

“Labor Market Baffles Economists”

August 4, 2003

The Keynesians and Supply Siders were absolutely ecstatic over the real 2.4% growth recorded in the 2nd quarter ended 6/30/2003. To be truthful we were a little surprised until we delved into the details. For example, lets look at the last four quarters of nominal GDP (real GDP plus inflation). The numbers are, not necessarily in order of occurrence, 5.1%, 3.8%, 3.4%, and 3.2%. From listening to the media which do you believe was the latest (2nd quarter 2003)? Nominal GDP is the best judge of economic activity, with real being that which is adjusted for inflation and product and service value. The following is the actual quarterly seasonally adjusted annual rates sequential results.

	<u>3rd Q 2002</u>	<u>4th Q 2002</u>	<u>1st Q 2003</u>	<u>2nd Q 2003</u>
Nominal	5.10%	3.20%	3.80%	3.40%
Inflation	1.00%	1.80%	2.40%	1.00%
Real	4.00%	1.40%	1.40%	2.40%

It is obvious from the above that there has been no meaningful acceleration in growth over the last 3 quarters. We, once again, caution you to pay attention to nominal growth as opposed to real as we head toward deflation. During the inflationary blow off of the late 70's one needed to adjust for inflation as it was running in double digits. Not today.

Nominal numbers will tell you the current dollars spent thus revealing more closely the actual amount of business activity. For example over the next year or two we may see a quarter of GDP something like this.

Nominal GDP	1.00%
Deflation	<u>1.50%</u>
Real growth	2.50%

This would indicate very slow economic activity but relatively good growth of 2.5% (real 3.5% is the long term average) due to the price level receding in aggregate.

The other adjustment that might also make sense is the hedonic mark-ups for purchases of information hardware and software. You see of this quarter's real increase of \$56.1B in real GDP over the quarter before \$9.6B or 17% represents fictitious dollars.

The point is there is absolutely no indication that we are soon to impart on a roaring inflationary economy. Real growth could go to 5% due to deflation more easily than inflation. We are in a different world and Wall Street just doesn't or won't understand or at least they won't tell us if they do. Keep you head. The traders are in panic – there is no reason for us to be. Be prepared for a major financial failure over the next 6 months or so – then a move to the safety of government bonds.

Oh yes, the headline above was from the Wichita Eagle on August 2, 2003 – they wouldn't be if they followed the correct economic model.

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