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# Statistics, Lies, & GDP - There Is No Politically-Acceptable Means Of Escape

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***This article debunks the misconception that GDP represents economic health.****It explains how monetary flows have led to markets in financial assets inflating while non-financials in the GDP bucket are in deep distress. And why, at a time of rapid monetary expansion, all attempts to quantify the effects of monetary policy on the real economy become even more meaningless.*

*Financial markets are acting like an inflation reservoir. And****when the dam bursts bond yields will rise substantially****, undermining values of other financial assets. The non-financial GDP economy will then face the full force of monetary depreciation, with calamitous consequences for ordinary people: the unemployed (of which there will be many), the low-paid and retirees living on meagre pensions and savings.*

***Macroeconomics have led state planners in all high-welfare economies headlong into policies of monetary and economic destruction from which there is no politically acceptable means of escape.***

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**Introduction**

Only those with a lack of perception are unaware that their nation’s economy is in deep trouble. It is far worse than just a pandemic-induced disruption in our lives which in a little time will return to normal. Lest we forget, liquidity strains had already appeared in the US repo market and forced the Fed to reverse its policy of reducing its balance sheet before the coronavirus even existed. And before that, the trade tariff war between the US and China had led to international trade grinding towards a halt.

The tariff war evolved into a financial war, centred on Hong Kong, closing the Shanghai Connect route for international investment into China. America is now successfully campaigning to stop its allies from buying Chinese technology. The economic effect is for America to isolate from the largest manufacturing economy in the world, and by persuading its allies to isolate themselves from China’s technology, China is becoming partially isolated itself from western trade.

Put another way, as a bad background to everyone’s domestic trade, global trade will continue to diminish. In this respect we have a 1930s doppelganger, with two major differences: today’s money is pure fiat compared with a gold exchange standard backing the dollar, and the macroeconomics invented by Keynes and his contemporaries now applies.

1. In the thirties it was all about gold;
2. in the new twenties it is about fiat money and its flows.

**Say’s law will return to bite us**

As an invented category by Keynes to dispose of classical theory, the basis of macroeconomics is to distance itself from that which we reasoned from human psychology and life experience. Macroeconomists argue that a different analysis applies at the aggregate level, without a convincing explanation as to why it is so.

The origin of their contempt for established theory stems from the denial of Say’s law, that we divide our labour to maximise our production and therefore our ability to satisfy our needs and wants. The role of money is to turn our production into our needs and wants by being able to evaluate and choose between different products. By a process of linguistic legerdemain, Keynes conned the economics profession to reject this truism by commenting in his *General Theory* as follows:

*“Thus, Say’s law, that the aggregate demand price of output as a whole is equal to the aggregate supply price for all volumes of output, is equivalent to the proposition that there is no obstacle to full employment. If, however, this is not the true law relating the aggregate demand and supply functions, there is a vitally important chapter of economic theory which remains to be written and without which all discussions concerning the future of aggregate employment are futile.”*

Say’s law was not mentioned again. Following this economy with the truth, he then proceeded to write that “vitally important chapter of economic theory” in the rest of his *General Theory*, which is the foundation for today’s mathematical macroeconomics. By this one artifice Pandora’s box had been opened. The promise from the gods was that it contained special gifts, but when Pandora opened it all the illnesses and hardships the gods had hidden therein escaped to trouble mankind, leaving hope alone trapped inside. The ancients had it right.

Keynes was not an economist but a mathematician, confirmed by his friend and Austrian economist, Hayek. Behind the maths there are data required for Keynes’s equations, giving rise to government econometrical departments in defiance of their misappropriation. And that lets one of Pandora’s evils to fly out of the box, because macroeconomics constructs a positive role for governments giving them free rein to remove individual freedoms and to tax and destroy personal wealth without economic contradiction.

Having distorted such a fundamental economic truism as the division of labour and having never understood the true role of money, macroeconomics has evolved to ignore all reality. It has become the justification for a mixture of capitalism and socialism. State intervention, it was argued, improves on capitalism, and the welfare state yields a kinder, better society. We shall not be side-tracked into demonstrating the flaws in this argument but will move on to one corruption of macroeconomics, the evolution from sound gold-backed to unsound unbacked state money, the quantity of which is expanded at the state’s will. And most remarkable of all, the statistics recorded in state money at times *T1, T2, …Tn* make no mention, nor allowance for the different quantities of money behind each data point, which disqualifies them as the basis for any theory of prices.

It can be truthfully argued that it is impossible to quantify the price effects of changes in the money quantity on recorded prices. But this is not the point; the point is data is corrupted from the outset, and that being unreliable due to changes in the money quantity data-driven analysis should never have been taken seriously.

That is not the world in which the state increasingly runs our affairs on our behalf. And now that we face a potential 1930s Depression Mark 2, we should understand how and why it will be misrepresented by the statistics upon which macroeconomists base their analysis.

