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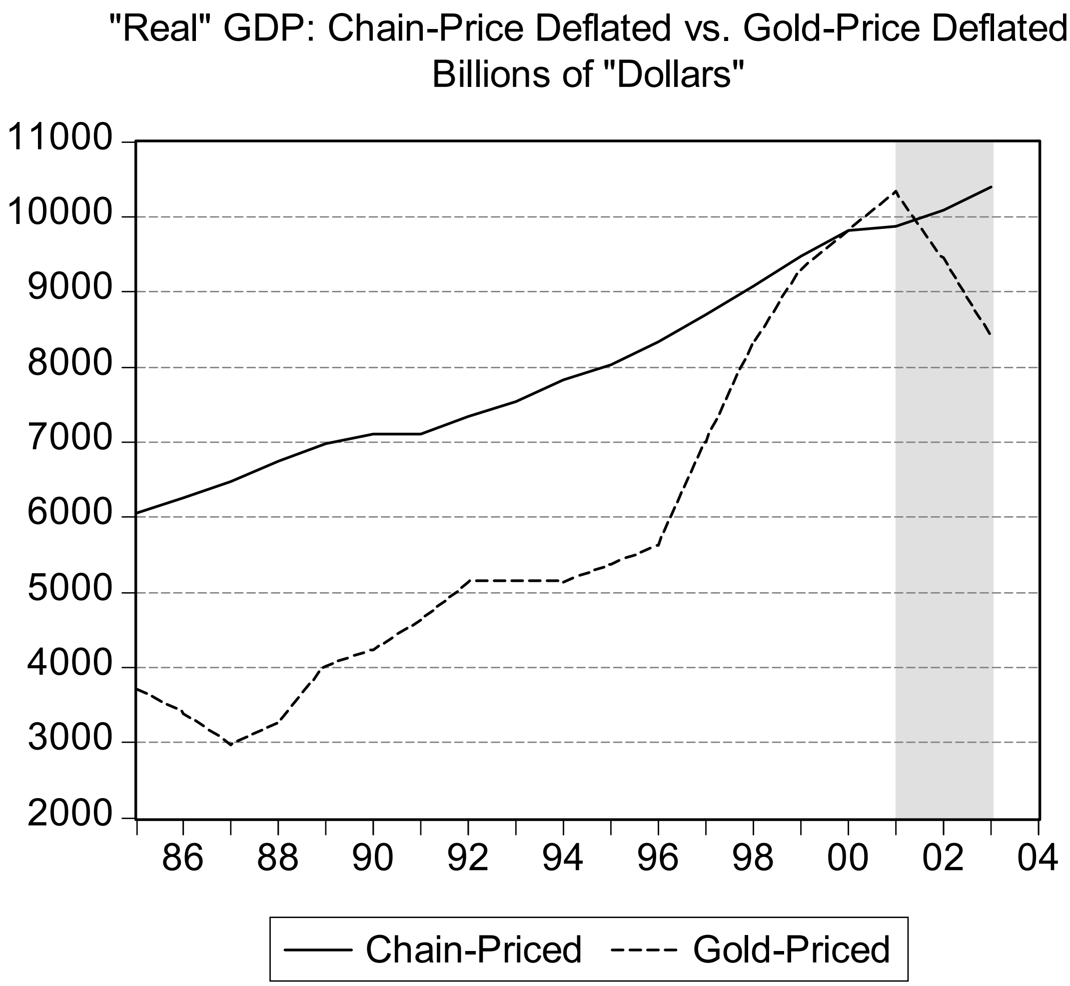
Real *"Real" GDP?*

Throughout time, gold has proved to be a relatively good store of value. (For a discussion of this see, "Gold As A Store Of Value," Stephen Harmston, Research Study No. 22, World Gold Council, November 1998, http://www.gold.org/value/stats/research/pdf/RS-22.PDF.) No government edict made gold a store of value. In fact, just the opposite. Governments from time to time have attempted to *prevent* their citizens from using gold as a store of value. Governments tell us what is happening to the purchasing power of their fiat money by calculating and publishing various measures of prices of goods and/or services. (Sometimes governments fall behind in this endeavor, as evidenced by the U.S. Bureau of Labor Statistics' failure to report the January 2004 PPI data on the scheduled date of February 19. With 0.5% increase in the January CPI being reported on February 20, conspiracy theorists might hypothesize why there was a delay in the PPI release.) Now, because our economy is so big, diverse, and dynamic, it is conceivable that it is impossible for government bean counters to accurately calculate the prices of the vast variety of legumes produced. (To get a flavor for how the bean counters attempt to do it, take a look, especially if you are having trouble sleeping, at "A Note on the Impact of Hedonics and Computers on Real GDP," J. Steven Landefeld and Bruce T. Grimm, *Survey of Current Business* (Bureau of Economic Analysis), December 2000, http://www.bea.doc.gov/bea/ARTICLES/BEAWIDE/2000/1200hm.pdf.) But if there is a free market in gold and the populace perceives that the government data with regard to purchasing power is flawed, then movements in gold prices just might provide some information about what really is happening to the value of paper money. And, oh yes, we do not have to worry about hedonics when it comes to an ounce of gold. Its quality has not changed throughout the ages. As an aside, some might argue that there is *not* a free market in gold inasmuch as central banks sit on large hoards of the stuff and sell it when the spirit moves them. Again, conspiracy theorists believe that central banks sell gold when the masses start to bid up its price.

It is in this spirit that I decided to calculate "real" GDP by deflating nominal GDP by the free market price of gold. I know it is a leap of faith to accept the government's figures on nominal GDP. But it has got to be easier to tote up nominal cash register receipts for computer sales than it is to determine what the quality adjustment should be on a computer. I took annual average dollar prices of an ounce of gold, as provided by the World Gold Council, and then indexed them to the price of gold in the year 2000. Why 2000? To make the gold-price index comparable to the GDP chain-price index. I then "deflated" annual average nominal GDP data by the gold-price index. The results of this, along with the "official" values of real GDP are shown in the chart below.



Well, as you can see, what has been happening to real GDP in the past two years differs according to what is being used to deflate nominal GDP. Using the Bureau of Economic Analysis' chain-price index, annual average real GDP has continued its upward march in recent years, not even slipping back in 2001, the year of the "official" recession. I guess this speaks to the incredible flexibility of the U.S. economy, to which Chairman Greenspan often alludes to so glowingly. Think about. **After the biggest stock market bubble in the history of this country and the biggest erosion of household net worth in the post-WWII era, in annual average terms, real production of goods and services in America did not**

decline – slowed, yes, but did not decline! But if we measure real GDP in terms of the price of that old *numeraire*, an ounce of gold, the story changes. In this case, "real" GDP peaked in 2001, and has declined for two successive years since. Of course, this is consistent with the notion that a nation's standard of living declines as its currency declines.

I report; you decide.

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