John Williams'
Shadow Government Statistics
Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 818
May Trade Deficit, Construction Spending, Fed and Dollar Troubles

July 6, 2016

QE4, Systemic and Dollar Troubles Appear on the Horizon

Trade Deficit Widened Anew, Damaging the Outlook for Second-Quarter GDP

Construction Spending Benchmarking Was to the Upside, but
Headline Growth Numbers Were Broadly Negative, with
Real Annual Growth Sinking to a 53-Month Low

Current Construction Spending Patterns Last Were Seen as
Construction Activity Fell into Depression

PLEASE NOTE: The next regular Commentary, *scheduled for Friday, July 8th, will cover June 2016 Employment and Unemployment Conditions, along with the release of the ShadowStats Ongoing M3 Measure for June.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Weakening of the U.S. Economy and Systemic Stability Issues Should Lead to QE4. Despite intermittent reporting gimmicks, the U.S. economy is slowing sharply in a new recession. Such should become quite evident in the month or so ahead, as second-quarter economic conditions gel in initial, full reporting, and as GDP reporting since January 2013 goes through its July 29th benchmark revision. GDP revisions should rewrite recent economic history, showing some outright quarterly contractions.

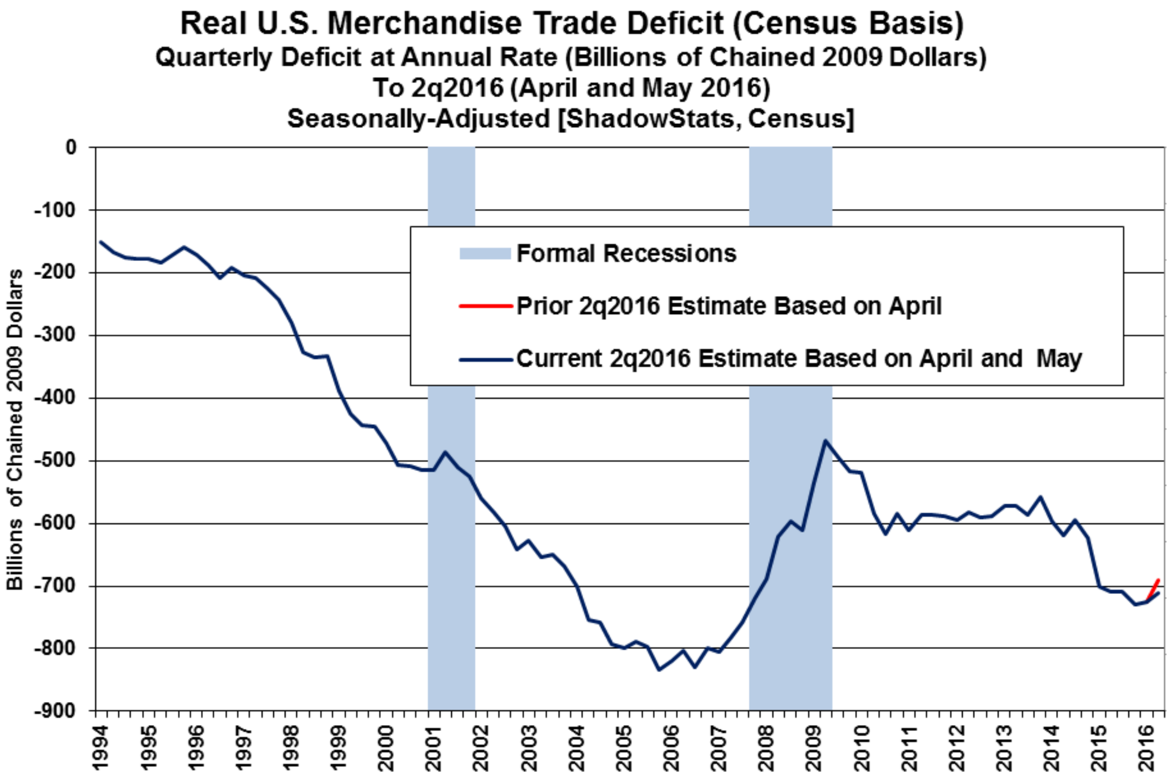
Faced with increasing financial stresses on the banking system, and U.S. Treasury funding needs deepened by deteriorating fiscal conditions and challenged by competing global liquidity needs, the U.S. Federal Reserve will have little option but to revert to an expanded quantitative easing. Buying up U.S. Treasury securities and possibly other assets, the Fed likely would continue or expand any options necessary to keep the U.S. banking, financial and government-funding systems intact and fluid, irrespective of how the U.S. dollar is viewed by the rest of the world. Indeed, this circumstance would tend to generate something of a downside spiral in the broad value of the U.S. dollar in the global currency markets.

At the same time (discussed briefly in *Commentary No. 817* and as will be expanded upon shortly in a major *Special Commentary*), Brexit likely already has set into motion a chain of events that will lead to a reorganization of the European Union and some form of a restructured euro. Wherever Germany settles in the new structure will become the strong currency. The Swiss franc also would tend to strengthen, against a reorganized euro circumstance. Despite continuing hits to the British pound, and some minimal resulting flight to safety in the U.S. dollar from most other currencies, the more-significant flights to safety have been seen into gold and silver, and the Japanese yen (non-euro, non-dollar). As we go to press the afternoon of July 6th, since just before the Brexit vote, the U.S. dollar has gained 14.7% against the British pound. Over that same timeframe, however, the price of gold has gained 12.2% on top of the U.S. dollar, the price of silver has gained 20.1% and the Japanese yen has gained 4.8%.

Where some recent relative dollar strength has helped to suppress current oil prices, that will change. As dollar selling becomes broader and more massive, oil prices will spike, too. The flight to gold and silver is basic. Irrespective of intervening market manipulations, holding physical gold and silver will preserve the purchasing power of today's U.S. dollar through the extraordinary financial and currency turmoil ahead. See *No. 777 Year-End Special Commentary* for general background to the unfolding financial and systemic circumstances; again, a new *Special Report* is pending.

Second-Quarter 2016 Real Trade Deficit Begins to Look Like Bad News for the GDP. In the context of annual benchmark revisions to the trade data, as covered in the June 5th *Commentary No. 810*), and the gimmicked, sharp narrowing of the headline trade deficit in March and April, today's headline deficit for May 2016 widened sharply. Such pulled the implied second-quarter 2016 real merchandise trade deficit much deeper, closer to par with the first-quarter detail and setting a likely net quarterly deterioration and negative contribution to second-quarter 2016 GDP growth, when the headline June trade detail is in place (see *Graph 1*).

Graph 1: Inflation-Adjusted, Quarterly U.S. Merchandise Trade Deficit to 2q2016 (May 2016)



While the Construction Spending Benchmark Revisions Broadly Were Positive, Quarterly Real Growth Patterns Deteriorated in Revision. On top of the unusual upside adjustments for "processing errors" to private residential construction spending, as discussed in *Commentary No. 778* of January 8th, the July 1st benchmark revisions (January 2014 to date) to the construction spending series also generally were to the upside, most consistently dominated again by upped estimates to private-residential construction spending (see *Graphs 2* to *7*). The revisions, detailed in these opening paragraphs, were released in conjunction with the regular headline reporting for May 2016. The regular monthly detail for May is graphed and covered as usual later in the *Opening Comments* and in the *Reporting Detail* section.

Revisions to private nonresidential construction were mixed (*Graphs 8* and *9*), while revisions to public construction largely were negative (*Graphs 10* and *11*).

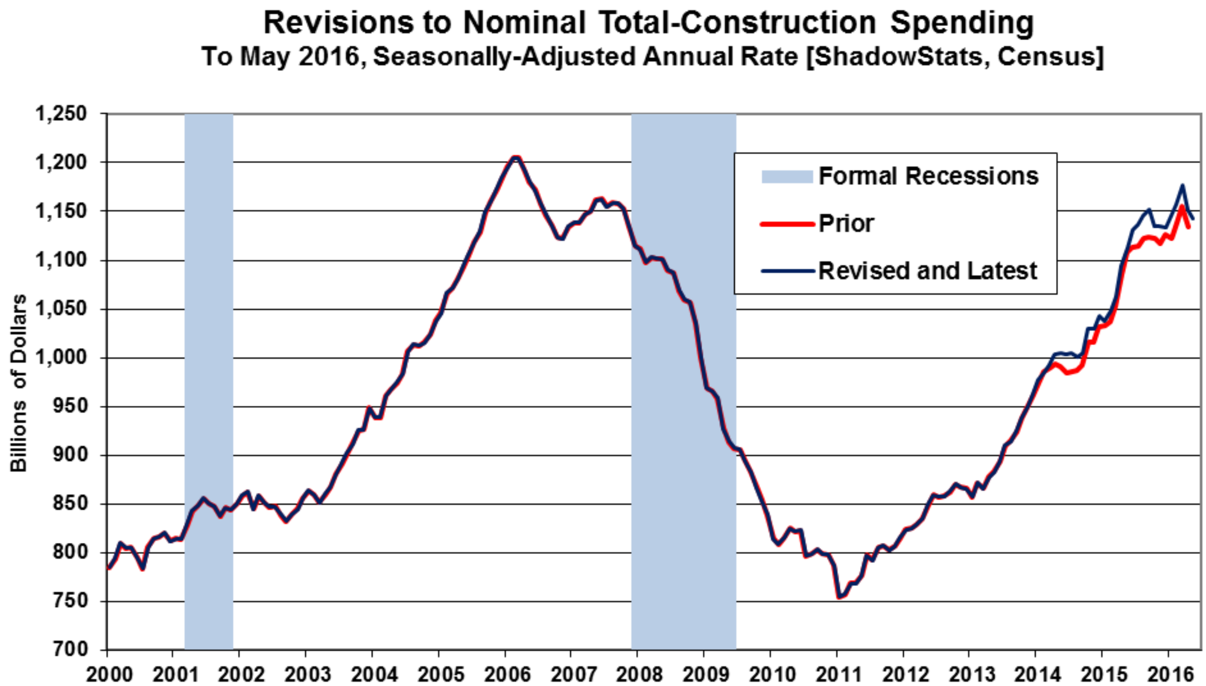
Implications for the pending July 29th GDP benchmark revisions to historical quarterly GDP growth rates, and the initial estimate of second-quarter 2016 GDP, generally were negative for first- and fourth-quarter 2015 and for second-quarter 2016, but positive for first-quarter 2016. Nonetheless those, four quarters likely will end up showing quarterly GDP contractions in what soon should gain recognition as a "new" recession, timed from December 2014.

Despite the generally positive construction-spending benchmarking, inflation-adjusted real activity patterns in the headline May 2016 detail turned sharply negative, on a monthly, quarterly and annual basis. While this series remains highly volatile and subject to large monthly revisions, the headline year-to-year growth in real inflation-adjusted terms was tumbling sharply, both before and after the benchmarking, with real year-to-year growth slowing in May 2016 to its lowest level since December 2011. The pattern here is consistent with movement into a recessionary contraction (see *Graph 4*). The last time real annual growth plunged like this for the aggregate series, outside of recession, was shortly after setting its pre-recession high in 2006.

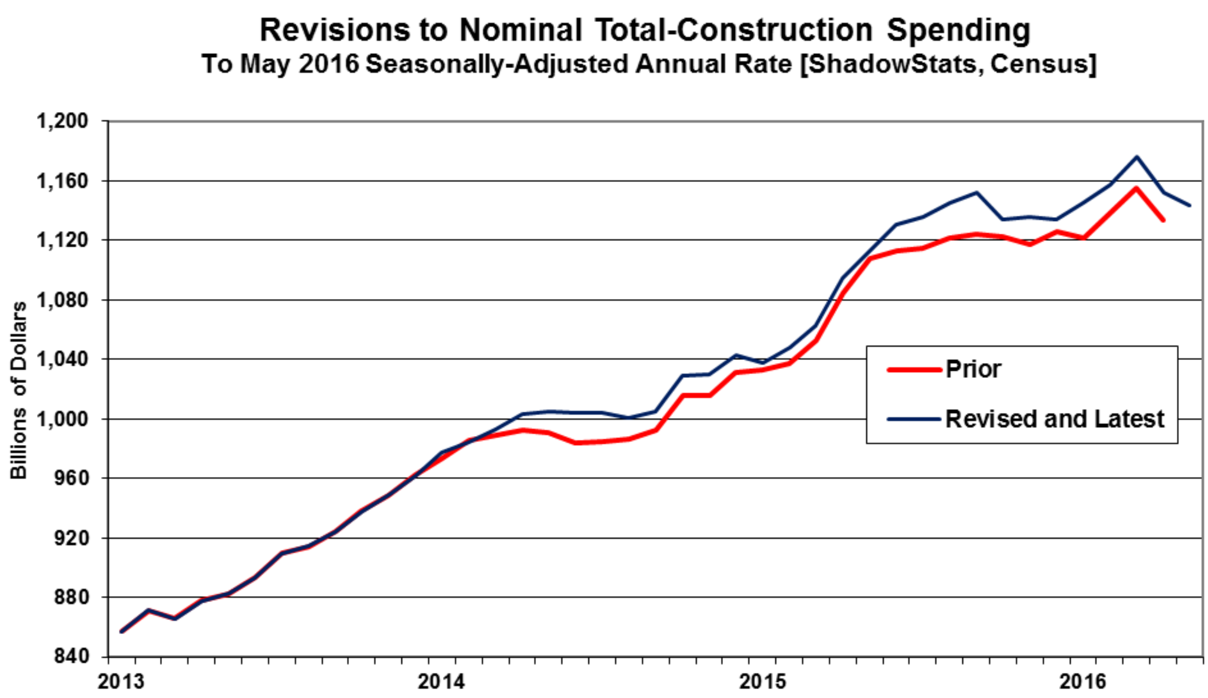
The historical data generally were revised upwardly since January 2014, yet real construction spending continued in deteriorating, low-level, stagnating non-recovery, still of its February 2006 pre-recession peak by 25.3% (-25.3%) in May 2016. That was changed little from the pre-benchmark level for April 2016, which had been down 25.9% (-25.9%) from the pre-recession high.

