John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

SPECIAL COMMENTARY NUMBER 888
Political Stability versus the Economy and Financial Markets,
Durable Goods Benchmarking, Consumer Liquidity

May 22, 2017

U.S. Political-System Instability Would Threaten U.S. Dollar,
Financial-Market and Economic Tranquility

Downwardly-Benchmarked Durable Goods Orders and Shipments of Manufacturers
Showed Weaker Historical Economic Activity and Potential Downside GDP Revisions

Heavily-Stressed Consumer Liquidity Conditions
Continue to Prevent Sustainable Economic Growth

PLEASE NOTE: The next regular Commentary *scheduled for Friday, May 26th, will cover April 2017 (post-benchmark) New Orders for Durable Goods, New- and Existing-Home Sales and the first-revision to, second-estimate of First-Quarter 2017 GDP.*

Please call me at (707) 763-5786 if you have any questions or would like to talk.
Best wishes to all — John Williams

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SPECIAL COMMENTARY – POLITICAL RISKS

Severely Stressed U.S. Economic Activity and an Extraordinarily Vulnerable U.S. Dollar Could Be Torn Apart by Untoward Political Machinations. Any developments suggestive of serious risk of impeachment for the President likely would have devastating, near-term impact on the U.S. dollar, related markets and domestic business activity. As seen during the Nixon era, perceptions of rising risk of impeachment can pummel a currency. Despite the oil shocks and other issues that hit the economy and markets in 1974, today's fragile and unstable economy, markets and financial system, post-Panic of 2008, likely are less able to absorb unexpected shocks.

Initially planned as a review of the annual benchmark revisions to Manufacturers' Shipments, including New Orders for Durable Goods, this *Special Commentary* has been expanded to cover developing political circumstances. The reviews of the revised data and updated consumer liquidity conditions follow shortly. Fundamentally, the perceived stability of a nation's government remains closely intertwined with the health and stability of that country's currency, financial markets and economy.

As background, I consider myself to be an old-line conservative Republican with a Libertarian bent, and do my best to keep personal politics out of my writing. Accordingly, I generally avoid political issues in these *Commentaries*, unless the matter has the potential for significant impact upon financial or economic circumstances. Such a matter has arisen with the continuing controversy over President Donald J. Trump's firing of FBI Director James B. Comey, and mounting speculation within elements of the media as to a possible presidential impeachment. Last Wednesday (May 17th), the Justice Department appointed former-FBI Director Robert S. Mueller III as special counsel to oversee an investigation into alleged ties between the Trump presidential campaign and Russian officials.

No Basis for Impeachment Based on Current Information. Given information of varying quality put before the public, so far, there appears to be no basis for an impeachment. "Obstruction of justice" presumably is the legal angle being pursued relative to the firing of Mr. Comey. An attorney familiar with the law, in this circumstance, indicated that one has to show clear "intent," such as a bribery payment or an extortion attempt, with the need prove that "intent" beyond a reasonable doubt, in order to develop a credible "obstruction of justice" charge. My friend did not see the clear "intent" element in the current information floated in the press. Eventually, the Special Counsel should address and clarify those issues.

Separately noted by another good friend, a complicating practical factor here has been that President Trump often appears to operate outside of established protocol, which sometimes works to the President's benefit and sometimes not.

Noted in *Commentary No. 846*, of November 11, 2016, "exit polls from the presidential election indicated the economy was the primary concern for voters. Trump had paid attention to the pocketbook issues that usually drive national elections. He recognized that despite happy headline numbers published by the government and touted by the Fed and Wall Street, underlying economic reality remained that Main Street U.S.A. continued to suffer in non-recovering economic stagnation, subsequent to the economic collapse into 2009. He addressed those needs and concerns, confounding the politicians and pundits who neither

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recognized, nor would admit to those underlying systemic stresses." See also the discussion in *No. 859 Special Commentary* of January 8, 2017.

Where Mr. Trump's electoral victory upset an establishment that had been advancing ever-expansive trade deals for decades, some of Mr. Trump's political antagonists were promising to pursue impeachment angles, even before the Inauguration. What is at work here easily could be the proverbial "investigation in search of a crime." While the headline issues pursued in the investigation may be alleged Russian ties to the election process, the motivating factors behind the "scandal" investigation most likely are issues tied to big money behind the global trade pacts.

Negative Developments for the President Easily Would Roil the Markets. The sharp decline seen in U.S. stock prices, the U.S. dollar and a rally in the price of gold during last Wednesday's trading was a small precursor of the type of market volatilities that could follow in the event of political circumstances deteriorating sharply. Last week's brief market turmoil reminded me of the era of the Watergate Hearings, before President Richard M. Nixon resigned his office in 1974. Recently out of college, I took on the currency trading and hedging for my family company, which imported power equipment from West Germany. As the Watergate Hearings progressed, and the news for Mr. Nixon looked increasingly bleak, the U.S. dollar's decline accelerated versus the Deutschemark. In those days, one could listen to the Hearings on the radio and have fifteen minutes to take a currency position before the markets began to move in response.

Major factors affecting the relative strength of the U.S. dollar versus another currency include relative interest-rate levels, relative economic activity, relative trade position, relative fiscal stability and relative political stability. Depending on the investigation and actions of the Special Counsel, or otherwise some surprise development in related areas, risks to relative political stability have moved to the fore as a "potential" primary disrupter to the U.S. dollar and domestic financial markets. Such joins deteriorating economic conditions and a potential shift in FOMC policy back towards expanded quantitative easing as "likely" currency-market and financial-system disruptors in the months ahead.

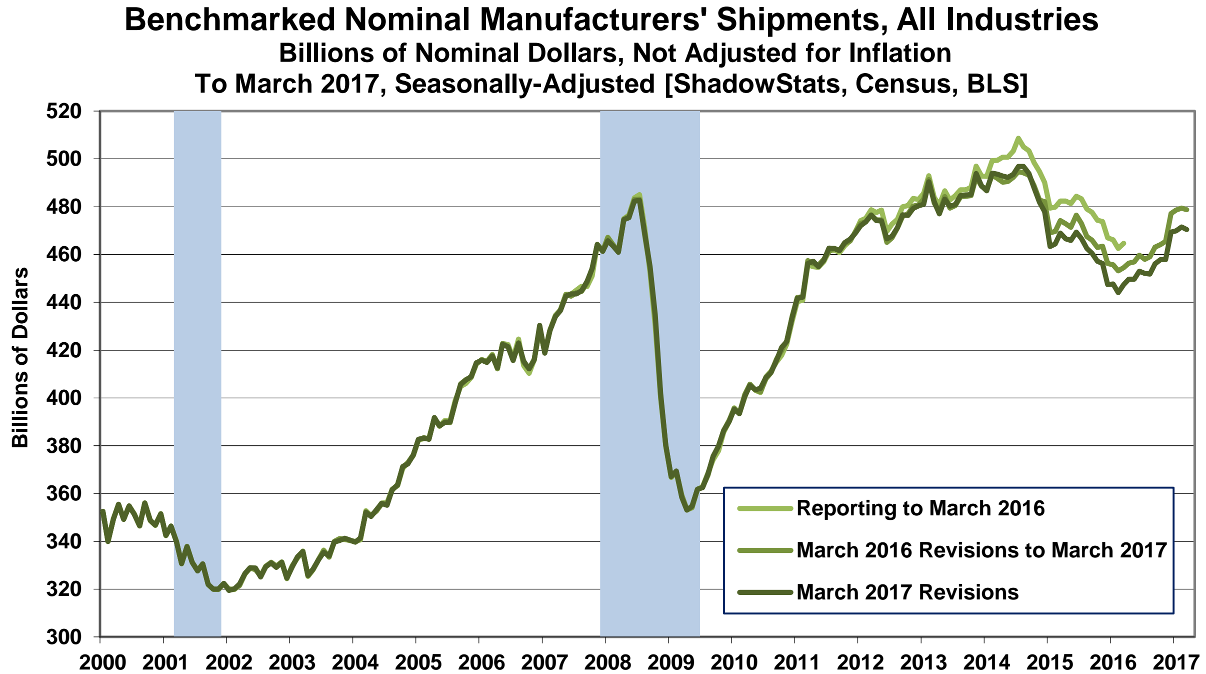
BENCHMARK-REVISED DURABLE GOODS ORDERS AND MANUFACTURERS' SHIPMENTS

Activity of Recent Years Revised Lower, Showing Ongoing Stagnation. Annual benchmark revisions to *Manufacturers' Shipments, Inventories & Orders* by the Commerce Department on Thursday, May 18th (the link provides links to related details), showed a much weaker than previously indicated economic history, with some parallel indications for upcoming GDP benchmarking. Downside revisions tended to flatten out recent history in a pattern of low level, non-economic expansion and non-recovery, where the real, inflation-adjusted series never have recovered their pre-recession peaks (see *Commentary No. 876* for related business-cycle definitions). The patterns here also were reflective of ongoing stagnation in the Manufacturing Sector of Industrial Production (see prior *Commentary No. 887*).

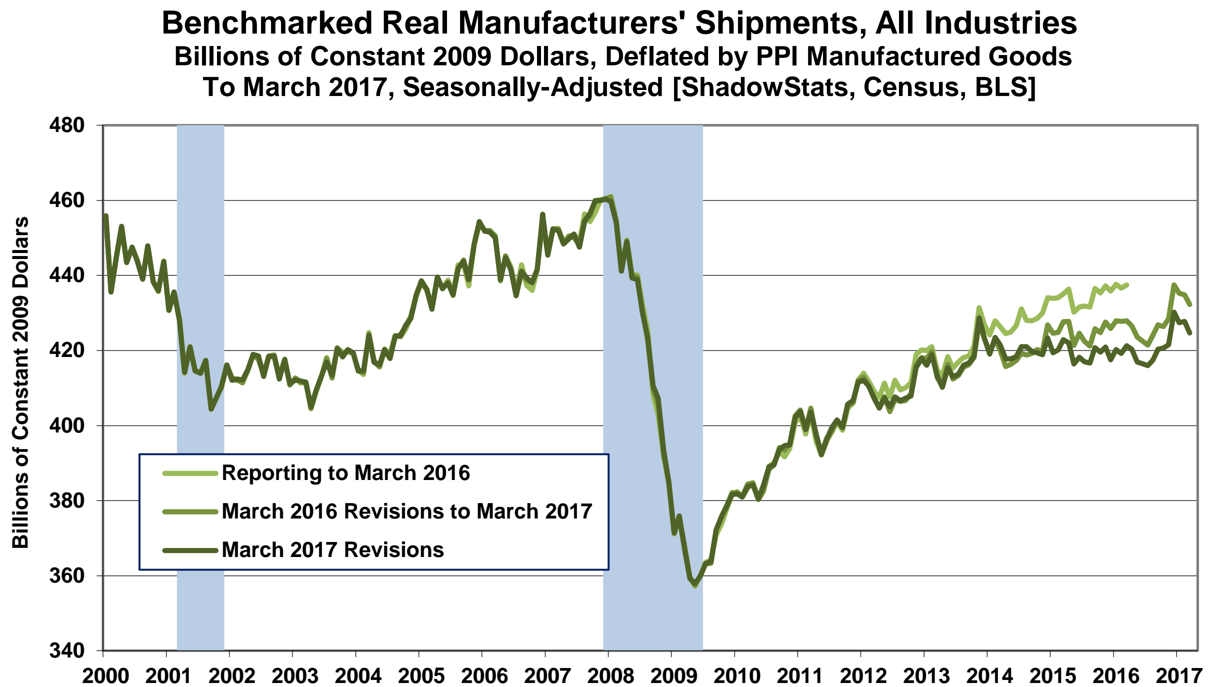
Summary plots of the revisions follow in *Graphs 1* to *12*, with *Graphs 3*, *4*, *9* and *10* showing near-term detail of key series. As a hint of the repetitive nature of these downside revisions, year-after-after, *Graphs*

1 to *10* show not only the latest revised detail (2017 benchmarking) versus prior reporting (based on 2016 benchmarking), but also the prior series (based on 2015 benchmarking). In terms of inflation adjustment, the "manufactured goods" series out of the Producer Price Index (PPI) is used for the Manufacturers' Shipments, All Industries, while the "manufactured durable goods" series is used in deflating the New Orders for Durable Goods series.

