To GDP — or not to GDP?

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Next week the US government releases its latest data on gross domestic product for the third quarter of 2019. It's a fair bet that this will trigger debate among pundits in Washington and on Wall Street about whether the world's largest economy is heading for a recession — and what that might mean for the re-election of Donald Trump.

But, as investors scrutinise those seemingly precise digits, are we missing a trick? Is it possible that apparently crucial GDP numbers are actually an illusion — or a distortion — when it comes to assessing the economy?

That is the seemingly heretical idea currently being tossed around some parts of America's Federal Reserve, as well as in academia and parts of Wall Street. For as Silicon Valley keeps delivering new technological innovations, these are not only transforming how we live but also overall growth.

Some economists fear, therefore, that our old measures of GDP no longer capture the "real" economy, not just in terms of output but also of prices and our own incomes.

"On conservative assumptions, we believe official data understates US GDP growth by 0.75 per cent per annum and overstates inflation by 0.4 per cent," argues Mark Cliffe, chief economist at ING Group.

Questioning GDP is nothing new. As both the economist Diane Coyle and David Pilling, my colleague at the Financial Times, have noted in their respectively esteemed books, GDP has always been a flawed concept.

It was, after all, devised in the early years of the 20th century to track industrial output, and cannot capture other aspects of our economic life such as unpaid housework or even some paid services.

What has really changed is that the explosive growth of technology is pushing more economic activity out of the realm of classic GDP measuring tools. This includes "free" services (say, social media) and huge improvements in the output of technology (such as the rising speed of mobile phones).

The GDP data also misses some "intangible" items such as brands or intellectual property (never mind that this is estimated to be generating three-quarters of the value of US stocks).

This matters. Cliffe of ING reaches his (gu)estimate that 0.75 percentage points of GDP is being missed each year by noting that the government's own statisticians admit that tech activity worth about 0.4 per cent each year is excluded from GDP — then adding separate estimates for the missed service sector and intangible activity.

He stresses, however, that 0.75 per cent is almost certainly an underestimate, as the real figure is "perhaps 1 per cent annually or even as much as 2 per cent, because of the growing importance of services in general".

While that might not sound dramatic, he calculates that, "If GDP has been underestimated by 1 per cent per annum since 1990, then median income has [actually] risen 50 per cent instead of the 15 per cent recorded."

To put it another way, some analysts think the dominant narrative about the US economy is partly wrong: although it is popularly presumed that mean earnings have stagnated in America in recent years as productivity has (seemingly mysteriously) collapsed, this partly reflects mismeasurement, not lived reality.

Some economists might strongly disagree. But Cliffe is not alone: officials at the International Monetary Fund are analysing the issue of mismeasurement, as are academics at MIT.

"We haven't been measuring big chunks of the economy and understanding where people are getting real value," says Erik Brynjolfsson, an MIT professor who is developing an alternative measure of GDP that tries to track the size of the excluded "free" services by asking consumers what they would pay to replace them and then factoring these calculations back into the data.

(This suggests that Facebook, YouTube and Google search are worth almost $600, $1,100 and $17,000 a year respectively to each consumer.)

Perhaps more surprisingly, the Federal Reserve chairman Jay Powell seems to agree. Last week, he cited the work of Brynjolfsson in a speech to an economics conference, and then pointed out that two of the Fed's economists — David Byrne and Carol Corrado — have recently conducted their own study of the missing tech activity.

"Good decisions require good data, but the data in hand are seldom as good as we would like," Powell observed.

So is there a solution? One option would be to put more money into statistical research to keep up with technological changes (at present it can take about a decade to capture new tech in inflation baskets, for example).

Another would be to publish the alternative GDP measures that other groups are creating. And a third possible response is to stop obsessing over precise GDP digits.

That is not easy in a world where many investors and analysts (and some journalists) derive their living by creating a drama out of these quarterly forecasts and announcements; it is only natural that we all seek a compass in a confusing world.

But when that data is released next week in the US, it is worth remembering this: in today's world, voters will experience "the economy" in ways that are very different from economists. Particularly when they have a mobile phone in their hands.

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