[Graphs 2 to 11 begin on the next page]

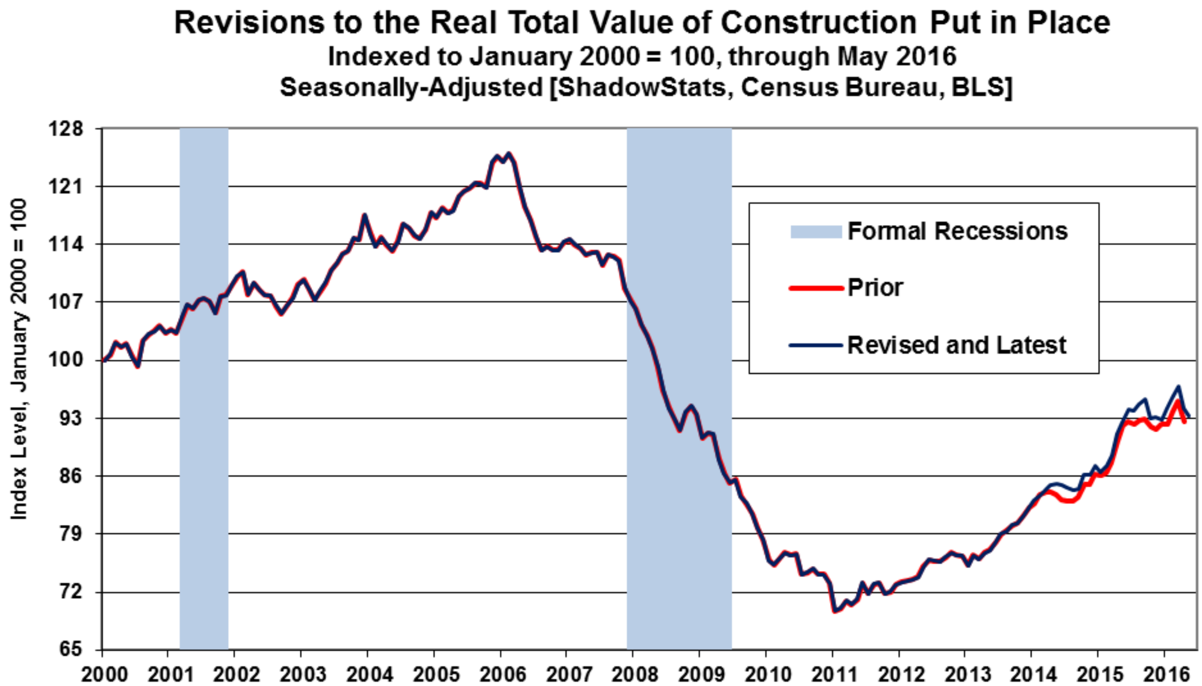
Graph 2: Revisions to Total Nominal Construction Spending



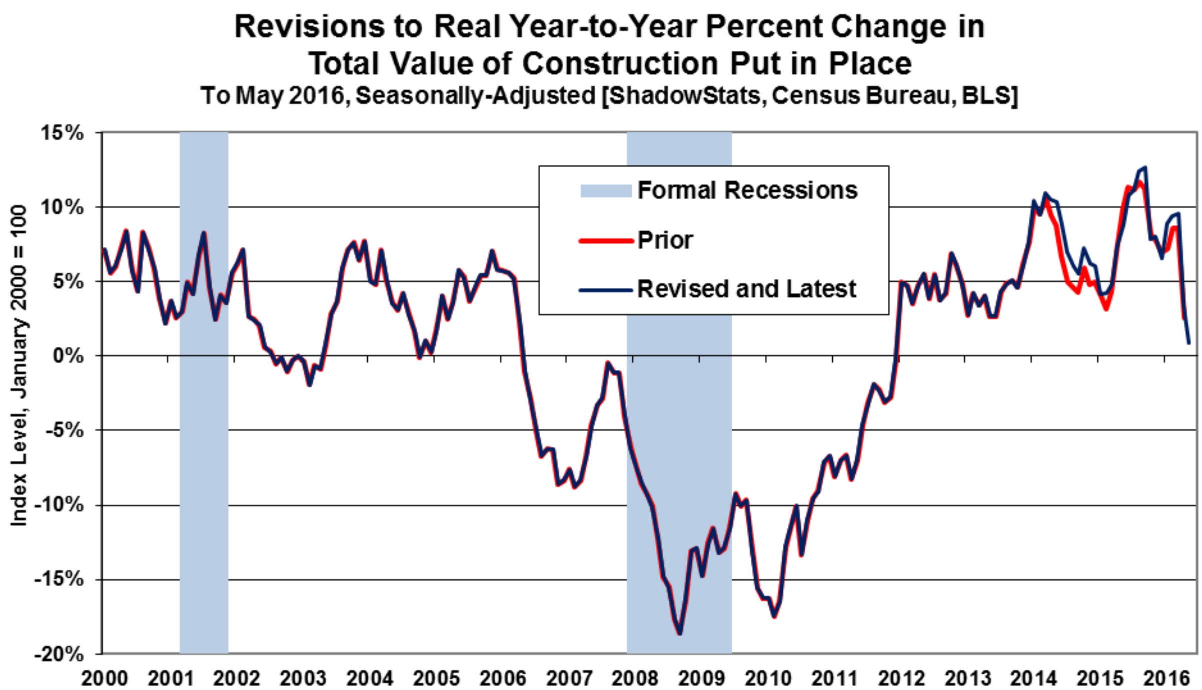
Graph 3: Revisions to Total Nominal Construction Spending



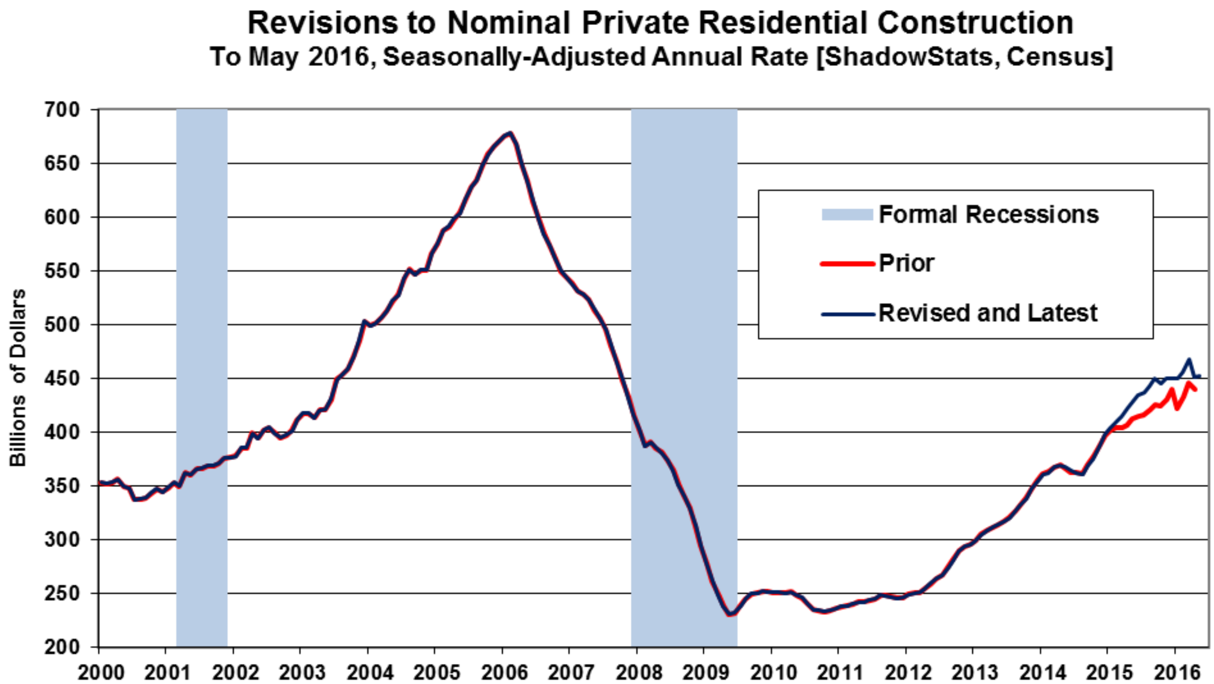
Graph 4: Revisions to the Index of Total Real Construction Spending



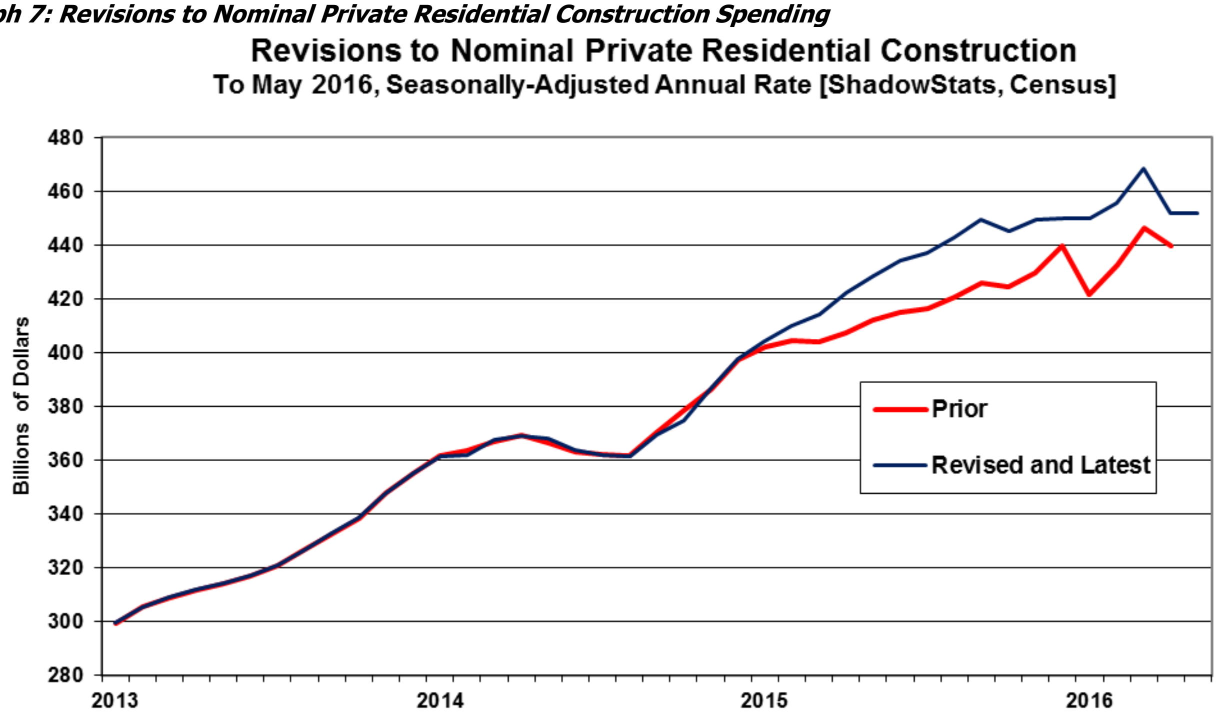
Graph 5: Revisions in Year-to-Year Real Growth in Total Construction Spending



