

COMMENTARY NUMBER 823
Second-Quarter 2016 GDP and Annual Revisions

July 31, 2016

Broad, Deepening Economic Downtrend Continued

**Revised Annual Change in GDP Slowed Sharply,
Consistent with Entering a Recession**

**Headline Real Quarterly GDP Revisions Took Fourth-Quarter 2015 and
First-Quarter 2016 Growth Rates Lower, Below 1.0%, but Not Negative, with
First-Quarter 2016 GNP Minimally Below Zero, Again**

**Well Below Consensus, the Advance Second-Quarter 2016 Real GDP
Annualized Growth of 1.22% Faces Likely Downside Revisions**

**Nonetheless, Aggregate GDP Revisions Were Minimal and
Heavily Gimmicked, Including Cycle-Dampening Three-Year Moving Averages**

**Carefully Structured Statistical Shenanigans Were
Designed to Smooth the Business Cycle, Not to Reveal It**

Velocity of Money Slowed Sharply in Second-Quarter 2016

PLEASE NOTE: The next regular Commentary, scheduled for Friday August 5th, will cover July employment and unemployment, the full June trade deficit and June construction spending.

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

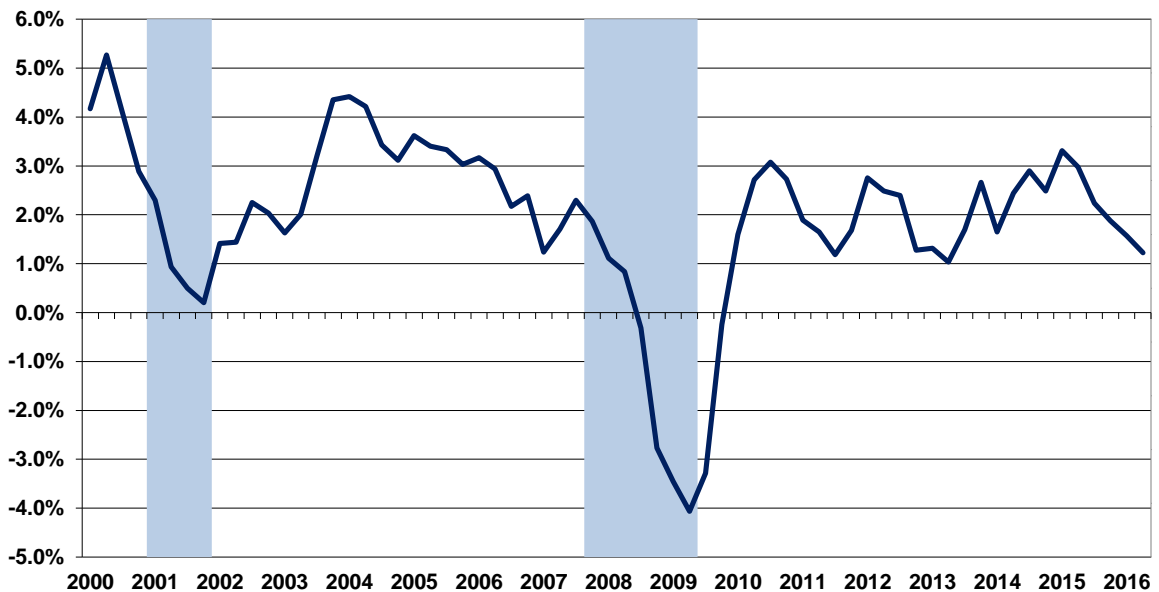
GDP News Was Bad, and the Markets Recognized It, Despite Unconscionable Gimmicks in the Annual Revisions. The Bureau of Economic Analysis (BEA) released its “advance” estimate of second-quarter 2016 GDP, in the context of inadequate, annual GDP benchmark revisions from 2013 through first-quarter 2016. An unfolding “new” recession remained very much in play, despite the Bureau’s efforts to obfuscate the underlying reality of faltering business activity. The BEA smoothed away slower, historical growth that had been confirmed in place, since before the prior 2015 GDP benchmarking.

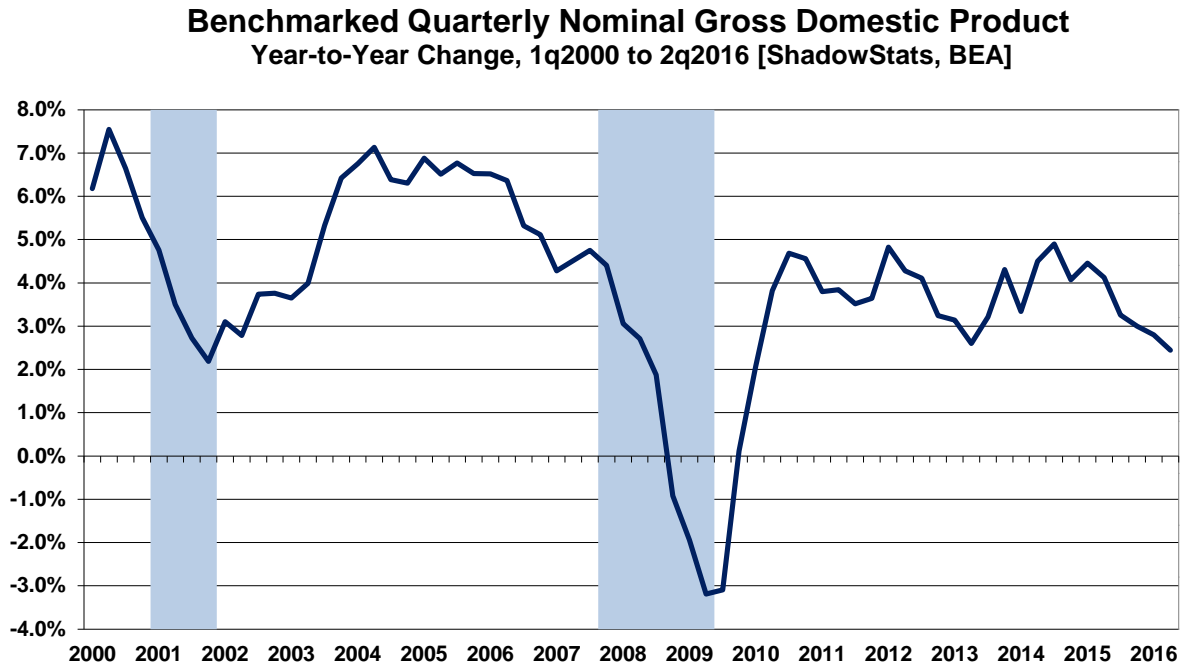
The “advance” inflation-adjusted real quarterly growth in second-quarter 2016 was a statistically-insignificant, annualized 1.22% (non-annualized quarterly growth of 0.31%), less than half the 2.5% to 2.6% gain expected by consensus forecasters. Where the BEA has extensive ability to bring in its first estimate wherever it chooses, and where the BEA usually targets the consensus forecast in its initial reporting, the BEA appears to have signaled consensus forecasters that even worse growth numbers lie ahead. Accordingly, consensus expectations should ease in the weeks ahead.

Soft second-quarter 2016 GDP growth followed a downwardly-revised estimate of 0.83% annualized (0.21% non-annualized) growth the first-quarter 2016 GDP, which previously had been a gain of 1.07%. In turn, that followed a downwardly-revised estimate of 0.87% annualized (0.22% non-annualized) growth in the fourth-quarter 2015, which previously had been a gain of 1.39%. Where ShadowStats had estimated these two quarters would turn negative, they were revised to below 1.0%.

Graph 1: Benchmarked Real GDP, Year-to-Year Percent Change

**Benchmarked Quarterly Real Gross Domestic Product
Year-to-Year Change, 1q2000 to 2q2016 [ShadowStats, BEA]**



Graph 2: Benchmarked Nominal GDP, Year-to-Year Percent Change

Nonetheless, the second-quarter 2016 GDP headline detail and the prior two quarters' revisions were consistent with a recession. So, too, was the sharp decline in second-quarter 2016, year-to-year real GDP growth to 1.23%, a pattern and level commonly seen when GDP and GNP have entered formal recessions (see *Graphs 1, 2, 8, 9 and 25*).

Weaker-than-expected GDP news triggered some flight from the U.S. dollar to gold and oil, but those circumstances still await a major negative economic shock to trigger the onset of a massive flight from the U.S. currency. Such shocks loom in headline monthly economic detail in the next month or so.

All that said, the annual GDP benchmark revisions were minimal, in aggregate, with no change in average GDP growth over the involved period. Such a result is not possible, with good-quality reporting, in the context of the underlying economic collapse in industrial production and other benchmarked series discussed in [Commentary No. 821](#).

Broad Benchmark Revisions Were Worthless: An Attempt to Smooth the Recent Business Cycle, Not to Define It. In aggregate, the limited benchmark revisions since first-quarter 2013 did not change average GDP growth in the period. Note in accompanying *Graph 6* how the business cycle, which had shown a growth dip in first-quarter 2015 (red line)—a likely first quarterly decline in a “new” recession timed from fourth-quarter 2015—was smoothed out by the benchmarking (blue line). While the BEA provided minimal, meaningful detail on the process determining the new details, what is available is discussed in the following paragraphs. Significant new detail and information should be published in the month ahead.

Recession Recognition Still Looms. I had expected that a traditional GDP benchmarking would show weaker GDP since 2013 (the arbitrary beginning date the BEA set for revisions), setting the stage for a formal recession recognition, timing a renewed downturn from December 2014 (see [Commentary No. 821](#), for example). That is not likely to happen now as a result of the benchmarking, but recession

recognition still looms. The National Bureau of Economic Research (NBER) remains the defining authority in calling U.S. recessions. As the GDP evolved over the decades to its current gimmicked state, the NBER long ago gave up using quarterly GDP contractions to define recessions. Per the [NBER](#):

“The Committee does not have a fixed definition of economic activity. It examines and compares the behavior of various measures of broad activity: real GDP measured on the product and income sides, economy-wide employment, and real income. The Committee also may consider indicators that do not cover the entire economy, such as real sales and the Federal Reserve's index of industrial production (IP). The Committee's use of these indicators in conjunction with the broad measures recognizes the issue of double-counting of sectors included in both those indicators and the broad measures. Still, a well-defined peak or trough in real sales or IP might help to determine the overall peak or trough dates, particularly if the economy-wide indicators are in conflict or do not have well-defined peaks or troughs.”

Indeed, recent historical patterns of series such as industrial production and real retail sales are showing a renewed recession that started at the end of 2014. Underlying economic detail is getting worse, not better. A recession call likely looms in the not-too-distant future, but politics suggest that formal recognition of a “new” recession, an offshoot of the 2007 economic collapse, most likely will come post-election.

With Production at 65% of GDP, How Could GDP Not Revise Lower? Based on the Federal Reserve's latest dollar valuation of industrial production, second-quarter 2016 production accounted for 65% of the headline dollar value of second-quarter 2016 real Gross Domestic Product. Yet, as of the latest reporting against both series' pre-2007 recession highs, real second-quarter 2016 GDP was up by 10.6%, June 2016 industrial production was down by 1.5% (-1.5%).

Consider that industrial production has contracted quarter-to-quarter in five of the six quarters since fourth-quarter 2014, with production contracting quarterly and year-to-year for the last three consecutive quarters. Those patterns of activity never have been seen outside of formal recessions. Much of the recent downside revision in production and the unfolding series weakness was reported only after third-quarter 2015 GDP had been finalized—two quarters subsequent to the prior 2015 GDP benchmarking—beginning with the industrial production benchmark revisions of April 1st (see [Commentary No. 796-A](#)). Incorporating a variety of benchmark revisions from other series (again see [Commentary No. 821](#)), well over two thirds of the GDP is in current contraction. The series, or the related underlying negative revisions to those series, in question, purportedly were incorporated into the 2016 GDP benchmarking. Other than for some quarter-to-quarter shifting, though, those negative hits were absorbed into the revised GDP with barely a flutter, a circumstance that is not credible.

The Games the BEA Plays. The mission of the Bureau of Economic Analysis presumably is to report the U.S. business cycle on a consistent, accurate and timely basis, not to obliterate meaningful detail of its economic patterns and activity. Individuals directly involved in the process have advised me of outright manipulations involving GDP/GNP reporting, at various times during my three-plus decades as an active, consulting economist. Circumstances have involved direct interventions with the Commerce Department, as seen during the era of President Lyndon Johnson, as well as external manipulations as seen during the era of President George H. W. Bush, among others.

I have met with, presented to, and had other direct communications with individuals at the BEA, since the 1980s, and have found those involved to be open, diligent, good people, endeavoring to publish the best quality information they are able to put together, on as timely a basis as possible. That environment, however, has neither prevented nor precluded direct political manipulation of the reporting process.

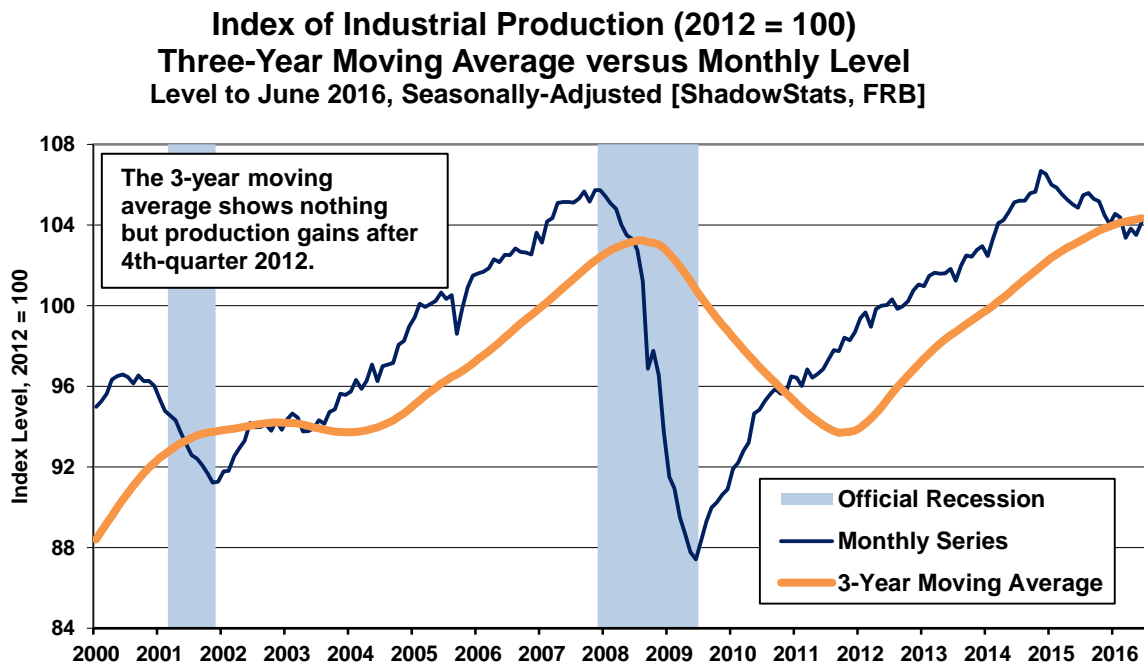
In the context of those factors, the 2016 GDP benchmark revisions were minimal, in aggregate, with no change in average GDP growth over the involved period. Again, that result was not consistent with the underlying economic collapse in industrial production and other series. What the BEA did—tentatively touched upon in the [BEA Briefing](#)—was to use factors such as three-year moving averages and related “Best-Change Basis” accounting, with the effect of muting and hiding the faltering business cycle. Other revisions simply were arbitrary, although “full reporting” should be seen in the “comprehensive” GDP benchmarking in 2018, two years from now. Where the BEA provided limited detail, the system appears to have picked up previously unknown state and local government “investment.”