Graph 1: Benchmarked Nominal Manufacturers' Shipments, All Industries

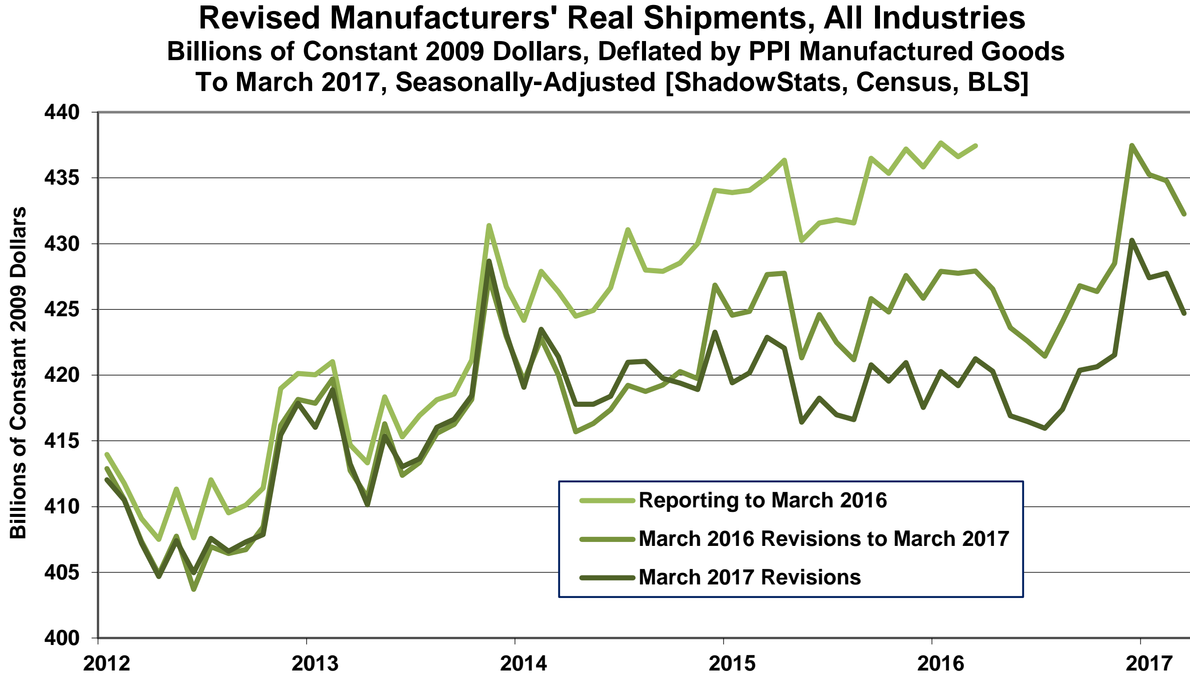


Graph 2: Benchmarked Real Manufacturers' Shipments, All Industries

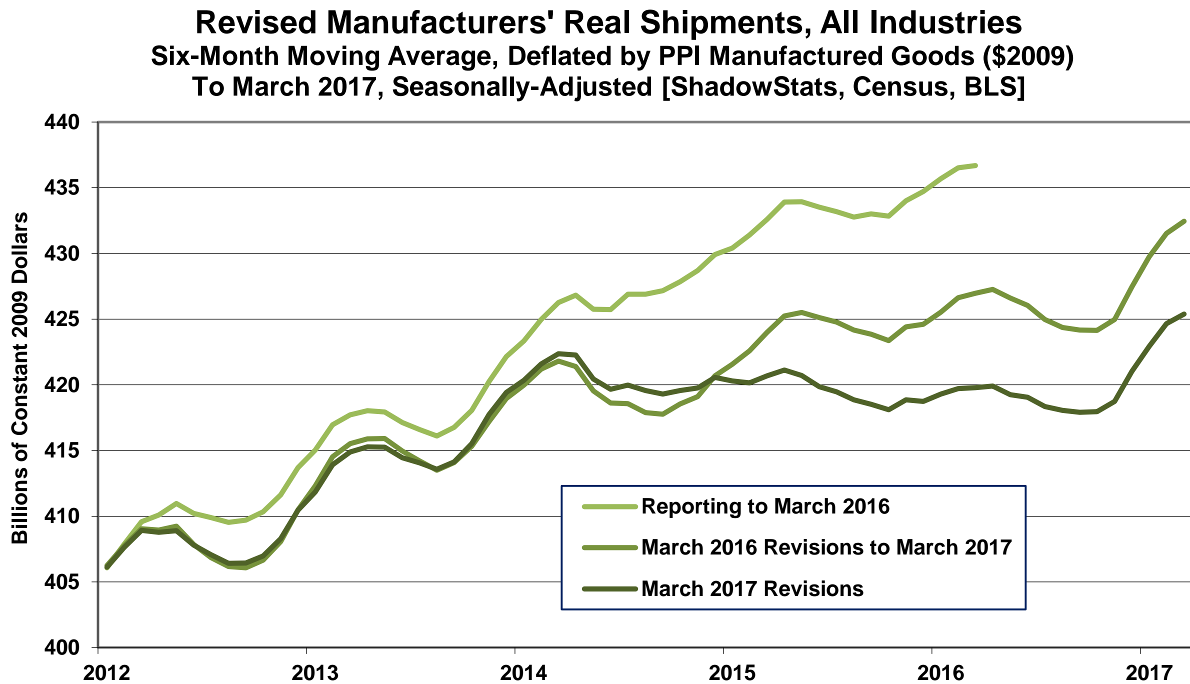


Real First-Quarter 2017 Shipments Revised Lower. Benchmark revisions reduced the level of shipments activity by roughly 2.0%, coming into 2017. Where shipments activity is more of a coincident indicator, and the new orders activity is more of a leading indicator, the downside revision to annualized real growth in first-quarter 2017 shipments from 3.11% to 2.35% should be indicative of some downside pressure on the pending first revision to first-quarter 2017 GDP (see the *Week, Month and Year Ahead*).

Graph 3: Revised Real Manufacturers' Shipments, All Industries, Monthly



Graph 4: Revised Real Manufacturers' Shipments, All Industries, Six-Month Moving Average



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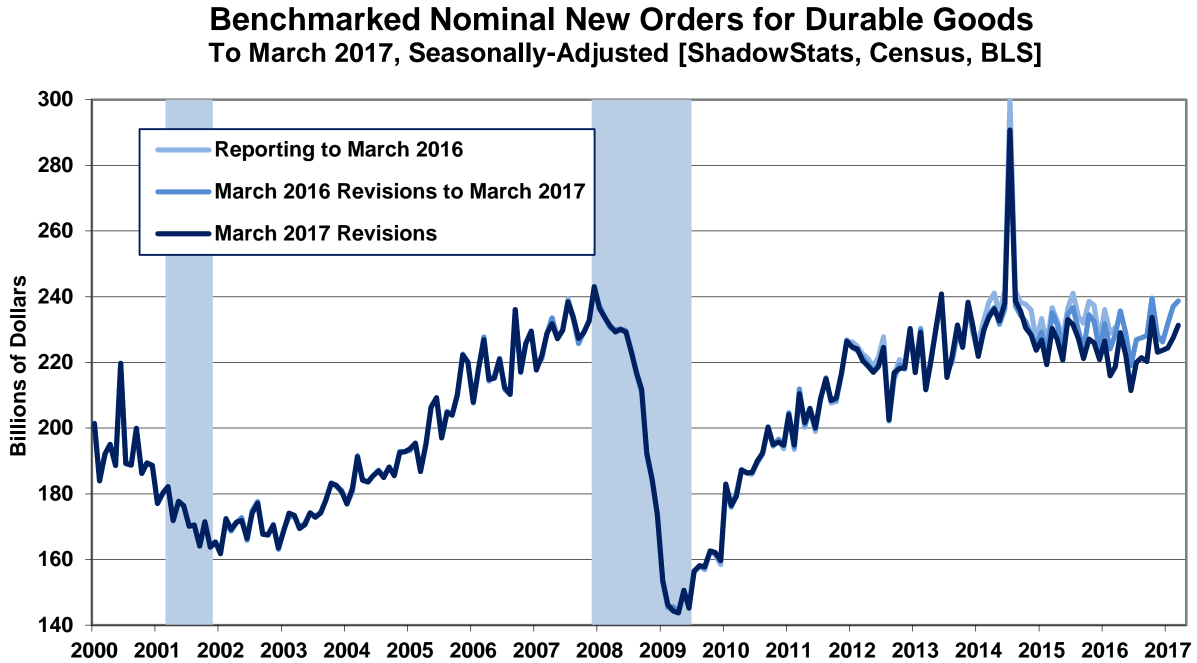
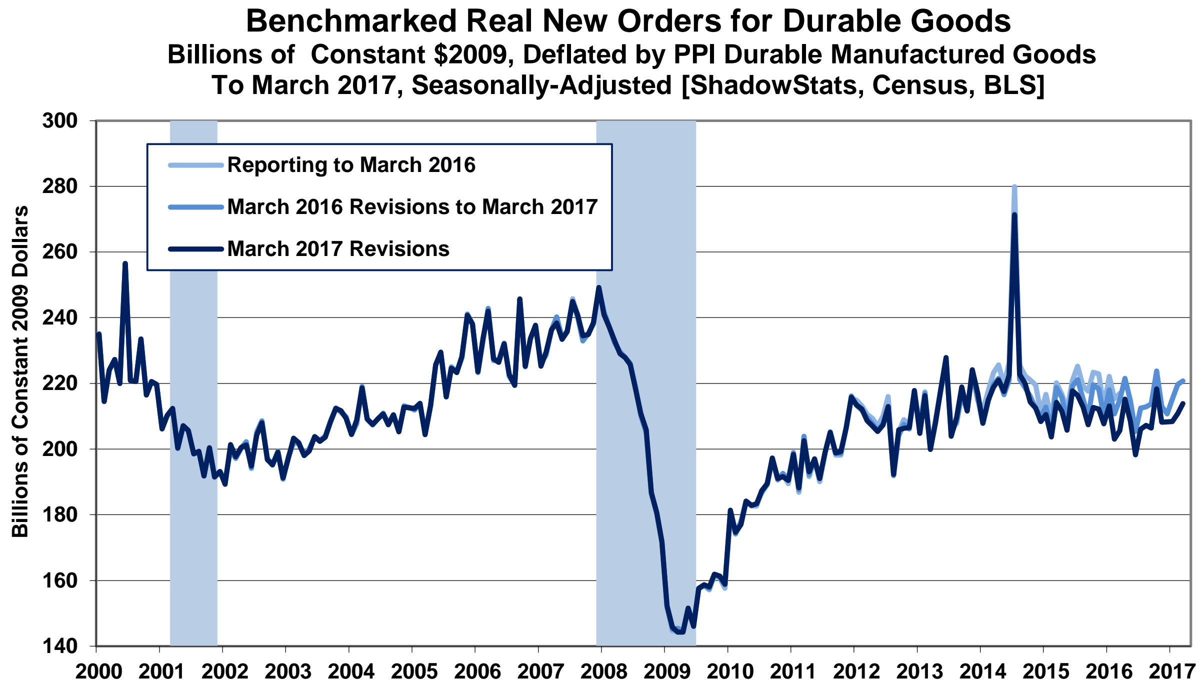
New Orders for Durable Goods Took a Heavier Hit than All Industries' Shipments. New orders for durable goods revised lower by roughly three to four percentage points, coming into 2017.