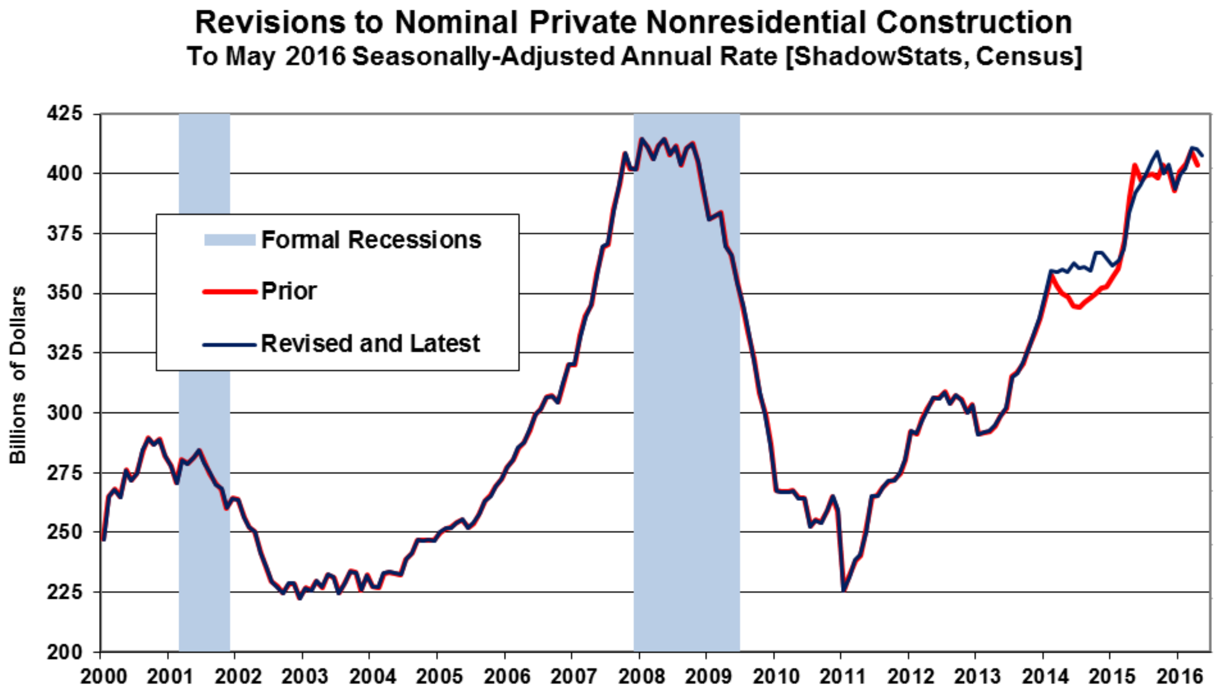
Graph 6: Revisions to Nominal Private Residential Construction Spending



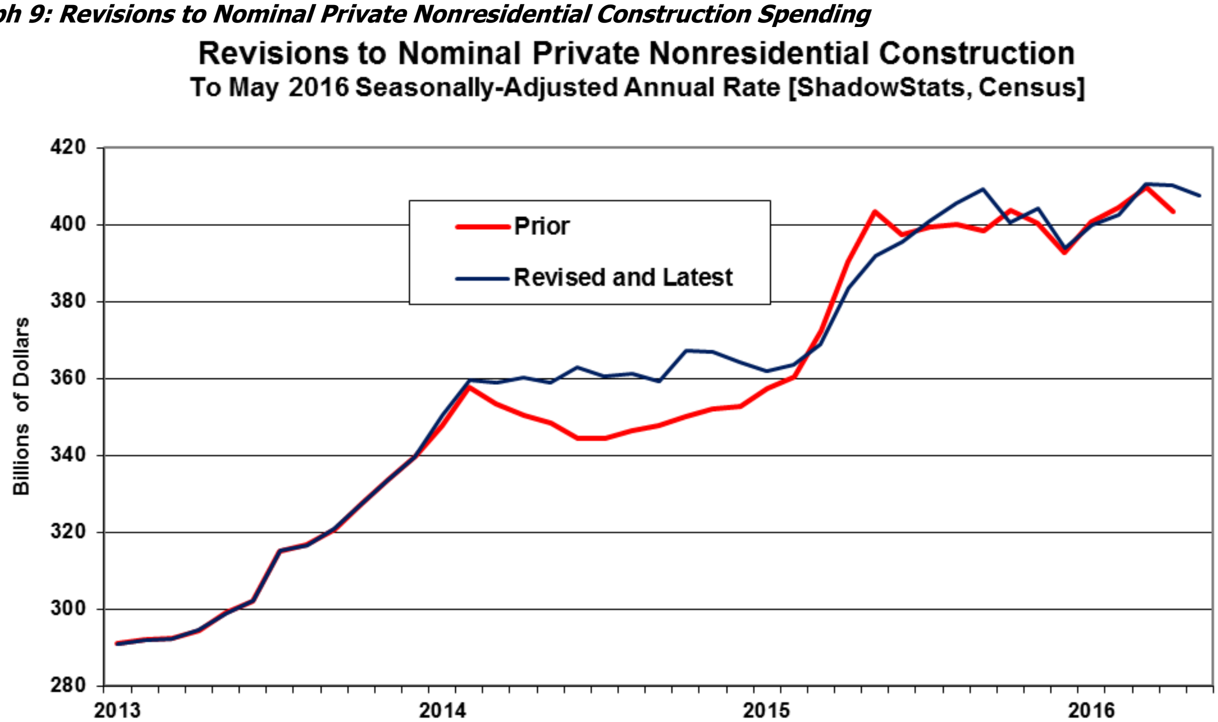
Graph 7: Revisions to Nominal Private Residential Construction Spending



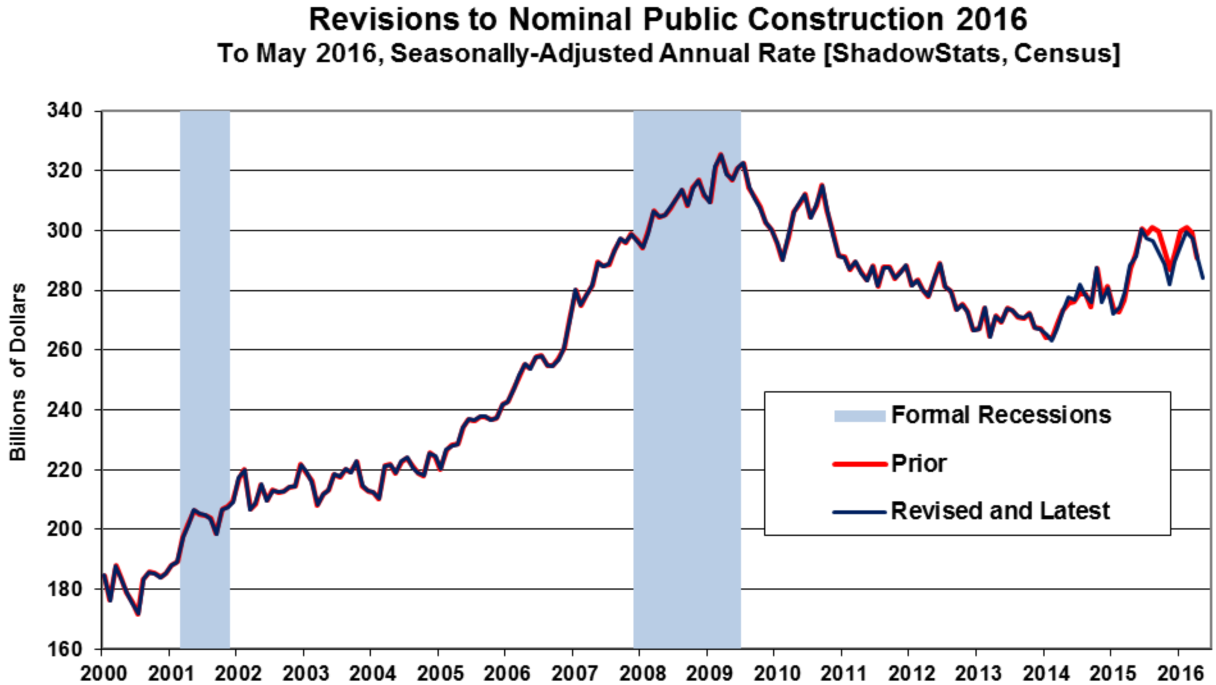
Graph 8: Revisions to Nominal Private Nonresidential Construction Spending



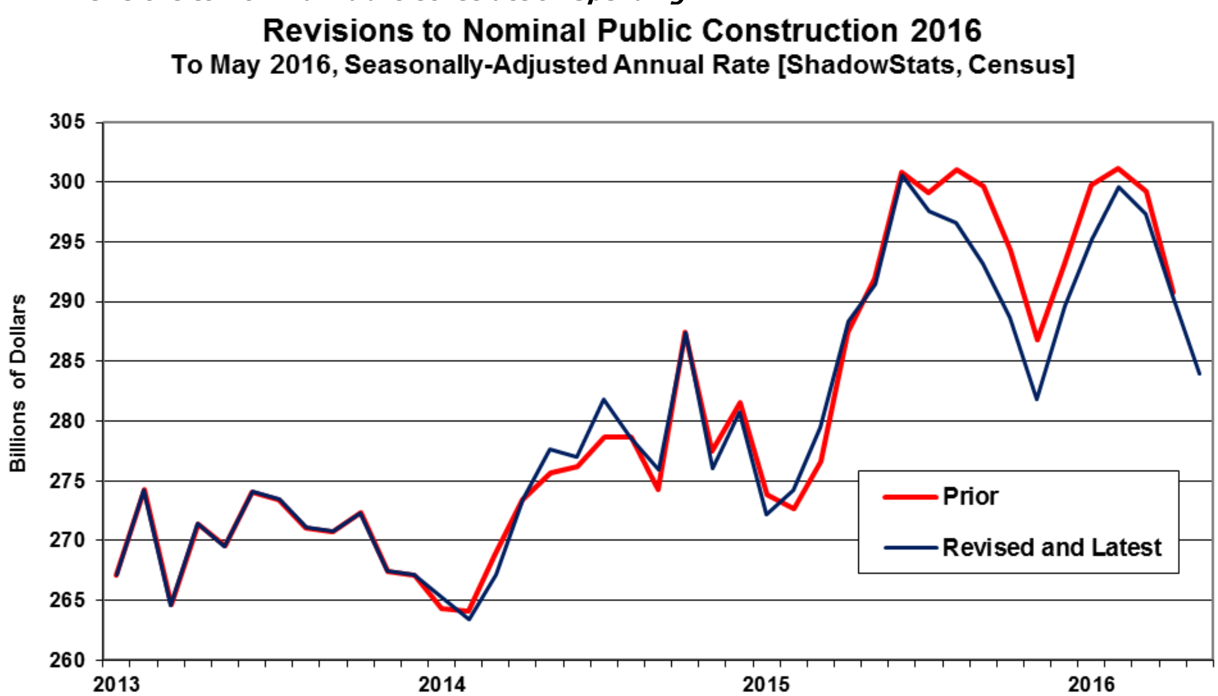
Graph 9: Revisions to Nominal Private Nonresidential Construction Spending



Graph 10: Revisions to Nominal Public Construction Spending



Graph 11: Revisions to Nominal Public Construction Spending



Today's *Commentary* (July 6th). The balance of these *Opening Comments* provides summary detail of the May Trade Deficit and revised May Construction Spending.

The most-recent *Hyperinflation Outlook Summary* is found in *Commentary No. 783*, with the *Opening Comments*, *Commentary No. 817*, *Commentary No. 814*, *General Commentary No. 811*, *Commentary No. 799* and *No. 777 Year-End Special Commentary* as background to the unfolding financial and systemic circumstances. These *Commentaries* will be updated and consolidated shortly in a new *Special Report*, when first half-2016 economic detail is in place.

The text in the *Week and Month Ahead* section has been revised. It also includes an expanded preview of the July 8th *Pending Release* of June 2016 labor-market conditions.

U.S. Trade Balance—May 2016—Nominal- and Real-Monthly and Prospective Quarterly Trade Deficits Deteriorated Sharply. In the context of last month's annual trade-deficit benchmark revision and the gussied-up redefinitions of the services sector discussed in *Commentary No. 808*, and of a slight narrowing of the revised April 2016 deficit, the May 2016 deficit widened sharply, the worst nominal monthly deterioration seen in ten months, the worst inflation-adjusted real deterioration in fifteen months.

Reflected in *Graph 1* of these *Opening Comments*, the prospective, second-quarter 2016 real quarterly trade shortfall pulled back from sharp-improvement to close-to-even, versus first-quarter 2016 activity. That should revise to net-deterioration with next month's June estimate.

Nominal May 2016 Trade Deficit. The nominal, seasonally-adjusted monthly trade deficit in goods and services for May 2016, on a balance-of-payments basis, deteriorated by $3.761 billion to $41.144 billion, versus a minimally-revised $37.383 billion in April 2016. The May 2016 deficit also widened from the May 2015 trade shortfall of $40.170 billion.

The $3.761 billion deterioration in the headline monthly deficit reflected a decline of $0.314 billion in monthly exports, exacerbated by an increase of $3.447 billion in imports. The minimal decrease in exports was broadly based, while the surge in imports reflected sharp increases in non-monetary gold and oil, and in consumer goods.

Declining oil prices bottomed out in February 2016, inching higher by 0.7% in March, gaining 6.5% in April and 16.0% in May, with a resulting upside impact on nominal oil-related activity.

<u>Energy-Related Petroleum Products.</u> The not-seasonally-adjusted average price of imported oil increased month-to-month. The average per-barrel price rose to $34.19 in May 2016, from $29.48 in April 2016. That was down from $50.76 per barrel in May 2015. Separately, not-seasonally-adjusted physical oil-import volume in May 2016 averaged 7.208 million barrels per day, down from 7.691 million in April 2016, but up from 6.152 million in May 2015.