Arbitrary Actions. ShadowStats predicted that first-quarter 2015 would turn to a quarterly contraction, in revision. That did not happen, because BEA arbitrarily just averaged first-quarter 2015 with second-quarter 2015 GDP growth, shifting second-quarter activity to first-quarter activity, consistently across many areas of activity. In the benchmarking, first-quarter 2015 annualized real growth revised from 0.64% to 2.05%, while second-quarter 2015 growth revised from 3.92% to 2.61%.

Benchmark Graphs 6, 7, 10 and 11 reflect that aggregate detail, with the disappearing first-quarter 2015 dip in the red lines versus the straight blue lines, and the relatively smoothed quarterly growth rates in the blue versus the red lines. Those revisions were despite the prior GDP-series benchmarking in July 2015, which had revised headline first-quarter 2015 detail from an annualized quarter-to-quarter contraction of 0.17% (-0.17%) to a quarterly gain of 0.64%. The headline second-quarter 2015 growth initially had been reported at 2.32%, revising higher to 3.68% and 3.92% in successive months.

Three-Year Moving Average. The BEA highlighted its use of a three-year moving average in revising improvements to residential construction spending (previously referred to as “processing error” discussed in [Commentary No. 778](#)).

Graph 3: Three-Year Moving Average versus Monthly Headline Industrial Production through June 2016



Upside revisions resulted not only from the use of the three-year moving average, but also from the use of a “best-change” basis accounting, where the revisions were used with a limited and out-of-context, inconsistent history. The revisions went back to 2005, but they were appended on to the GDP growth estimates beginning only with first-quarter 2013.

Consider first the three-year moving average. As noted by the BEA in its briefing, “Use of moving average dampens impact on GDP trends, cyclical movements.” ShadowStats uses three- or six-month moving averages, which generally are adequate to smooth reporting patterns of volatile monthly statistics, such as housing starts or home sales, leaving meaningful trend information intact. A three-year moving average, however, is enough to flatten out (eliminate) the average business cycle. The NBER indicates that the average post-World War II economic contraction ran 11.1 months.

Graph 3 provides an indication of the impact of such smoothing on a series such as monthly industrial product. The three-year moving average shown as the thick orange line, effectively masked the 2001 recession. Although it turned down with the unusually-severe 2007 contraction, the moving average showed continual positive growth in the period of the current GDP benchmark revision, which was only for activity after fourth-quarter 2012. Add that type of smoothing onto historical data using “best-change” basis accounting, and all sorts of negative data begin to disappear.

Best-Change Basis Accounting. The three-year-average-based construction spending revision went back to 2005, but only the data after fourth-quarter 2012 were added to the benchmarking, and now are fully inconsistent with prior data, including any biases, which most likely were on the upside.

Similar distortions were apparent in last month’s third estimate of first-quarter GDP, tied to the gimmicked boosted “surplus” in trade services. These types of revisions are best done in full context to avoid inconsistencies and near-term distortions. Accordingly, these otherwise optional updates usually have been held until the next comprehensive GDP revision (in this case 2018), where the data are all recast, at the same time, on a consistent basis, back to 1929.

Noted in [Commentary No. 817](#), the trade deficit benchmarking just prior to the third-estimate of first-quarter 2016 GDP should not have altered the headline first-quarter trade data used in the GDP, on a “Best-Change Basis.” ShadowStats had calculated the new historical data, and the basis for the first-quarter revision was not consistent with the already fixed-trade detail in fourth-quarter 2015 GDP:

“Net Exports Added a Revised 0.12% to [Previously Subtracted 0.21% (-0.21%), Initially 0.34% (-0.34%) from] First-Quarter 2016 GDP Growth; Subtracted 0.14% (-0.14%) from Fourth-Quarter Growth. This flip-flop reflected the trade-deficit benchmark revision ([Commentary No. 810](#)). Normally, that would have been reflected first in the GDP benchmarking, along with a directly related downside revision to fourth-quarter 2015 GDP growth. Instead, the first-quarter 2016 number now is inconsistent and not comparable with fourth-quarter 2015 reporting. The same can be said for the revised, aggregate first-quarter GDP estimate.”

So what happened here with benchmark revision? The first-quarter 2016 trade-deficit contribution to first-quarter GDP growth revised from a positive 0.12% to 0.01%, in the context of a fourth-quarter 2015 negative trade contribution to aggregate GDP growth revising from down 0.14% (-0.14%), to down by 0.45% (-0.45%). Those changes accounted for the bulk of the fourth-quarter 2015 and first-quarter 2016 benchmarked, downside growth revisions published on July 29th.

As discussed in [Commentary No. 810](#), the gimmicked redefinition of and expansion of the trade surplus in services brought some upside revisions into 2013 GDP, but with limited relative quarter-to-quarter impact thereafter. The artificially spiked levels of the benchmarked GDP in that early period, where the introduction of the new data should not have had noticeable relative impact, are adjusted for in *Graphs 6* and *7*. Those changes in this benchmarking had no purpose other than to spike the average GDP level to “unchanged” in the revisions; it would have been down somewhat, otherwise.

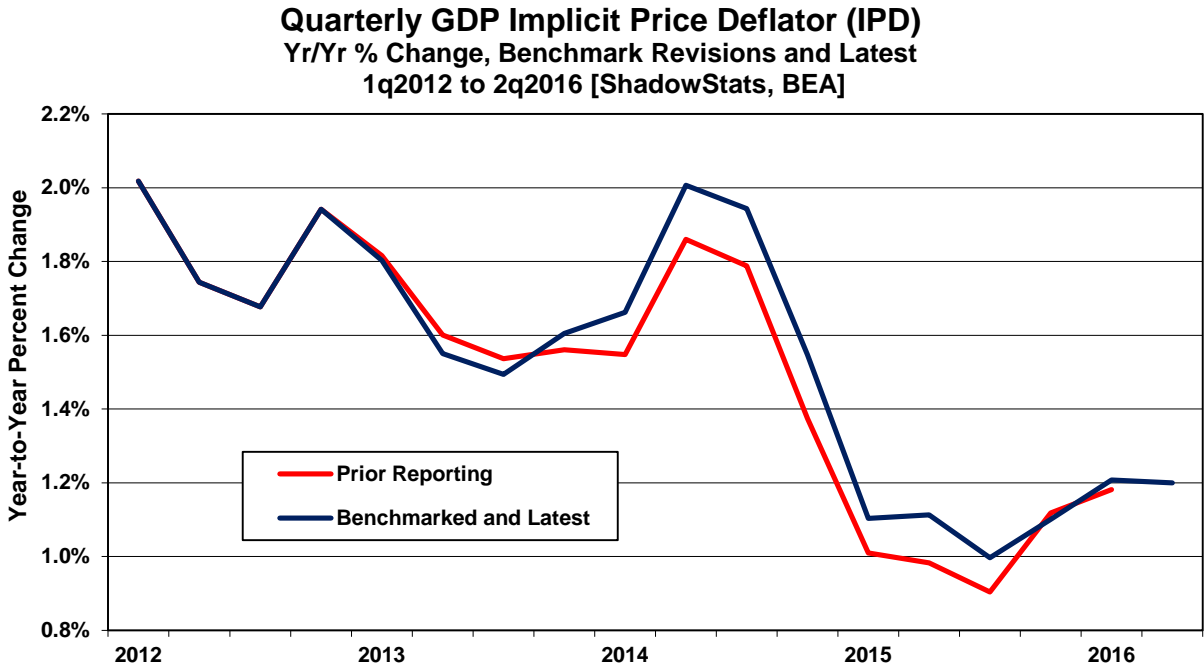
BENCHMARK REVISION GRAPHS: IPD and Real GDP, GNP, GDI and Statistical Discrepancy Quarterly Revisions from First-Quarter 2013 to First-Quarter 2016

Schedule of Graphs Reflecting Benchmark Revisions and Headline Reporting of Second-Quarter 2016
Gross Domestic Product (GDP), Gross National Product (GNP), Gross Domestic Income (GDI),
Statistical Discrepancy and the Implicit Price Deflator (Definitions Found in the *Reporting Detail* section)

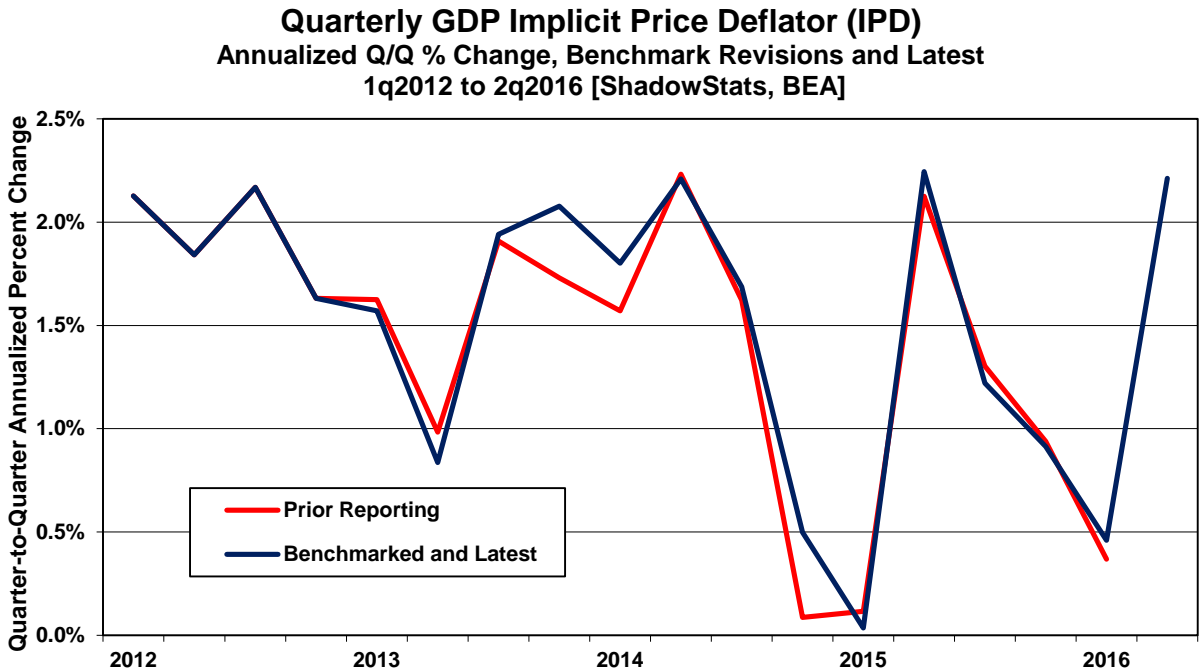
- Graph 4: GDP Implicit Price Deflator, Year-to-Year Percent Change
- Graph 5: GDP Implicit Price Deflator, Annualized Quarter-to-Quarter Percent Change
- Graph 6: Real GDP, Level (Benchmarking 1q2013 to 1q2016, and Headline 2q2016)
- Graph 7: Real GNP, Level (Benchmarking 1q2013 to 1q2016)
- Graph 8: Real GDP, Yr/Yr Change (Benchmarking 1q2013 to 1q2016, and Headline 2q2016)
- Graph 9: Real GNP, Yr/Yr Change (Benchmarking 1q2013 to 1q2016)
- Graph 10: Real GDP, Annualized Qtr/Qtr Change (Benchmarking 1q2013 to 1q2016, and Headline 2q2016)
- Graph 11: Real GNP, Annualized Qtr/Qtr Change (Benchmarking 1q2013 to 1q2016)
- Graph 12: Real GDI, Level (Benchmarking 1q2013 to 1q2016)
- Graph 13: Real Statistical Discrepancy, GDP Minus GDI, Level (Benchmarking 1q2013 to 1q2016)
- Graph 14: Real GDI, Yr/Yr Change (Benchmarking 1q2013 to 1q2016)
- Graph 15: Real GDI, Annualized Qtr/Qtr Change (Benchmarking 1q2013 to 1q2016)

[GDP Benchmark Revision Graphs 4 to 15 begin on the next page]

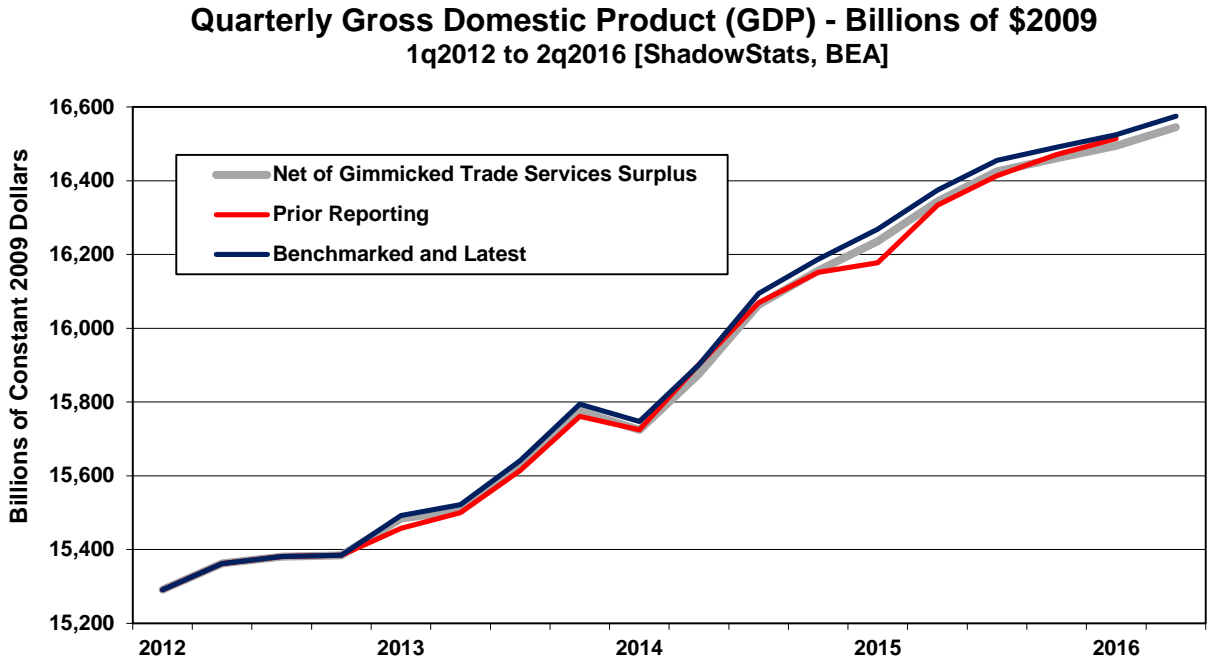
Graph 4: GDP Implicit Price Deflator, Year-to-Year Percent Change



