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ECO Note

Business spending dropped sharply in the second quarter. Blame the trade war.

Beneath the GDP, a Recession Warning

By Mark Skousen

The White House and Wall Street were exuberant last week when the Commerce Department's Bureau of Economic Analysis revised upward its secondquarter estimate of gross domestic product to show 3.8% growth in real terms, compared with a negative number in the first quarter. "US economy notches fastest growth pace in nearly two years in second quarter," reported Yahoo Finance, "suggesting robust growth despite uncertainty set off by President Donald Trump's tariff policy."

Dig into the numbers, however, and you find the trade war is in fact wreaking economic havoc. Buried in last week's BEA report is a much more reliable measure of the economy—gross output, or GO. It measures spending at all stages of production, totaling an esti--mated $63 trillion this year— more than twice GDP of $30 trillion.

GO revealed that economic growth is slowing to a crawl, ahead only 1.2% in real terms. If you include all transactions in wholesale and retail trade, the adjusted GO is up only 0.3%. More important, overall

business spending fell sharply, by an annualized 5.6% in real terms. These results are much more consistent with the weak labormarket data.

Note

For the first time since the financial crisis of 2008, we're seeing a huge gap between consumer and business spending. While consumption is still robust (up a real 2.6%), business is pulling in its horns, largely due to higher tariffs and the uncertainty of the trade war. This is the first pullback in business spending after four consecutive periods of steady growth. Fixed business investment is holding up, but for how long?

But wait. Isn't consumer spending the key factor in economic growth? Yahoo Finance states that "consumer spending, which accounts for about two-thirds of U.S. economic activity, is a key bellwether for the outlook of the nation's economy."

Note

The idea that consumption is two-thirds of the economy is one of the great myths in economics. It's based on a faulty reading of national income accounting. Consumer spending represents twothirds of GDP, but GDP measures only finished or final goods and services. It leaves out the value of the supply chain, which is bigger than GDP itself. Note

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GO shows that consumption is only about one-third of economic activity, not twothirds. Business spending is almost twice as big and more volatile, and it is a leading indicator. When business puts on the brakes, employment slows, and recession strikes.

Think of GO as the "top line" in national income accounting, and GDP as the " bottom line." GO measures the "make" economy, GDP the "final use" economy. GDP looks strong, but GO is flashing yellow, if not red.

The BEA has promised to highlight and advance this vital statistic, and release it at the same time as GDP data. The sooner the better.

Mr. Skousen holds a chair in free enterprise at Chapman University. His latest book is "The Greatest American: Benjamin Franklin, the World's Most Versatile Genius."

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