

THE ECONTRARIAN

YOUR ALTERNATIVE TO THE ECONSENSUS

GDP Is A Terrific *Coincident* Indicator

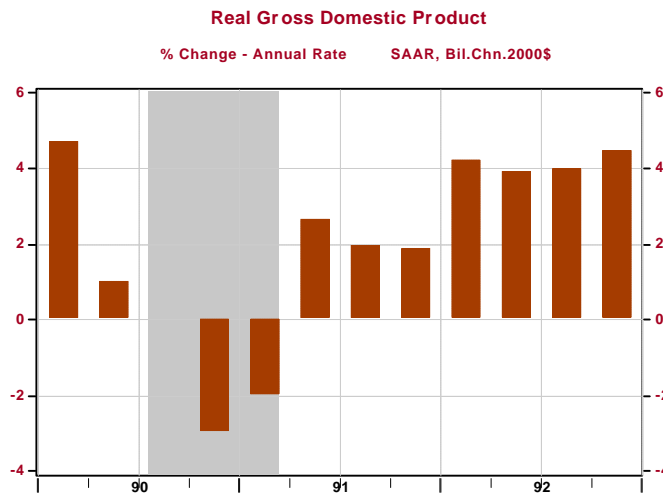
April 28, 2006

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

Paul L. Kasriel
Director of
Economic Research
312.444.4145
312.557.2675 fax
plk1@ntrs.com

But it is a lousy *leading* indicator. For example, in 1990:Q1, real GDP increased at an annual rate of 4.70% quarter-to-quarter -- its fastest growth since 5.38% in 1988:Q4. But, as Chart 1 shows, sequential quarterly real GDP did not attain annualized growth of 3-1/2% or higher until 1992:Q1.

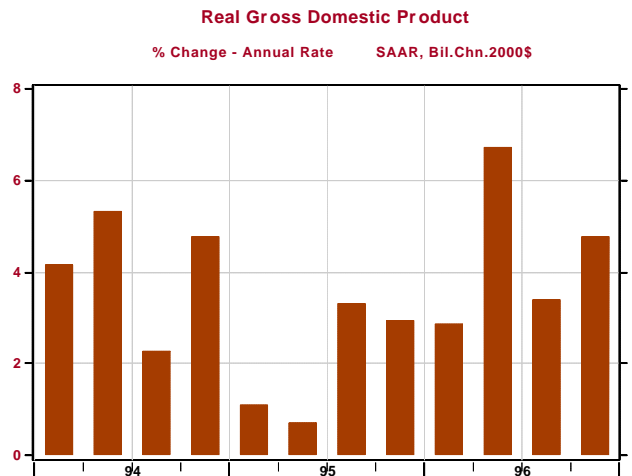
Chart 1



Source: Bureau of Economic Analysis /Haver Analytics

Quarter-to-quarter annualized real GDP growth hit 4.77% in 1994:Q4. As shown in Chart 2, real GDP growth did not surpass 3-1/2% until 1996:Q2.

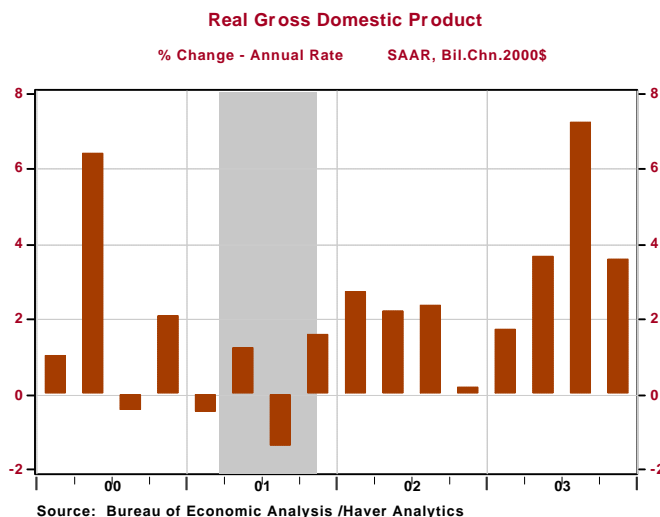
Chart 2



Source: Bureau of Economic Analysis /Haver Analytics

Quarter-to-quarter annualized real GDP growth hit 6.43% in 2000:Q2. As shown in Chart 3, it did not surpass 3-1/2% until 2003:Q2.

Chart 3



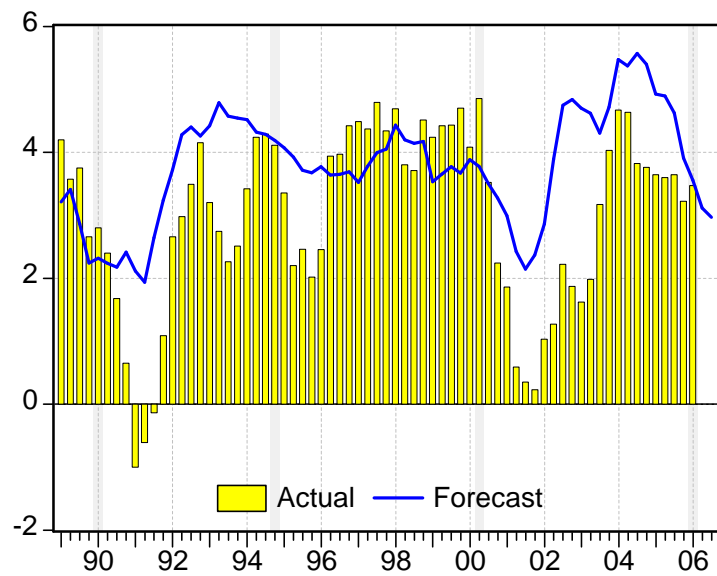
All of which brings us to the advance estimate of 4.82% real GDP growth in 2006:Q1. Is this the harbinger of continued solid growth in excess of 3-1/2% or the swan song for such growth? I'm placing my bets on swan song. The reason is that just like 1990:Q1, 1994:Q4 and 2000:Q2, my proprietary real GDP *forecasting* model, which, by definition incorporates *leading* indicators of economic activity, is now signaling slower economic growth ahead – in fact, considerably slower growth.

Chart 4 shows the year-over-year growth in actual real GDP along with the year-over-year growth in real GDP as forecasted by my proprietary model. The shaded areas in the chart are the quarters of relative peaks in quarter-to-quarter real GDP growth as discussed above. The (blue) line is the forecasted year-over-year real GDP growth. The model gives a forecast two quarters ahead. So, at each of these relative peaks in actual real GDP growth, the model was forecasting that the growth would be moderating in the two quarters *ahead*. **As of right now, the model is forecasting that by 2006:Q3, year-over-year real GDP growth will be about 3% vs. 3.5% as of 2006:Q1. This implies that annualized real GDP growth quarter-to-quarter will average about 2.7% over the next two quarters vs. its 3.2% average over the past two quarters.**

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

Chart 4

Year-over-Year Real GDP Growth (%): Actual vs. Forecast
(quarterly observations)



Both in the minutes to the March 28 FOMC meeting and in Chairman Bernanke's April 27 testimony to the Joint Economic Committee, the message was communicated that the Fed *expects* real GDP growth to moderate from its blistering pace set in 2006:Q1. I doubt seriously if the Fed's forecasting model bears much resemblance to mine. But both are sending the same message – economic growth is set to slow. **And the policy implication is that the FOMC is set to pause after one more 25 basis point funds rate hike on May 10.**

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.