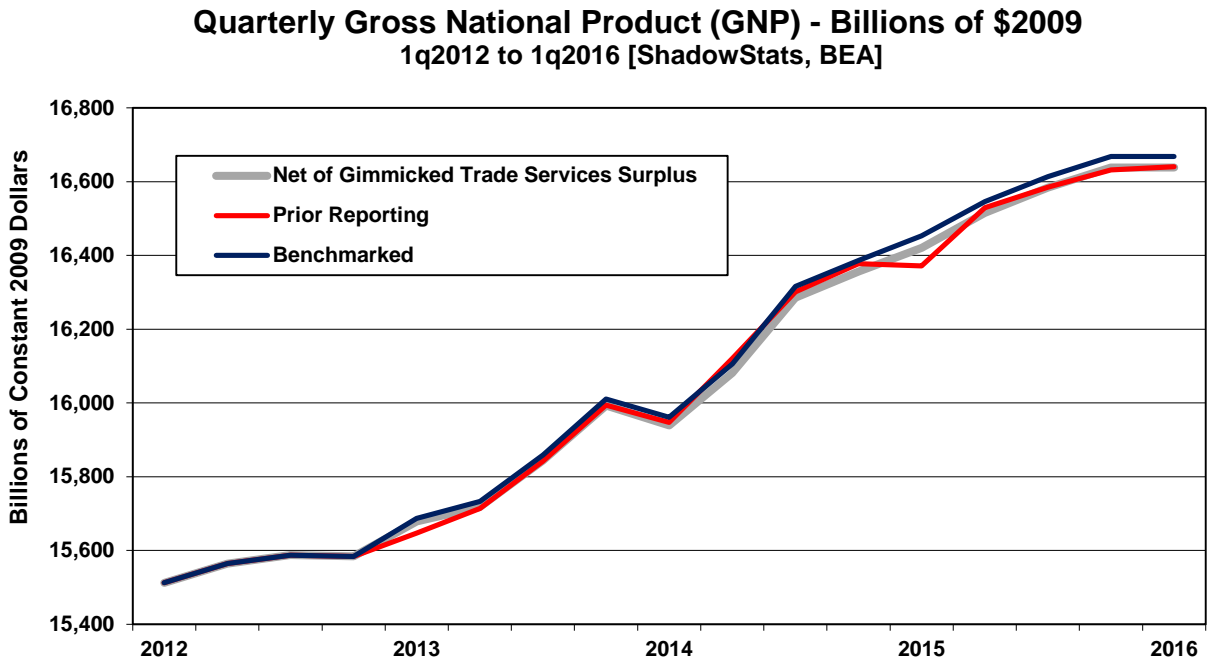
Graph 5: GDP Implicit Price Deflator, Annualized Quarter-to-Quarter Percent Change



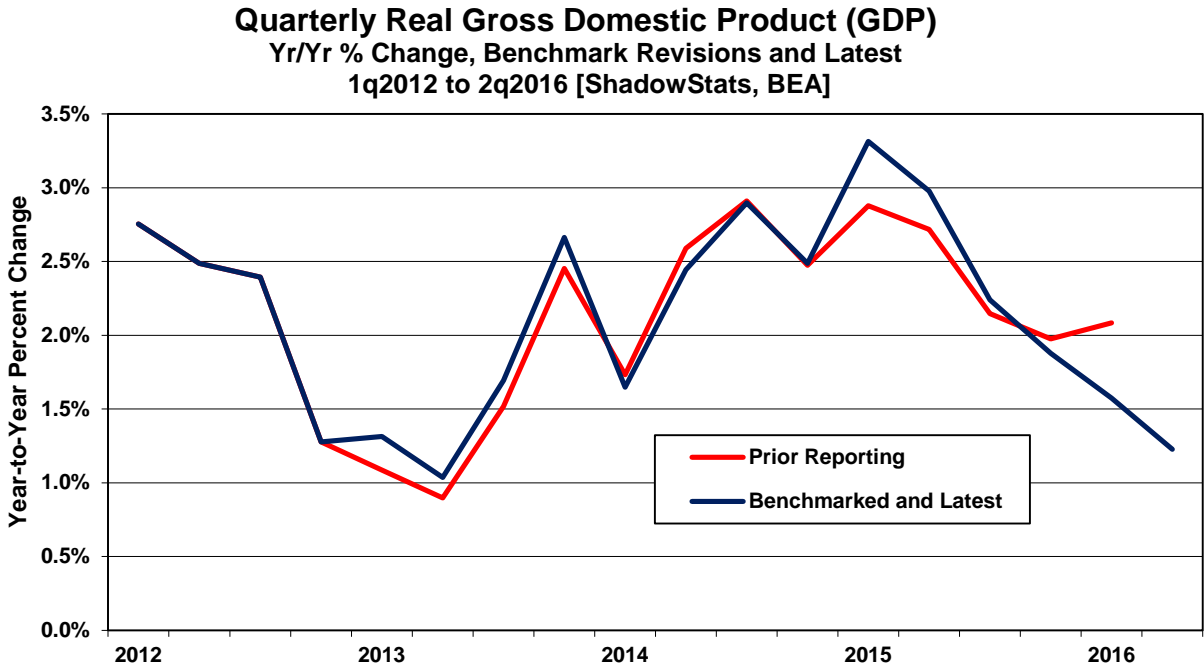
Graph 6: Real GDP, Level (Benchmarking 1q2013 to 1q2016, and Headline 2q2016)



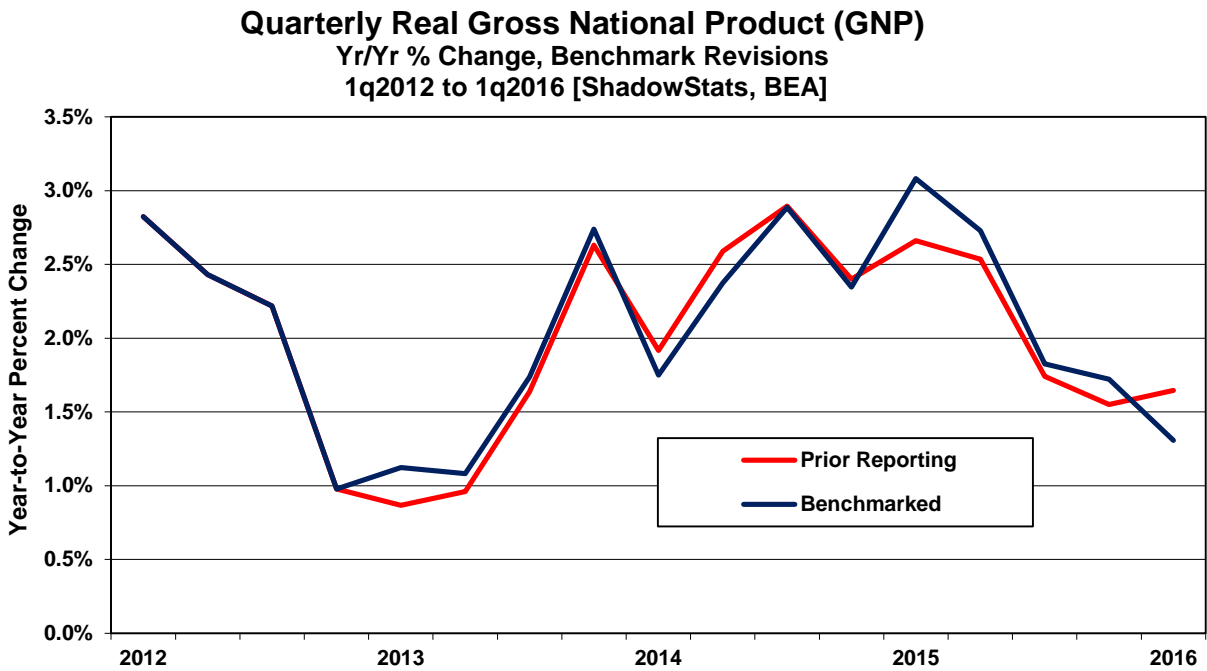
Graph 7: Real GNP, Level (Benchmarking 1q2013 to 1q2016)



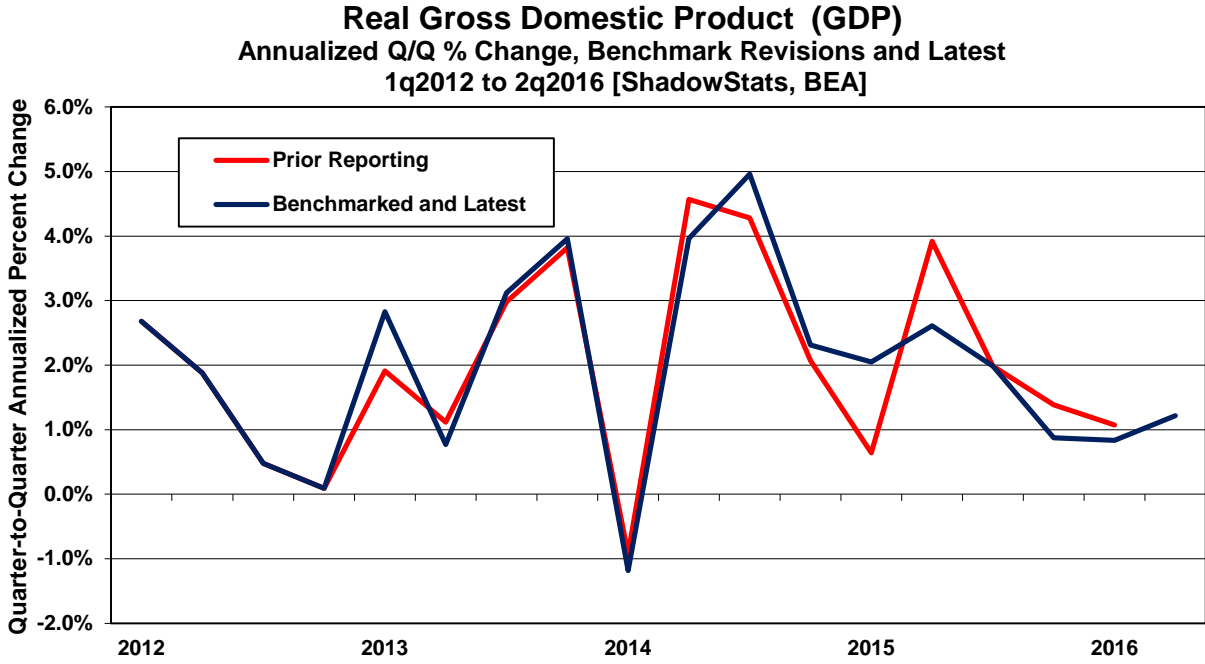
Graph 8: Real GDP, Yr/Yr Change (Benchmarking 1q2013 to 1q2016, and Headline 2q2016)



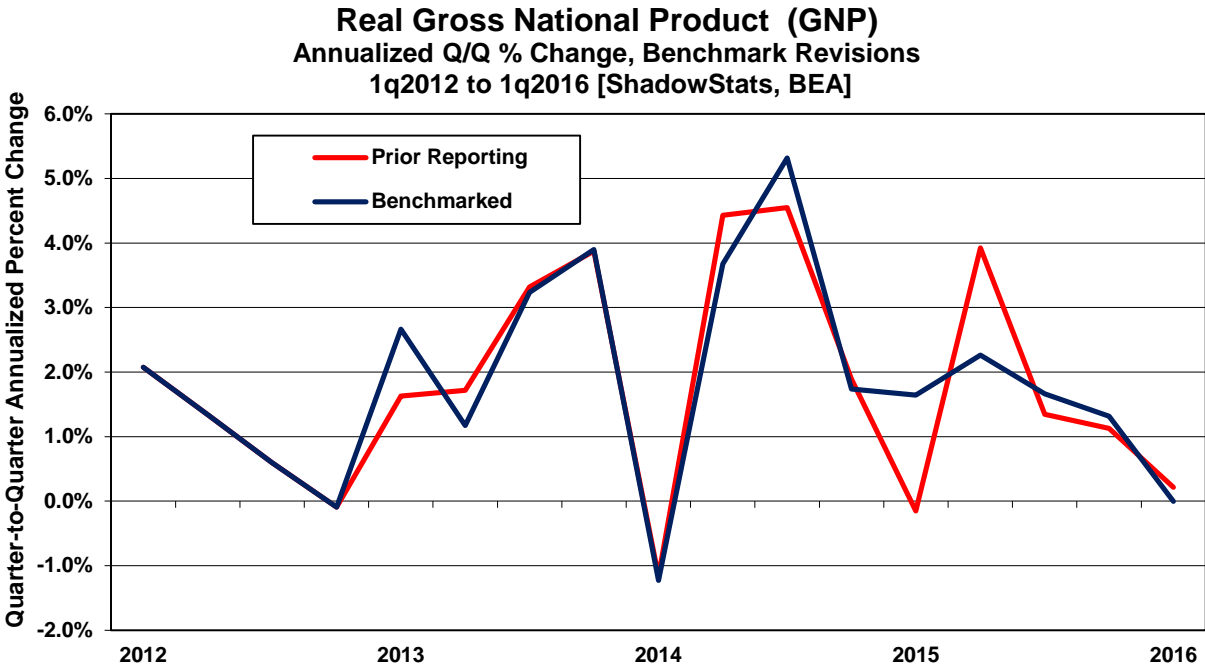
Graph 9: Real GNP, Yr/Yr Change (Benchmarking 1q2013 to 1q2016)



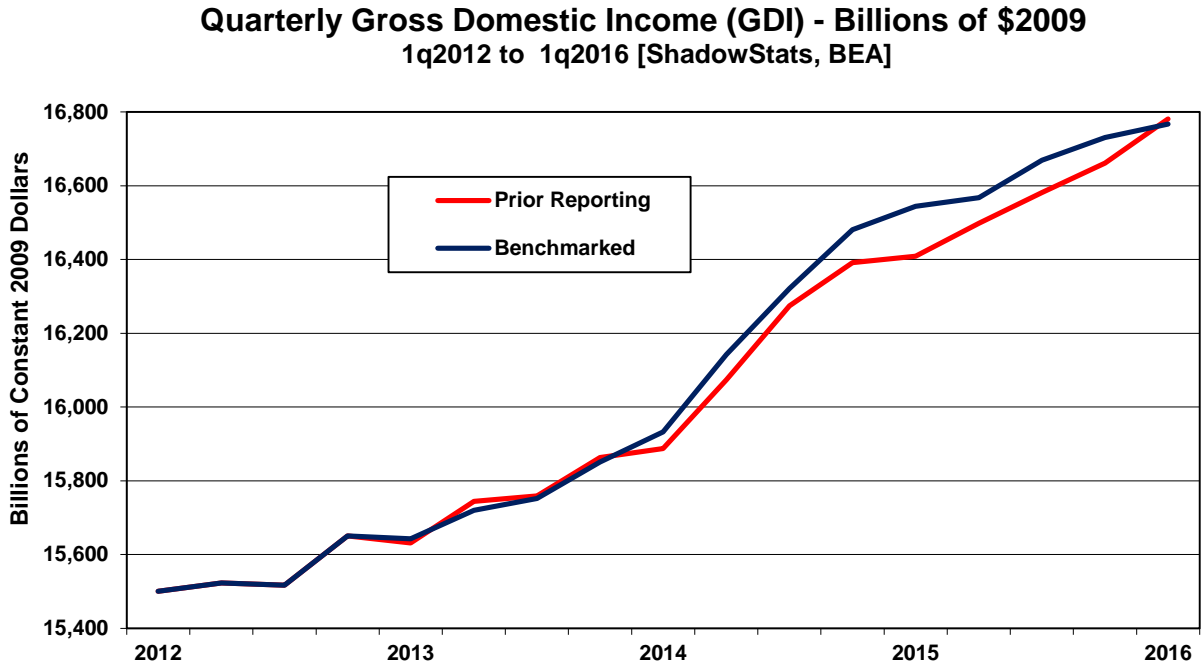
Graph 10: Real GDP, Annualized Qtr/Qtr Change (Benchmarking 1q2013 to 1q2016, and Headline 2q2016)