Graph 5: Benchmarked Nominal New Orders for Durable Goods, Monthly



Graph 6: Benchmarked Real New Orders for Durable Goods, Monthly



The best leading indicator here to industrial production (particularly manufacturing) and to the general economy, is inflation-adjusted real new orders, ex-commercial aircraft. The reporting of extreme

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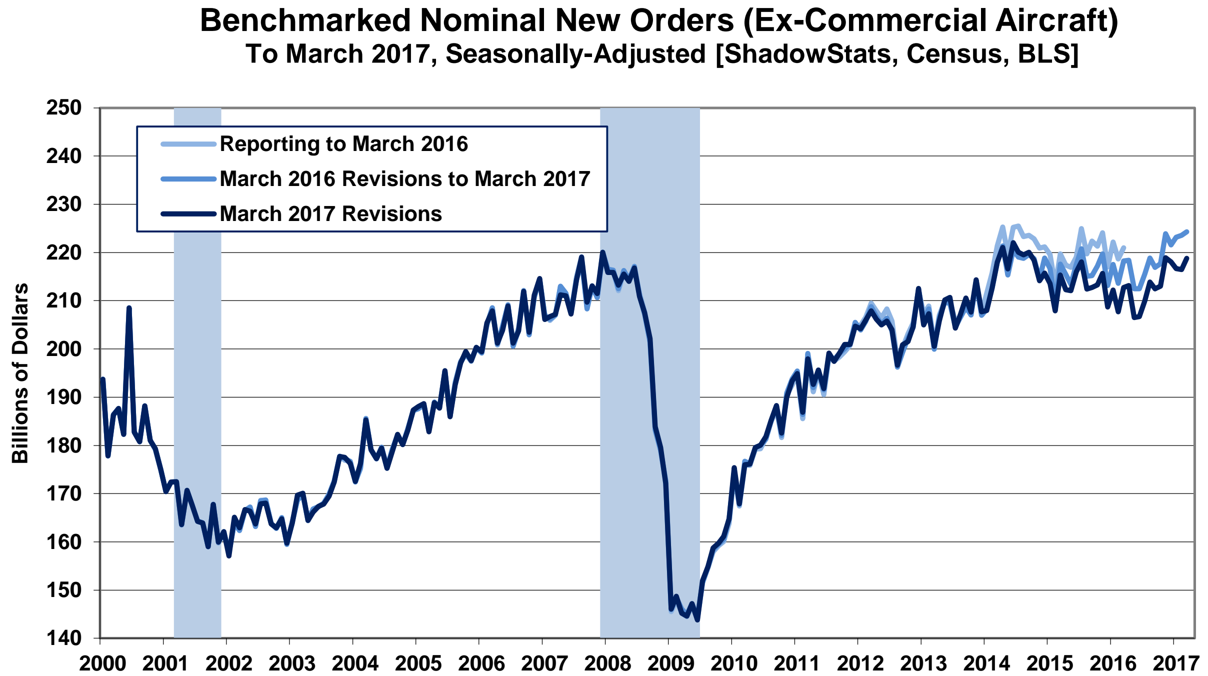
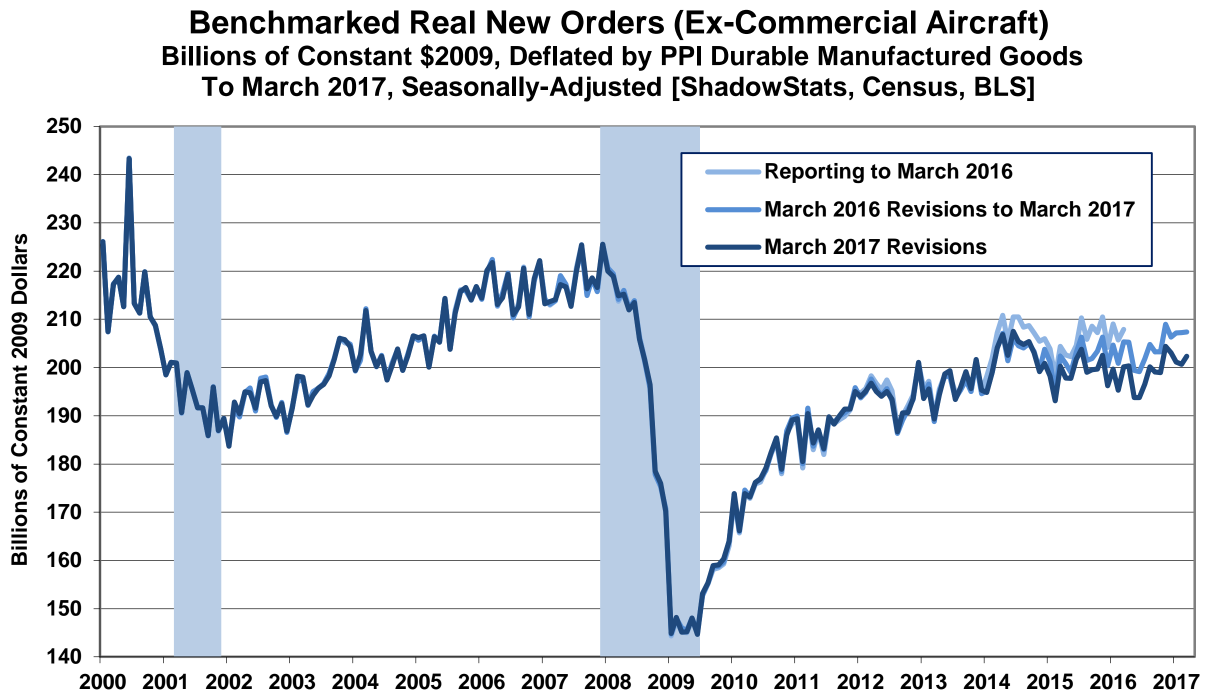
contractions and surges in commercial-aircraft orders is seen in an irregularly-repeating process throughout the year, and that often dominates changes in headline monthly durable goods orders. These extremely volatile aircraft orders are booked years into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

Graph 7: Benchmarked Nominal New Orders for Durable Goods (Ex-Commercial Aircraft), Monthly



Graph 8: Benchmarked Real New Orders for Durable Goods (Ex-Commercial Aircraft), Monthly



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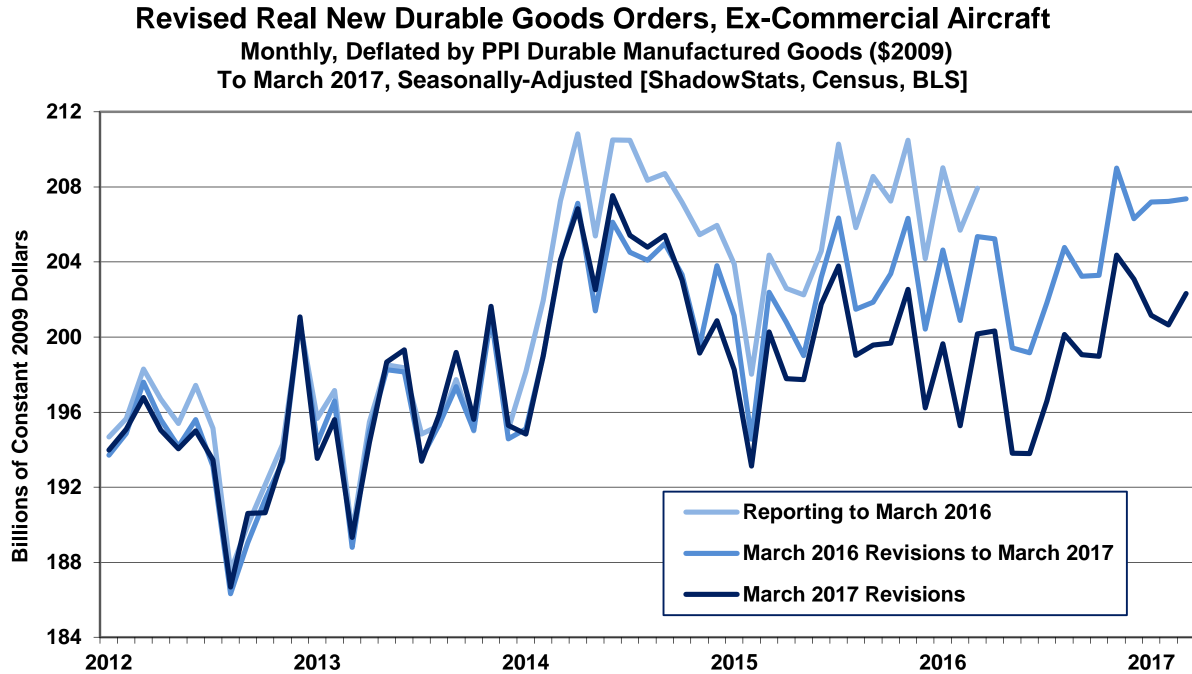
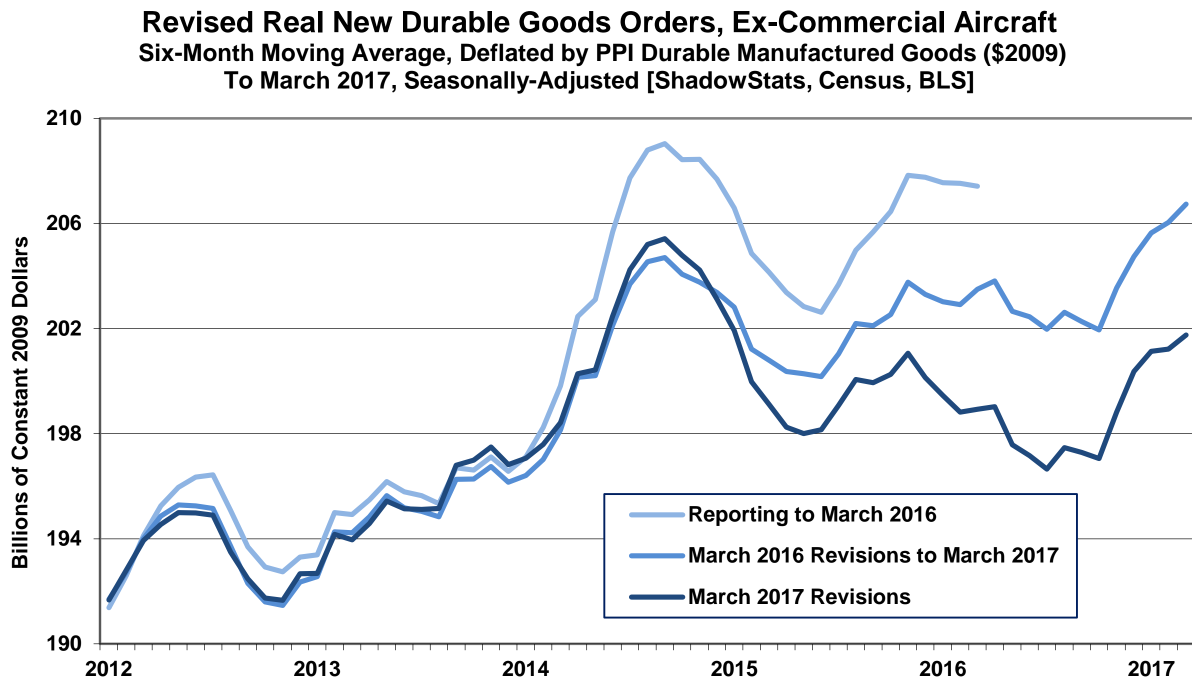
Real First-Quarter 2017 New Orders Revised Lower. Benchmark revisions reduced the pace of real annualized first-quarter 2017 growth in New Orders for Durable Goods, Ex-Commercial Aircraft from an annualized 2.07% gain to an annualized contraction of 1.51% (-1.51%), suggestive of some pending weakness in Industrial Production.

