US Macroeconomics

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Hoard Now, Pay Later

Since inflation began to soar in 2022, real GDP has grown just 1.0% at an annualized pace. But, **real Gross Domestic Income (GDI) has been even weaker during this time**, falling at a 0.6% annualized pace. Some economists believe the GDI figures are more accurate than the GDP figures because the former are derived from tax receipts, which is arguably the most accurate data we have.

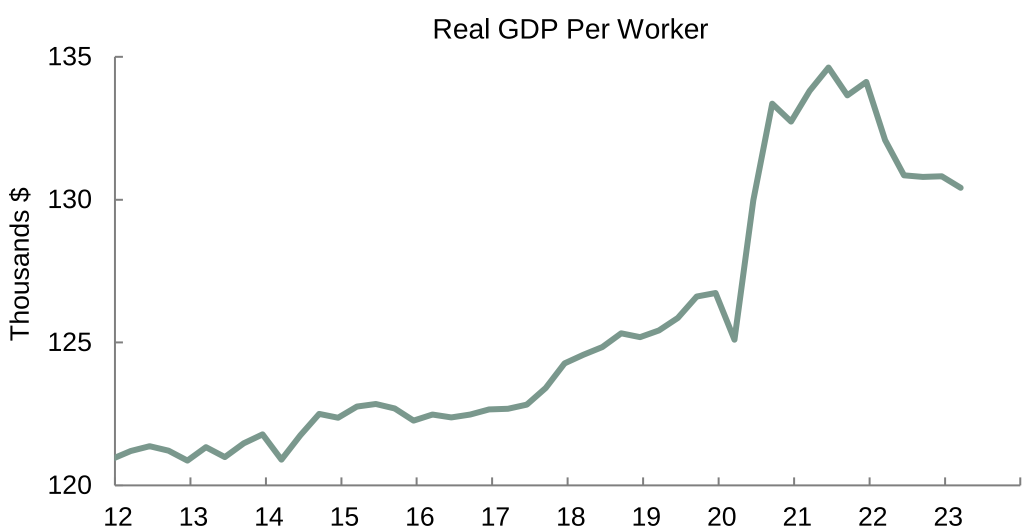
Remember, that when real GDP shrunk in the first half of 2022, the Administration highlighted the healthier GDI numbers to downplay recession fears. Today GDI has declined two quarters in a row, at -2.8% annualized.

Regardless of whether one chooses GDP or GDI, top down growth is indisputably soft. Meanwhile, the labor market has been improving. In Q1 2022, the unemployment rate was 3.8% which compares to 3.7% at current. Normally, when growth is as weak as it has been, unemployment rises, and a downturn ensues. So far that has not happened. What has changed?

Our best guess is that **firms are hoarding workers, meaning that layoffs have been slow to happen even though demand for goods and services (i.e., GDP) has softened**. The reason for the hoarding is almost certainly due to the aftermath of the pandemic. Businesses had a difficult time finding and retaining workers, especially skilled ones while the economy boomed. Consequently, firms may be hesitant to let go of these workers, hoping that demand rebounds in the interim.

In response to this situation, **productivity growth and profit margins have collapsed**. This is evident in the chart below which shows the level of real GDP versus the level of nonfarm payrolls. Of course, if we used the GDI data, it would show an even sharper downturn in implied productivity and margins. This has critical implications for the economic and financial outlook for which we see only two outcomes.

One, firms eventually lay off workers to restore profit margins. In turn, this leads to recession, which is typically what happens. Two, the economy (i.e., demand) improves allowing companies to keep their existing staff. But if this happens, then the Fed will be less confident inflation will fall. Hence, monetary policy stays tighter for longer. As such, an anticipated recession is only delayed, not averted.



Sources: BEA, BLS, Haver, SMBC Nikko

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