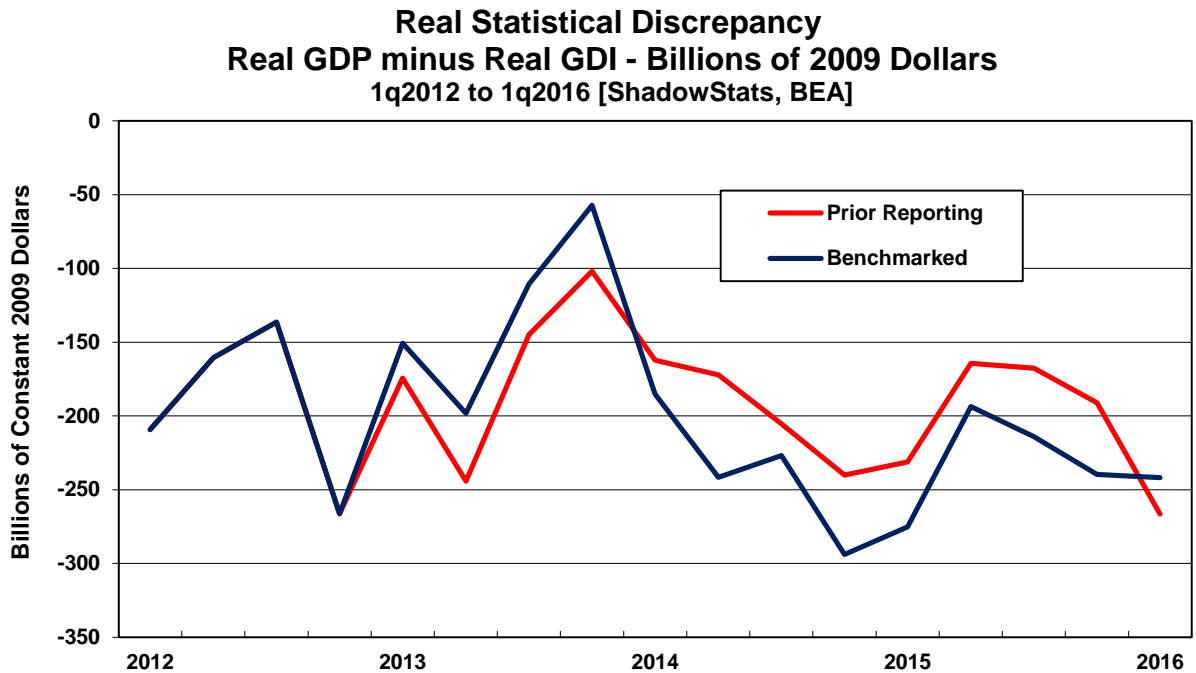
Graph 11: Real GNP, Annualized Qtr/Qtr Change (Benchmarking 1q2013 to 1q2016)



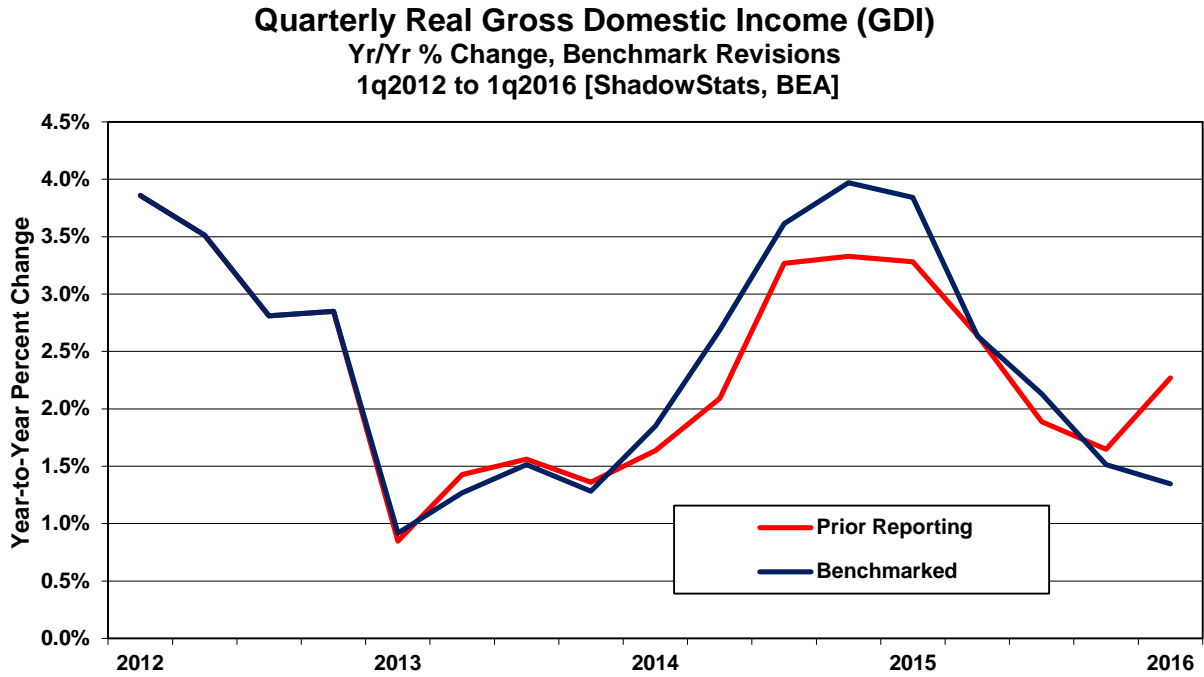
Graph 12: Real GDI, Level (Benchmarking 1q2013 to 1q2016)



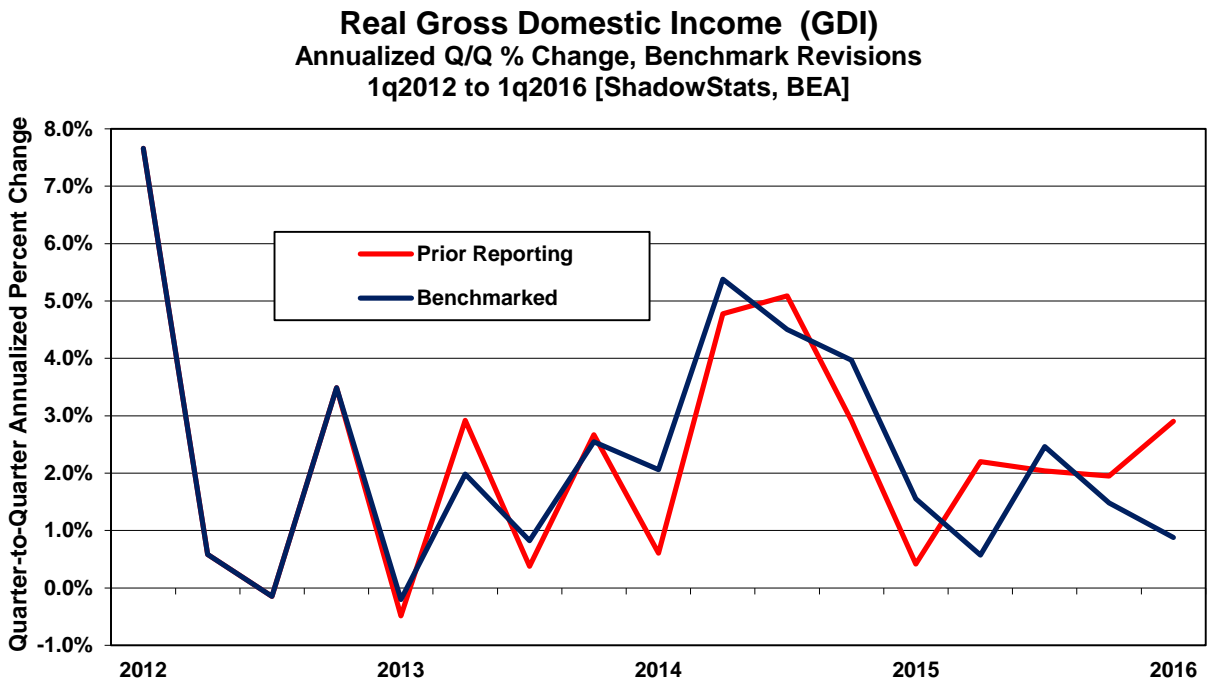
Graph 13: Real Statistical Discrepancy, GDP Minus GDI, Level (Benchmarking 1q2013 to 1q2016)



Graph 14: Real GDI, Yr/Yr Change (Benchmarking 1q2013 to 1q2016)



Graph 15: Real GDI, Annualized Qtr/Qtr Change (Benchmarking 1q2013 to 1q2016)



Today's Commentary (July 31st). The balance of these *Opening Comments* provides summary detail of the first-estimate of second-quarter 2016 GDP. The GDP benchmarking is covered in the opening pages of these *Opening Paragraphs*.

The *Hyperinflation Outlook* shows the latest estimates of the velocity of money for M1, M2 and M3, in the context of the headline second-quarter 2016 GDP estimate and annual revisions. The most-recent *Hyperinflation Outlook Summary* is found in [Commentary No. 783](#), with an updated outlook for Fed activity and the U.S. dollar in the *Hyperinflation Watch* of [Commentary No. 820](#). The various background *Commentaries* will be updated and consolidated in a new *Special Report*. With first half-2016 economic detail in place, that publication is anticipated for August 19th.

The *Week and Month Ahead* section previews next week's releases of June Construction Spending, the June Trade Deficit and July labor conditions.

Gross Domestic Product (GDP)—Second-Quarter 2016, “Advance” or First Estimate—Annual Growth Slowed to Levels Usually Seen Early in Formal Recessions. In the context of annual benchmark revisions, the first estimate of second-quarter 2016 GDP showed a statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 1.22%.

The headline quarterly growth was well below consensus expectations that were around 2.5%, and it still has two monthly revisions (likely to the downside) ahead of it on August 26th and September 29th. The accompanying benchmark revisions lowered the headline quarterly real growth rates to 0.83% for first-quarter 2016, and to 0.87% in fourth-quarter 2015, versus 1.99% in third-quarter 2015 (see *Graphs 6, 8 and 10* in the *Benchmark Revision Graphs*).

Headline year-to-year real GDP growth in second-quarter 2016 slowed to 1.23%, the weakest growth in three years, since second-quarter 2013, as seen in *Graph 8* (and related *Graphs 1* and *2*). That was down from the downwardly-benchmarked 1.57% annual growth in first-quarter 2016, and a downwardly-benchmarked 1.88% in fourth-quarter 2015. Real annual growth now has been in continual decline since the benchmark-revised, near-term peak of 3.31% in first-quarter 2015, the new post-recession high annual growth for the series. The sharp downtrend in annual growth now in place is common at the onset of formal recessions.

The current-cycle trough in annual change remained in second-quarter 2009, reflecting an unrevised year-to-year decline of 4.09% (-4.09%). That was the deepest year-to-year contraction for any quarterly GDP in the history of the series.

Related *Graphs 22* and *24* in the *Reporting Detail* plot the latest headline levels of real quarterly GDP activity, while *Graphs 23* and *25* show plots of year-to-year change.

Second-Quarter 2016 GDP, First Estimate - Growth Distribution. In the context of the annual benchmark revisions, the first or “advance” estimate of annualized quarterly real growth for second-quarter 2016 GDP was 1.22%, versus 0.83% [previously 1.07%] in first-quarter 2016, versus 0.87% [previously 1.39%] in fourth-quarter 2015, 1.99% [previously 1.98%] in third-quarter 2015, 2.61% [previously 3.92%] in second-quarter 2015 and 2.05% [previously 0.64%] in first-quarter 2015.

The annualized growth number in each sub-category of consumer spending, business/residential investment, trade deficit and government spending is the additive contribution to the total, headline change in GDP, where $2.83\% - 1.68\% + 0.23\% - 0.16\% = 1.22\%$. [Commentary No. 817](#) of June 28th detailed the growth-distribution estimate for the third estimate (pre-benchmark) of first-quarter GDP.

Regrouped by general product line, the BEA estimated that the headline 1.22% quarterly GDP growth rate included a 1.36% growth-rate contribution from services and a 0.54% contribution from goods, with a growth-rate subtraction of 0.68% (-0.68%) from structures.

Contributing Growth Factors. The headline gain in second-quarter 2016 GDP was dominated by consumer spending and some trade contribution, with the other factors negative in their second-quarter GDP-growth contribution.

- **Consumer Spending Contributed 2.83% to Second-Quarter 2016 GDP Growth; First-Quarter Growth Contribution was 1.11% [Pre-Benchmark 1.02%].** The dominant GDP growth contribution from consumer spending was about evenly split between goods and services. Goods were dominated by durable goods, with an unbelievably-strong contribution of 0.41% growth in food and beverage consumption dominating nondurable goods. Services were dominated by an unseasonable-weather spike in utility usage, and the continuing surge in the highly questionable and non-productive health-care consumption tied to Obamacare. Although those latter healthcare numbers have no credibility, they continue to account for about half the headline GDP growth.
- **Business/Residential Investment Subtracted 1.68% (-1.68%) from Second-Quarter 2016 GDP Growth; Subtracted 0.56% (-0.56%) [Pre-Benchmark 0.29% (-0.29%)] from First-Quarter 2016 GDP Growth.** A slowing pace of inventory growth accounted for 1.16% (-1.16%) of the negative GDP growth contribution for this the category. Accordingly, headline final sales—GDP net of inventory change—rose at an annualized quarterly pace of 2.38% in second-quarter 2016, versus 1.24% [1.30% pre-benchmark] in first-quarter 2016. Residential and nonresidential real estate investment provided the bulk of the remaining negative contribution here.
- **Net Exports Added 0.23% to Second-Quarter 2016 GDP Growth; Added a Revised 0.01% [Pre-Benchmark 0.12%] to First-Quarter 2016 GDP Growth.** The gain here likely will reverse to contraction, subsequent to the March 2016 full trade deficit reporting (see *Week Ahead* section).
- **Government Spending Subtracted 0.16% (-0.16%) from Second-Quarter 2016 GDP Growth, Contributed 0.28% [Pre-Benchmark 0.23%] to First-Quarter 2016 GDP Growth.** Both the second-quarter and first-quarter growth contributions were dominated by large swings in state and local government investment, most likely tied to Affordable Care Act distortions.

Implicit Price Deflator (IPD). As general guidance, again, the weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth. The initial reading on second-quarter 2016 GDP inflation, or the implicit price deflator (IPD), in the context of accompanying benchmark revisions was an annualized 2.21%, up sharply versus an annualized benchmarked 0.46% in first-quarter 2016. The relative pick-up in second-quarter inflation was broadly consistent with the gasoline-price boosted upturn in the CPI-U shown in the *Reporting Detail*. Such followed benchmarked annualized IPD inflation of 0.91% in fourth-quarter 2015, 1.22% in third-quarter 2015, 2.25% in second-quarter 2015 and a 0.04% in the first-quarter 2015.

Year-to-year, headline second-quarter IPD inflation was 1.20%, versus a benchmarked 1.21% in first-quarter 2016, a benchmarked 1.10% in fourth-quarter 2015, 1.00% in third-quarter 2015, 1.11% in second-quarter 2015 and 1.10% annual gain in first-quarter 2015 (see previous *Graphs 4* and *5*).

Gross National Product (GNP) and Gross Domestic Income (GDI). The first estimates of second-quarter 2016 GNP and GDI activity will be published, along with the first revision to second quarter GDP on August 26th, but both the GNP and the GDI series were revised in the benchmark revisions (see *Graphs 6 to 15*) in the *Benchmark Revision Graphs*.

Gross National Product (GNP) remains the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments). As a reporting gimmick aimed at boosting the headline reporting of economic growth for net-debtor nations such as the United States, international reporting standards were shifted some decades back to reporting headline GDP instead of what standardly had become a relatively weaker GNP.

