

**ECONOMICS:** US PERSPECTIVES—JULY 16, 2010

# Income Flows and Tax Receipts Offer a More Upbeat View of the US Economy

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First-quarter US gross domestic product was revised downward in late June, but looking at economic output from the perspective of income flows, rather than production, indicates that the economy probably performed better than many believe.

When the Bureau of Economic Analysis (BEA) revised first-quarter nominal gross domestic product (GDP) on June 29, it lowered total GDP by roughly \$9 billion, producing a modest downward adjustment in annualized growth from 4.1% to 3.9%.

But at the same time, the BEA made an upward revision to nominal gross domestic income (GDI) of \$29 billion, boosting the first-quarter gain from 4.5% to 5.4%, or 1.5 percentage points above the gain in GDP. If we adjust each series by the 1.2% annualized increase in GDP prices, the resulting real economic growth was 2.7% based on product data but 4.2% based on income flows as estimated from GDI.

Both GDP and GDI measure aggregate economic activity. GDP sums the value of all goods and services sold to final users, plus the change in inventories. GDI, on the other hand, essentially adds up the income payments received, and other costs incurred, in the production of the economy's ultimate output. In theory, the two should yield similar results. But since

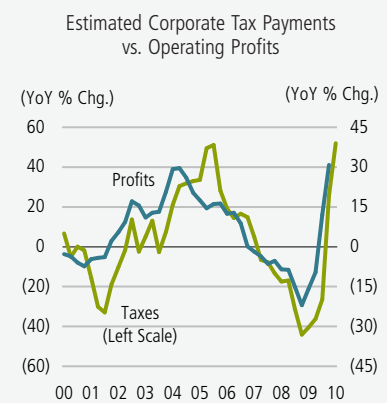
they're estimated with different source data, they often diverge—at least temporarily, until all final numbers are received. When the two series differ, revisions very often move in the direction of the income series.

### Measuring the Economy ... from the Income Side

The income side of GDP accounts is often overlooked or ignored, but it shouldn't be. It often provides an early—and more accurate—reading of underlying economic trends, according to research presented in April at the Brookings Institution by a Federal Reserve economist. It found that after several rounds of revisions, government GDP estimates tend to move back into closer alignment with GDI, so GDI's income-based perspective may provide important clues as to the actual path of the nation's GDP.

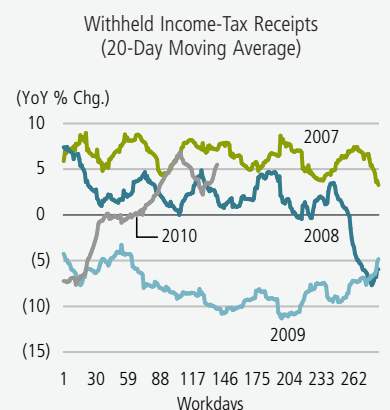
One way we try to track the income side of the accounts is by following tax-receipt data from the US Treasury Department. Admittedly, these data are noisy, but they're also "hard"—they're final, so not

Display 1  
**Corporate Taxes Indicate Strong 2Q Earnings**



Source: Bureau of Economic Analysis, Haver Analytics and US Treasury

Display 2  
**Tax Receipts Point to Rising Wage and Salary Income**



Source: Haver Analytics and US Treasury

altered by government statisticians. They're also timely, giving an indication of what's happening well before other economic series are released. The tax receipts for individuals are reported on a daily basis, but there is a "lumpiness" to the receipts—many workers' paydays are either at the beginning of the month or at mid-month. Because of this, we monitor individual tax-receipt data by tracking a 20-day moving average and comparing it with the same period one year earlier.

Corporate tax payments are even more bulky, because companies make estimated payments on the 15th day of the final month of the quarter. The data, however, are crucial, because they're a very strong indicator of corporate profits (**Display 1, previous page**), providing an important early tally of profit trends in the

current quarter—well ahead of the earnings reporting season.

### What Are Tax Receipts Saying?

Receipts from federal income-tax withholdings foreshadow much stronger income gains than what's implied by aggregating payroll jobs and wages (**Display 2, previous page**). Receipts are up about 5% from a year ago, having run between 3% to 6% higher year over year in the past few months.

On June 15, companies made a relatively large tax payment of \$46.2 billion, up 9.2% from a year ago. Many companies reduce their tax liabilities early in recoveries by applying tax-loss carry-forwards from the downturn, so the large gain makes it likely that actual second-quarter earnings will handily outpace consensus expecta-

tions of 27% growth year over year. To be fair, it's still very early in the earnings season, but initial reports from companies like Alcoa, CSX, Intel, WW Grainger and JPMorgan are following this script.

In the current environment, with considerable uncertainty over the speed and sustainability of the economic recovery, it's vital to examine all dimensions of business activity. Trends in corporate profits are critical to the path of GDP ahead. Indeed, cyclical turns in operating profits very often signal a change in underlying growth trends. Current reports of strong profit gains, surpassing relatively high analyst estimates, do not indicate a trend that we'd see if the economy was on the brink of a double dip. In fact, the trend in profits points to more growth, investment and hiring, and a sustainable recovery. ■

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