Graph 9: Revised Real New Orders for Durable Goods, Ex-Commercial Aircraft, Monthly

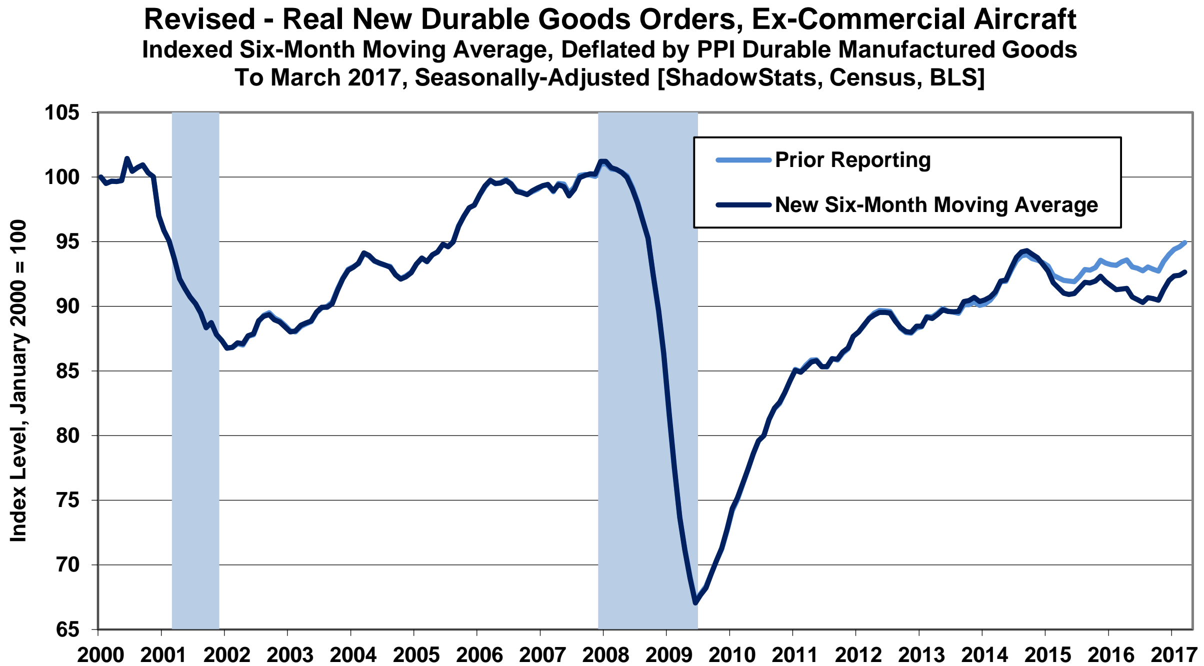


Graph 10: Revised Real New Orders, Ex-Commercial Aircraft, Six-Month Moving Average

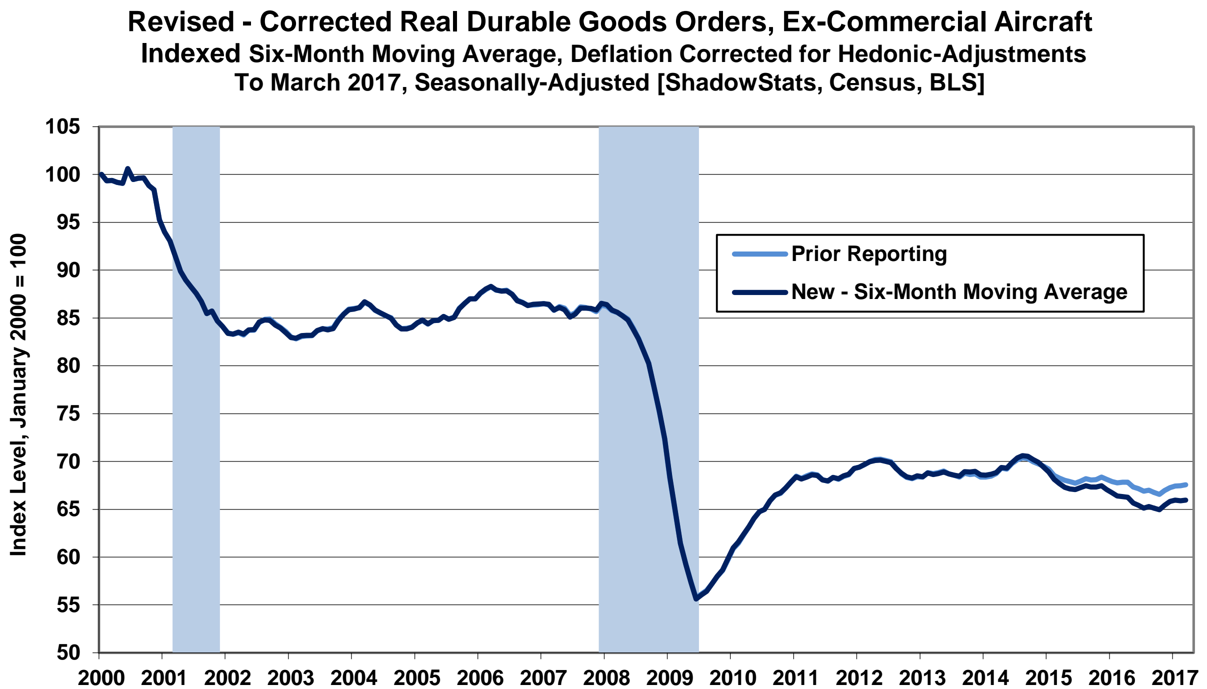


The final two *Graphs 11* and *12* in this section are primary indicators of pending economic activity, plotted just for the current revisions versus the prior reporting. *Graph 11* reflects real new orders, ex-commercial aircraft, smoothed with a six-month moving average. *Graph 12* reflects *Graph 11* adjusted for the understatement of headline inflation in the deflation process. The adjusted, *Graph 12* probably is the best indicator here of actual economic activity (see discussion in [*Commentary No. 882*]).

Graph 11: Real New Orders for Durable Goods, Ex-Commercial Aircraft, Six-Month Moving Average



Graph 12: Corrected Real Durable Goods Orders, Ex-Nondefense Aircraft, Six-Month Moving Average



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CONSUMER LIQUIDITY CONDITIONS

Updated Consumer Liquidity Conditions—Income and Credit Stresses Continue Amidst Peaking Optimism. The U.S. consumer faces continuing financial stress, which increasingly should impact headline Retail Sales activity (see *Commentary No. 886*). On the income side, Real Average Weekly Earnings notched minimally higher, with first-quarter 2017 activity holding in annual and quarterly contraction, while historically low-level Median Real Monthly Household Income has remained stagnant. Consumer Credit continued to falter as if it is back in the second-half of 2012, when headline GDP growth stalled. Not-so-coincidentally, the first-revision to annualized first-quarter 2017 real GDP growth (May 26th) likely will vary minimally from the initial estimate of 0.69%, statistically indistinguishable from the annualized growth rates of 0.48% and 0.09% seen in the last two quarters of 2012. The consumer confidence and sentiment measures continued to flutter at levels shy of recent highs. Further to the opening comments in this *Special Commentary*, it will be interesting as to how expectations respond the “impeachment” talk.

This general discussion of Consumer Liquidity Conditions has been updated for March Consumer Credit outstanding, and for the advance-May 2017 estimate of the University of Michigan Consumer-Sentiment measure, updating *Commentary No. 883* and as fully reviewed in the *CONSUMER LIQUIDITY* section of *No. 859 Special Commentary.*

Liquidity Issues Limit Economic Activity**.** Severe and persistent constraints on consumer liquidity of the last decade or so drove economic activity into collapse through 2009, and those conditions have prevented meaningful or sustainable economic rebound, recovery or ongoing growth since. The limited level of, and growth in, sustainable real income, and the inability and/or unwillingness of the consumer to take on new debt have remained at the root of the liquidity crisis and ongoing economic woes.

These same pocket-book issues contributed to the anti-incumbent electoral pressures in the 2016 presidential race. The post-election environment showed a near-term surge in consumer optimism to levels generally not seen since before the formal onset of the recession in 2002, let alone 2007, while underlying liquidity conditions and economic reality continued to remain shy of consumer hopes. Accompanying details reflect February 2017 and Fourth-Quarter 2016 readings of consumer credit and obligations, stressed real median monthly household income in March 2017 and those elevated, but faltering April/early-May confidence and sentiment numbers.

Generally, the higher and stronger these measures are, the healthier is consumer spending. Most measures of consumer liquidity and attitudes remain off their lows, and one of the hard ones—real monthly median household income—actually had spiked recently to pre-recession levels, reflecting the temporary collapse in gasoline prices and deflation by the otherwise underestimated headline CPI-U inflation. Having stagnated briefly, real monthly median household income generally has begun to falter, anew.

Even so, the broad underlying consumer liquidity fundamentals simply have not supported, and still do not support a turnaround in general economic activity. Never truly recovering post-Panic of 2008, limited growth in household income and credit have eviscerated and continue to impair broad, domestic U.S. business activity, which feeds off the financial health and liquidity of consumers.

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This circumstance remains in play in the context of that post-election surge in consumer expectations that now has exceeded pre-recession levels, but appears to have topped out. Nonetheless, underlying liquidity conditions and reality—particularly income and credit—remain well shy of consumer hopes and needs.

The combined issues here have driven the housing-market collapse and ongoing stagnation in consumer-related real estate sales and construction activity, and have constrained both nominal and real retail sales. The related, personal-consumption-expenditure and residential-construction categories accounted for 73.0% of the headline real, first-quarter 2017 U.S. GDP.

Yet, with the better-quality economic indicators and underlying economic reality never having recovered fully from the collapse into 2009, consumers increasingly should pull back on consumption in the month or two ahead. Underlying reality is evident in more-meaningful series—not the GDP—irrespective of the transient, gimmicked boosts to, and current headline slowing in, that most worthless of economic indicators.

April/Early-May Consumer Confidence and Sentiment Measures Continue to Falter. This detail incorporates full-April 2017 reporting for the Conference Board's Consumer-Confidence and the early-May 2017 estimate of University of Michigan's Consumer-Sentiment. Reflected in *Graphs 13* and *14*, both confidence and sentiment rose in September and plunged in October, likely reflecting concerns as to the direction of the presidential race. Post-election, both measures rallied sharply, reflecting a surge in consumer optimism. Both series now, however, appear to have topped and are beginning to pull back.

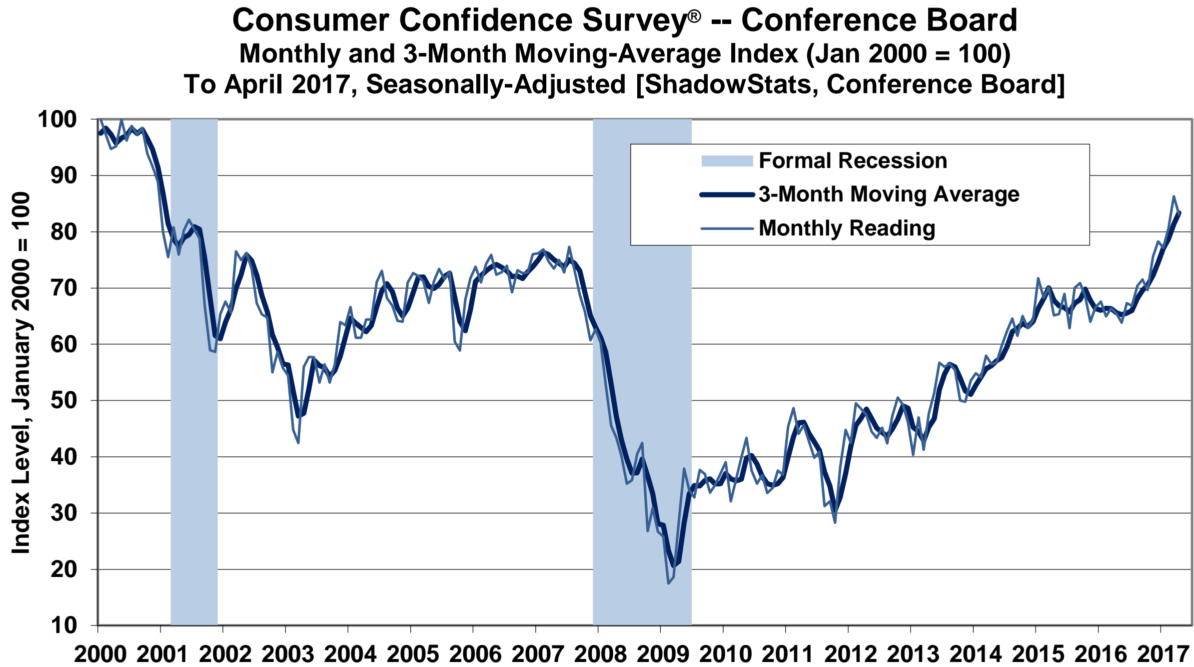
The Conference Board's seasonally-adjusted [unadjusted data are not available] Consumer-Confidence Index® (*Graph 13*), and the University of Michigan's not-seasonally-adjusted Consumer-Sentiment Index (*Graph 14*), again, both soared post-election, took breathers in January 2017, boomed into March but declined minimally in April with continued fluttering in early-May. The three-month moving averages in both series have broken pre-recession highs, with the Consumer-Confidence Index® at levels not seen since before the 2001 recession.