**Gross domestic product**

In seeking to measure everything, econometricians gave us the dubious gift of gross national product and gross domestic product, the latter being in fashion today and the former in times past. While there are different ways of measuring it, GDP is commonly taken as a measure of spending, comprised of household spending, government spending, investment spending and net exports. The Bank of England’s guide says it is a measure of the size and health of the economy.[iii]And the US’s Bureau of Economic Analysis similarly says, “the growth rate of GDP is the most popular indicator of the nation’s overall economic health”.[iv]

While it is a measure of the size of an economy, it is an error to describe it as a measure of its health. Economic theory and empirical evidence are clear on the matter: an economy dominated by government spending is not a healthy economy, compared with one dominated by private spending; yet these two different models can produce the same total consumption figures. When Gordon Brown was Britain’s Chancellor of the Exchequer at the turn of the millennium, he consistently delivered GDP growth greater than forecast by independent economists. But when you took the numbers apart, it was achieved not by a private sector doing well as everyone assumed but by the government spending more than expected.

We must therefore disassociate changes in GDP from economic health, or put more specifically, they tell us nothing about human progress or regress. It is simply a total of recorded transactions, a national but less accurate equivalent of a company’s turnover figure. We can go further. Let us assume there is a fixed amount of money in the economy, which means that net exports must be zero because the counterpart to an imbalance in trade is net money flows. Obviously, that leaves the allocation of GDP free to adjust between non-government, government and investment categories without any change in the GDP total.

Assuming there is no change in the ratio of recorded GDP transactions to unrecorded and excluded transactions, of which a total economy is always comprised, all individual actors in all GDP categories will rearrange their spending priorities within a fixed money total. There will be no increase or decrease in GDP, though the benefits to the human condition can increase or decrease.

In reality, the situation is complicated by large elements of transactions being excluded from GDP. The acquisition of securities and trade in second-hand goods are examples of exclusions. But for the moment let’s stick with the fiction that there’s no movement between GDP and its exclusions. Now let us further assume there is an increase in the quantity of money, emanating from the central bank. The extra money will flow into both GDP and excluded categories. The extent to which the extra money effects both categories is simply additional. In other words, GDP, being the total of recorded transactions, increases exactly by the extra money spent on items within the statistic. Other than the distortions solely connected with the absorption of additional money as it filters into the economy, there is more money being spent on the same quantity of goods. It is just that after a period of adjustment each monetary unit buys on average proportionately less.

We can confirm this by referring back to Say’s law, which posits that we divide our labour, specialising in what we are good at in order to buy the things we need and want. Money is just the commodity we use to turn our own production into consumption, allowing us to evaluate and compare different goods with each other. The quantity of money and its purchasing power are immaterial to its function as a transaction medium in this respect. The point can be made in a different way: a consumer in Europe, or India or America uses the local currency to facilitate the division of his or her labour: whether it is euros, rupees or dollars does not matter, so long as it is accepted as a medium of exchange.

Therefore, an increase in GDP does not reflect the health of an economy but only the extra money inflated into it as a category of economic measurement. And for those seeking to estimate how much of the extra money has gone into included transactions over a period of time, all they need to do is to measure the difference between the more recent GDP figure and the former, adjusted for any change in net exports.

In the monetary conditions we face today, that is to say a sharply accelerating rate of monetary inflation, after a brief period allowing for its absorption into general circulation, nominal GDP will rise at an increasing rate. But, as we have seen, those who take it as indicating a healthy economy will be badly misled.

Armed with this knowledge, we know that economies that collapse their currencies through monetary inflation will exhibit high levels of growth in the nominal GDP statistic. But can we find examples to prove it? It is difficult to do so for two reasons.

1. Firstly, the statistics available are so inaccurate as to be even more meaningless than those produced by nations with more moderate rates of monetary inflation; and
2. secondly, statisticians in international bodies abandon domestic currency measures replacing them with dollar equivalents at official exchange rates.

Whether one uses an official rate of exchange or the black-market rate, which is always the more accurate of the two, will produce wildly different results. But that is ignored by government statisticians. And we have found from examples of high monetary inflation that the inadequacy of statistical analysis and misconceptions over GDP are confirmed by econometricians discarding the principals behind their method in these extreme cases. But we are all becoming extreme cases now.

High-spending governments face a period of accelerating monetary inflation for the dollar as their international currency, as well as for their own, driven by an imperative to rescue their economies from the crises they were mainly responsible for in the first place. Only this week, the Atlanta Fed forecast a 41.8% collapse in America’s GDP in the current second quarter, admittedly the immediate consequence of lockdowns. There will be a statistical recovery as lockdown rules are withdrawn.

Beyond that, there can be no doubt that the transmission of the rapid increase in the quantity of money issued by the Fed in recent weeks into GDP constituents takes time, not least due to the commercial banks’ reluctance to lend and because the downturn in consumption and product supply is both current and severe. But we know that the quantity of money included in the GDP statistic will increase through government spending and helicopter money. The nominal GDP statistic will recover, but the recovery simply reflects the amount of new money, even though economic activity will likely remain badly depressed.

The extra money will be reflected in the prices of the goods and services upon which it is spent. But the consequences for prices are not so straightforward. Changes in supply and demand factors for individual goods will have their own effect on individual prices, while the increased quantity of money as it is absorbed into the economy will have another. Equally important are the different choices people make in these changed circumstances. And this is where the fallacy of disregarding Say’s law really undermines the relevance of the statistical approach.