The headline benchmark revised first-quarter 2016 GNP reverted to a fractional annualized quarterly contraction of 0.003% (-0.003%), versus a pre-benchmarked, annualized real first-quarter gain of 0.21%, which initially had been a contraction of 0.21% (-0.21%). That was against an upwardly-benchmarked 1.32% annualized gain in fourth-quarter 2015 GNP (see *Graphs 9* and *11*).

On a year-to-year basis, benchmarked first-quarter 2016 GNP declined to 1.31%—the lowest level since second-quarter 2013—versus a pre-benchmarked annual gain of 1.64%. That followed a benchmarked year-to-year gain in fourth-quarter 2015 of 1.72%.

Gross Domestic Income (GDI) is the theoretical income-side equivalent to the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a “statistical discrepancy” to the GDI-side of the equation. Heavily touted by the BEA as *the* GDP counterpart, the increasingly unstable GDI continues to be bloated heavily by effectively-worthless income reporting out of the Bureau of Labor Statistics (BLS). The purported income gains reflect heavily-upside-biased income estimates out of the otherwise-rigged nonfarm payroll survey, held in almost perpetual growth by built-in upside biases.

Reflecting ongoing significant overstatement of income growth in the GDI, and other instabilities in the headline reporting, the real first-quarter 2016 “statistical discrepancy” continued at \$241.9 billion in the context of generally-widened, not narrowed discrepancies between the GDI and the GDP. One would expect benchmark revisions generally to narrow the differences between these theoretically equivalent series (see *Graph 13*).

Nonetheless, the benchmark revisions sharply reduced headline GDI growth rates. For the benchmarked first-quarter 2016 real annualized GDI growth slowed to 0.88% [previously 2.90%], versus 1.48% [previous 1.95%] in the fourth-quarter 2015. Year-to-year real GDI growth benchmarked to 1.35% [previously at 2.27%] for first-quarter 2016, versus a benchmarked 1.51% [previously 1.65%] in fourth-quarter 2015 (see *Graphs 12, 14* and *15*).

Underlying Economic Reality. Despite broadly neutral, artificially-smoothing benchmark revisions, and in the context of a weaker-than-expected initial second-quarter 2016 GDP growth rate, the U.S. economy continued in a deepening and as-yet-unrecognized “new” recession. Headline monthly reporting activity

in subsidiary economic series broadly has continued to move market expectations in that general direction (the ShadowStats contention remains that the “new” downturn is in reality just a continuation of the economic crash into 2009).

The first-estimate of second-quarter 2016 GDP at an “unexpectedly” weak annualized real quarterly pace of 1.22% was statistically-insignificant. That followed downwardly benchmarked and also statistically-insignificant annualized real quarterly growth of 0.83% in first-quarter 2016 and 0.87% in fourth-quarter 2015. Those were the weakest three consecutive quarters of real GDP growth since 2012, and otherwise since formally exiting the 2007 recession.

Discussed in the opening paragraphs, the benchmark revisions effectively were neutral in aggregate, with the business-cycle reporting “smoothed” by the BEA. The revisions were not of a nature to trigger formal immediate recognition of a “new” recession, which likely still will be clocked from December 2014. While such eventually will happen, the focus now shifts to the rapidly weakening economy in the current period and near-term months, which should trigger the “formal” recession recognition. More on that will follow in the *ShadowStats Special Report* planned for August 19th.

Formal headline GDP activity continues to run well above economic reality as signaled by a number of business indicators, such as corporate revenues, domestic freight activity (see *Graph 18*), domestic consumption of petroleum products and a variety of better-quality economic series, such as industrial production, new orders for durable goods and real retail sales. These circumstances have been detailed most recently in [Commentary No. 819](#), [Commentary No. 820](#) and [Commentary No. 822](#).

Accordingly, the broad ShadowStats economic outlook has not changed, and the gist of most of the following text remains along the lines of other recent *GDP Commentaries*. The details and numbers, however, are updated to reflect the latest headline detail and benchmarking.

Discussed in [Commentary No. 739](#), which covered last year’s 2015 GDP annual benchmark revisions, annual benchmarkings increasingly are reshaping the GDP-reporting history into a post-2007 collapse pattern of successive multiple dips, irrespective of the current gimmicked revisions. By the next comprehensive GDP benchmark revision in July 2018, post-2007 historical GDP reporting should be confirming a non-recovering, multiple-dip economic collapse including a “new” or ongoing recessions.

That circumstance should encompass the evolving, current downturn in broad, domestic economic activity, discussed previously in [No. 777](#) and [No. 742 Special Commentary: A World Increasingly Out of Balance](#). Where again, the present “new” recession or multiple-dip downturn remains likely to be timed from December 2014, without headline back-to-back contractions of quarterly GDP currently in place, formal recognition of same remains pending, although the consecutive quarterly GDP contractions no longer are necessary for formal recession recognition (see the opening paragraphs of these *Opening Comments*). Recognition of the onset of the December 2007 recession was not formalized until November 28, 2008, but did have consecutive GDP contractions.

Ongoing monthly economic-reporting details for key series, public and private, however, increasingly confirm the patterns of declining or collapsing economic activity. For example, consider the discussion in [Commentary No. 820](#) on The Conference Board Help Wanted OnLine[®] Advertising through June, which was generating a signal for an economic downturn. In combination, these various collapsing economic

indicators should engender a formal recession call, irrespective of the timing of actual, headline quarterly contractions in real GDP or related political gaming of the data out of Washington.

Fundamental, real-world economic activity shows that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in recent quarters. Irrespective of the reporting gimmicks introduced in the July 2013, July 2014 and July 2016 GDP benchmark revisions—including a recent pattern of inclusion and estimation of highly-questionable data on the Affordable Care Act (ACA)—a consistent, fundamental pattern of faltering historical activity is shown in the accompanying “corrected” GDP graphs.

Please note that the pattern of activity shown for the “corrected” GDP series is much closer to the patterns shown in the graphs of unemployment (see [Commentary No. 819](#)), monthly real median household income and other consumer measures (see the updated *Consumer Liquidity Conditions* in [Commentary No. 822](#)). This also has been detailed in [No. 742 Special Commentary: A World Increasingly Out of Balance](#) and [No. 692 Special Commentary: 2015 - A World Out of Balance](#). Similar patterns are found in economic series not otherwise reliant on understated inflation for their reported growth, such as housing starts (see [Commentary No. 821](#) and [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)).

With liquidity-strapped consumers unable to fuel sustainable growth in consumption, a full business recovery could not have taken place since 2009, and a recovery will not be forthcoming until consumer structural income and liquidity problems are resolved, including more-normal credit functioning of the domestic banking system.

Official and Corrected GDP. Usually discussed in these *Commentaries* covering the quarterly GDP reporting and monthly updates, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created at least partially by using a too-low rate of inflation in deflating (removing certain inflation effects) from the GDP series. The accompanying graphs tell that story, updated for the “advance” estimate of second-quarter 2016, in the context of annual GDP benchmark revisions since first-quarter 2013, again as discussed in the opening paragraphs.

The first set of graphs (2000-to-date) is the one that traditionally has been incorporated in the *GDP Commentaries*. *Graphs 16* and *17* show short-term detail, expressed on an index base where first-quarter 2000 = 100.0. Added for comparison is the Cass Freight Index[™], a measure of North American freight volume as calculated by, and used with the permission of Cass Information Systems, Inc. Shown in *Graph 18*, the freight index, as a broad measure of basic domestic economic activity, has much more in common with the “corrected” GDP of *Graph 17*, than the headline GDP of *Graph 16*.

The second set of graphs (*Graphs 19* and *20*) updates the detail 1970-to-date, expressed in billions of 2009 dollars as used with the headline GDP. The graphs show official periods of recession as shaded areas, with ShadowStats-defined recessions indicated by the lighter shading in *Graph 20*, the second graph of the second set, as published initially in [2014 Hyperinflation Report—Great Economic Tumble](#).

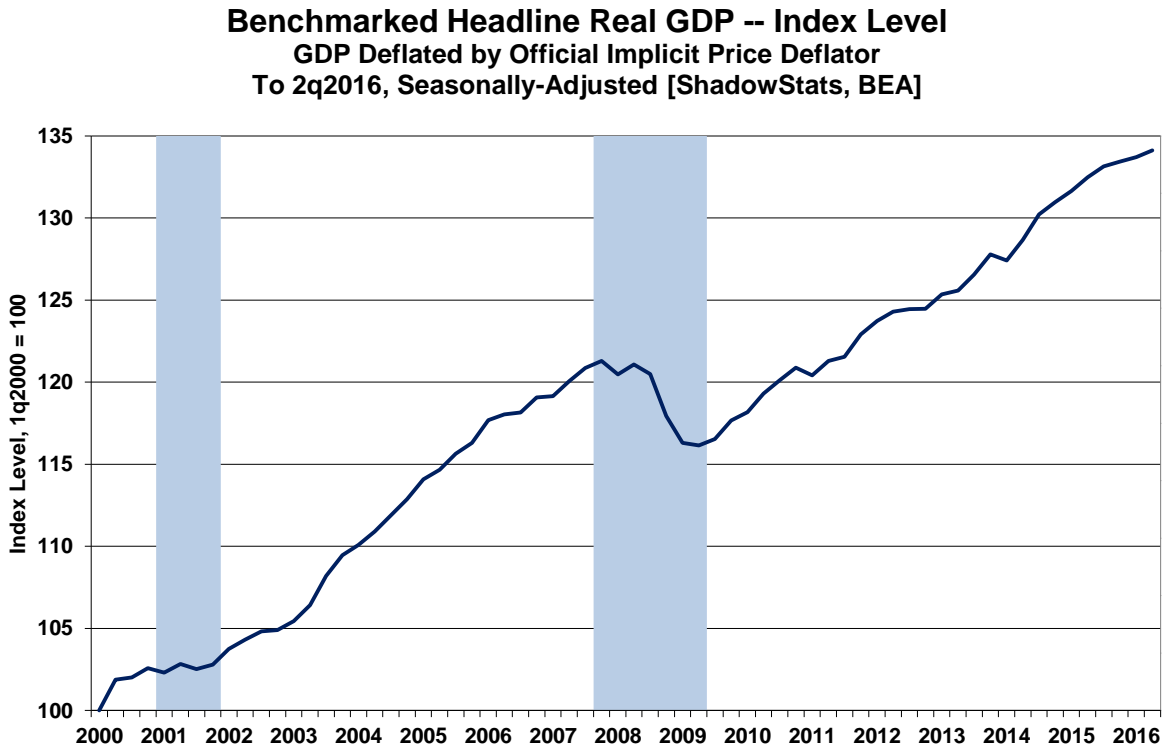
Shown in the first graph of each set (*Graphs 16* and *19*) of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (growth pauses or interruptions for second-half 2012 and first-quarter 2014 excepted). Adjusted for GDP inflation (the implicit price deflator - IPD), the context of

the benchmark revisions headline second-quarter 2015 GDP currently stands 10.6% above its pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the “corrected” GDP version, in the second graph of each set (*Graphs 17 and 20*), shows second-quarter 2016 GDP activity to be down from its pre-recession peak of first-quarter 2006 by 7.5% (-7.5%).

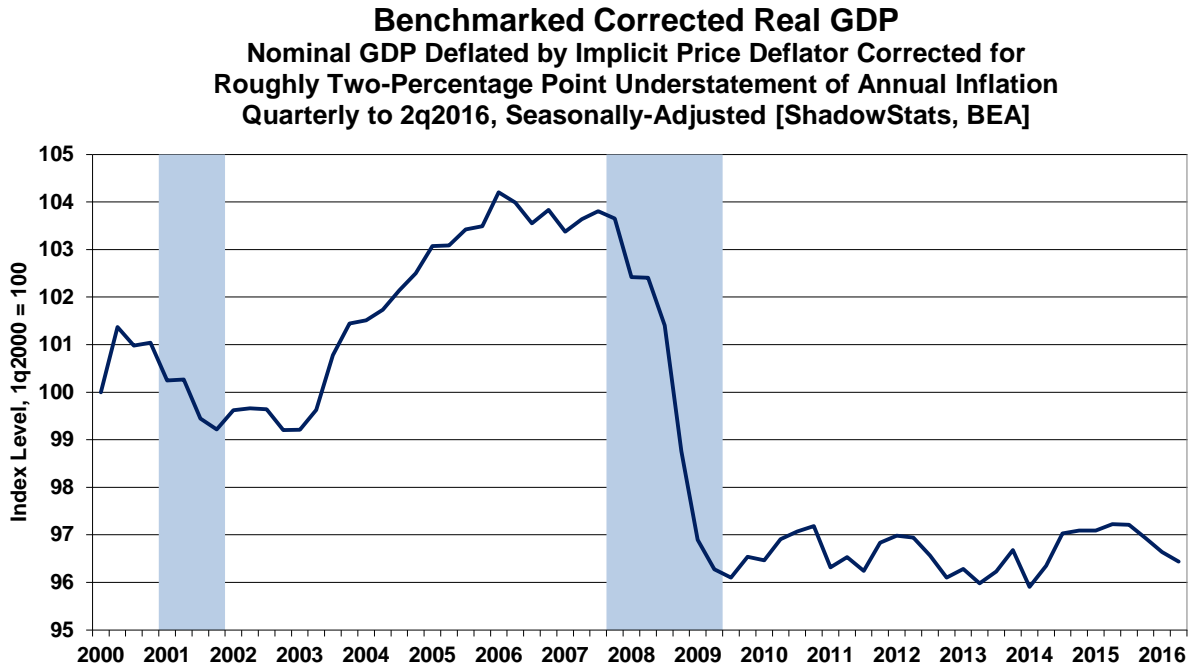
Again, the second graph in each series (*Graphs 17 and 20*) plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates (see [Public Commentary on Inflation Measurement](#)), with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation in recent years. The inflation understatement has resulted from hedonic-quality adjustments, also as discussed in the *Hyperinflation Reports*.

Further, discussed broadly in the second installment of the *Hyperinflation Report*, no other major economic series has shown a pattern of official full economic recovery and meaningful expansion thereafter, consistent with the headline GDP reporting. Such is covered in the recent discussions on industrial production, real retail sales and real durable goods orders (see [Commentary No. 820](#) and [Commentary No. 822](#)). Either the GDP reporting is wrong, or all other major economic series are wrong. While the GDP is heavily modeled, imputed, theorized and gimmicked, it also encompasses reporting from those various major economic series and private surveys, which still attempt to measure real-world activity. Flaws in the GDP inflation methodologies and simplifying reporting assumptions have created the “recovery.”