Showing the Consumer Confidence and Consumer Sentiment measures on something of a comparable basis, *Graphs 13* to *15* reflect both measures re-indexed to January 2000 = 100 for the monthly reading. Standardly reported, the Conference Board's Consumer Confidence Index® is set with 1985 = 100, while the University of Michigan's Consumer Sentiment Index is set with January 1966 = 100.

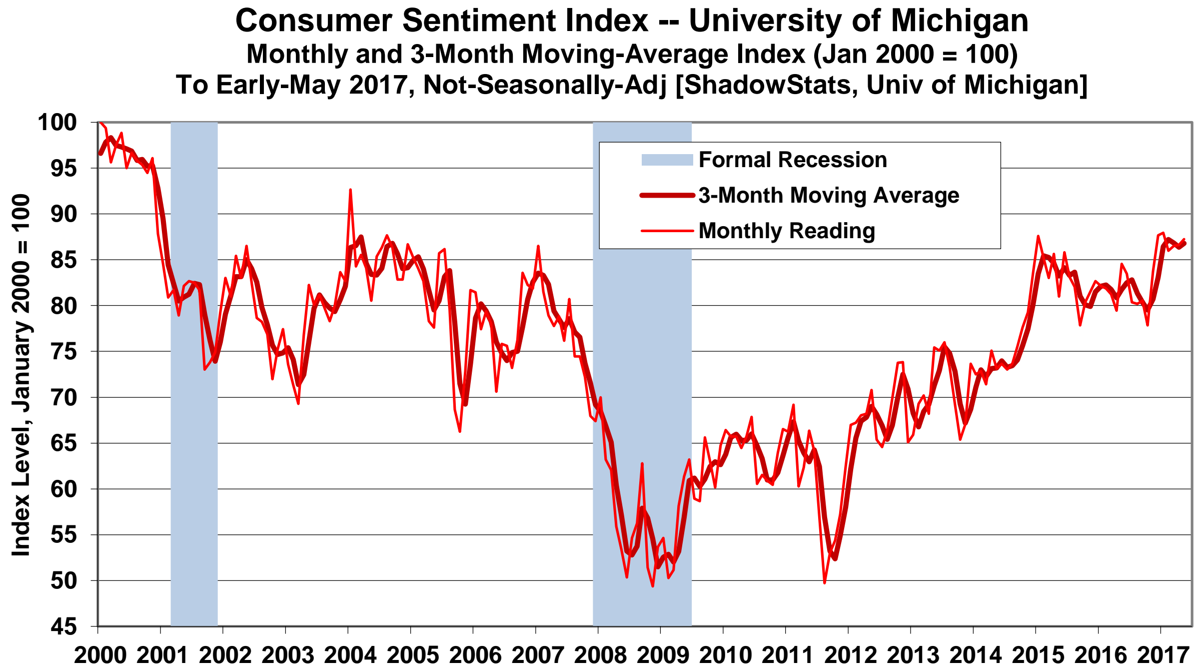
The Confidence and Sentiment series tend to mimic the tone of headline economic reporting in the press (see discussion in *Commentary No. 764*), and often are highly volatile month-to-month, as a result. With what should become increasingly-negative, unstable and uncertain headline financial and economic reporting in the months ahead—beyond the early change-in-government euphoria—successive negative hits to both the confidence and sentiment readings remain increasingly likely in the near future. Further to the opening section in this *Special Commentary*, it will be interesting as to how expectations respond following recent "impeachment" talk.

[Graphs 13 and 14 follow on the next page.]

Graph 13: Consumer Confidence (2000 to 2017)



Graph 14: Consumer Sentiment (2000 to 2017)



Smoothed for irregular, short-term volatility, the two series still generally had held at levels seen typically in recessions, until the post-2016 election circumstance. Suggested in *Graph 15*—plotted for the last 47 years—the latest readings of Confidence and Sentiment recently have recovered levels seen in periods of normal, positive economic activity of the last four decades, with their six-month moving averages at

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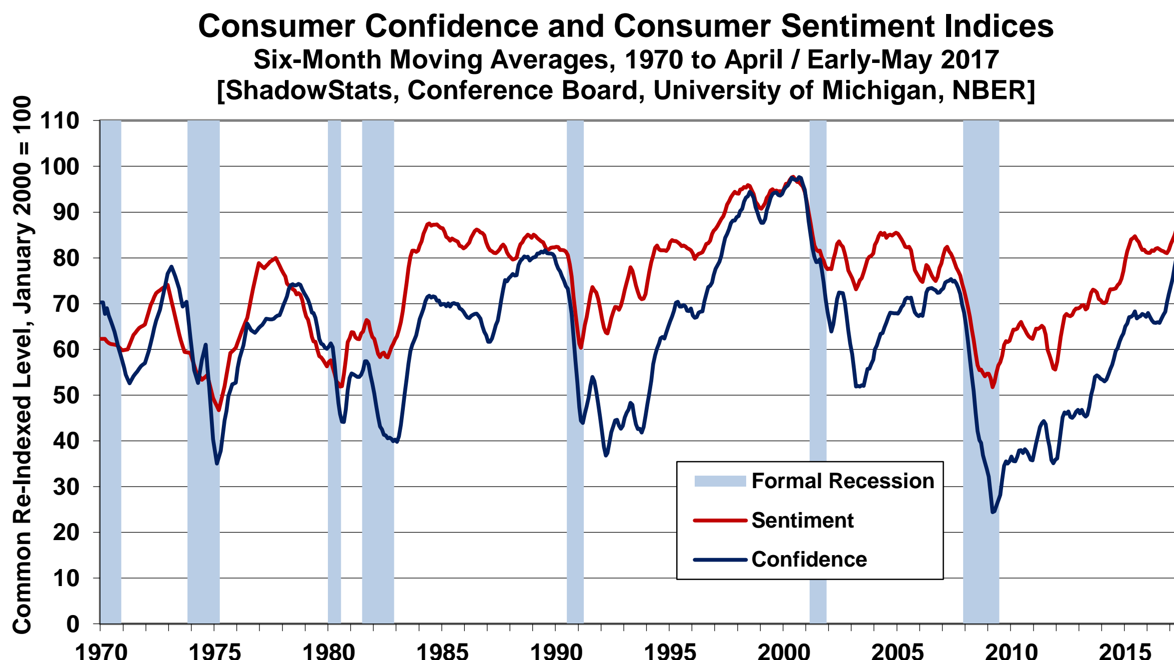
levels last seen going into the 2001 recession. Broadly, though, the harder, financial consumer measures remain well below, or are inconsistent with, periods of historically-strong economic growth as suggested by headline GDP growth in 2014, for second-and third-quarter 2015 and for third-quarter 2016. Beyond having happy feelings about the future, Consumers still need actual income, cash-in-hand or credit in order to increase their spending.

Graph 15: Comparative Confidence and Sentiment (6-Month Moving Averages, 1970 to 2017)



March 2017 Real Median Household Income Was "Statistically Unchanged." In the context of the faltering gains in consumer optimism, www.SentierResearch.com reported that March Real Median Household Income was "statistically unchanged" versus February. Consider that the circumstance reflected a 0.29% monthly boost to real monthly income from the headline decline of 0.29% (-0.29%) in the March 2017 CPI-U inflation, where the resulting, month-to-month real gain of 0.22% in median income was statistically-insignificant. That means the corresponding change in nominal median monthly household income was an outright decline of 0.07% (-0.07%) in March 2017. The headline real monthly income number not only remained minimally below pre-recession levels, but also below the January 2000 initial reading for the series. The March monthly change of 0.22% followed a statistically-significant 1.01% gain in February, having declined by 0.23% (-0.23%) in January. The series also rose by 0.31% year-to-year in March 2017, having gained 0.16% in February 2017 and declined by 0.99% (-0.99%) in January 2017. Plotted in accompanying *Graphs 16* and *17*, those details showing ongoing stagnation both in terms of level and year-to-year change.

Where low or negative headline CPI-U inflation and related spikes in inflation-adjusted real income had resulted from collapsing gasoline prices in 2014, that process began to reverse in the latter part of 2016, although it came back and hit the March 2017 data hard.

On a monthly basis, when headline GDP purportedly started its solid economic recovery in mid-2009, the monthly household income number nonetheless plunged to new lows. Again, the income series had been

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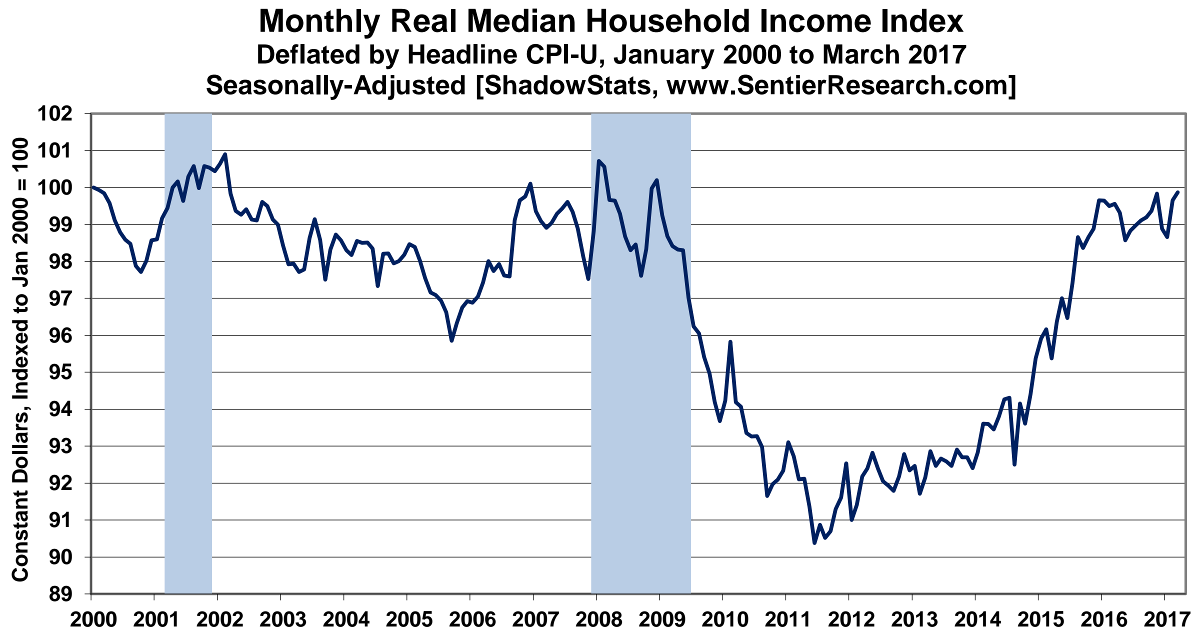
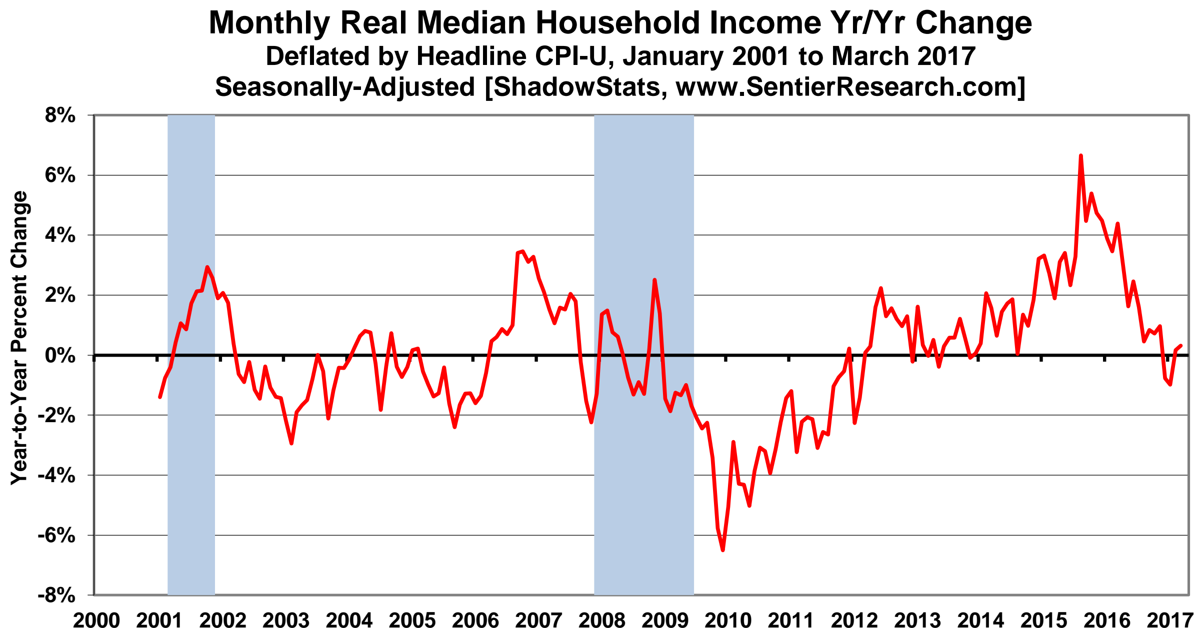
in low-level stagnation, with the post-2014 uptrend in the inflation-adjusted monthly index boosted specifically by collapsing gasoline prices and related, negative headline CPI-U consumer inflation. The index approached pre-recession levels in the December 2015 reporting, but it remained minimally below the pre-recession highs for both the formal 2007 and 2001 recessions. It should continue turning down anew, as headline monthly consumer inflation generally picks up at an accelerating pace.

