

Making Something Out of Nothing

September 15, 2003

Wall Street has become extremely pleased with the “strong” recovery, which seemingly has become apparent to all when the 2nd quarter real GDP was set at 3.1% up from 1.4% reported for each of the previous two quarters. As you know, we have been and continue to be quite suspicious of this indicating any such thing. We don’t quibble with the 3.1%, but we question if its make up indicates sustainable strength.

Of the \$73.5B increase in real GDP during the 2nd quarter, \$40.6B or 55% is attributed to defense spending. But you say the war is still on going, therefore it will be a recurring item, and thus should be properly counted. Two things: (1) Expenditures on war material really add nothing to enlarging the economic pie. It’s a cost of maintaining the status quo (an insurance policy, if you will). (2) It’s very cyclical in nature. For example, during the 1st quarter of this year, defense spending actually declined \$6.5B. One needs to also remember that a dollar spent is not always of equal value. Do you believe that all the dollars spent on defending one’s self from the huge number of plaintiff’s lawyers have the same weight as those spent on building a Beechcraft airplane? We don’t think so.

Another item to take into consideration is the value adjustments made by the keepers of GDP numbers. For example, during the second quarter, there was an increase in computer sales of \$6.3B over the 1st quarter’s \$76.3B, making a total of \$82.6B. In computing the increase in GDP for the 2nd quarter, the \$6.3B became \$38.4B. Why? Because of value improvements. Out of thin air \$6.3B became \$38.4B. We sure wish we could adjust our income statement in such a manner. Only in “Disneyland East” (as Ronald Reagan once called Washington D.C. before Disney World was built) can one do such a thing.

The point of all of this is: Yes, there has been an uptick in GDP and that’s good. The problem is, it is not sustainable. Jobs continue to be lost and profits and wages grow ever so little. The real growth is in debt and it stays on the balance sheet, while the asset it produces is either consumed or is likely to go down in value. Lenders do like to be repaid.

The present quarter (3rd quarter) should be close to 3 ½ - 4%, but again we will need analysis to ascertain if it represents sustainable growth or just primarily a one time shot in the arm public policy type effects.