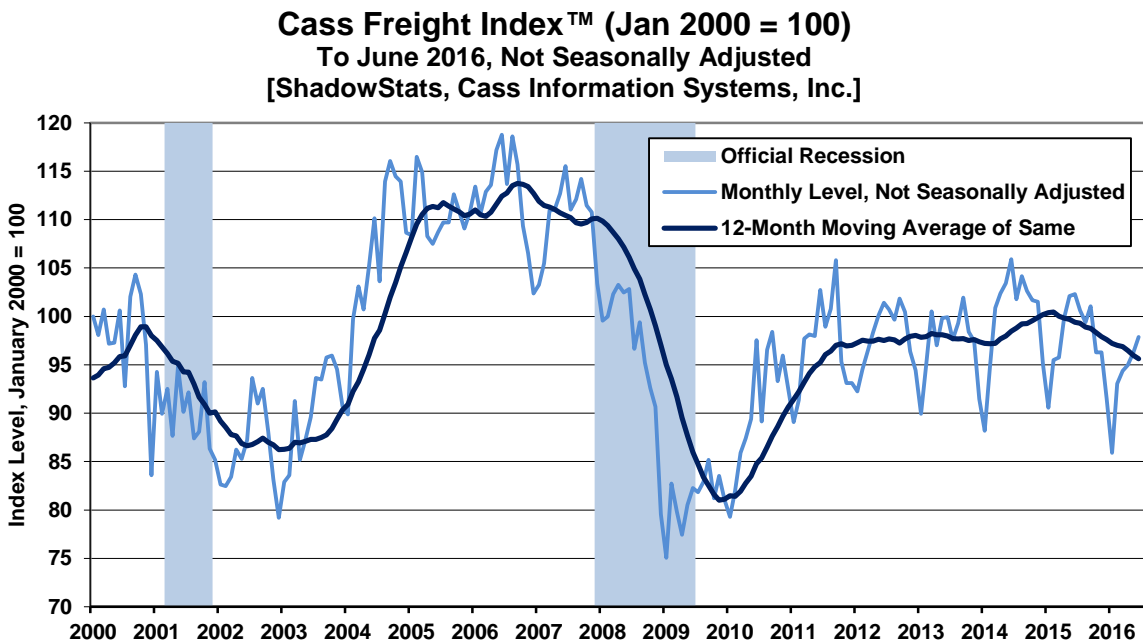
Graph 16: Benchmarked Real GDP Index – Headline Real GDP through First Estimate of Second-Quarter 2016



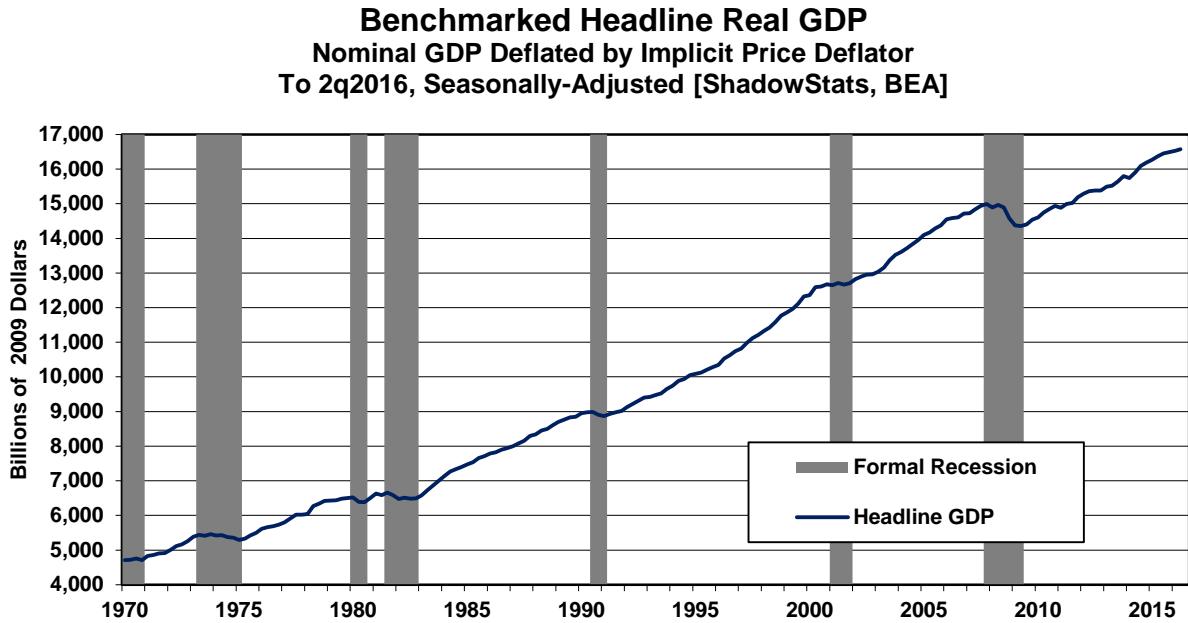
Graph 17: Benchmarked "Corrected" Real GDP Index (2000-2016), First Estimate of Second-Quarter 2016



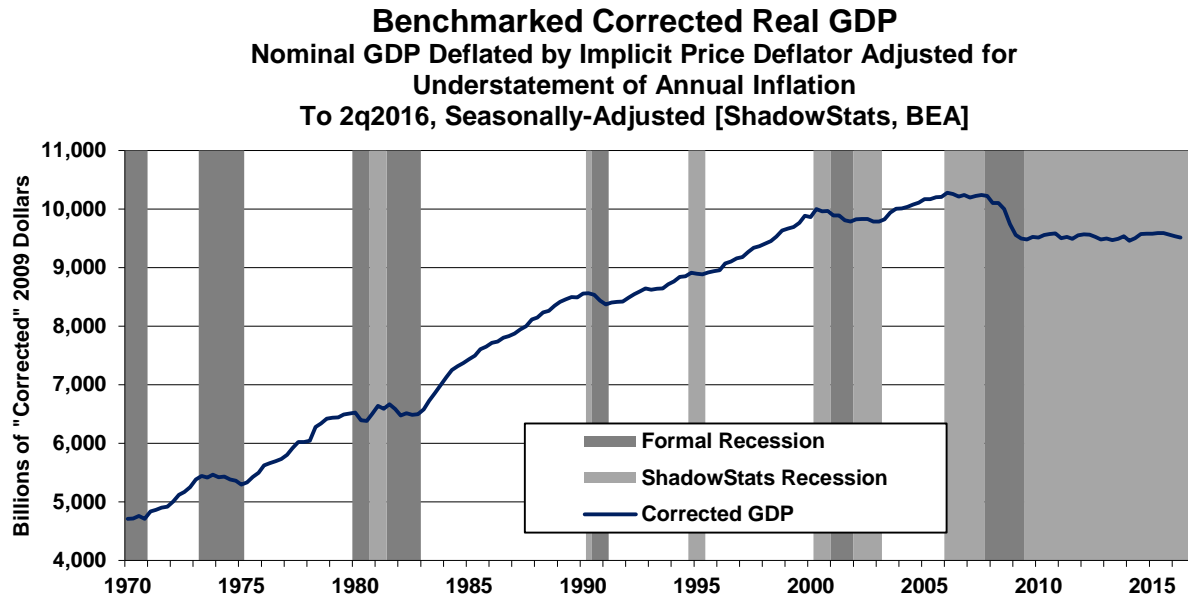
Graph 18: Cass Freight Index™ (2000-June 2016)



Graph 19: Benchmarked Real GDP Index (1970-2016), First Estimate of Second-Quarter 2016



Graph 20: Benchmarked "Corrected" Real GDP (1970-2016), First Estimate of Second-Quarter 2016



The pattern of economic collapse into 2009, followed by some minimal recovery, low-level stagnation and renewed contraction is seen with many series, as shown in the unemployment-related *Commentaries* such as [Commentary No. 819](#). Independent numbers—non-U.S. government—such as the Cass Freight Index (copied here from prior [Commentary No. 822](#)), put the lie to the gimmicked headline reporting that has been massaged for decades by government agencies and consulting academics, often publishing numbers adjusted for economic theories that have limited application to real word activity.

[The Reporting Detail section contains significant additional GDP revision analysis and graphs.]

HYPERINFLATION WATCH

MONETARY CONDITIONS—VELOCITY OF MONEY

The Velocity of Money Slowed Markedly in Second-Quarter 2016. Incorporating the headline detail of nominal second-quarter 2016 GDP, in the context of the annual GDP revisions, as well as detail from the latest Federal Reserve benchmark revisions to money-supply-related data through first-quarter 2016, *Graphs 21* and *22* show estimates of the velocity of money, broken out for money supply M1, M2 and M3 (the ShadowStats Ongoing-M3 Measure). Velocity is a measure of how many times the money turns over in a year, versus the broad economy, as measured by the GDP. The velocity is calculated simply as the ratio of the nominal GDP (not adjusted for inflation) to the nominal money supply measure.

Reflecting a rapid near-term spurt in nominal money supply annual growth measures, and a rapidly slowing pace of growth in the nominal GDP, the respective headline velocities of money supply M1, M2 and M3 all slowed down in second-quarter 2016. Where nominal GDP is in the numerator and the nominal money measure is in the denominator of the velocity ratio, the slowing velocity there indicated a relatively slower pace of nominal economic growth versus the money supply growth. Nominal headline annual GDP growth slowed in second-quarter 2016 to 2.4%, from 2.8% in first-quarter 2015, while year-to-year growth in the money measures rose. Year-to-year growth in nominal money supply, second-quarter versus first-quarter 2016, rose to 7.4% from 4.9% for M1, to 6.7% from 6.1% for M2 and to 4.2% from 3.9% for M3.

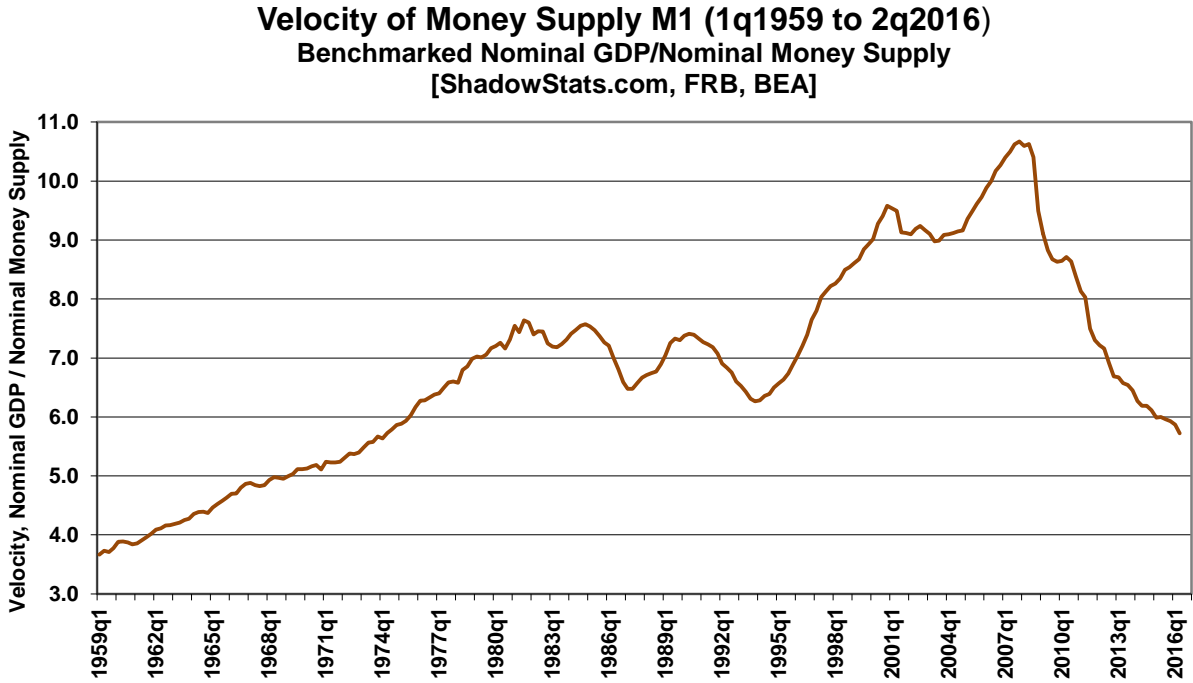
Velocity had plunged into first-quarter 2015 for M1 and M2. Since the end of 2010, however, the broader measure of M3 velocity had been steady through third-quarter 2014, when it also turned lower. With the exception of an uptick in second-quarter 2015, all velocity measures have been declining since late-2014.

As to M1, consider that perhaps 70% or more of the cash-in-circulation component of that measure (with cash accounting for about 43% of M1) could be physically outside the United States, per the Federal Reserve. Where that has been an increasing trend, a true measure of domestic M1 velocity well could be showing a significant uptrend. In like manner, where M1 includes cash, M2 includes M1, and M3 includes M2, M2 and M3 velocities also would be higher (cash is roughly 11% of M2, 8% of M3).

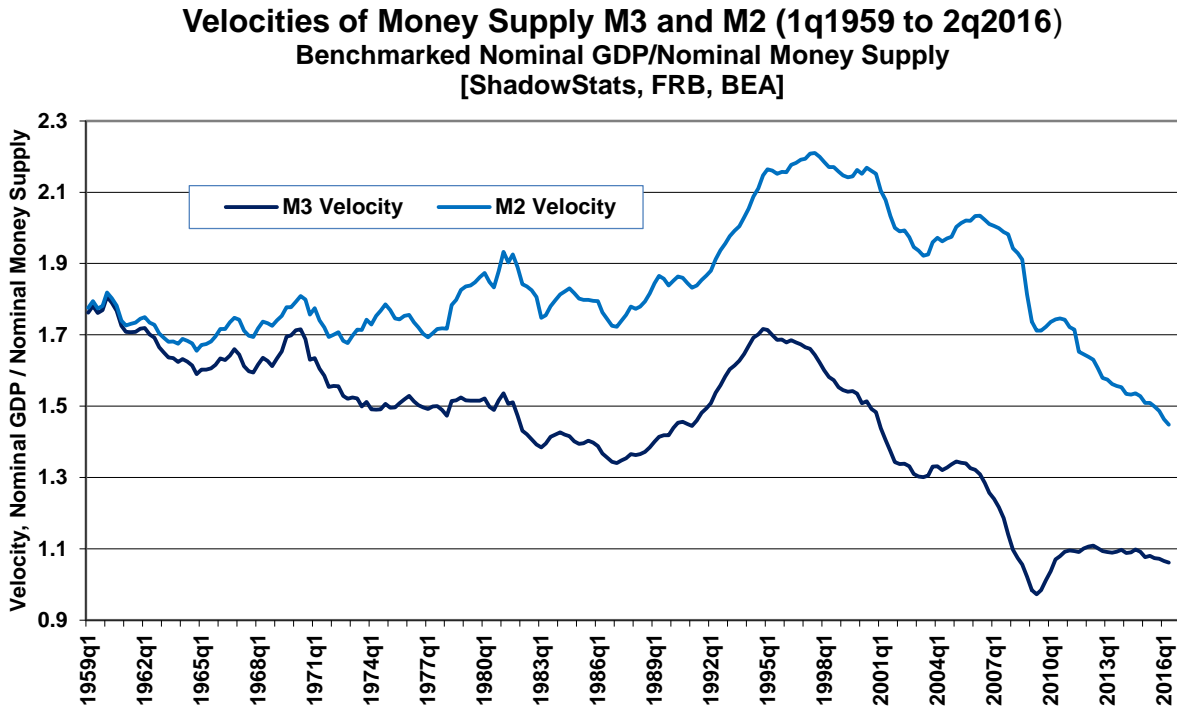
M3 versus M1 and M2 had been showing opposite patterns since 2011, because growth in M3 had been weaker than growth in M1 and M2. The reason behind that difference was that much of the relatively stronger M1 and M2 growth reflected cash moving out of M3 categories—such as large time deposits and

institutional money funds—into M2 or M1 accounts. The clarity of what happened there is why ShadowStats still tracks what had been the broadest money measure (M3) available. Again, though, M3 velocity also has started to turn down in the last year or two.