Since the virus lockdown, what people desired beforehand bears little relation to their needs and wants in the coming months. Meanwhile, the assumption behind GDP is that what was desired yesterday will also be desired tomorrow, any adjustments to outcomes being altered in retrospect. The monetary expansion, insofar as it is spent in the non-financial GDP economy, lends support to yesterday’s production. The reallocation of capital in all its forms, of money, labour, establishments and product inputs to respond to change, is thereby discouraged and restricted.

Furthermore, the debasement of people’s earnings and savings impoverishes them even further. Inflation of the money quantity always transfers wealth and earnings from savers and individuals to borrowers. And with governments being the largest borrowers for increasing amounts, they are the largest beneficiaries of wealth transfer and their electors are the losers. The impoverishment of the masses through monetary inflation guarantees that monetary policies touted as rescuing the non-financial economy will fail.

Bottom of Form

Econometricians divide economic categories between transactions included in GDP and others which are specifically excluded. The division is artificial, because in practice money is freely used to purchase items in either category.

Besides the intention to put consumption into a statistical box, there is no economic justification for the division between financial assets excluded from GDP, and the non-financial products and services for which GDP was devised. And if extra money intended to stimulate the economy is channeled into financial assets, its effect on the non-financial economy covered by GDP is thereby limited.

In funding the government and ensuring commercial banks have sufficient liquidity, a central bank satisfies these objectives by buying government debt and other securities from commercial banks. The non-financial economy, most of which is represented within GDP, only receives the new money in due course through government spending and bank loans, assuming the banks are willing to lend.

The economic distortions created are many. But what interests us here is the “reservoir” effect of the new money being parked in government securities. With commercial banks desperate to contain lending risk and therefore reluctant to pass on central bank money to the non-financial economy, they devote their balance sheets to financial assets, principally government debt, in the knowledge the central bank will continue to buy them. For this reason, government bonds deemed to be risk-free by bank regulators remain strongly bid at suppressed yields, and other asset classes take their cue from them.

Additionally, central banks are extending the principal of buying government debt to buying corporate debt to ensure their prices are also firmly underwritten. Governments either directly or through their sovereign wealth funds and central banks are extending support or proposing to do so to equities. All major governments are not just supporting financial markets but are increasing the range of assets in their support operations. Therefore, there is an inherent bias in the application of these money flows, favouring financial assets at a time of economic distress in the non-financial economy.

Meanwhile, the excess of government spending over tax income leads to the funds raised from sales of government debt being passed through government hands to the non-financial economy contained in the GDP statistic. The reservoir effect of money accumulating in financial assets begins to be offset by flows from it into GDP. Not all of it will be spent in GDP categories because net exports in the GDP equation will tend to become negative or more negative if it is already so, assuming there are no offsetting changes in the savings rate.

The current position is therefore like a reservoir filled with newly created money inflating asset prices instead of those of goods and services. But this is a temporary situation, and the reservoir of inflated money will begin to be drained through government spending, instead of by increases in bank lending because of banks’ aversion to risk.

The implications of the reservoir effect are unlikely to be fully appreciated by central banks, who currently observe contracting demand in GDP constituents: recall the Atlanta Fed’s forecast of 41.8% contraction in GDP for the current quarter. But unless central banks and other state agencies maintain the pace at which they inflate financial assets, being dramatically mispriced markets will simply collapse. Concluding that the stimulus must at all costs be maintained, central banks are likely to accelerate monetary inflation yet again by increasingly aggressive purchases of financial assets from commercial banks to keep the asset bubble inflated.

The effect on prices in the non-financial sector is always recorded with hindsight. The deluge of new money entering an overflowing financial sector reservoir flows down the government river to inundate the non-financial economy downstream. Despite all the bankruptcies and unemployment, prices begin to rise alarmingly, particularly for life’s essentials. What does the central bank then do? It cannot turn off the tap, because its neo-Keynesian macroeconomists know no other policy but inflationism.

The policies that demand accelerating monetary inflation must focus increasingly at attempts by central banks to maintain financial asset values, which, when beginning to fail, require even greater amounts of asset purchases to keep government bond yields suppressed, particularly if foreign holders sell their existing holdings. Continuing our reservoir analogy, the dam will inevitably be breached, and investors will attempt to stampede out of financial assets to… Where?

In bear markets of this one’s likely magnitude, prices fall too rapidly for anyone hoping for a better selling opportunity to leave the party with anything much rescued from the wreckage. Asset values will be mostly extinguished. It will have become evident to investors that with rising bond yields governments are entrapped by a combination of excessive debt and the prospect of sharply higher borrowing costs.

**Once it starts, the loss of confidence in government debt is likely to be rapid, perhaps no more than a matter of months, and is likely to take down the state’s money as well.**For a confirming precedent, we need look no further than John Law’s Mississippi bubble, which once pricked destroyed his unbacked currency in about seven months. He had pursued the same policies of today’s central banks almost to the letter. The only difference was he bankrupted France. Today it is global.