included within the BEA's comprehensive update were revisions to [“Personal Income and Outlays: June 2018.”](#) The new data revealed an eye-popping upward revision to the personal savings rate (personal saving as a percentage of personal disposable income) for 2017 of 3.3ppts to 6.7% ([Fig. 5](#))! That's a big deal because the initially published rate implied that consumers are saving at a lower rate today than just before the 2008 recession. As initially published, the rate averaged 3.0% in 2007; it peaked at 11.0% during 2012 before decreasing to 2.4% by the end of 2017. With that data now debunked, so is the previous storyline about consumers saving at historically low rates.

Before the revisions, consumers seemed to be banking personal savings faster than prior to the recession ([Fig. 6](#)). The average of the 12-month sum of personal saving from 2009 to 2018, at \$714.0 billion, was double the average from 2000 to 2008 at \$357.0 billion ([Fig. 7](#)). The latest pace of personal saving fell sharply along with the rate during 2016 and 2017. It seemed as if a new era of substantially lower average personal saving were beginning. But, never mind! The recent drop was revised away. And the average of the 12-month sum of personal saving increased to \$882.0 billion from 2009 to 2018 and to \$408.5 billion from 2000 to 2008.

Some media reports covering the 2017 personal saving revisions suggested that small business owners had contributed to the increase in saving rather than workers. The implication was that the revisions were not widespread, but isolated among wealthier individuals. I asked Melissa to dig into the [numbers](#) to verify that conclusion.

Looking at the revisions as a percentage of the previously published figures for each of the major components of personal income, the obvious standout is indeed proprietors' income, which is included in personal income rather than corporate income in the NIPAs. Proprietors' income was revised 8.3% higher than initially published for 2017. Another major component of personal income, personal income receipts on assets, was also revised up by 7.7%. Like proprietors' income, that category tends to reflect the income of wealthier individuals as well. Meanwhile, the compensation of employees was revised just 0.9% higher. (See Table 1A within the "Tables Only" download available on the right of the BEA's Q2-2018 [webpage](#).)

Melissa also observed that the upward revisions were broad based in dollar terms. Contributing to the \$499.4 billion increase in personal saving for 2017 were increases in personal income totaling \$401.9 billion as follows: personal income receipts on assets (up \$189.2 billion), proprietors' income (up \$114.9 billion), and compensation of employees (up \$97.9 billion), along with other less significant offsetting revisions. Most of the revisions to these components of personal income data resulted from adjustments to the underlying source data. Here are a few more details:

(1) *Personal income receipts on assets* (up \$189.2 billion) consists of personal dividend income and personal interest income, [according](#) to the BEA's "A Guide to the National Income and Product Accounts of the United States." For 2017, personal dividend income and personal interest income were revised up by \$143.3 billion and \$45.9 billion, respectively. The revisions to personal dividend income primarily reflect the incorporation of newly available IRS Statistics of Income data, according to the BEA ([Fig. 8](#)).

(2) *Proprietors' income* (up \$114.9 billion) is essentially the current production income of sole proprietorships and partnerships and of tax-exempt cooperatives, according to the BEA's guide. Table 1A from the BEA's Q2-2018 GDP release breaks down proprietors' income into two categories: farm and nonfarm. Most of the revision to proprietors' income was in nonfarm (up \$111.2 billion). BEA's Personal Income and Outlays update explained that these revisions primarily reflect adjustments to estimates of underreported income based on newly available IRS data ([Fig. 9](#)).

(3) *Compensation of employees* (up \$97.9 billion) includes wages and salaries (up \$100.6 billion) in addition to supplements to wages and salaries (down \$2.7 billion). The BEA sources the wages and salaries data from the Bureau of Labor Statistics Quarterly Census of Employment and Wages, which was revised and incorporated into the BEA's update ([Fig. 10](#) and [Fig. 11](#)).

(4) *Personal outlays* (down \$83.6 billion) captures personal consumption expenditures, personal interest payments, and personal current transfer payments. The series is deducted from disposable personal income to derive personal saving. Consumers spent slightly less than was previously thought, according to the BEA's revisions. But that didn't move the personal saving rate nearly as much as the increases in personal income we discussed above ([Fig. 12](#)).