Graph 21: Velocity of Money Supply M1 through 2q2016



Graph 22: Velocities of Money Supply M2 and M3 through 2q2016



Subscribers often ask for specifics on the velocity of the money supply, with the result that this section has become a standard feature for *Commentaries* covering the “advance” GDP reporting of a given quarter. The nature of velocity is discussed in further detail in the 2008 [Money Supply Special Report](#). Again, velocity simply is the number of times the money supply turns over in the economy in a given year, or the ratio in nominal terms (not adjusted for inflation) of GDP to the money supply. It is a residual number, not otherwise open to calculation or independent surveying.

Velocity has theoretical significance. In combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is a ratio of two not-particularly-well or realistically-measured numbers, its actual estimate is of limited value. As an inflation predictor, it has to be viewed in the context of accompanying money-supply growth, and vice versa, generally as a coincident indicator. Again, full definitions can be found in the [Money Supply Special Report](#).

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Second-Quarter 2016, First or “Advance” Estimate)

“New” Recession Remains in Play. Irrespective of the heavily gimmicked and cycle-smoothed, benchmark-revised GDP detail, underlying reality remains that broad U.S. economic activity is in a renewed downturn, never having recovered its pre-recession peak. That circumstance should continue to intensify, as should be seen in the regular monthly reporting of series such as industrial production, new orders for durable goods, real retail sales, housing starts and construction spending, along with a variety of private indicators ranging from S&P 500[®] revenues and the Cass Freight Index[™] to the Conference Board’s Help Wanted OnLine[®] advertising survey.

In this most-politically-sensitive of popularly followed domestic economic series, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity has shown that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in late-2014.

The GDP (or the broader GNP headlined in earlier decades) simply remains the most worthless of the popular government economic series, in terms of determining what really is happening to U.S. business activity. The series is the most-heavily-modeled, politically-massaged and gimmicked government indicator of the economy. It has been so since at least the 1960s, and the reporting quality deteriorated anew in the just-published benchmarking.

Referenced in the *Opening Comments*, back in the days when GNP was the headline economic measure, President Lyndon Johnson reportedly reviewed the numbers before their release, and he would return them to the Commerce Department, if Commerce had gotten them “wrong.” He would keep doing so until Commerce got the numbers “right.” Johnson may not have been the first, but he definitely was not the last president to have a direct interest in headline GNP reporting, or what since has become the generally more-positive, but less-substantive GDP reporting in today’s heavily-politicized environment.

Notes on GDP-Related Nomenclature and Definitions

For purposes of clarity and the use of simplified language in the text of the GDP analysis, here are definitions of several key terms used related to GDP reporting:

Gross Domestic Product (GDP) is the headline number and the most widely followed broad measure of U.S. economic activity. It is published quarterly by the Bureau of Economic Analysis (BEA), with two successive monthly revisions, and with an annual revision in the following July.

Gross Domestic Income (GDI) is the theoretical equivalent to the GDP, but the popular press generally does not follow it. Where GDP reflects the consumption side of the economy and GDI reflects the offsetting income side. When the series estimates do not equal each other, which almost always is the case, since the series are surveyed separately, the difference is added to or subtracted from the GDI as a “statistical discrepancy.” Although the BEA touts the GDP as the more accurate measure, the GDI is relatively free of the monthly political targeting the GDP goes through.

Gross National Product (GNP) is the broadest measure of the U.S. economy published by the BEA. Once the headline number, now it rarely is followed by the popular media. GDP is the GNP net of trade in factor income (interest and dividend payments). GNP growth usually is weaker than GDP growth for net-debtor nations. Games played with money flows between the United States and the rest of the world tend to mute that impact on the reporting of U.S. GDP growth.

Real (or Constant Dollars) means the data have been adjusted, or deflated, to reflect the effects of inflation.

Nominal (or Current Dollars) means growth or level has not been adjusted for inflation. This is the way a business normally records revenues or an individual views day-to-day income and expenses.

GDP Implicit Price Deflator (IPD) is the inflation measure used to convert GDP data from nominal to real. The adjusted numbers are based on “Chained 2009 Dollars,” as introduced with the 2013 comprehensive revisions, where 2009 is the base year for inflation. “Chained” refers to the substitution methodology, which gimmicks the reported numbers so much that the aggregate of the deflated GDP sub-series missed adding to the theoretically-equivalent deflated total GDP series by \$60.4 billion in “residual,” as of the second estimate of fourth-quarter 2014.

Quarterly growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by multiplying it by four, the BEA uses the compounding method, raising the quarterly growth rate to the fourth power. So a one percent quarterly growth rate annualizes to $1.01 \times 1.01 \times 1.01 \times 1.01 = 1.0406$ or 4.1%, instead of $4 \times 1\% = 4\%$.

Annual growth refers to the year-to-year change of the referenced period versus the same period the year before.

Gross Domestic Product (GDP). Published July 29th, by the Bureau of Economic Analysis (BEA), in the context of annual benchmark revisions, the first estimate of second-quarter 2016 GDP showed a

statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 1.22% +/- 3.5% (95% confidence interval). Distribution of the benchmarked second-quarter 2016 GDP growth by major category is detailed in the *Opening Comments*.

The headline quarterly growth was well below consensus expectations that were around 2.5%, and it still has two monthly revisions (likely to the downside) ahead of it on August 26th and September 29th. The accompanying benchmark revisions lowered the headline quarterly real growth rates to 0.83% [previously 1.07%] for first-quarter 2016, and to 0.87% [previously 1.39%] in fourth-quarter 2015, versus 1.99% [previously 1.98%] in third-quarter 2015 (see *Graphs 6, 8 and 10* in the *Opening Comments, Benchmark Revisions*).

Graphs 22 and 24 plot the benchmarked and latest headline levels of real quarterly GDP activity, respectively showing short-term (since 2000) and long-term (since the historical onset of the quarterly GDP series in 1947) perspectives.

Shown in *Graphs 23 and 25*, headline year-to-year real GDP growth in second-quarter 2016 slowed to 1.23%, the weakest growth in three years, since second-quarter 2013, as seen in *Graph 8* (and related *Graphs 1 and 2*) in the *Opening Comments* and *GDP Benchmark* section. That was down from the downwardly-benchmarked 1.57% annual growth [previously 2.08%] in first-quarter 2016, and a downwardly-benchmarked 1.88% [previously 1.98%] in fourth-quarter 2015. Real annual growth now has been in continual decline since the benchmarked, near-term peak of 3.31% [previously 2.88%] in first-quarter 2015, the new post-recession high annual growth for the series. The sharp downtrend in annual growth now in place is common at the onset of formal recessions.

The current-cycle trough in annual change was in second-quarter 2009 (see *Graphs 23 and 25*), reflecting a year-to-year decline of 4.09% (-4.09%). That was the deepest year-to-year contraction for any quarterly GDP in the history of the series, which began with first-quarter 1947 (1948 in terms of available year-to-year detail).

Graph 23 shows current year-to-year quarterly detail, from 2000-to-date, where *Graph 25* shows the same series in terms of its full quarterly, year-to-year history back to 1948. *Graph 26* of full-year annual growth through 2015 generally was mixed in revisions, with 2013 growth notching higher to 1.68% [previously 1.49%], notching lower in 2014 to 2.37% [previously 2.43%] and higher again in 2015 to 2.60% [previously 2.43%].

Implicit Price Deflator (IPD). As general guidance, again, the weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth. The initial reading on second-quarter 2016 GDP inflation, or the implicit price deflator (IPD), in the context accompanying benchmark revisions was an annualized 2.21%, versus an annualized benchmarked 0.46% [previously 0.37%] in first-quarter 2016. Such followed benchmarked annualized IPD inflation of 0.91% [previously 0.94%] in fourth-quarter 2015, 1.22% [previously 1.30%] in third-quarter 2015, 2.25% [previously 2.13%] in second-quarter 2015 and a 0.04% [previously 0.12%] in the first-quarter 2015.

Year-to-year, headline second-quarter IPD inflation was 1.20%, versus a benchmarked 1.21% [previously 1.18%] in first-quarter 2016, a benchmarked 1.10% [previously 1.12%] in fourth-quarter 2015, a benchmarked 1.00% [previously 0.90%] in third-quarter 2015, a benchmarked 1.11% [previously 0.98%]

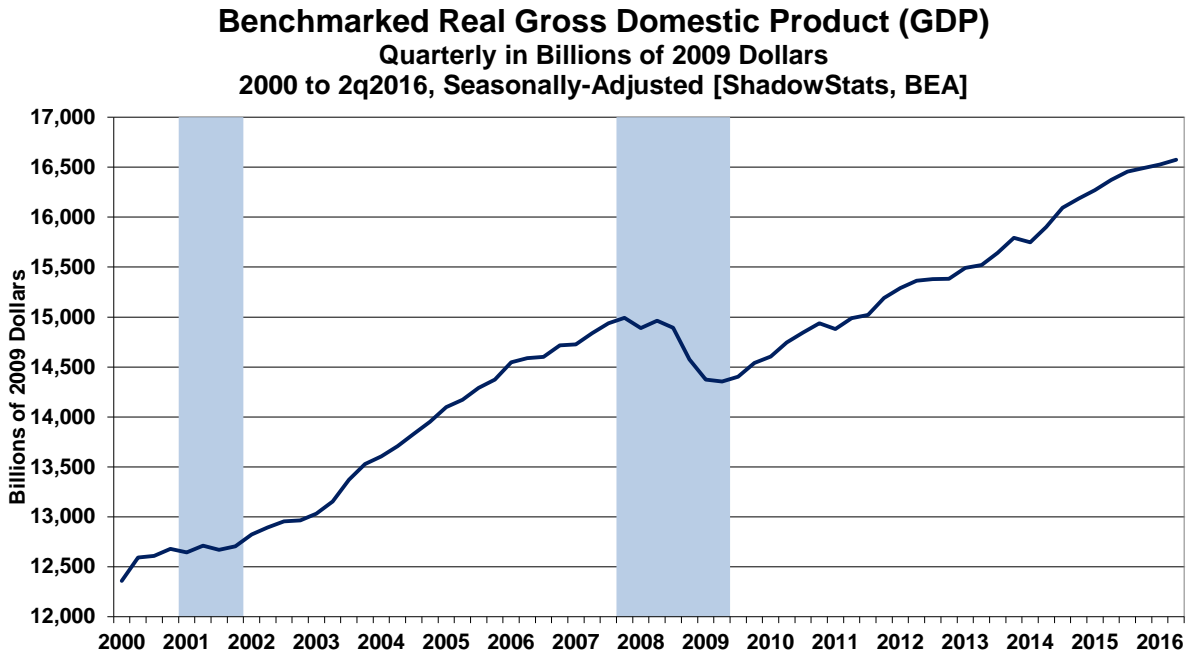
in second-quarter 2015 and a benchmarked 1.10% [previously 1.01%] annual gain in first-quarter 2015 (see *Graphs 4 and 5* in the *Opening Comments, Benchmark Section*).

For purposes of comparison, the seasonally-adjusted Consumer Price Index CPI-U rose by an annualized 2.54% in second-quarter 2016, versus a decline of 0.31% (-0.31%) in first-quarter 2016, a 0.77% gain in fourth-quarter 2015, a 1.38% gain in the third quarter, a 2.44% gain in the second quarter and a quarterly contraction of 2.86% (-2.86%) in the first quarter of 2015.

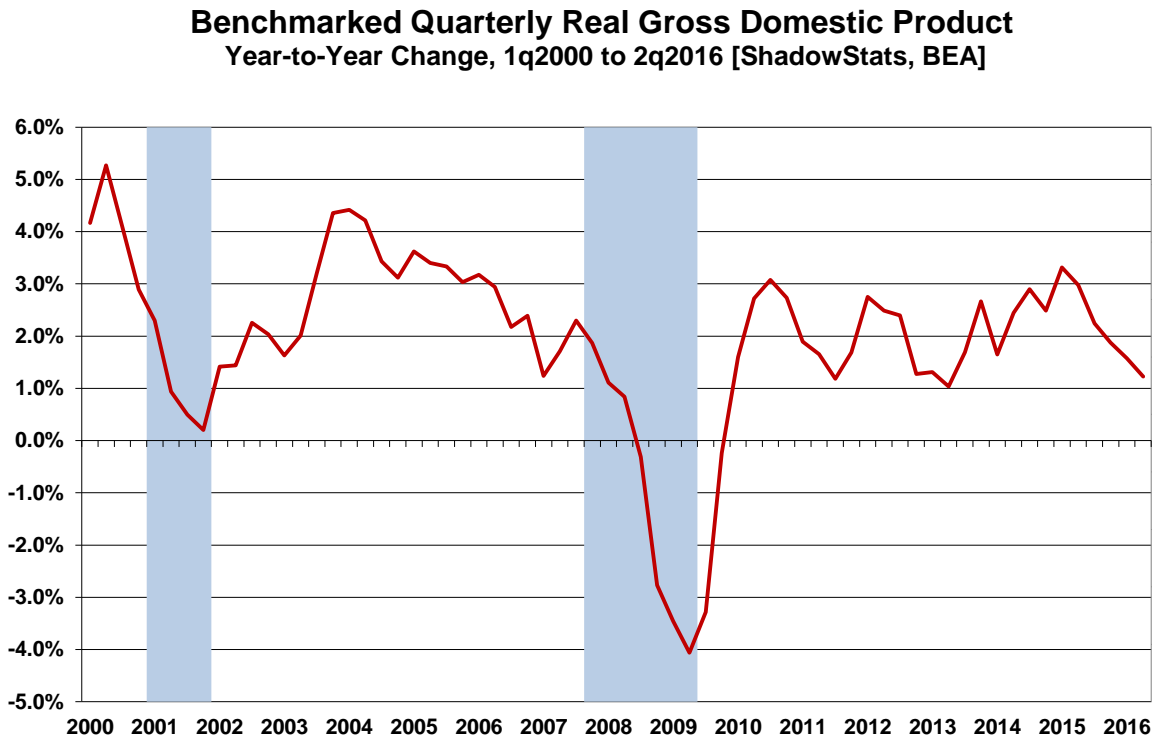
Unadjusted, year-to-year quarterly CPI-U inflation showed a year-to-year second-quarter 2016 gain of 1.05%, versus a first-quarter 2016 gain of 1.08%, a fourth-quarter 2015 gain of 0.47%, a third-quarter 2015 gain of 0.11%, an annual contraction of 0.04% (-0.04%) in second-quarter 2015 and a year-to-year decline of 0.06% (-0.06%) in first-quarter 2015 (see [Commentary No. 820](#)).

