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The Up hot
STATISTICAL PUZZL

Dueling View on the Fir t-Quarter Slump

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No one really knows how fast the economy is growing, or indeed if it is growing at all. This question has started an unusual wonk war among economists working in different parts of the Federal Reserve system.

The government's official numbers say that economic growth was weak in the first quarter, and the next update is likely to suggest that economy may even have shrunk. But no one really knows whether to believe the official numbers.

At issue is whether the official measure of gross domestic product has been distorted by problems with the arcane statistical adjustments the authorities use to account for the predictable annual winter slowdown in economic activity. As I reported a few weeks ago, in recent years — and indeed, decades — reported rates of economic growth in the first quarter have been substantially weaker than those recorded for the rest of the year. This pattern of unusual first-quarter statistics produced by the Bureau of Economic Analysis suggests that something is awry with these adjustments.

The issues may be esoteric, but the stakes are high. If the latest slowdown is a statistical aberration, we should just ignore it. But if it's real, and likely to continue, negative growth should put all of us — and especially government officials — on high alert.

The boffins at the Bureau of Economic Analysis have promised to investigate further and will report back in July. In the meantime, policy makers are trying to sort out what to make of the data. The result is Fed economists giving their principals different advice.

First out of the gate with an analysis was Charles Gilbert, Norman Morin, Andrew Paciorek and Claudia Sahm, who are all economists at the Washington headquarters of the Federal Reserve. While they found that economic growth in the first quarter has been weaker in recent years, they conclude that they could "find no firm evidence that this pattern primarily reflects residual seasonality." ("Residual seasonality" is a euphemism for "problems with seasonal adjustment.")

But Tom Stark from the Federal Reserve Bank of Philadelphia disagrees. He finds that "the first-quarter effect is economically large and statistically significant." The problem is that "the B.E.A.'s seasonal adjustment procedures are not filtering out all the intra-year movements in the data." Given the degree of uncertainty in the published estimates, he suggests emphasizing statistical models that are only partly based on these problematic first-quarter G.D.P. numbers. The statistical model preferred by the Philadelphia Fed suggests that the economy grew at an annual rate of 1.7 percent rate in the first quarter.

And a complementary analysis from three economists from the Federal Reserve Bank of San Francisco, Glenn Rudebush, Daniel Wilson and Tim Mahedy, finds that "there is a good chance that underlying economic growth so far this year was substantially stronger than reported." By their telling, the problem is that the Bureau of Economic Analysis seasonally adjusts each of the component series that go into calculating gross domestic product, rather than adjusting the total G.D.P. number.

But in their judgment, "macroeconomic policy makers may prefer instead to eliminate residual seasonality in the aggregate G.D.P. data in order to have the most accurate top-line measure of the broad economy." According to their math, seasonally adjusting total G.D.P. shows that the economy grew at an annual rate of 1.8 percent, rather than 0.2 percent, in the first quarter.

These dueling briefing notes disguise a fairly broad consensus that the first-quarter slowdown in G.D.P. growth is not to be taken too seriously. After all, even the Washington-based team that was unconvinced that the problem is due to seasonal adjustment suggests that there remain alternative explanations “such as statistical noise, unusually harsh weather, and other idiosyncratic factors — that might lead one to discount some of the weak first-quarter G.D.P. growth.”

A parallel wonk war has also ensued among private-sector economists. A Goldman Sachs economist, Alec Phillips, was probably the first to systematically explore this problem, finding “that the apparent seasonality in some components of G.D.P. seems to have weighted on the Q1 growth rate over the last few years.” Michael Gapen and Jesse Hurwitz from Barclays agree, finding that “residual seasonality in U.S. G.D.P. data was apparent prior to the crisis but has become significantly more pronounced since.” Ben Herzon, an economist at Macroeconomic Advisers, calculated that residual seasonality “is responsible for regularly reducing G.D.P. growth in the first quarter of each year by an average of 1.6 percentage points.” He also estimates that an unusually snowy winter subtracted another 1.6 percentage points from growth, suggesting that the underlying growth rate is in fact very healthy.

By contrast, Bank of America Merrill Lynch economists argue that “the statistical evidence of a seasonal bias is weak.” And J.P. Morgan’s Jesse Edgerton thinks the first-quarter effect “is most likely a coincidence,” although his colleague Michael Feroli has noted a “seasonal tendency for Q1 to be weak,” and another colleague, Daniel Silver, notes “that new patterns in defense spending have emerged in recent years that are not fully accounted for by the seasonal factors.”

For those not keeping track, it boils down to two camps: economists who blame first-quarter weakness on idiosyncratic factors versus those blaming mismeasurement. Essentially, both camps argue that we should discount the first-quarter numbers, which means that your views about pace of growth should be shaped largely by the early readings on the second quarter. So far, retail trade, industrial production and consumer confidence reports have been disappointing, although labor market indicators are more sanguine.

In both camps, there are further reasons for concern. For the mismeasurement crowd, the problem is that other economic indicators — including those thought not to suffer from seasonal adjustment difficulties — also slowed during the first quarter, and they have yet to pick up. And the problem for those emphasizing idiosyncratic factors is that now that the unusually heavy winter snow and the port strike are behind us, the level of economic activity should return to normal, and this snapback should have yielded a short-run boost to growth. The weak April data are even more disappointing relative to this more optimistic baseline.

There are plenty of excuses for the first quarter. What's worrying is that there are few excuses for a weak second quarter.

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