Real May 2016 Trade Deficit. Seasonally-adjusted, and net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), the May 2016 merchandise trade deficit (no services) widened to $61.104 billion, from a minimally-revised $57.479 billion in April 2016, versus a benchmark-revised $56.109 billion in March 2016, $63.601 billion in February 2016 and $62.663 billion in January 2016. The May 2016 real shortfall also widened versus a revised $58.396 billion deficit in May 2015.

The annualized quarterly real merchandise trade deficit was $623.1 billion for fourth-quarter 2014, $700.0 billion for first-quarter 2015, $709.1 billion for second-quarter 2015, $708.4 billion for third-quarter 2015, $728.6 billion for fourth-quarter 2015 and $725.5 billion for first-quarter 2016.

Based on reporting for just April and May 2016, the second-quarter 2016 real trade shortfall was on a track for an annualized quarterly pace of $711.5 billion. Such deepened sharply from the initial estimate of $691.4 billion, based solely on April reporting (again, see *Graph 1*). Net quarter-to-quarter deterioration in the real deficit is likely, once the headline June detail is in place, with negative implications for second-quarter GDP. Headline deficits likely will get even deeper in the months and quarters ahead, intensifying the ongoing negative impact on headline GDP growth.

Construction Spending—May 2016—Despite the Upside Benchmarking, Annual Growth Hit a 53-Month Low. In the context of generally upside annual benchmark revisions to Construction Spending, as detailed in the opening paragraphs of these *Opening Comments*, inflation-adjusted real activity in the spending series turned sharply negative, on a monthly, quarterly and annual basis. Real monthly spending fell by 0.8% (-0.8%) in May 2016, second quarter 2016 real spending was on track for an annualized quarter-to-quarter contraction of 7.2% (-7.2%) and real year-to-year growth slowed to 0.9%, the lowest level seen since December 2011. Real construction spending generally continued in low-level, stagnating non-recovery, shy by 25.3% (-25.3%) of its February 2006 pre-recession peak.

Quarterly Trends. As revised in the benchmarking, fourth-quarter 2015 real construction spending contracted at a deeper annualized quarterly pace of 6.8% (-6.8%), following annualized quarterly real gains of 9.5% in third-quarter 2015, 25.8% in second-quarter 2015 and 4.2% in first-quarter 2015.

Post-benchmarking, first-quarter 2016 real construction spending rose at a revised annualized pace of 11.4%. Based just on the latest reporting for April 2016 and May 2016, the trend for second-quarter 2016 activity was for an annualized quarterly contraction of 7.2% (-7.2%). The earlier trend had been for a contraction of 4.7% (-4.7%), based solely on initial April reporting.

PPI Final Demand Construction Index (FDCI). ShadowStats uses the Final Demand Construction Index (FDCI) component of the Producer Price Index (PPI) for deflating the current aggregate activity in the construction-spending series. The subsidiary private- and public-construction PPI series are used in deflating the subsidiary series, again, all as shown in *Graphs 12* to *15*.

Seasonally-adjusted May 2016 FDCI month-to-month inflation rose by 0.09%, following monthly gains of 0.79% and 0.09% in April and March. In terms of year-to-year inflation, the May 2016 FDCI was 1.87%, the same level as in April, having gained 1.07% in March 2016, all on both an adjusted and unadjusted basis. Further deflation details follow in the *Reporting Detail*.

Headline Reporting for May 2016. In the context of annual benchmark revisions (see the opening paragraphs), the headline, total value of construction put in place in the United States for May 2016 was $1,143.3 billion, on a seasonally-adjusted, but not-inflation-adjusted, annual-rate basis. That estimate was down month-to-month by a statistically-insignificant 0.8% (-0.8%), versus the benchmark-revised April 2016 level of $1,152.4 billion. In turn, April was down by 2.0% from the benchmarked March 2016 level of $1,176.4 trillion, which was up by 1.6% from the benchmarked level of $1,157.7 billion in February 2016.

Adjusted for FDCI inflation, total real month-to-month spending in May 2016 fell by a benchmarked 0.9% (-0.9%), following a monthly decline of 2.8% (-2.8%) in April and a monthly gain of 1.5% in March 2016.

On a year-to-year annual-growth basis, May 2016 nominal construction spending rose by a statistically-significant 2.8%, versus annual gains of 5.3% in April 2016 and 10.7% in March 2016. Net of construction costs indicated by the FDCI, the year-to-year gain in total real construction spending dropped to 53-month low of 0.9% in May 2016, from annual gains of 3.8% in April and 9.6% in March 2016.

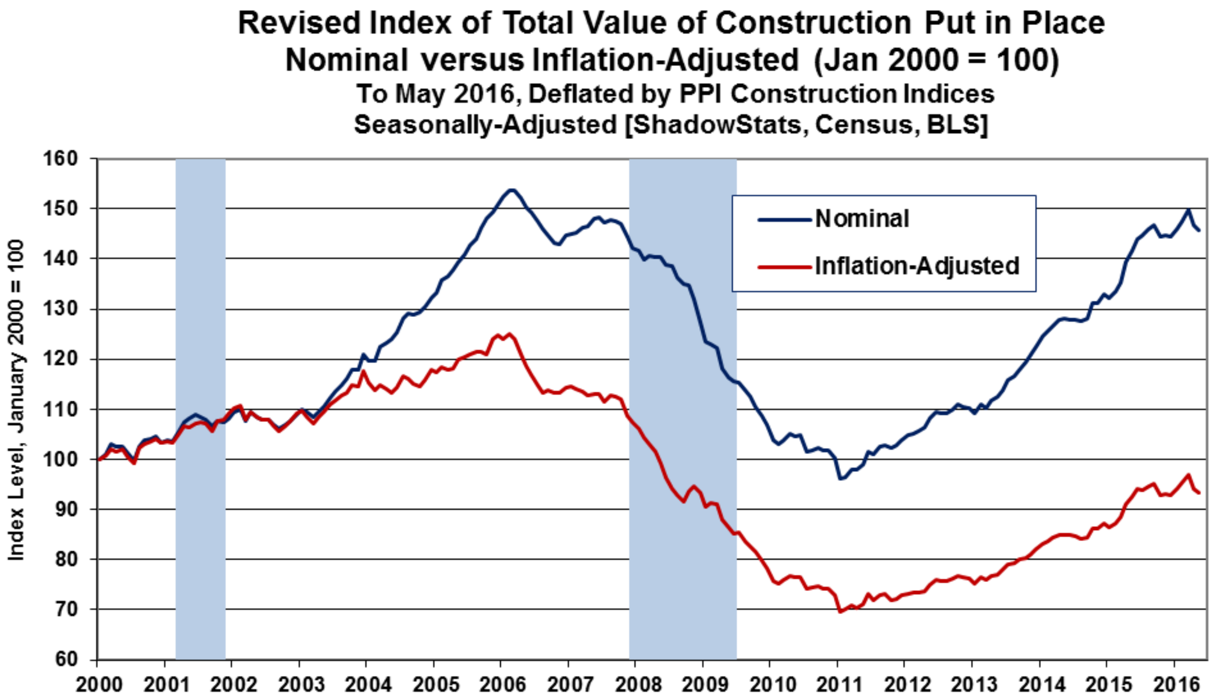
The statistically-insignificant, headline month-to-month nominal decline of 0.8% (-0.8%) in aggregate May 2016 construction spending, versus a decline of 2.0% (-2.0%) in April 2016, included a headline monthly drop of 2.6% (-2.6%) in May public spending, versus a 2.3% (-2.3%) decline in April. Private spending fell by 0.3% (-0.3%) month-to-month in May, following a 1.0% gain in April. Within total private construction spending, residential-sector activity was unchanged at 0.0% in May, having declined by 3.5% (-3.5%) in April, while the nonresidential sector fell by 0.7% (-0.7%) in May, following a decline of 0.1% (-0.1%) in April. All the May measures contracted month-to-month, after inflation adjustment.

Construction Graphs. Despite protracted and variable stagnation in broad activity, the pattern of inflation-adjusted activity here—net of government inflation estimates—does not confirm the economic recovery indicated by the headline GDP series (see *Commentary No. 817* and the unemployment detail in *Commentary No. 810*). To the contrary, the latest broad construction reporting in real terms generally has shown a pattern of low-level, albeit variably up-trending stagnation, where activity never recovered pre-recession highs, and where the pattern of stagnation has begun to flatten out anew.

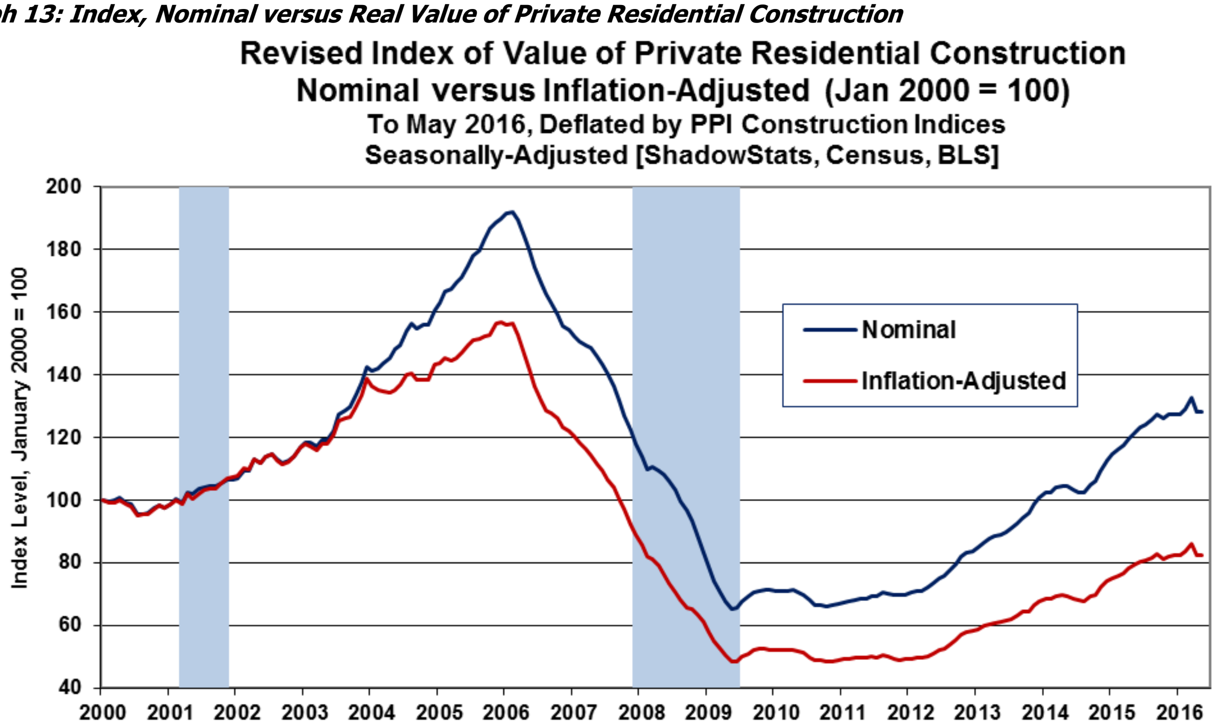
A variety of construction spending and related, comparative graphs (*Graphs 16* to *24*) are found in the *Reporting Detail* section. *Graphs 12* to *15*, which follow here, show plots of the comparative construction series both before and after adjustment for headline inflation.

[Graphs 12 to 15 begin on the next page.]