CALENDARS

US. Tues: NFIB Small Business Optimism Index 107.0, Import & Export Prices 0.0%/0.2%. **Wed:** Retail Sales Total, Ex Auto, Ex Auto & Gas, and Control Group 0.1%0.4%/0.4%/0.4%, Business Inventories 0.1%, Headline & Manufacturing Industrial Production 0.3%/0.3%, Capacity Utilization 78.2%, Empire

State Manufacturing Index 20.0, Productivity & Unit Labor Costs (saar) 2.5%/-0.2%, Housing Market Index 69, Atlanta Fed Business Inflation, Treasury International Capital. (*Wall Street Journal* estimates)

Global. Tues: Eurozone GDP 0.3%q/q/2.1%y/y, Eurozone Industrial Production -0.4%m/m/2.4%y/y, Germany GDP 0.4%q/q/2.1%y/y, Germany CPI 0.3%m/m/2.0%y/y, Germany ZEW Economic Survey Current Situation & Expectations 72.1/-21.3, UK ILO Unemployment Rate (3-month) 4.2%, Japan Industrial Production, China Industrial Production 6.3% y/y, China Retail Sales 9.2% y/y, China Fixed Assets Ex Rural (YTD) 6.0% y/y. **Wed:** UK Headline & Core CPI 2.5%/1.9% y/y. (DailyFX estimates)

STRATEGY INDICATORS

YRI Weekly Leading Index ([link](#)): Our Weekly Leading Index (WLI)—a good coincident indicator that can confirm or raise doubts about stock market swings—is just shy of a new record high. Our WLI, which is the average of our Boom-Bust Barometer (BBB) and Bloomberg's Weekly Consumer Comfort Index (WCCI), climbed 1.8% during the five weeks ending August 4, just 0.6% below early May's record high. Our BBB rebounded 2.4% over the five-week period, and was within 2.7% of its record high. Jobless claims—one of the components of our BBB—moved down for the fifth week to 214,250 (4-wa), nearly matching its recent low of 213,500 12 weeks ago, which was the lowest reading since December 13, 1969. Meanwhile, the CRB raw industrial spot price index, another BBB component, remains on a steep downtrend. The WCCI increased for the eighth time in nine months, by a total of 8.2%, to a new cyclical high.

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings rose to record highs for the LargeCap and MidCap indexes last week, but SmallCap fell for the first time in 11 weeks. Forward earnings activity has been relatively strong in the past 12 months: LargeCap's forward earnings has risen in 52 of the past 54 weeks, MidCap's in 51 of those weeks, and SmallCap's in 47. Earnings momentum remains healthy, as the yearly change in forward earnings is up from six-year lows in early 2016 and should remain strong in 2018. In the latest week, the rate of change in LargeCap's forward earnings rose to a seven-year high of 22.6% y/y from 22.5%, which compares to a six-year low of -1.8% in October 2015; MidCap's rose to 22.8% from 22.4%, which compares to a seven-year high of 24.0% in early June and a six-year low of -1.3% in December 2015; and SmallCap's rose w/w to an eight-year high of 34.5% from 33.2%, which compares to a six-year low of 0.3% in December 2015. Here are the latest consensus earnings growth rates for 2018 and 2019: LargeCap 22.9% and 10.1%, MidCap 21.0% and 12.2%, and SmallCap 30.1% and 15.1%.