Graph 16: Monthly Real Median Household Income (2000 to 2017) Index, January 2000 = 100



Graph 17: Monthly Real Median Household Income (2000 to 2017) Year-to-Year Change



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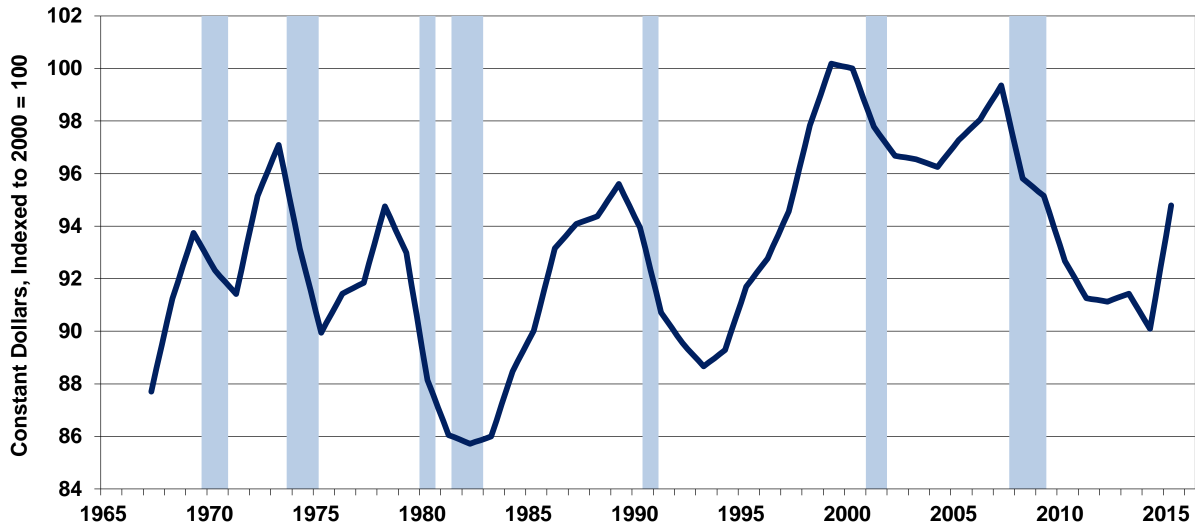
Where lower gasoline prices had provided some minimal liquidity relief to the consumer, indications are that any effective extra cash generally was used to help pay down unsustainable debt or other obligations, not to fuel new consumption. Again, the effects of changing gasoline prices have reversed, pushing headline consumer inflation higher.

This measure of real monthly median household income generally can be considered as a monthly version of the annual detail shown in *Graph 18*, which was updated nine months ago for 2015 detail (see the full analysis of the 2015 annual household income reporting in *Commentary No. 833*). The relative jump seen in the headline annual 2015 median income, despite formal adjustment for discontinuities in the recent annual reporting, was due largely to series redefinitions, not due to a sudden change in consumer liquidity, other than as tied to the collapse in gasoline prices and a related spike in the inflation-adjusted numbers. The level of real annual median household income for 2015, not only was below that seen at the purported trough of the economic collapse into 2009, but also it was below levels seen in the early-1970s and the late 1980s.

Differences in the Monthly versus Annual Median Household Income. The general pattern of relative historical weakness also has been seen in the headline reporting of the annual Census Bureau numbers, again, shown in *Graph 18*, with 2014 real annual median household income having hit a ten-year low, and, again, with the historically-consistent 2015 annual number still holding below that seen when the collapsing economy hit its purported trough in 2009.

Graph 18: Annual Real Median U.S. Household Income (1967 to 2015)



The Sentier numbers had suggested a small increase in 2014 versus 2013 levels. Still, the monthly and annual series remain broadly consistent, although based on separate questions within the monthly Consumer Population Series (CPS), as conducted by the Census Bureau.

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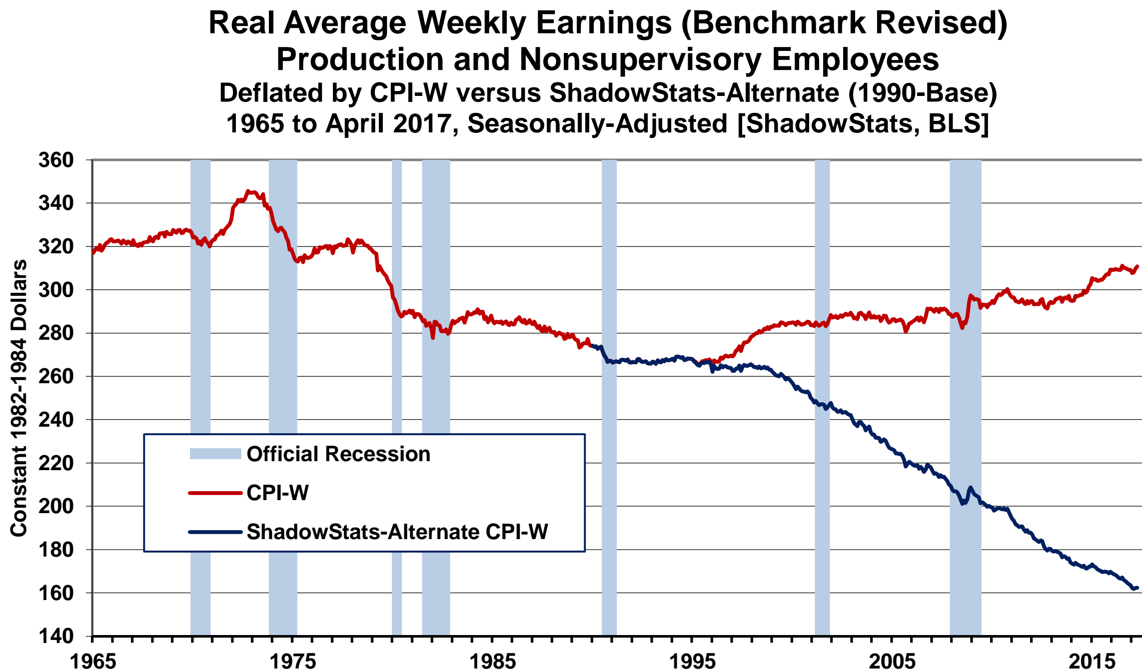
Where Sentier uses monthly questions surveying current annual household income, the headline annual Census detail is generated by a once-per-year question in the March CPS survey, as to the prior year's annual household income. The Median Household Income surveying results are broadly consistent with Real Average Weekly Earnings, now through March 2017.

Real Average Weekly Earnings Declined Year-to-Year and Contracted Quarter-to-Quarter for the Second, Consecutive Quarter, but Notched Higher in April. April 2017 real average weekly earnings were published by the Bureau of Labor Statistics on May 12th (see *Commentary No. 886*). In the production and nonsupervisory employees category—the only series for which there is a meaningful history, the regularly-volatile real average weekly earnings gained 0.3% month-to-month in April 2017 and 0.4% year-to-year, boosted generally by softer inflation numbers, following annual and quarterly contractions in first-quarter 2017 activity.

Graph 19 plots the seasonally-adjusted earnings as officially deflated by the BLS (red-line), and as adjusted for the ShadowStats-Alternate CPI Measure, 1990-Base (blue-line). When inflation-depressing methodologies of the 1990s began to kick-in, the artificially-weakened CPI-W (also used in calculating Social Security cost-of-living adjustments) helped to prop up the reported real earnings. Official real earnings today still have not recovered their inflation-adjusted levels of the early-1970s, and, at best, have been in a minimal uptrend for the last two decades (albeit spiked recently by negative headline inflation). Deflated by the ShadowStats (1990-Based) measure, real earnings have been in fairly-regular decline for the last four decades, which is much closer to common experience than the pattern suggested by the CPI-W. See the *Public Commentary on Inflation Measurement* for further detail.

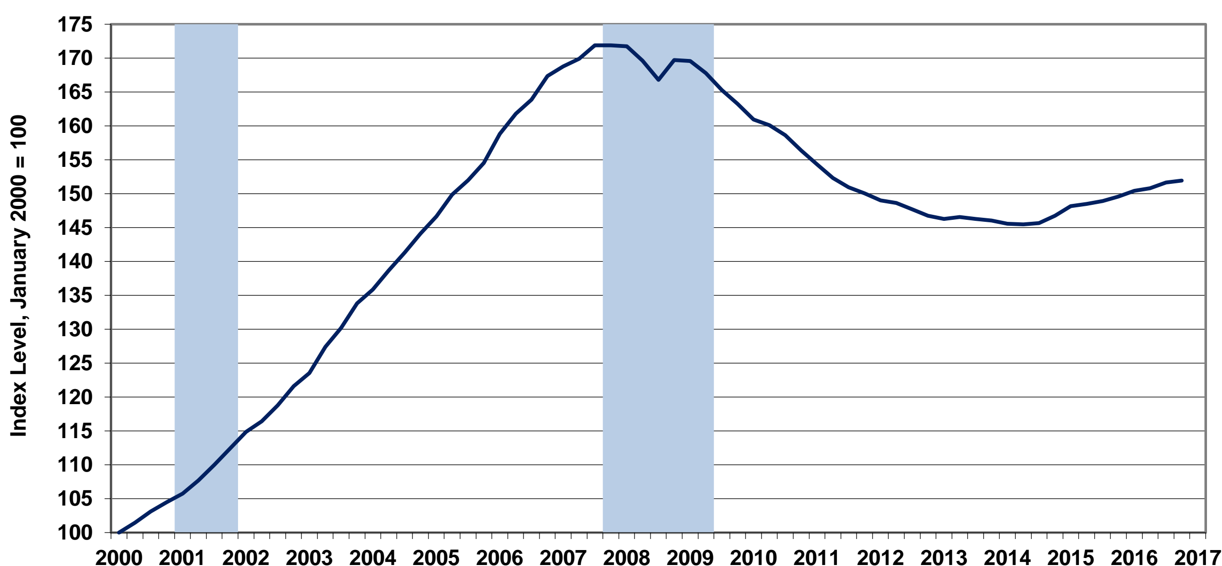
Graph 19: Real Average Weekly Earnings, Production and Nonsupervisory Employees, 1965-to-Date



Consumer Credit Has Continued to Tighten—Seasonally-Adjusted Monthly Growth Turned Flat-to-Minus. The final four graphs on consumer conditions address consumer borrowing. Debt expansion can help make up for a shortfall in income growth.