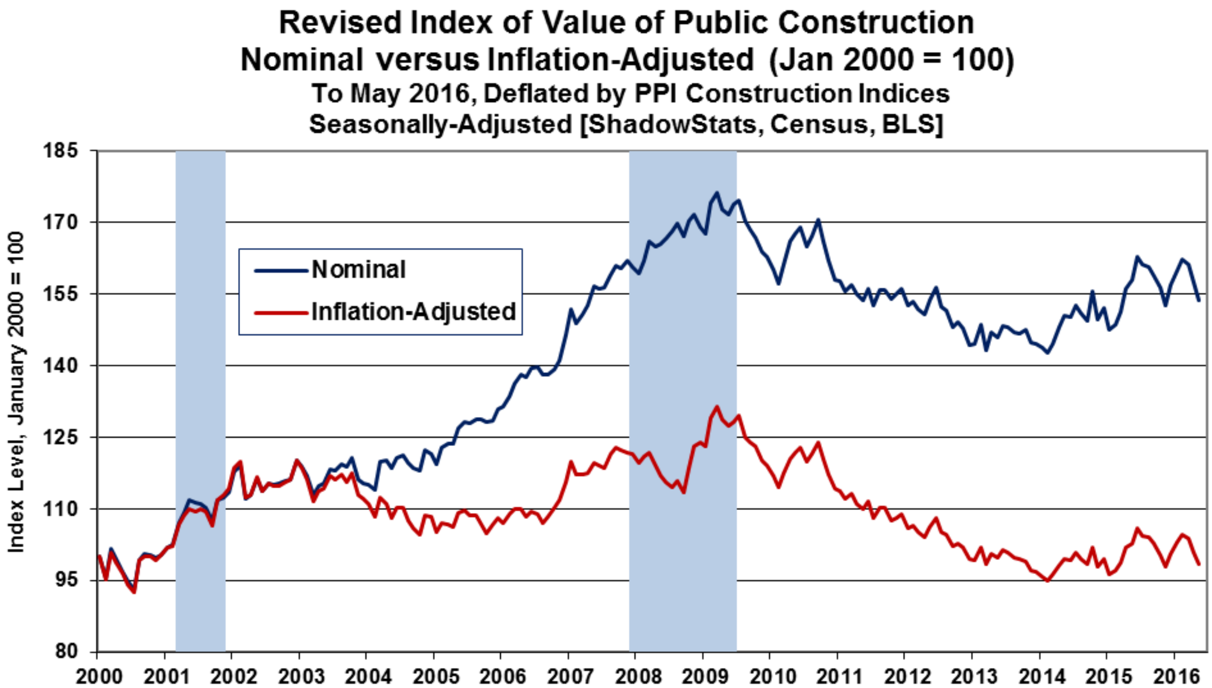
Graph 12: Index, Nominal versus Real Value of Total Construction



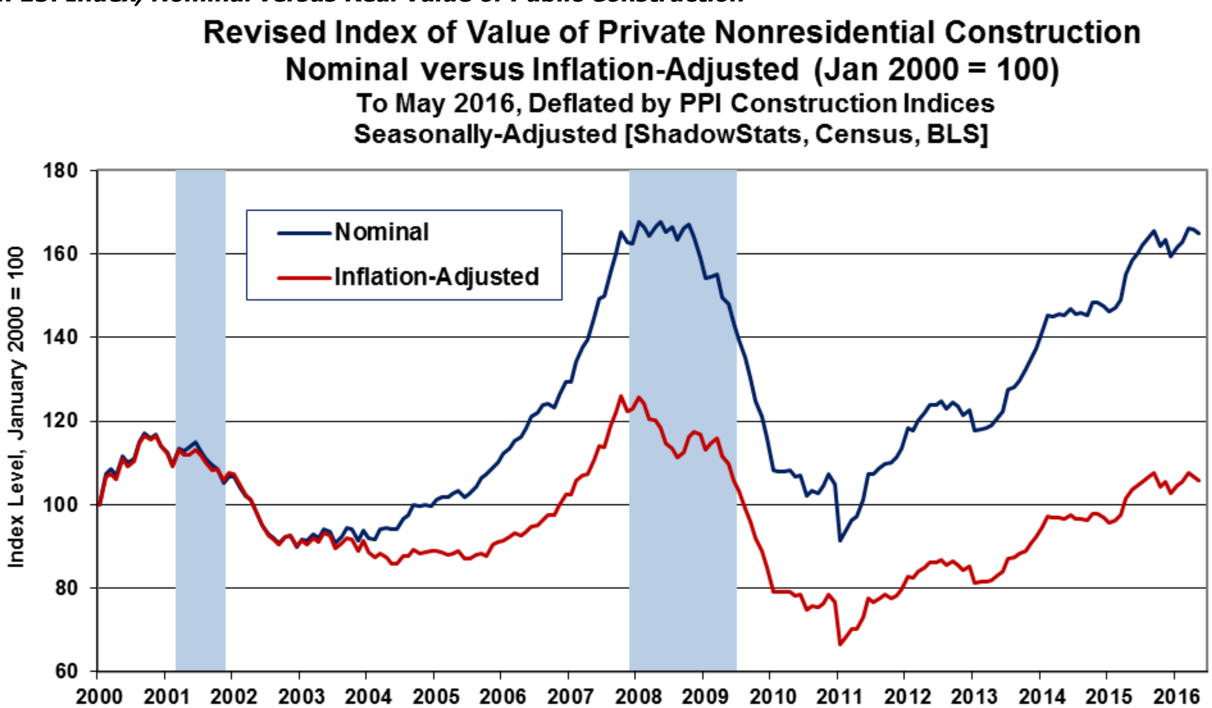
Graph 13: Index, Nominal versus Real Value of Private Residential Construction



Graph 14: Index, Nominal versus Real Value of Private Nonresidential Construction



Graph 15: Index, Nominal versus Real Value of Public Construction



[The* Reporting Detail *section contains additional statistical analysis and graphs.]

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REPORTING DETAIL

U.S. TRADE BALANCE (May 2016)

Nominal- and Real-Monthly and Prospective Quarterly Trade Deficits Deteriorated Sharply with the May Detail. In the context of last month's annual benchmark revisions to the trade deficit, and the gussied-up redefinitions of the services sector discussed in *Commentary No. 808*, and of a slight narrowing of the revised April 2016 deficit, the May 2016 deficit widened sharply, the worst nominal monthly deterioration seen in ten months, the worst inflation-adjusted real deterioration in fifteen months.

Reflected in *Graph 1* of the opening paragraphs in the *Opening Comments*, the prospective, second-quarter 2016 real quarterly trade shortfall pulled back from sharp-improvement to close-to-even versus first-quarter 2016 activity. That should revise to net-deterioration with next month's June estimate.

Nominal (Not-Adjusted-for-Inflation) May 2016 Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported this morning, July 6th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for May 2016, on a balance-of-payments basis, deteriorated by $3.761 billion to $41.144 billion, versus a revised $37.383 [previously $37.436] billion in April 2016. The May 2016 deficit also widened from the May 2015 trade shortfall of $40.170 billion.

The $3.761 billion deterioration in the headline monthly deficit reflected a decline of $0.314 billion in monthly exports, exacerbated by an increase of $3.447 billion in imports. The decrease in exports was distributed broadly, while the surge in imports reflected sharp increases in non-monetary gold and oil, and in consumer goods.

Declining oil prices bottomed out in February 2016, inching higher by 0.7% in March, gaining 6.5% in April and 16.0% in May, with a resulting upside impact on nominal oil-related activity.

Energy-Related Petroleum Products. The not-seasonally-adjusted average price of imported oil increased month-to-month. The average per-barrel price rose to $34.19 in May 2016, from $29.48 in April 2016. That still was down from $50.76 per barrel in May 2015. Separately, not-seasonally-adjusted physical oil-import volume in May 2016 averaged 7.208 million barrels per day, down from 7.691 million in April 2016 but up from 6.152 million in May 2015.

Ongoing Cautions and Alerts on Data Quality. Potentially heavy distortions in headline data continue from seasonal adjustments. Similar issues affect other economic releases, such as labor conditions and retail sales, where the headline number reflects seasonally-adjusted month-to-month change. Discussed frequently (see *2014 Hyperinflation Report—Great Economic Tumble* for example), the extraordinary length and depth of the current business downturn and disruptions have distorted regular seasonality patterns. Accordingly, markets should not rely too heavily on the accuracy of the monthly headline data.

Real (Inflation-Adjusted) May 2016 Trade Deficit. Seasonally-adjusted, and net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), the May 2016 merchandise trade deficit (no services) widened to $61.104 billion, from a revised $57.479 [previously $57,618] billion in April 2016, versus a benchmark-revised $56.109 billion in March 2016, $63.601 billion in February 2016 and $62.663 billion in January 2016. The May 2016 real shortfall also widened versus a revised $58.396 billion deficit in May 2015.

Reflected in *Graph 1* of the *Opening Comments*, the annualized quarterly real merchandise trade deficit was $623.1 billion for fourth-quarter 2014, $700.0 billion for first-quarter 2015, $709.1 billion for second-quarter 2015, $708.4 billion for third-quarter 2015, $728.6 billion for fourth-quarter 2015 and $725.5 billion for first-quarter 2016.

Based on reporting for just April and May 2016, the second-quarter 2016 real trade shortfall is on a track for an annualized quarterly pace of $711.5 billion. Such deepened sharply from the initial estimate of $691.4 billion, which was based solely on April reporting (again, see *Graph 1*). Net quarter-to-quarter, real-deficit deterioration is likely, once the headline June detail is in place, with negative implications for second-quarter GDP. Headline deficits likely will get even deeper in the months and quarters ahead, intensifying the ongoing negative impact on headline GDP growth.

CONSTRUCTION SPENDING (May 2016)

Despite the Upside Benchmark Revisions, Annual Growth Hit a 53-Month Low. In the context of generally upside annual benchmark revisions to Construction Spending, as discussed and graphed in the opening paragraphs of the *Opening Comments* section, inflation-adjusted real activity in the spending series turned sharply negative, on a monthly, quarterly and annual basis. Real monthly spending fell by 0.8% (-0.8%) in May 2016, second quarter 2016 real spending was on track for an annualized quarter-to-quarter contraction of 7.2% (-7.2%) and real year-to-year growth slowed to 0.9%, the lowest level seen since December 2011.

Despite upwardly revised historical data since January 2014, real construction spending generally continued in low-level, stagnating non-recovery. Still shy of its pre-recession peak in February 2006 by 25.3% (-25.3%) in the benchmarked reporting for May 2016, that was little changed from the pre-benchmarked level of April 2016, which had been 25.9% (-25.9%) shy of the pre-recession high.

While this series remains highly volatile and subject to large monthly revisions, the headline year-to-year growth in real inflation-adjusted terms was tumbling sharply, both before and after the benchmarking, as though the series were falling rapidly into a recessionary contraction (see *Graph 4*) in the opening paragraphs of the *Opening Comments*.

The Data and Graphics Here Reflect Monthly Levels, Not Smoothed, Moving Averages. Unlike the housing-starts and home-sales series—where ShadowStats smooths the irregular and continually-revised monthly data with accompanying plots of smoothed, six-month moving averages—the construction spending series is shown here only on a monthly basis, as published. While the spending series is extremely volatile in its monthly revisions, it tends to be reasonably smooth in month-to-month movement. Note the comparative monthly *Graphs 17* and *19.* Unusual in the current headline construction-spending detail is the sharp upside spike to March 2016 activity and the ensuing-more-thanoffsetting plunge in the headline April 2016 detail, a pattern that appears as a near-term spike in at least the aggregate headline graphs.

Quarterly Trends. As revised in the benchmarking, fourth-quarter 2015 real construction spending contracted at a deeper annualized quarterly pace of 6.8% (-6.8%) [previously down by 2.7% (-2.7%)], following annualized quarterly real gains of 9.5% [previously 4.1%] in third-quarter 2015, 25.8% [previously 25.0%] in second-quarter 2015 and 4.2% [previously 6.0%] in first-quarter 2015.

Post-benchmarking, first-quarter 2016 real construction spending rose at a revised annualized pace of 11.4% [previously 8.3%]. Based just on the latest reporting for April 2016 and May 2016, the trend for second-quarter 2016 activity was for an annualized quarterly contraction of 7.2% (-7.2%). The early trend had been for a contraction of 4.7% (-4.7%), based solely on initial April reporting.

Graphs 12 to *15* in the *Opening Comments* show comparative nominal and real construction activity for the aggregate series as well as for private residential- and nonresidential-construction and public-construction. Again, seen after adjustment for inflation, the real aggregate series generally has remained in low-level stagnation, now down-trending into second-quarter 2016. Areas of recent relative real strength in all of the major subcomponents have flattened out, or turned down, after inflation adjustment.

The general pattern of real activity had been one of low-level, but up-trending stagnation. Again, that uptrend, however, largely had flattened out, allowing for some short-term fluttering, which again is headed lower. The aggregate nominal detail, before inflation adjustment, is shown in *Graph 16* of this *Reporting Detail*, with the real, inflation-adjusted activity plotted in *Graph 17*. *Graphs 19* and *20* show the relative patterns of nominal and real activity aggregated by sector.

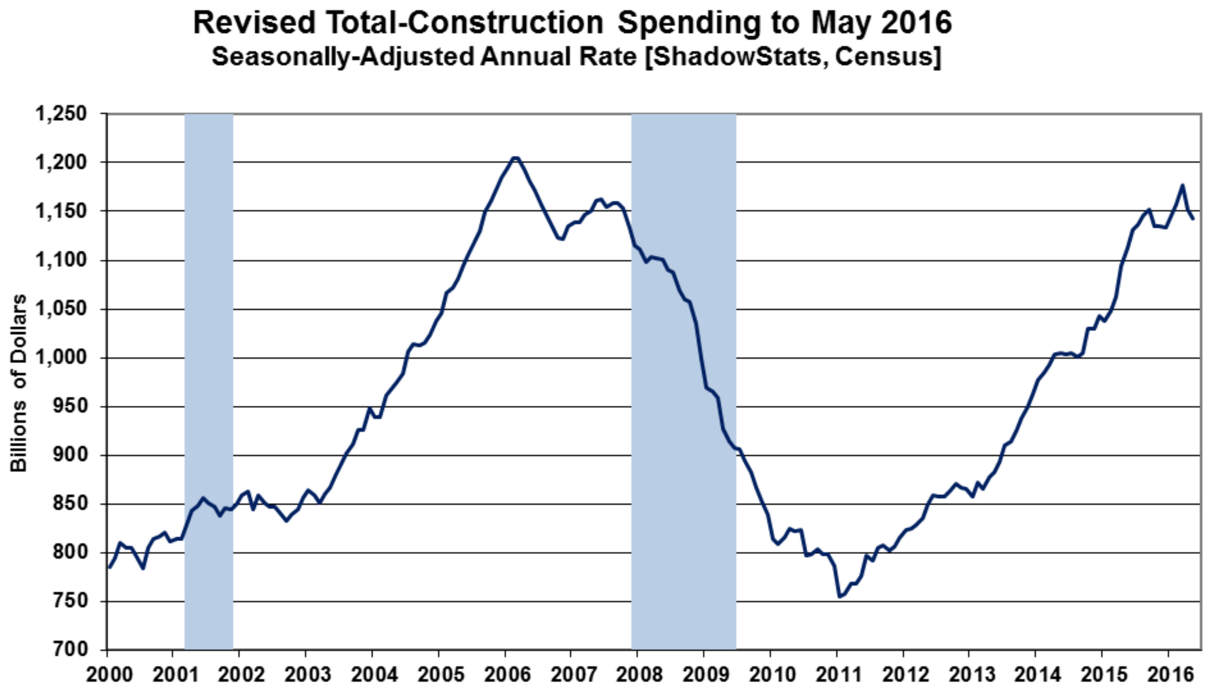
PPI Final Demand Construction Index (FDCI). ShadowStats uses the Final Demand Construction Index (FDCI) component of the Producer Price Index (PPI) for deflating the current aggregate activity in the construction-spending series. The subsidiary private- and public-construction PPI series are used in deflating the subsidiary series, again, all as shown in *Graphs 12* to *15* in the *Opening Comments*, accompanying *Graph 20*, and in the inflation-adjusted real *Graphs 4* and *5* in the opening discussion on the annual benchmarking.