[Graphs 22 to 26 begin on the next page]

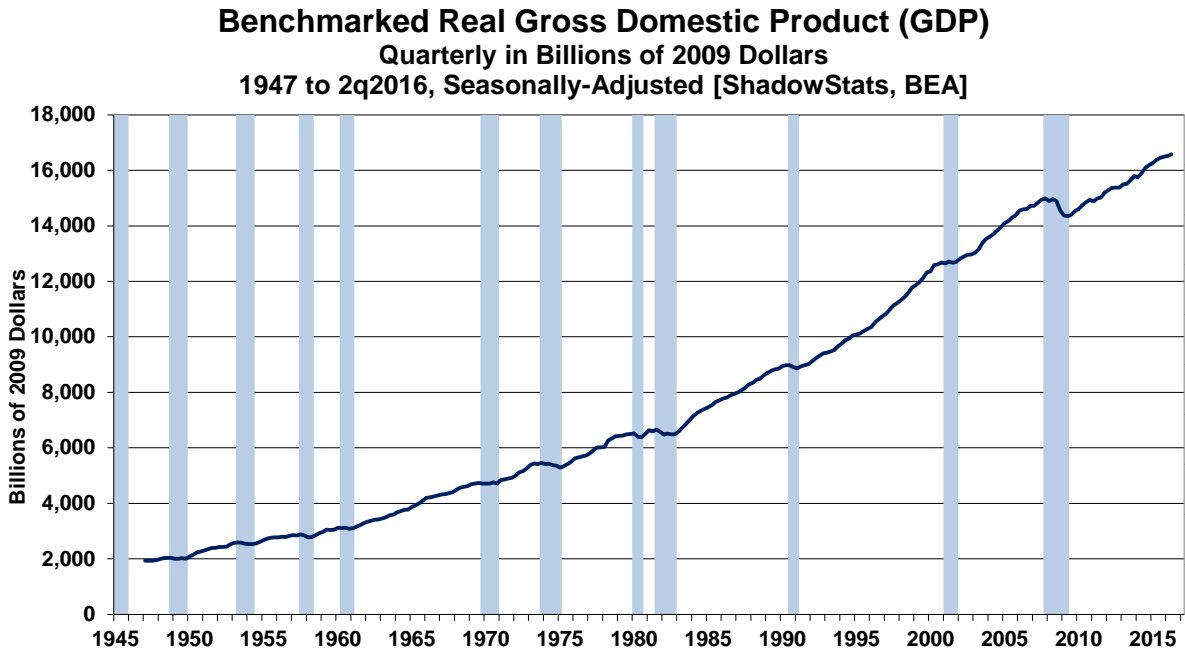
Graph 22: Quarterly GDP in Billions of 2009 Dollars (2000 to 2016), First Estimate of Second-Quarter 2016



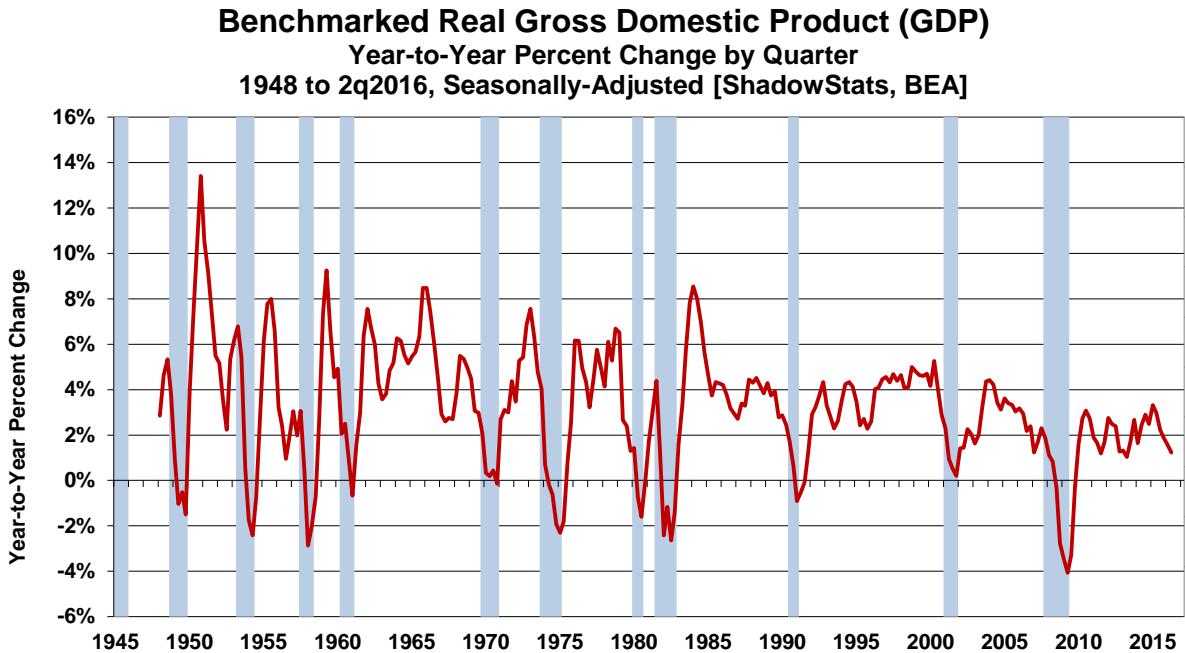
Graph 23: Quarterly GDP Real Year-to-Year Change (2000 to 2016), First Estimate of Second-Quarter 2016

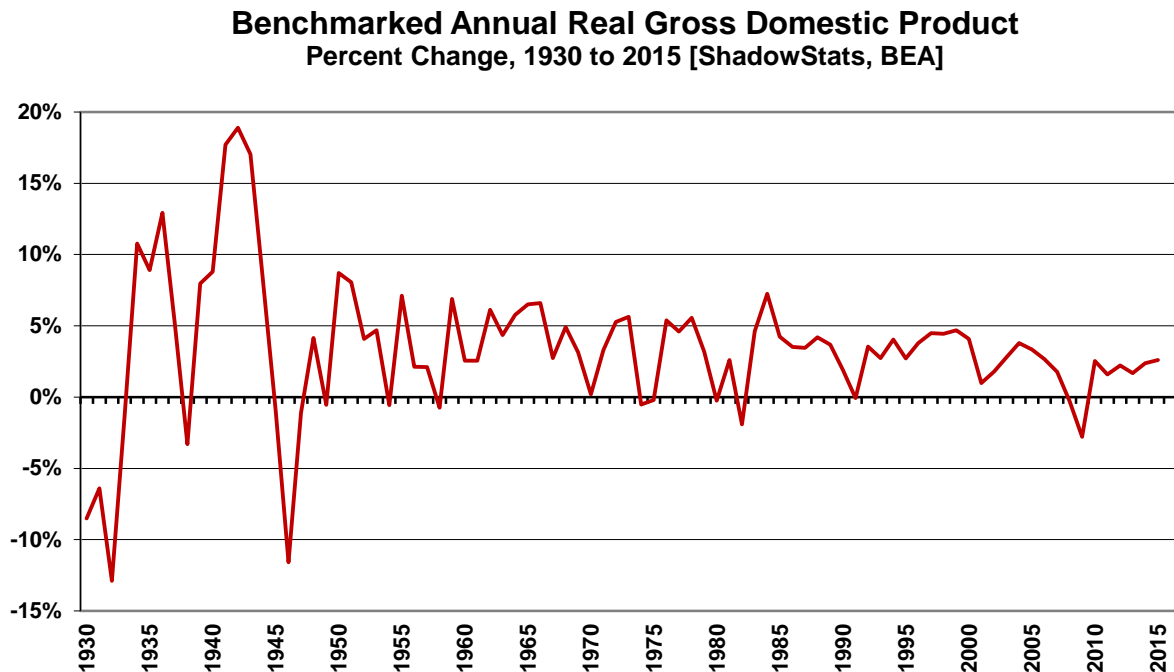


Graph 24: Quarterly GDP in Billions of 2009 Dollars (1947-2016), First Estimate of Second-Quarter 2016



Graph 25: Year-to-Year GDP Real Change (1948-2016), First Estimate of Second-Quarter 2016



Graph 26: Benchmarked Real Annual GDP Change (1930-2015)

Gross National Product (GNP) and Gross Domestic Income (GDI). The first estimates of second-quarter 2016 GNP and GDI activity will be published, along with the first revision to second quarter GDP on August 26th. These related series are not published along with initial GDP reporting, due to a lack of information or data quality issues, factors that also limit the significance of the initial second-quarter GDP reporting.

Nonetheless, both the GNP and the GDI series were revised in the benchmark revisions covering the period from first-quarter 2013 to first-quarter 2016 (see *Graphs 6 to 15*, in the *Opening Comments, Benchmark Revisions*).

Gross National Product (GNP) remains the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments). As a reporting gimmick aimed at boosting the headline reporting of economic growth for net-debtor nations such as the United States, international reporting standards were shifted some decades back to reporting headline GDP instead of what standardly had become a relatively weaker GNP.

The headline benchmark revised first-quarter 2016 GNP reverted to a fractional annualized quarterly contraction of 0.003% (-0.003%), versus a pre-benchmarked, annualized real first-quarter gain of 0.21%, which initially had been a contraction of 0.21% (-0.21%). That was against an upwardly-benchmarked 1.32% [previously 1.13%] annualized gain in fourth-quarter 2015 GNP (see *Graphs 9 and 11*).

On a year-to-year basis, benchmarked first-quarter 2016 GNP declined to 1.31%—the lowest level since second-quarter 2013—versus a pre-benchmarked annual gain of 1.64%. The followed a benchmarked year-to-year gain in fourth-quarter 2015 of 1.72% [previously 1.55%].

Gross Domestic Income (GDI) is the theoretical income-side equivalent to the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a “statistical discrepancy” to the GDI-side of the equation, but the discrepancy just as easily could be added to the GDP number. Heavily touted by the BEA as *the* GDP counterpart, the increasingly unstable GDI continues to be bloated heavily by effectively-worthless income reporting out of the Bureau of Labor Statistics (BLS). The purported income gains reflect heavily-upside-biased income estimates out of the otherwise-rigged nonfarm payroll survey, held in almost perpetual growth by built-in upside biases (see [Commentary No. 818](#), *Birth-Death/Bias Factor* discussion on page 25).

Reflecting ongoing significant overstatement of income growth in the GDI, and other instabilities in the headline reporting, the real first-quarter 2016 “statistical discrepancy” continued at \$241.9 billion in the context of generally-widened, not narrowed discrepancies between the GDI and the GDP. One would expect benchmark revisions generally to narrow the differences between these theoretically equivalent series (see *Graph 13*).

Nonetheless, the benchmark revisions sharply reduced headline GDI growth rates. For the benchmarked first-quarter 2016 real annualized GDI growth slowed to 0.88% [previously 2.90%], versus 1.48% [previous 1.95%] in the fourth-quarter 2015. Year-to-year real GDI growth benchmarked to 1.35% [previously at 2.27%] for first-quarter 2016, versus a benchmarked 1.51% [previously 1.65%] in fourth-quarter 2015 (see *Graphs 12, 14 and 15*).

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for second-quarter 2016 GDP deepened to a year-to-year contraction of 2.0% (-2.0%), versus an initial, estimated second-quarter annual real headline GDP gain of 1.2%, which was in the context of annual benchmark revisions. That was against an unrevised ShadowStats 1.8% (-1.8%) annual decline estimate for first-quarter 2016, versus the official, downwardly-revised headline gain of 1.6% [previously 2.1%] in first-quarter 2016 GDP.

While the annualized, real quarterly growth rate is not estimated formally on an alternate basis, the statistically-insignificant 1.2% annualized, “advance” headline quarter-to-quarter gain in second-quarter 2016 was much weaker, net of all the happy assumptions and regular reporting gimmicks coming into the headline detail. It is of high risk of revising into an outright quarterly contraction in the subsequent two monthly revisions. Actual quarterly contractions appear to have been a realistic possibility for inflation-adjusted GDP in most quarters since the official, second-quarter 2009 end to the 2007 recession.

Adjusted for understated inflation and other methodological changes—such as the inclusion of intellectual property, software and recent accounting for the largely not-measurable and questionable impact of the Affordable Care Act (ACA)—the business collapse that began in 2006/2007 is ongoing; there has been no meaningful economic rebound. The “corrected” real GDP graph, and the longer-term “corrected” graph (see *Graphs 17 and 20* in the *Opening Comments*), updated from [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#), are based on the removal of the impact of hedonic quality adjustments that have reduced the reporting of official annual GDP inflation by roughly two-percentage points. It is not the same measure as the ShadowStats-Alternate GDP, here, which reflects reversing additional methodological distortions (“Pollyanna Creep”) of recent decades.

WEEK AND MONTH AHEAD

Headline 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. Those unfolding circumstances have been discussed in today's *Opening Comments* and [Commentary No. 822](#), [Commentary No. 821](#), [Commentary No. 820](#), [Commentary No. 819](#), [Commentary No. 818](#), [Commentary No. 817](#), [General Commentary No. 811](#), [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](#).

Negative market reactions surfaced in trading of the U.S. dollar and in related financial markets, with some upside pressure on gold, silver and oil prices, subsequent to the weaker-than-expected headline and annual real growth in second-quarter 2016 GDP and downside revisions to recent quarters, as discussed in the opening paragraphs of the *Opening Comments*. Such reflects short-lived waning of systemic disruptions from global political circumstances, as well perpetual U.S. economic non-recovery and a renewed, intensifying downturn. Market activity in oil has been mixed, due partially to some irregular U.S. dollar strength, as discussed in the *Opening Comments* of [No. 818](#). 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 is 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 two (see [No. 820](#)).

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 initial reporting of a small 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 ([Commentary No. 817](#)), only to fall minimally back below zero with the July 29th benchmark revisions.

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 June 2016 detail moved into positive headline territory, in tandem with rising gasoline prices. CPI inflation is on track to increase again in July (with a switch to positive seasonal adjustments to gasoline prices in July) 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. 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. That construction spending issue now appears to have been structured as a gimmick to help boost the just-published GDP benchmark revisions, discussed in the opening paragraphs of today’s *Opening Comments*.

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 RELEASES:

Construction Spending (June 2016). The Commerce Department will release its estimate of June 2016 construction spending tomorrow, Monday, August 1st. Detail will be covered in *ShadowStats Commentary No. 824* of August 5th.

As usual, headline monthly changes should not be statistically-significant. Irrespective of almost perpetually-positive market expectations for this series, the detail should continue in down-trending stagnation, net of a continued positive trend in related headline inflation.

In what will have some impact on the nominal (not-inflation-adjusted) growth, relative to real (inflation-adjusted) growth, June 2016 inflation (PPI – Final Demand Construction) rose month-to-month by a seasonally-adjusted 0.09%, the same as in May (April was up by 0.79% for the month) in the aggregate construction spending category. That will reduce the headline monthly real spending growth rate, accordingly, versus the nominal performance. In the aggregate construction category, seasonally-adjusted and unadjusted annual inflation for June 2016 was 1.96%, up from 1.87% in both April and May 2016, still roughly two percentage points or so shy of private surveying. The headline annual inflation will subtract accordingly from the nominal annual growth to generate the real year-to-year growth rate.

U.S. Trade Balance (June 2016). The Commerce Department and Bureau of Economic Analysis (BEA) will release their full version of the monthly U.S. trade balance for June 2016 on Friday, August 5th, which will be covered in *Commentary No. 824* of that date. Such also will update the relative quarter-to-quarter trade deterioration in second-quarter 2016, and likely will be suggestive of an early downside revision to the just-published, initial estimate of second-quarter 2016 GDP growth. The full version of the June 2016 deficit will revise the generally worthless July 28th “advance” estimate in merchandise trade, which did show a somewhat greater-than-expected monthly deterioration.

Employment and Unemployment (July 2016). The Bureau of Labor Statistics (BLS) will publish its July 2016 labor data on Friday, August 5th. Headline detail will be covered in *Commentary No. 824* of that date. Both the more-inclusive unemployment-rate numbers, as well as the headline payroll-employment details, are open for continuing negative headline surprises, given the ongoing, general weakening tone in a number of business indicators.

In the context of recent the extreme volatility and inconsistencies in the last several months of payroll and unemployment detail, almost anything is possible with the BLS, with presidential race underway. Nonetheless, underlying reality remains a much weaker-than-expected economy, which increases the odds of a hefty downside surprise to the headline payroll gain in July.

The headline unemployment detail, however, is completely unstable and not comparable month-to-month, due to the inconsistent use of published seasonally-adjusted numbers. Such has been demonstrated in recent reporting, as discussed fully in [Commentary No. 819](#). That said, anything is possible in the next month, but the Household-Survey data increasingly should trend weaker than expected.

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.