Consider *Graph 20* of *Household Sector, Real Credit Market Debt Outstanding*. Household debt declined in the period following the Panic of 2008, and it has not recovered fully, based on the Federal Reserve's flow-of-funds accounting through fourth-quarter 2016. Household Sector, Real Credit Market Debt Outstanding in fourth-quarter of 2016 still was down by 11.6% (-11.6%) from its pre-recession peak of third-quarter 2007. Third-quarter 2016 was down by 11.8% (-11.8%) from the peak.

Graph 20: Household Sector, Real Credit Market Debt Outstanding (2000 through Fourth-Quarter 2016)



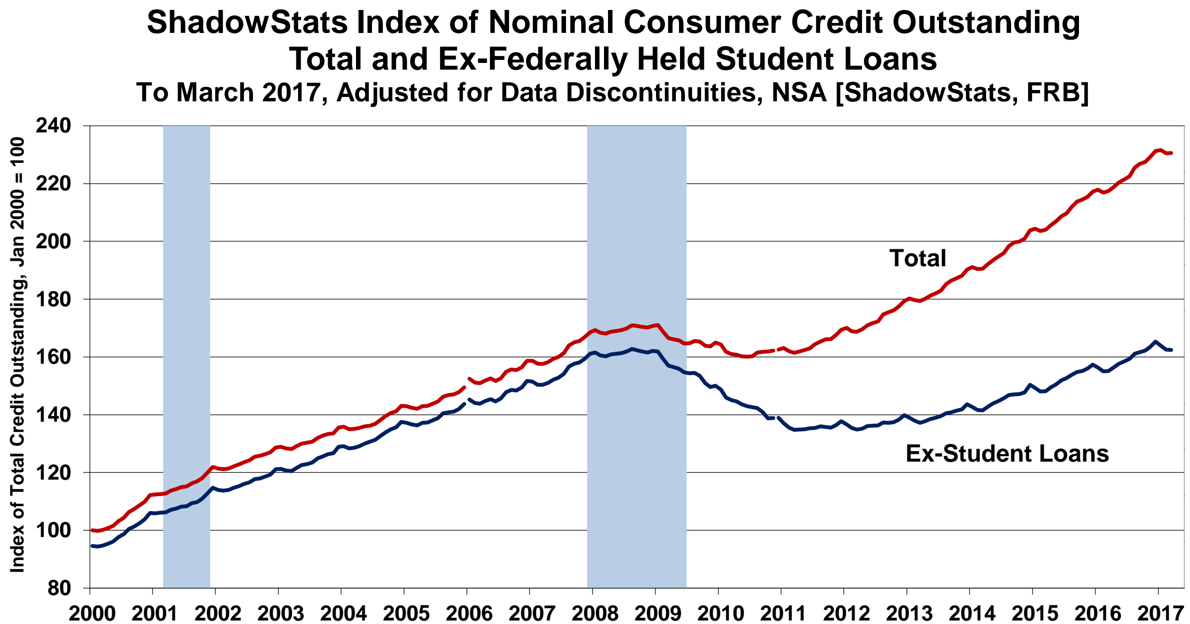
The series includes mortgages, automobile and student loans, credit cards, secured and unsecured loans, etc., all deflated by the headline quarterly CPI-U. The level of real debt outstanding has remained stagnant for several years, reflecting, among other issues, lack of normal lending by the banking system into the regular flow of commerce. The slight upturn seen in the series through 2015 and into 2016 was due primarily to gasoline-price-driven, negative CPI inflation, which continued to impact the system through second-quarter 2016. Current activity also has reflected continued relative strength from student loans, as shown in the *Graphs 21* to *23*.

The ShadowStats analysis usually focuses on the particular current weakness in consumer credit, net of what has been rapidly expanding government-sponsored student loans. Where detail on that series is only available not-seasonally-adjusted, the following graphs are so plotted.

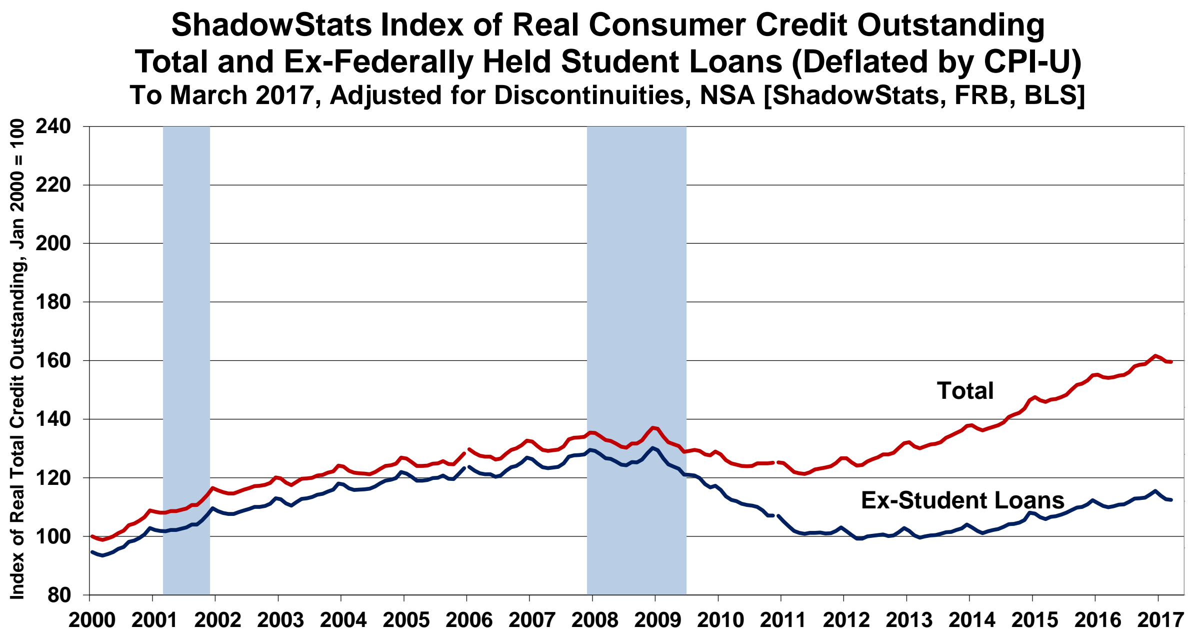
Shown through the latest reporting (March 2017), *Graph 21* of monthly Consumer Credit Outstanding is a subcomponent of *Graph 20* on real Household Sector debt. Where *Graph 21* reflects the nominal reporting, not adjusted for inflation, inflation-adjusted real activity for the monthly Consumer Credit Outstanding is shown both in terms of level (*Graph 22*) and in terms of year-to-year change (*Graph 23*).

Post-2008 Panic, growth in outstanding consumer credit has continued to be dominated by growth in federally-held student loans, not in bank loans to consumers that otherwise would fuel broad consumption or housing growth. Although in slow uptrend, the nominal level of Consumer Credit Outstanding (ex-student loans) has not recovered since the onset of the recession. These disaggregated data are available and plotted only on a not-seasonally-adjusted basis, with the pattern of monthly levels over one year reflecting some regular, unadjusted seasonal dips or jumps.

Graph 21: Nominal Consumer Credit Outstanding (2000 to 2017)

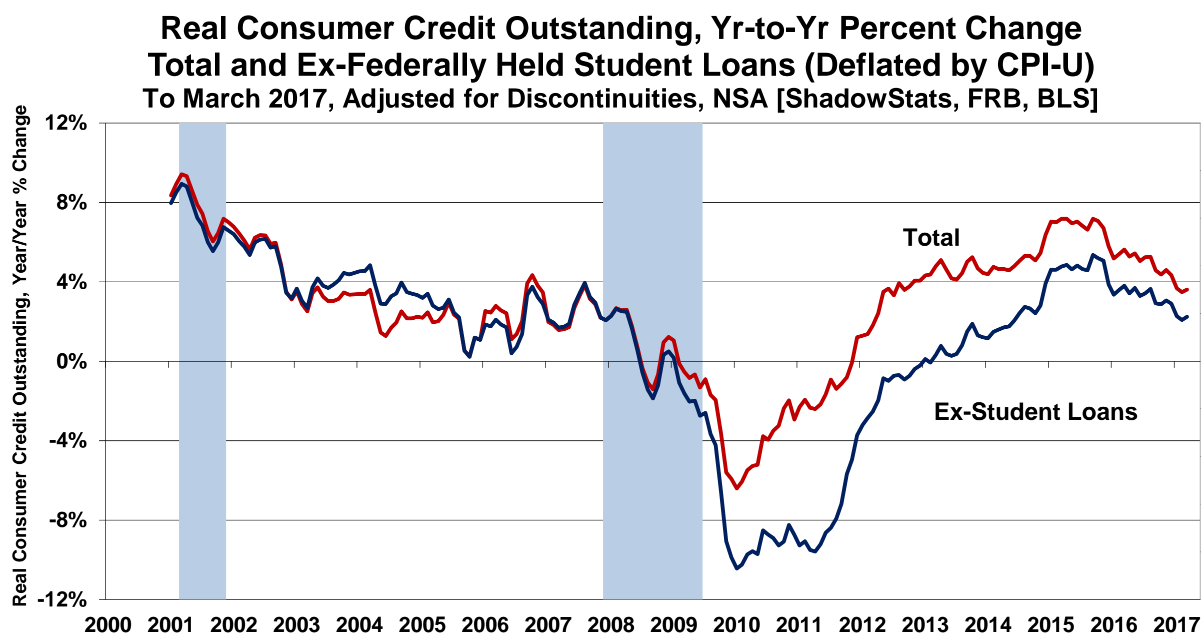


Graph 22: Real Consumer Credit Outstanding (2000 to 2017)



Adjusted for inflation, the lack of recovery in the ex-student loan area is more obvious. Although the recent monthly dips in the not-seasonally-adjusted consumer credit reflect a seasonal pattern, the pace of year-to-year growth continues to slow, suggesting some tightening of credit conditions. Adjusted for discontinuities and inflation, ex-student loans, consumer credit outstanding in March 2017 was down from its December 2007 pre-recession peak by 13.2% (-13.2%). Year-to-year growth in *Graph 23* tends to resolve most of the monthly distortions in the not-seasonally-adjusted data

Graph 23: Year-to-Year Percent Change, Real Consumer Credit Outstanding (2000 to 2017)



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UPDATED - WEEK, MONTH AND YEAR AHEAD

Continued Economic Weakening, Stagnation and Downturn Still Should Compromise Fed Policies, Pummeling the U.S. Dollar and Boosting the Price of Gold. Recent benchmark revisions to Industrial Production (*Commentary No. 877*), Manufacturers' Shipments (today's *Special Commentary*), Housing Starts (*Commentary No. 887*) and Retail Sales (*Commentary No. 882*) broadly have confirmed that recent historical activity has been overstated and/or that it is turning down anew, despite near-term spikes in some headline April details, such as the labor numbers and industrial production. Reporting patterns likely will continue to weaken in the next month or so, which should trigger anew financial-market concerns as to the direction of pending Fed policy actions. Adding uncertainty are risks of political surprise, as surfaced last week. Otherwise, the broad outlook has not shifted.

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In the context of the *Opening Special Comments* of *Special Commentary No. 885*, and as discussed in the *Opening Comments* of *Commentary No. 883*, the still-unfolding downshift in economic expectations increasingly should move market expectations for Federal Reserve policy away from rate hikes and the normalization of the Fed's balance sheet, towards renewed quantitative easing. The problem for the U.S. central bank remains that faltering domestic economic activity stresses banking-system solvency. Aside from formal obligations of the Fed to maintain healthy domestic economic and inflation conditions, the central bank's primary function, in practice, always has been to keep the banking system afloat. The near-absolute failure of that function in 2008 remains the primary ongoing and unresolved problem for the Fed, and it is one of the ongoing primary issues preventing the return of U.S. economic activity to normal functioning.

The outlook for future FOMC activity is updated in the *Hyperinflation Watch* of *Commentary No. 886*, and remains otherwise as reviewed in the *Opening Comments* and *Hyperinflation Watch* of *Commentary No. 880*, and as previously reviewed in *Commentary No. 873*. The circumstances and outlook remain as broadly outlined in *No. 859 Special Commentary*.