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios were mostly lower last week at levels that are not much above their recent post-election lows. LargeCap's weekly forward P/E edged down to 16.4 from 16.5, which is up from a post-election low of 16.0 in late March and down from 18.6 on January 26—the highest since May 2002. That compares to the post-Lehman-meltdown P/E of 9.3 in October 2008, but is well below the tech-bubble record high of 25.7 in July 1999. MidCap's forward P/E dropped to 16.5 from 16.6, which compares to a 25-month low of 16.1 in early April. MidCap's P/E is down from a 15-year high of 19.2 in February 2017 and compares to the record high of 20.6 in January 2002; however, it is up from a three-year low of 15.0 in January 2016. MidCap's P/E had mostly been at or below LargeCap's P/E from August to March for the first time since 2009. SmallCap's P/E rose to 17.7 from 17.5, which compares to a post-election low of 17.0 in mid-March. That's well below its 51-week high of 20.2 in December (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed), but is comfortably above its three-year low of 15.5 in February 2016. Looking at daily forward price/sales (P/S) ratios, they were all higher w/w for the three indexes, but remain at levels well below January highs: LargeCap's P/S of 2.05 is down from a record high of 2.19 on January 26; MidCap's 1.32 compares to its record high of 1.40, also on January 26; and SmallCap's 1.03 is down from 1.05 then, which compares to its record high of 1.17 in November 2013,

when Energy revenues were depressed.

S&P 500 Q2 Earnings Season Monitor ([link](#)): With Q2 results in hand for over 90% of the S&P 500 companies, we find a higher percentage of companies reporting positive surprises than at the same point during the Q1 earnings season but a lower overall percentage surprise. Year-over-year growth rate metrics for the Q2 reporters to date are close to Q1's historically high levels. More specifically, of the 452 companies in the S&P 500 that have reported through mid-day Wednesday, 80% exceeded industry analysts' earnings estimates by an average of 5.2%; they have averaged a y/y earnings gain of 26.4%. At the same point during the Q1-2018 reporting period, a lower percentage of companies (79%) in the S&P 500 had beaten consensus earnings estimates by a higher 7.3%, and earnings were up a lower 24.9% y/y. On the revenue side, 71% of companies beat their Q2 sales estimates so far, with results coming in 1.6% above forecast and 10.1% higher than a year earlier. At this point in the Q1 season, a higher 76% of reporting companies had exceeded revenue forecasts by a lower 1.1%, and sales had risen by a lower 8.4% y/y. Q2 earnings results are higher y/y for 83% of companies, vs a higher 86% at the same point in Q1, and Q2 revenues are higher y/y for 86% vs a higher 87% a quarter ago. These results are very encouraging, particularly the percentage of companies growing revenues y/y and their Q2 surprise. Q2-2018 marks the eighth straight quarter of positive y/y earnings growth and among the highest growth since Q4-2010. The strong results are mostly due to lower tax rates and improved business conditions.

GLOBAL ECONOMIC INDICATORS

France Industrial Production ([link](#)): June headline industrial production rose for the first time in four months. Headline production, which excludes construction, rebounded 0.6% in June after a three-month slide of -1.2%. Meanwhile, manufacturing output remains in a volatile flat trend around recent lows, climbing 0.6% in June after a -0.5% loss and a 0.3% gain the previous two months. The main industrial groupings show consumer durable (1.6%), capital (0.6), and intermediate (0.3) goods output were all up during the month, while consumer nondurable goods production was unchanged. July's M-PMI (to 53.3 from 52.5) showed the manufacturing sector improved in July, after slowing at the end of Q2. Both output and new orders grew at a faster pace in July, which encouraged a sharper rise in purchasing activity and staff hiring. The one blip: the first decline in new export orders since September 2016, as global trade tensions curbed foreign demand.

Japan GDP ([link](#)): Japan's economy rebounded 1.9% (saar) after dipping into negative territory during Q1 for the first time in nine quarters. Domestic demand accelerated 2.4% (saar) last quarter, after falling -1.3% during the first three months of the year, driven by strong household and capital spending. Meanwhile, trade was a drag on growth as imports (3.9%, saar) grew four times faster than exports (0.8). Household consumption (2.8) rebounded from Q1's -0.9% decline—recording its best growth in a year, while capital spending (5.2) posted its best performance since Q4-2016, as companies stepped up investment in labor-saving technologies to deal with the tightest labor market in decades. Government consumption accelerated 0.9% (saar) last quarter after holding right around zero the prior three quarters. Japan's economy is expected to keep growing, thanks to consumer and capital spending, though there is mounting concern about the pace of future growth if the US imposes an auto tariff globally.

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