The previously-used New Construction Index (NCI) in the PPI was so far shy of reflecting construction costs as to be virtually useless. Although closely designed to match this construction-spending series, the FDCI and subsidiary numbers have two problems. First, the historical data only go back to November 2009. Second, they generally still understate actual construction inflation. Private surveys tend to show higher construction-related inflation than is reported by the government. For example, year-to-year inflation reflected in the privately-published Building Cost Index and Construction Cost Index [Dodge Data and Analytics (McGraw Hill) *Engineering News-Record*] usually runs well above the headline pace of annual inflation in the PPI's Final Demand Construction Index.

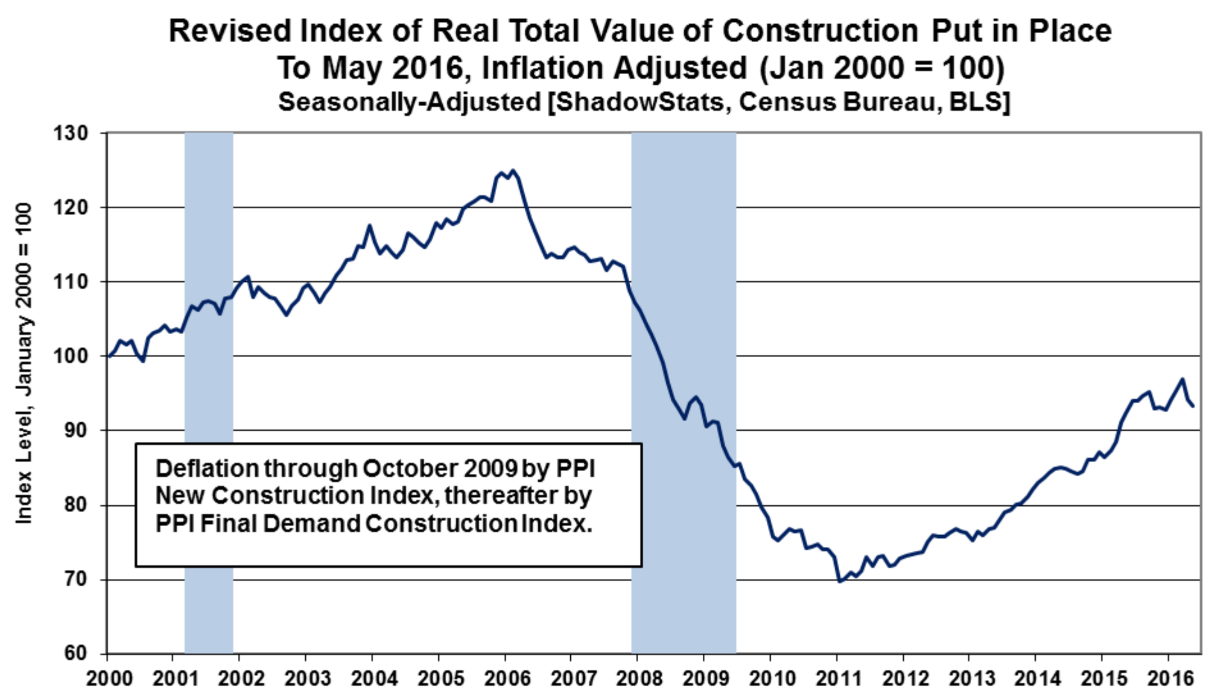
Where the current annual PPI construction-inflation measure briefly and recently had moved to about even with, if not somewhat higher than the private-sector measures, once again, it has fallen significantly below them in the most-recent detail, by a couple of hundred basis points.

There is no perfect, publicly-available inflation measure for deflating construction. For the historical series in the accompanying graphs, the numbers are deflated by the NCI through November 2009, and by the FDCI and subsidiary series thereafter.

Graph 16: Total Nominal Construction Spending



Graph 17: Index of Total Real Construction Spending



Seasonally-adjusted May 2016 FDCI month-to-month inflation rose by 0.09%. That followed headline monthly gains of 0.79% in April 2016 and 0.09% in March 2016. In terms of year-to-year inflation, the

May 2016 FDCI was up by 1.87%, the same level as in April 2016, and up from 1.07% annual inflation in March 2016, on both a seasonally-adjusted and unadjusted basis.

May 2016 headline inflation for government-funded construction rose by 0.17% month-to-month, having gained 0.62% in April and 0.09% in March, while it rose by 1.78% (both adjusted and unadjusted) year-to-year in May 2016, versus annual gains of 1.87% in April 2016 and 1.34% in March 2016, seasonally adjusted. Unadjusted, April and March 2016 annual gains respectively were 1.78% and 1.43%.

Separately, inflation for privately-funded construction rose month-to-month by 0.09% in May 2016, versus a monthly gain of 0.88% in April 2016 and an "unchanged" reading at 0.00% in March 2016, with year-to-year inflation at a positive 1.88% in May 2016, the same level as in April 2016, versus 0.89% in March 2016, on both an adjusted and unadjusted basis.

Headline Reporting for May 2016. In the context of the annual benchmark revisions (see the opening paragraphs of the *Opening Comments*), the Census Bureau reported July 1st that the headline, total value of construction put in place in the United States for May 2016 was $1,143.3 billion, on a seasonally-adjusted, but not-inflation-adjusted, annual-rate basis. That estimate was down month-to-month by a statistically-insignificant 0.8% (-0.8%) +/- 1.5% (all confidence intervals are at the 95% level), versus the benchmark-revised April 2016 level of $1,152.4 billion [April initially had been reported at $1,133.9 billion]. In turn, April was down by 2.0% from the benchmarked March 2016 level of $1,176.4 trillion [previously $1,155.1 billion], which was up by 1.6% from the benchmarked level of $1,157.7 billion [previously 1,137.9 billion] in February 2016.

Adjusted for FDCI inflation, total real month-to-month spending in May 2016 fell by a benchmarked 0.9% (-0.9%), following a monthly decline of 2.8% (-2.8%) in April and a monthly gain of 1.5% in March 2016.

On a year-to-year annual-growth basis, May 2016 nominal construction spending rose by a statistically-significant 2.8% +/- 1.9%, versus annual gains of 5.3% in April 2016 and 10.7% in March 2016. Net of construction costs indicated by the FDCI, the year-to-year gain in total real construction spending dropped to 53-month low of 0.9% in May 2016, from annual gains of 3.8% in April and 9.6% in March 2016.

The statistically-insignificant, headline month-to-month nominal decline of 0.8% (-0.8%) in aggregate May 2016 construction spending, versus a decline of 2.0% (-2.0%) in April 2016, included a headline monthly drop of 2.6% (-2.6%) in May public spending, versus a 2.3% (-2.3%) decline in April. Private spending fell by 0.3% (-0.3%) month-to-month in May, following a 1.0% gain in April. Within total private construction spending, residential-sector activity was unchanged at 0.0% in May, having declined by 3.5% (-3.5%) in April, while the nonresidential sector fell by 0.7% (-0.7%) in May, following a decline of 0.1% (-0.1%) in April. All the May measures contracted month-to-month, after inflation adjustment.

Construction and Related Graphs. Earlier *Graphs 16* and *17*, and later *Graphs 19* and *20* reflect total construction spending through May 2016, both in the headline nominal dollar terms, and in real terms, after inflation adjustment. *Graph 15* is on an index basis, with January 2000 = 100.0. Adjusted for the PPI's NCI measure through October 2009 and the PPI's Final Demand Construction Index (FDCI) thereafter, real aggregate construction spending showed the economy slowing in 2006, plunging into 2011, then turning minimally higher in an environment of low-level stagnation, trending lower from late-

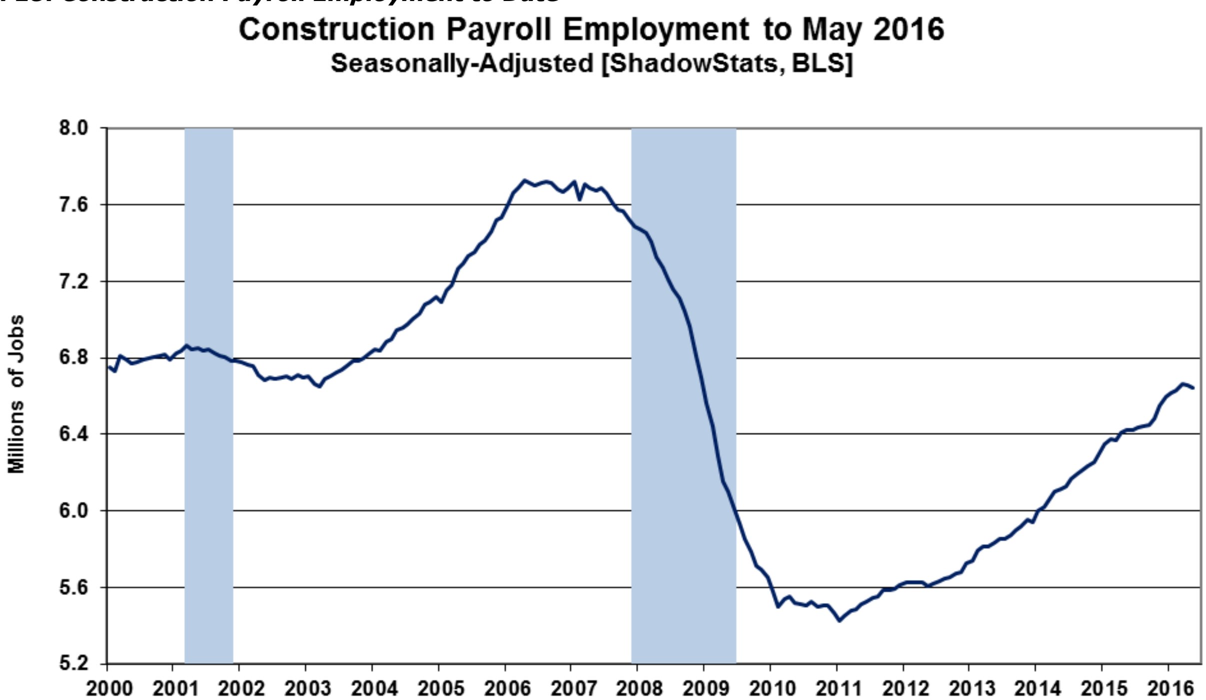
2013 into mid-2014 and then some boost into early-2015. Activity declined in fourth-quarter 2015, with an early-2016 fluttering trend that is headed lower, once again, in second-quarter 2016.

The pattern of non-recovered, inflation-adjusted activity here—net of government inflation estimates—does not confirm the economic recovery indicated by the headline GDP series (see *Commentary No. 817*, the unemployment detail in *Commentary No. 810* and *No. 777 Year-End Special Commentary*). To the contrary, the benchmark-revised broad construction reporting, both before (nominal) and after (real) inflation adjustment, generally still shows a pattern of low-level activity, where aggregate activity never recovered pre-recession highs and has flattened-out anew, turning lower in fourth-quarter 2015, higher in first-quarter 2016, but lower in second-quarter 2016.

Liquidity Conditions Continue Constraining the Consumer and Related Construction Activity. Briefly updated in prior *Commentary No. 817* and *Commentary No. 816* for the June 2016 Consumer Confidence and Sentiment measures and the May 2016 Median Real Monthly Household Income measure, consumer liquidity conditions last were reviewed fully in *General Commentary No. 811* of June 10th. More extensive background detail is available in *No. 777 Year-End Special Commentary*.

Underlying fundamental drivers of consumer economic activity, such as liquidity, have not supported, and do not support a turnaround in broad economic activity. Never truly recovering in the post-Panic era, limited growth in household income and credit, and a still broadly faltering consumer outlook, have eviscerated and continue to impair the personal consumption and residential real estate sectors, which feed off the financial health and liquidity of consumers and account for more than 70% of total GDP activity in the United States.