As reflected in common experience, actual U.S. economic activity generally continues in stagnation or downturn, never having recovered fully its level of pre-economic-collapse (its pre-2007-recession peak). While the latest headline GDP shows economic expansion of 12.3% since that series purportedly recovered its 2007-pre-recession high in 2011, no other "recovered" economic series has come close to showing that expansion either in terms of magnitude or in the purported brevity of the depression. Most of the better-quality series have remained in continuing, not-recovered status, in a period of protracted downturn that now rivals that of the Great Depression (see *Commentary No. 887*, and *Commentary No. 869*). With intensifying signals, near-term economic woes, the FOMC soon should come under pressure to shift policies, once again, reverting to some form of quantitative easing, in an effort to address related, intensifying solvency risks in the domestic banking system.

Discussed in *No. 859 Special Commentary*, the Trump Administration continues to face extraordinarily difficult times, but has a chance to turn the tide on factors savaging the U.S. economy and on prospects for long-range U.S. Treasury solvency and for stability and strength in the U.S. dollar. Any forthcoming economic stimulus faces a nine-month to one-year lead-time, once in play, before it meaningfully affects the broad economy. Delays from political discord continue to push targeted programs back in time. Needed at the same time are a credible plan for bringing the U.S. long-term budget deficit (sovereign solvency issues) under control, and action to bring the Federal Reserve under control and/or to reorganize the banking system. These actions broadly are necessary to restore domestic-economic and financial-system tranquility (see *No. 859*), but they will not happen without the cooperation of Congress.

Prior General Background. *No. 859 Special Commentary* updated near-term economic and inflation conditions, and the outlook for same, including the general economic, inflation and systemic distortions evolving out of the Panic of 2008 that have continued in play, and which, again, need to be addressed by the new Administration in the immediate future (see also the *Hyperinflation Watch* of *Commentary No. 862* and *Commentary No. 869*).

Contrary to the official reporting of an economy that collapsed from 2007 into 2009 and then recovered strongly into ongoing expansion, underlying domestic reality remains that the U.S. economy started to turn down somewhat before 2007, collapsed into 2009 but never recovered fully. While the economy bounced off its 2009 trough, it entered a period of low-level stagnation and then began to turn down anew

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in December 2014, a month that eventually should mark the beginning of a "new" formal recession (see *General Commentary No. 867*).

Coincident with and tied to the economic crash and the Panic of 2008, the U.S. banking system moved to the brink of collapse, a circumstance from which U.S. and global central-bank policies never have recovered. Unwilling to admit its loss of systemic control, the Federal Reserve had been making loud noises of continuing to raise interest rates, in order to contain an overheating economy, but that "overheating" activity has started to fade. As this ongoing crisis evolves towards its unhappy end, the U.S. dollar ultimately should face unprecedented debasement with a resulting runaway domestic inflation.

Broad economic and systemic conditions are reviewed regularly, with the following *Commentaries* of particular note: *Special Commentary No. 885*, *Commentary No. 869*, *No. 777 Year-End Special Commentary* (December 2015*)*, *No. 742 Special Commentary: A World Increasingly Out of Balance* (August 2015) and *No. 692 Special Commentary: 2015 - A World Out of Balance* (February 2015). Those publications updated the long-standing hyperinflation and economic outlooks published in *2014 Hyperinflation Report—The End Game Begins – First Installment Revised* (April 2014) and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* (April 2014). The two *Hyperinflation* installments remain the primary background material for the hyperinflation circumstance. Other references on underlying economic reality are the *Public Commentary on Inflation Measurement* and the *Public Commentary on Unemployment Measurement*.

Recent Commentaries (Most-Recent Coverage of Specific Series or with Special Features):

Commentary No. 887 reported on the April 2017 detail for Industrial Production and Residential Construction (Housing Starts), with some particular attention to historic, protracted periods of economic non-expansion, of which the current non-recovery is the most severe.

Commentary No. 886 reviewed the headline details of the April 2017 CPI and PPI detail, along with headline reporting of nominal and real Retail Sales, real Average Weekly Earnings and regular monthly review of U.S. dollar conditions and prospects.

Special Commentary No. 885, entitled *Numbers Games that Statistical Bureaus, Central Banks and Politicians Play*, reviewed the unusual nature of the headline reporting of the April 2017 employment and unemployment details.

Commentary No. 884 reviewed the March 2017 details for the U.S. Trade Deficit and Construction Spending and the Conference Boards' reporting of April 2017 Help Wanted OnLine.

Commentary No. 883 covered the headline detail for the "advance" or first-estimate of first-quarter GDP, along with an update to *Consumer Liquidity Conditions*.

Commentary No. 882 summarized the annual benchmark revisions to Retail Sales and reviewed the March 2017 releases of New Orders for Durable Goods and for New- and Existing-Home Sales.

Commentary No. 881 reviewed the prior March 2017 Industrial Production, Housing Starts and the Cass Freight Index™, along with an economic update in advance of the initial first-quarter 2017 GDP estimate.

Commentary No. 880 detailed the prior March 2017 headline reporting the of both Real and Nominal Retail Sales, Real Earnings, the CPI, the PPI and updated Consumer Liquidity, where mounting stresses on consumer income and credit are signaling major economic issues ahead.

Commentary No. 879 covered March 2007 Employment and Unemployment, Help-Wanted Advertising and an update on monetary policy and Money Supply M3 (the ShadowStats Ongoing Measure).

Commentary No. 878 reviewed detail on the February 2007 Trade Deficit and Construction Spending, along with the latest update on Consumer Liquidity conditions.

Commentary No. 877 outlined the nature of the downside annual benchmark revisions to industrial production, along with implications for pending annual revisions to Retail Sales, Durable Goods Orders and the GDP.

Commentary No. 876 current headline economic activity in the context of formal definitions of the business cycle (no other major series come close to the booming GDP, which is covered in its third revision to fourth-quarter activity. Also the February 2017 SentierResearch reading on real median household income was highlighted.

Commentary No. 875 assessed and clarified formal definitions of the U.S. business cycle, which were expanded upon significantly, subsequently, in *No. 876*. It also provided the standard review of the headline February 2017 New Orders for Durable Goods, New- and Existing-Home Sales and the Cass Freight Index™.

Commentary No. 873 discussed prospects for future tightening and/or a return to quantitative easing by the FOMC, along with the prior review of the February 2017 Residential Construction reporting.

Commentary No. 872 offered some initial comment on the FOMC rate hike, in conjunction with the review of last month's February 2017 Retail Sales (real and nominal), Real Earnings and the CPI and PPI.

Commentary No. 871 covered prior reporting of February Labor Conditions, updated Consumer Liquidity and the ShadowStats Ongoing M3 Measure for February 2017, and a revised FOMC outlook.

Commentary No. 869 reviewed and assessed underlying economic reality and a broad variety of indicators in the context of the second-estimate of fourth-quarter 2016 GDP.

General Commentary No. 867 assessed mixed signals for a second bottoming of the economic collapse into 2009, which otherwise never recovered its level of pre-recession activity. Such was in the context of contracting and faltering industrial production that now rivals the economic collapse in the Great Depression as to duration. Also covered were the prior January 2017 New- and Existing Home Sales.

Commentary No. 864 analyzed January 2017 Employment and Unemployment detail, including benchmark and population revisions, and estimates of December Construction Spending, Household Income, along with the prior update to Consumer Liquidity.

Commentary No. 861 covered the December 2016 nominal Retail Sales, the PPI, with a brief look at some summary GAAP reporting on the U.S. government's fiscal 2016 operations. The GAAP-detail will be reviewed in a *Special Commentary*.

No. 859 Special Commentary reviewed and previewed economic, financial and systemic developments of the year passed and the year or so ahead.

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 inflation and to

overstate economic activity—as generally viewed in the common experience of Main Street, U.S.A.—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 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, with the use of concurrent seasonal adjustments (as seen with retail sales, durable goods orders, employment and unemployment data). That issue is 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 2016 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 July 2016 GDP benchmark revisions, aimed at smoothing the headline reporting of the GDP business cycle, instead of detailing the business cycle and reflecting broad economic trends accurately, as discussed in *Commentary No. 823*.

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* has continued his investigations in reporting irregularities: *Crudele Investigation*, *Crudele on Census Bureau Fraud* and *John Crudele on Retail Sales* (worth a review in the context of the recently-published 2017 retail sales benchmarking).

PENDING ECONOMIC RELEASES: ***Updated*** **-Existing- and New-Home Sales April 2017).** The April 2017 New-Home Sales report is due from the Census Bureau, tomorrow, Tuesday, May 23rd, with April Existing-Home Sales due for release on Wednesday, May 24th, from the National Association of Realtors (NAR). Both New- and Existing-Home Sales will be covered in *Commentary No. 889* of May 26th.

The extreme liquidity bind besetting consumers continues to constrain residential real estate activity, as updated in today's *Special Commentary*. Without sustainable growth in real income, and without the ability and/or willingness to take on meaningful new debt in order to make up for income shortfall, the U.S. consumer remains unable to sustain positive growth in domestic personal consumption, including real estate activity. That circumstance—in the last ten-plus years of economic collapse and stagnation—has continued to prevent a normal recovery in broad U.S. economic activity.

Where the private housing sector never recovered from the business collapse of 2006 into 2009, there remains no chance of a near-term, sustainable turnaround in home-sales activity, without a fundamental upturn in consumer and banking-liquidity conditions. That does not appear to be in the offing.

Smoothed for regular extreme and nonsensical monthly gyrations, a pattern of low-level stagnation in New-Home Sales also should remain in play for that series. While the pattern of low-level stagnation in new sales has continued to fluctuate in recent months, it recently has begun to show somewhat of a

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weakening trend, which likely will intensify. Monthly changes in activity here rarely are statistically-significant, amidst otherwise unstable headline reporting and revisions.

Headline Existing-Home Sales should continue their current general pattern of low-level stagnation. Although there is an uptrend in the smoothed, six-month moving average, that should flatten out again.

***Updated* - New Orders for Durable Goods (April 2017).** In the context of the downside, annual 2017 benchmark revisions released on May 18th, reviewed earlier in this *Special Commentary*, the Census Bureau will report April New Orders for Durable Goods on Friday, May 26th, to be covered in *Commentary No. 889* of that date. Net of irregular activity in commercial aircraft orders, aggregate orders likely continued a pattern of down-trending real stagnation.

Commercial aircraft orders are booked for the long-term—years in advance—so they have only limited impact on near-term production. Further, by their nature, these types of orders do not lend themselves to seasonal adjustment. As a result, the durable goods measure that best serves as a leading indicator to broad production—a near-term leading indicator of broad economic activity and the GDP—is the activity in new orders, ex-commercial aircraft, adjusted for inflation.

In inflation-adjusted real terms, reflecting PPI-related inflation for "manufactured durable goods," nominal order weakness increasingly will be exacerbated by rising inflation, with monthly inflation of 0.24% in both April 2017 and March 2017 and 0.18% in February 2017. Year-to-year annual inflation continued to rise, hitting 1.87% in April 2017, versus 1.75% in March 2017 and 1.45% in February 2017 (see prior *Commentary No. 886*).

***Updated* - Gross Domestic Product (GDP)—First-Quarter 2017, Second-Estimate, First-Revision.** The Bureau of Economic Analysis (BEA) will publish its second guesstimate of, or first revision to first-quarter 2017 Gross Domestic Product (GDP) on Friday, May 26th. Detail will be covered in *Commentary No. 889* of that date. Also pending release are the initial estimate of first-quarter 2017 Gross Domestic Income (GDI), which is the theoretical income-side equivalent to the GDP's consumption side, and the initial estimate of first-quarter 2017 Gross National Product (GNP), which encompasses the narrower GDP measure, adding in the effects of trade flows in factor income (interest and dividend payments). The GDI and GNP often add unusual twists to the headline GDP estimate.

The first revision to GDP likely will be minimal and most assuredly will keep the headline annualized real first-quarter growth rate statistically indistinguishable from "no growth." Discussed in *Commentary No. 883*, the initial growth estimate was a below-consensus 0.69%. While late consensus expectations are for a minimal upside revision into the 0.8% to 0.9% range, the negative benchmarking to Manufacturers' Real Shipments (All Industries) showed a downside revision to previously estimated real quarterly growth (see page 5), offering some prospects for a downside revision.