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US Macroeconomics

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Something Is Not Adding Up

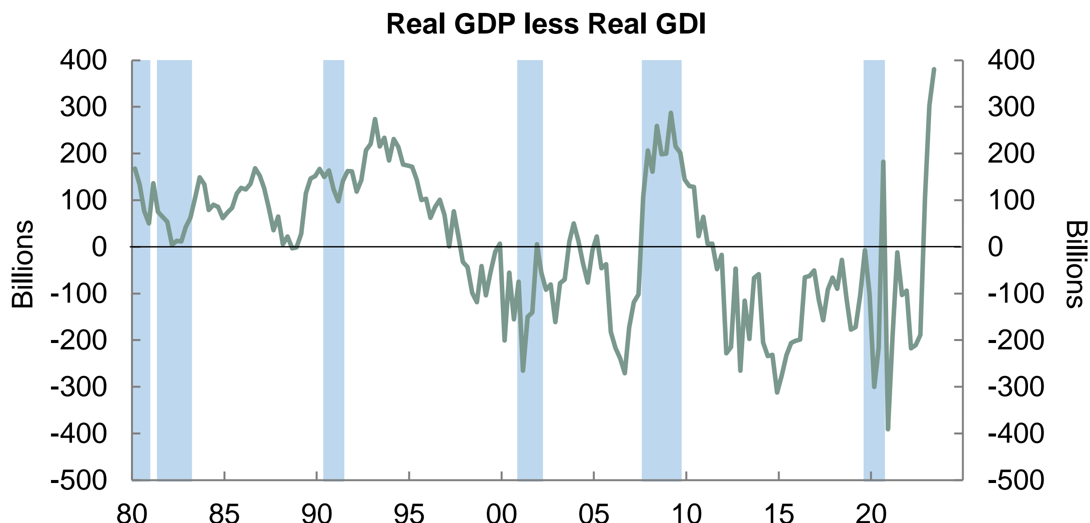
Gross domestic product (GDP) is constructed by adding up economy-wide spending. Gross domestic income (GDI) is constructed by adding up economy-wide income. Since one person's spending represents another's income, **GDP and GDI in theory should be the same** but often they are not.

The difference in both measures of economic output is known as the **statistical discrepancy** (or measurement error) which is plotted in the chart below. For reasons that are not entirely clear, GDI had been growing consistently above GDP for the past dozen years, but this recently changed. Over the past year, there has been a massive divergence in the two series.

As shown in the chart below, real GDP has been growing much faster than real GDI. **In Q2 2023, the statistical discrepancy was nearly $400 billion last quarter, the highest gap ever recorded**. And as share of real GDP, the statistical discrepancy is a large 2%, which is the highest since a similar reading was recorded in Q1 2009. Recall, the economy was in a deep recession at that time.

Arguably, **GDI is a better measure of "true" economic output than GDP because the former is based off tax revenues**, a bedrock statistic because neither businesses nor consumers pay tax on phantom income. Consequently, the income figures may be more accurate. If so, this is troubling because real GDI rose just 0.5% last quarter after having declined at a near 3% annualized rate in the two previous quarters. Meanwhile, real GDP looks healthy, having risen 2.1% last quarter and 2.5% over the last year.

What is the bottom line? **If economic output is as weak as the income-side of the economy suggests, then real GDP growth is much closer to an inflection point than many investors currently think**. If so, then the labor market should show much weaker employment readings in the months immediately ahead. In this case, real GDP will be revised down, thereby making it more consistent with real GDI. Conversely, if job gains remain positive and the unemployment rate remains comfortably below 4%, investors will be proven correct in largely ignoring the income data. Consequently, GDI would then be revised up. Stay tuned.



Sources: BEA, Haver, SMBC Nikko

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