Graph 18: Construction Payroll Employment to Date



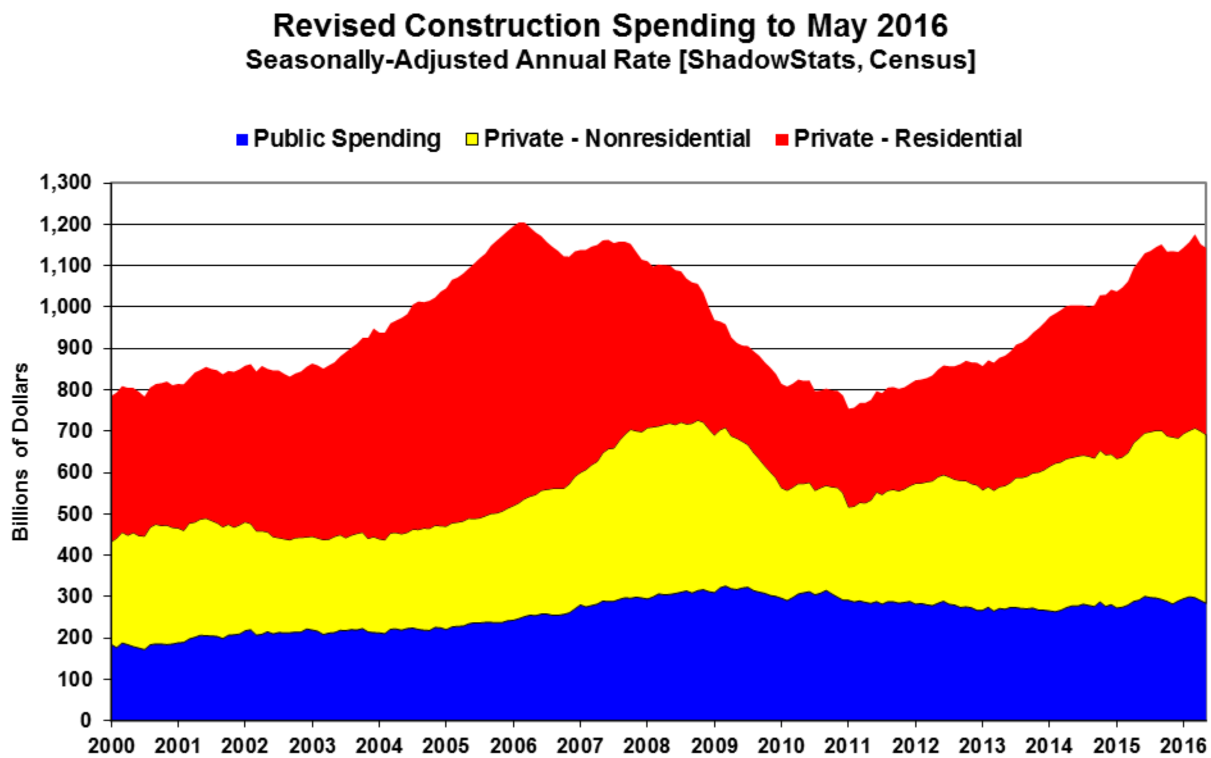
With the economy never having recovered fully from the collapse into 2009, consumers again are pulling back on consumption, as evidenced by a renewed slowdown in broad economic activity. There has been no economic recovery, and there remains no chance of meaningful, broad economic growth, without a meaningful, fundamental upturn in consumer- and banking-liquidity conditions.

Faltering Construction Employment. *Graph 18* shows May 2016 construction employment, as discussed and detailed in the *Payroll Employment* section of *Commentary No. 810*. In theory, payroll levels should move more closely with the inflation-adjusted aggregate series, where the nominal series reflects the impact of costs and pricing, as well as a measure of the level of physical activity. Where construction payrolls had shown increasing strength at the same time that broad construction activity—measured in terms of units or in real, inflation-adjusted dollars—generally had begun to slow, flatten-out or turn down anew, the various series likely will be moving lower, in tandem together, in the near term. This graph will be updated in Friday's employment coverage in *Commentary No. 818*.

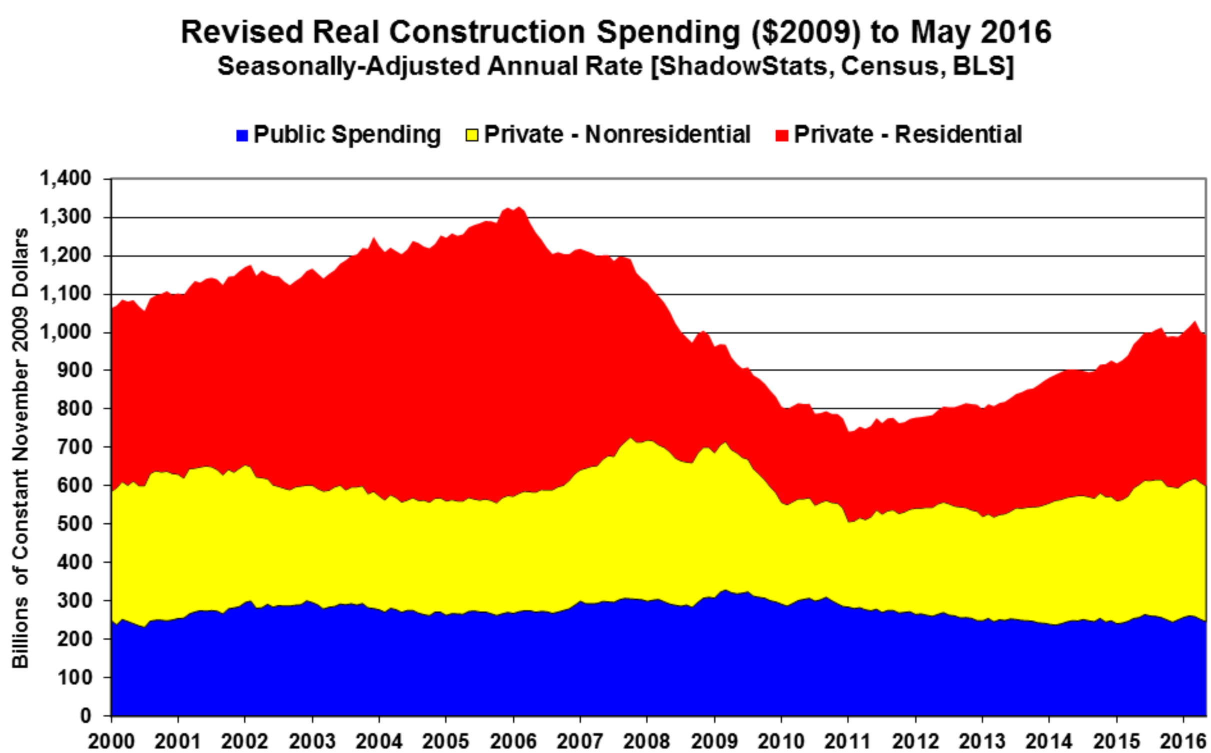
Graphs of Construction Activity. *Graph 19* shows total nominal construction spending, broken out by the contributions from total-public (blue), private-nonresidential (yellow) and private-residential (red) spending. *Graph 20* shows the same breakout by sector as in *Graph 19*, but the detail is in real, inflation-adjusted terms, reflected in constant November 2009 dollars, deflated by the final-demand PPI inflation measure for construction, as discussed otherwise in the earlier *PPI Final Demand Construction Index* section.

[Graphs 19 to 24 begin on the next page.]

Graph 19: Aggregate Nominal Construction Spending by Major Category to Date

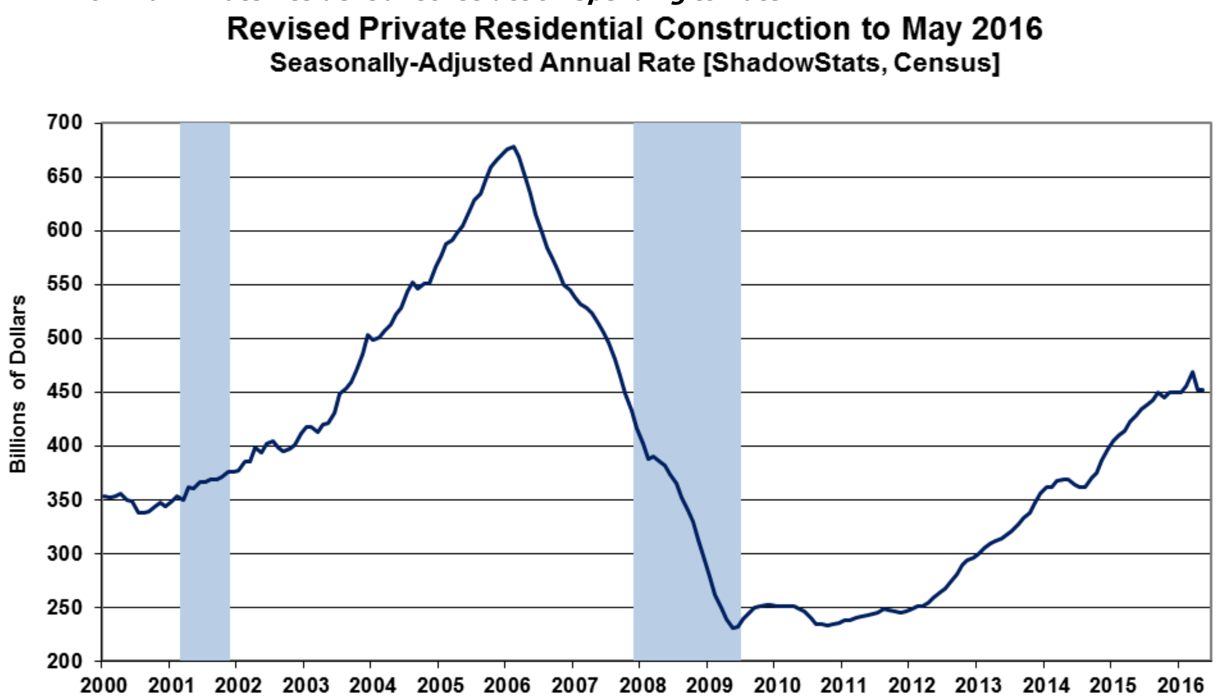


Graph 20: Aggregate Real Construction Spending by Major Category (Billions of November 2009 Dollars)

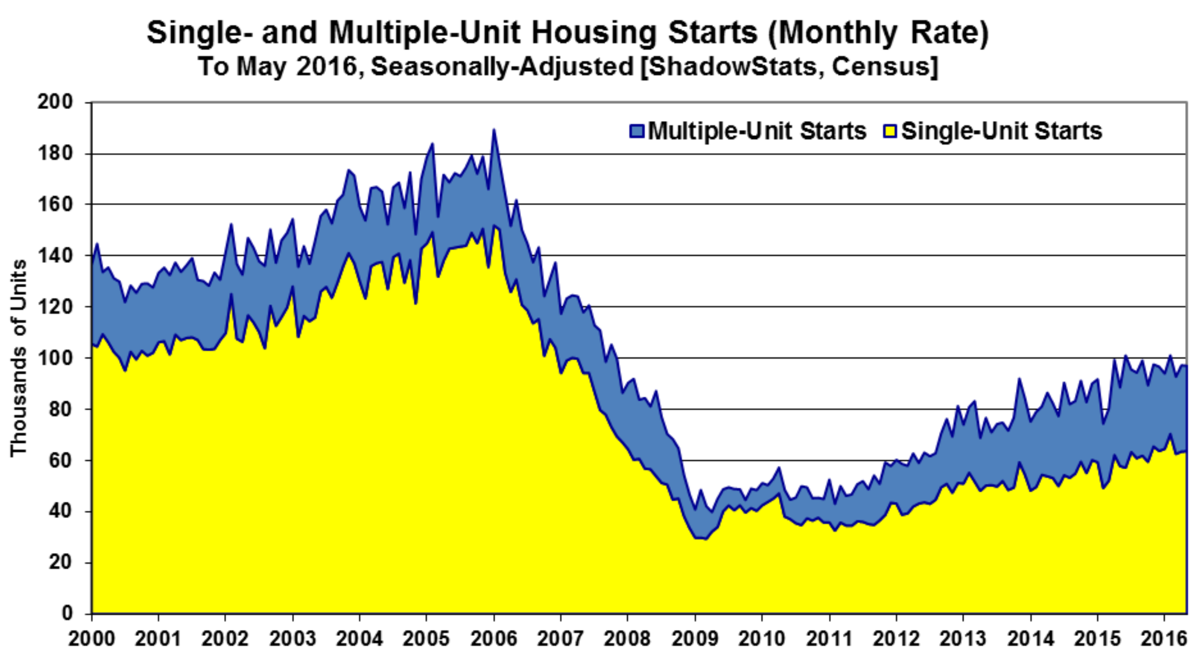


The next two graphs (*Graphs 21* and *22*) cover private residential construction spending, along with housing starts (combined single- and multiple-unit starts) for May 2016 (see *Commentary No. 815*).

