ARE WE MISMEASURING OUR ECONOMY?

Jeremy Schwartz — Global Chief Investment Officer
09/11/2018

On last week's "Behind the Markets" podcast, we spoke with Leonard Nakamura, an economist at the Federal Reserve (Fed) Bank of Philadelphia and a former professor at the Wharton School. This was a privilege, and we had a special conversation commemorating the launch of a new partnership between Wharton Business Radio and the Philadelphia Fed for a new Philadelphia Fed podcast, featuring segments from live conversations aired on Wharton Business Radio. The Philadelphia Fed anticipates this podcast starting at a quarterly frequency, but those organizing it hope to increase the amount of content over time.

Inflation and Growth Mismeasurement

Nakamura's research focuses on mismeasurements in the official gross domestic product (GDP) statistics. Nakamura started off the conversation talking about estimates—and he fully cautioned that these estimates have a very wide standard error and uncertainty associated with them. He said that we may be mismeasuring real economic growth by as much as 2%. This mismeasurement alone essentially would be a doubling of the reported GDP statistics. He also can see how we may be "overcounting" inflation by as much as 2% a year—or we may have more declining prices (deflation) than we realize. Both are very large numbers relative to the reported statistics. Here are some of the calculation examples:

- We have gone from a "widget-driven" economy to a "digit-driven" economy. Digital information has been growing at roughly 60% per year, but this amount of "digital growth" is only 1% of personal consumption expenditures. Yet in GDP accounts, we've had nearly zero real growth in telecommunication output, showing that there are real problems measuring the growth in this output. The reason: the way the statisticians meter measure telecommunications output is the *number of minutes* spent on phone calls—yet all the other digital transfer information has exploded higher.
- Health care: Our doctors are better trained and have more knowledge, yet their contribution to GDP is essentially measured by the time spent with a patient. Therefore, a hospital stay that used to take seven days but now only takes one day shows up as declining GDP, even though same outcome was achieved with a dramatic increase in productivity. There was some conversation about the proper classification of this as either being in the consumption component of GDP or the investment component, and in a general sense, health care was more an investment rather than consumption—and education is in a similar situation.
- Nakamura was also careful to emphasize that he does not believe this is the fault of our agencies doing the calculations. He thinks the U.S. has the best statistical agencies in the world, and some of the global slowdown in productivity that we see in the U.S. is a global phenomenon, suggesting some of the mismeasurements happening are percolating globally.

For those who follow economic growth statistics and want to understand the important and real issues inherent in measuring the size and growth of economy, this was a great conversation with the Philly Fed and Professor Siegel.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Inflation : Characterized by rising price levels.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Deflation : The opposite of inflation, characterized by falling price levels.

Personal Consumption Expenditure (PCE) Price Index : measure of price changes in consumer goods and services in the U.S. economy.