Graph 21: Nominal Private Residential Construction Spending to Date

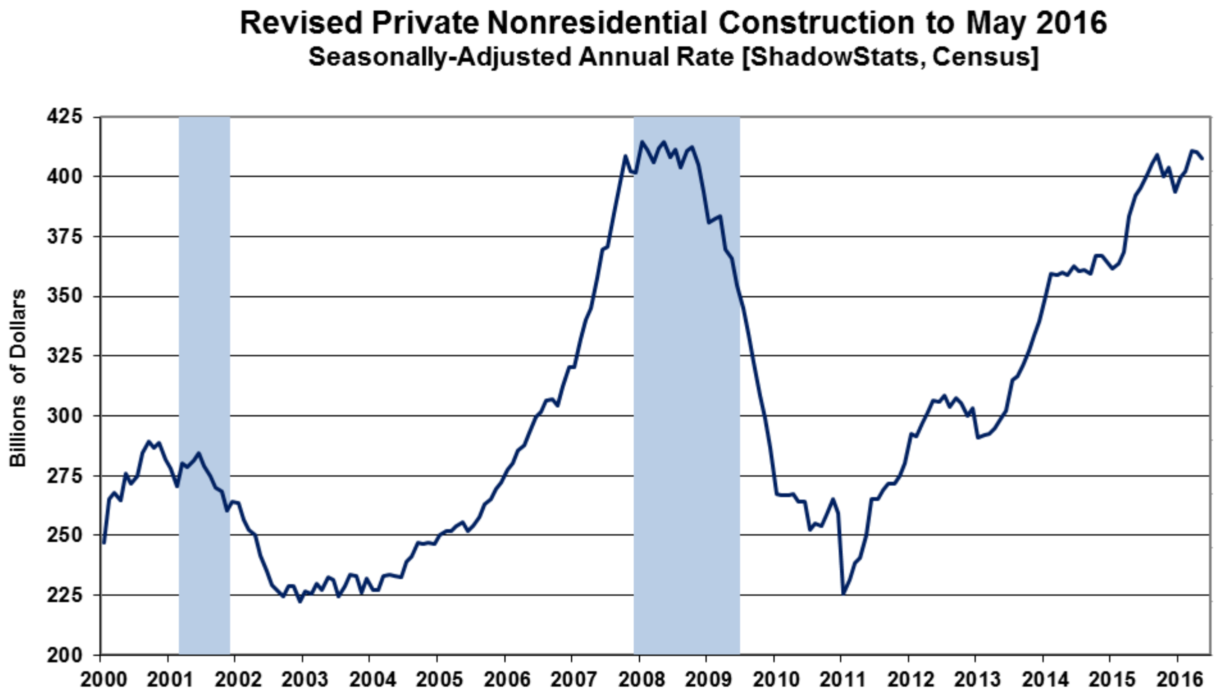


Graph 22: Single- and Multiple-Unit Housing Starts to Date

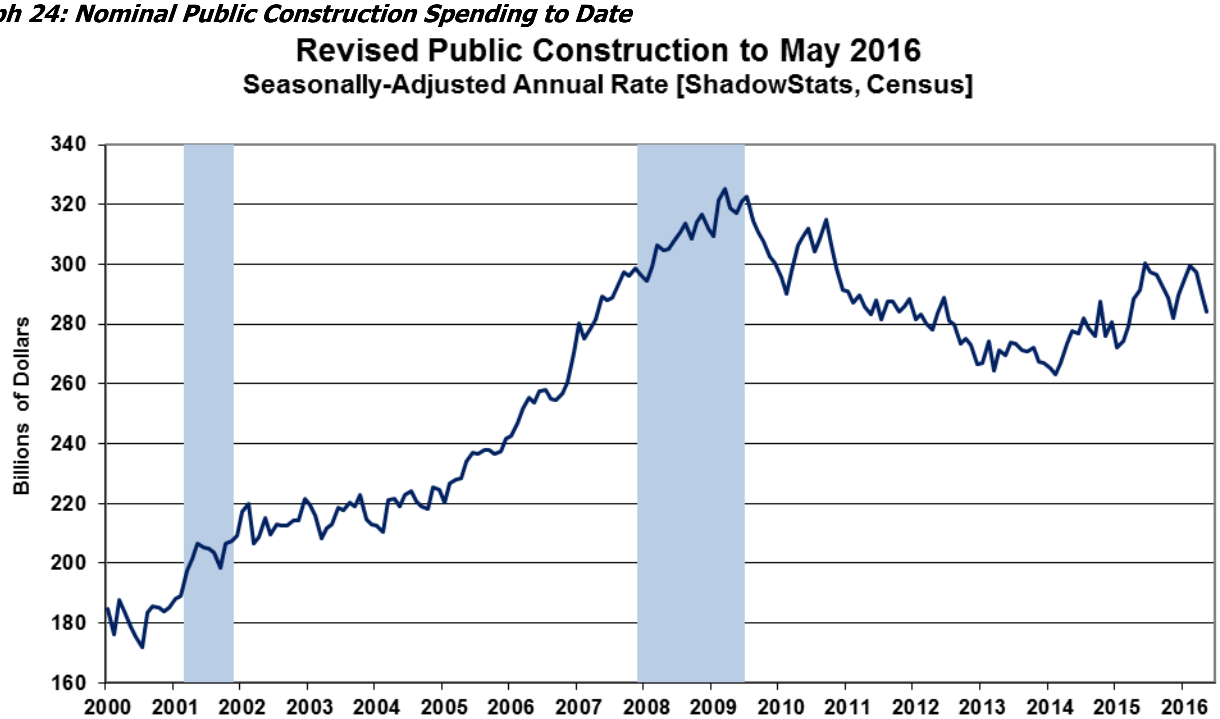


Keep in mind that the construction spending series is in nominal terms, while housing starts reflect unit volume, which should be parallel with the inflation-adjusted series shown in *Graph 13* of the *Opening Comments* section, *Graph 20* and presumably with the headline construction-payroll data in *Graph 18*.

Graph 23: Nominal Private Nonresidential Construction Spending to Date



Graph 24: Nominal Public Construction Spending to Date



The final two graphs (*Graphs 23* and 24) show the patterns of the monthly level of activity in private nonresidential-construction spending and in public-construction spending.

Private non-residential construction spending appears to be topping out near-its pre-recession nominal high. Public Construction spending, which is 98% nonresidential, had continued in a broad downtrend into 2014, with intermittent bouts of fluttering stagnation and then some upturn in 2015. In 2016, the series still appears to be fluttering in something of a volatile topping-out process, turning lower in its latest reporting, shy of its pre-recession peak. Viewed net of inflation, in *Graphs 14, 15* and *20,* indeed, both series appear stalled shy of their pre-recession peaks.

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WEEK AND MONTH AHEAD

Economic Deterioration Should Intensify in the Weeks and Month Ahead, Increasingly Pummeling the U.S. Dollar and Boosting Gold, Silver and Eventually Oil Prices. Market expectations for business activity should continue to deteriorate at an accelerating pace, amidst intensifying, negative headline economic reporting and continued Fed-policy retrenchment, with likely movement towards renewed quantitative easing in the months ahead. The general trend in weakening expectations for business activity and movement towards looming recession recognition, reflect a broad spectrum of market-disappointing headline data. That unfolding circumstance has been detailed in the *Opening Comments*, *Commentary No. 817*, *Commentary No. 816*, *Commentary No. 815*, *Commentary No. 814*, *Commentary No. 813*, *Commentary No. 812*, *General Commentary No. 811*, *Commentary No. 810*, *Supplemental Commentary No. 807-A*, *Commentary No. 800*, *Commentary No. 799*, *Commentary No. 796-A*, *Commentary No. 796* and *No. 777 Year-End Special Commentary*.

In the context of continued gyrations related to Brexit and a likely evolving re-organization of the EU and the euro, as well as in response to perpetual U.S. economic non-recovery and a renewed, intensifying downturn, negative market reactions have surfaced in trading of the U.S. dollar and in related financial markets, with upside pressures on gold, silver and oil prices. Market activity in oil has been mixed, due partially still to some relative U.S. dollar strength, as discussed in the *Opening Comments*. These market reactions reflect an intensifying sense of Federal Reserve impotence, with bleak longer term implications for the U.S. dollar. Further tightening by the Fed prior to the election appears unlikely, while renewed quantitative easing could become a target of intensified market speculation, as the deepening recession unfolds and becomes increasingly obvious in the next month or so.

Rapidly weakening, regular monthly economic reporting should be accompanied by much worse-than-expected—negative—reporting for at least the next several quarters of GDP (and GDI and GNP). That was seen with the small initial reporting of a first-quarter 2016 contraction in the Gross National Product (GNP)—the broadest measure of U.S. economic activity—discussed in *No. 809*, which revised minimally into positive territory with inflation gimmicks (see the *Opening Comments* of *Commentary No. 817*).

Pending are meaningful downside revisions to GDP history (including likely headline quarterly contractions for first-quarter 2015, fourth-quarter 2015 and first-quarter 2016), come the July 29, 2016 annual GDP benchmark revisions. A review of likely pending revisions (limited to 2013 to date) will be published mid-month.

Consistent with the relatively neutral benchmark revisions to retail sales and housing starts, and in line with recent sharp downside revisions to industrial production, durable goods orders, and the real merchandise-trade deficit, and despite the positive benchmark revisions to construction spending (see the *Opening Comments*), expectations for the GDP benchmarking also should fall sharply. Discussed in the *Opening Comments* of *No. 810*, upside redefinitions to the service-sector trade surplus could have some minimal upside revision impact pre-2015. Nonetheless, that GDP benchmarking now appears to be the most-likely point at which the elements for a "formal" recession call will come into full play.

CPI-U consumer inflation—intermittently driven lower in 2015 and early-2016 by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low. Headline monthly March to May 2016 detail moved into positive headline territory, in tandem with rising gasoline prices. CPI inflation is on track to rise again in June and likely going forward, still boosted by a weakening U.S. dollar environment, with a generally-related upturn in oil prices, gasoline and other commodities. Separately, gasoline-price seasonal adjustments shift to the plus-side in July. Fundamental reporting issues with the headline CPI are discussed here: *Public Commentary on Inflation Measurement*.

Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. Beyond the pre-announced gimmicked changes to reporting methodologies of the last several decades, which have tended to understate actual inflation and to overstate actual economic activity, ongoing headline reporting issues are tied largely to systemic distortions of monthly seasonal adjustments.

Data instabilities—induced partially by the still-evolving economic turmoil of the last nine-to-eleven years—have been without precedent in the post-World War II era of modern-economic reporting. The severity and ongoing nature of the downturn provide particularly unstable headline economic results, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data). That was discussed and explored in the labor-numbers related *Supplemental Commentary No. 784-A* and *Commentary No. 695*.

Further, discussed in *Commentary No. 778*, a heretofore unheard of spate of "processing errors" surfaced in recent surveys of earnings (Bureau of Labor Statistics) and construction spending (Census Bureau). This is suggestive of deteriorating internal oversight and control of the U.S. government's headline economic reporting. At the same time, it indicates an increasing openness of the involved statistical agencies in revealing the reporting-quality issues.

Combined with ongoing allegations in the last year or two of Census Bureau falsification of data in its monthly Current Population Survey (the source for the BLS Household Survey), these issues have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series (see *Commentary No. 669*). John Crudele of the *New York Post* continues his investigations in reporting irregularities: *Crudele Investigation*.

PENDING RELEASE:

***Updated* - Employment and Unemployment (June 2016).** The Bureau of Labor Statistics (BLS) will publish its June 2016 labor data this Friday, July 8th. Headline detail will be covered in *Commentary No. 819* of that date. Both the more-inclusive unemployment-rate numbers, as well as the headline payroll-employment details, remain open for negative headline surprises, given the ongoing, general weakening tone in a number of business indicators.

Consensus expectations appear to be overly optimistic, with an expected payroll gain in the range of 170,000 to 180,000 for June, and with the headline U.6 unemployment rate notching higher to 4.8%, having dropped in May to 4.7%, from 5.0% in June.

Such is despite the low, market-shocking 38,000 jobs gain [jobs dropped by 50,000 (-50,000) net of revisions to April] in May 2016, and includes a 35,000 jobs boost to the June 2016 payrolls from returning Verizon strikers (*Commentary No. 810*). The assumption appears to be that the unusual softness in May payrolls was an aberration, but the May detail more likely was the beginning of a downside trend.

The nonsensical decline in the May headline unemployment rate to 4.7% from 5.0%, driven by the disappearance of 460,000 unemployed from labor force who did not find employment, well could have reflected severe month-to-month non-comparability issues and/or unusual "discouraged worker" shifts. If the unemployment rate jumps back sharply in June, month-to-month comparability likely will have been the distortion.

Established monthly distortions to payroll employment (excessive upside biases, and publishing irregularities with the concurrent-seasonal-factor process) continue, as do the regular monthly distortions to headline unemployment (definitional issues with "discouraged workers," and publishing irregularities with the concurrent-seasonal-factor process).

Underlying economic fundamentals continue to deteriorate, suggesting continued slowing or negative month-to-month growth in headline payrolls, as well as stagnation or deterioration in the broader unemployment rates such as U.6 and particularly the ShadowStats Alternate Unemployment Measure.