

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

**COMMENTARY NUMBER 396**

**3rd-Quarter GDP, October Confidence, September Durables Orders and Home Sales**

**October 27, 2011**

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**Consumer Confidence and Sentiment Sink to Levels Never Seen Outside of the Worst Recessions**

**No Economic Recovery Is in Place or in the Works**

**Third-Quarter GDP Gain Not Statistically Meaningful**

**GDP Nonsense: Consumption Surged 1.7% While Disposable Income Collapsed 1.7%?**

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*PLEASE NOTE: The next regular Commentary is scheduled for Friday, November 4th. It will cover October 2011 unemployment and payroll employment reporting.*

*—Best wishes to all, John Williams*

**Opening Comments and Executive Summary.** The U.S. economy is sinking anew, not rebounding. Such is contrary to the media hype around this morning's (October 27th) headline 2.5% second-quarter GDP growth, which was up from the 1.3% growth estimate of the first-quarter. Officially the broadest measure of U.S. economic activity published by the U.S. government, the widely-followed gross domestic product (GDP) nonetheless remains the most-heavily-biased, the most-heavily-guessed-at, the most-heavily politicized and the most-worthless major indicator of domestic business activity. Today's numbers out of the Bureau of Economic Analysis are outright nonsense.

Consider that latest numbers showed that the level of inflation-adjusted third-quarter 2011 GDP broke above the pre-recession high of fourth-quarter 2007: a full recovery. That is absurd. No other major economic indicator, including payrolls, real (inflation-adjusted) retail sales, industrial production, trade deficit or housing starts is showing that. The GDP previously had been reported as breaking above its pre-recession high in fourth-quarter 2010, but that happy news revised away with July 2011's benchmark revisions to the GDP series. Downside revisions also should erase today's nonsensical news, eventually.

Consider that personal consumption contributed 1.72%, or 70%, of the annualized real 2.46% quarterly growth rate attributed to third-quarter GDP. Yet, consumer liquidity problems intensified in the third-quarter, with real disposable income (effectively inflation-adjusted take-home pay) falling at an annualized pace of 1.73%. Year-to-date, since fourth-quarter 2010, real disposable income has been flat (up 0.02%), while real personal consumption has gained 1.3%, which accounted for more than the total 1.0% growth in real GDP in the same period.

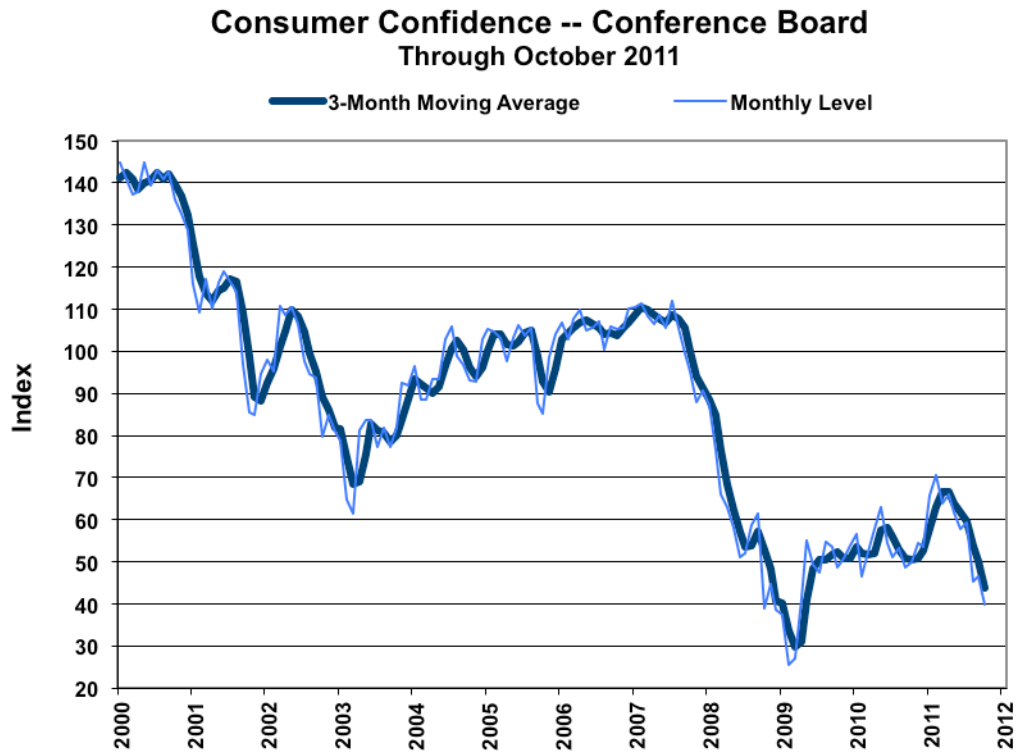
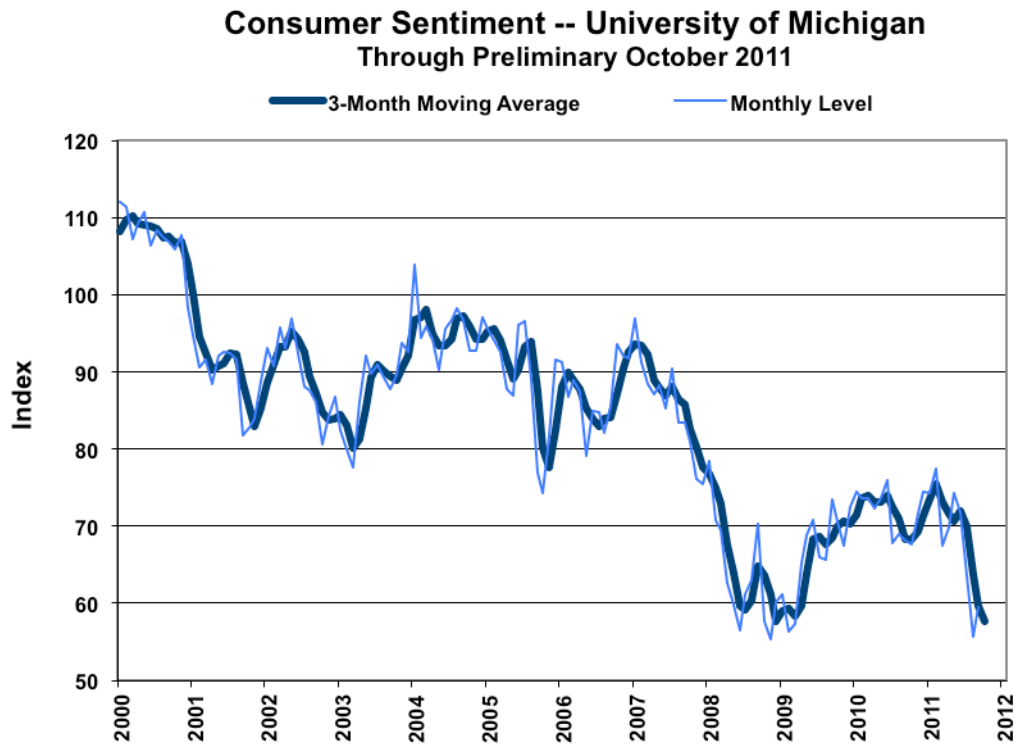
As discussed in recent *Commentaries* (see the [Hyperinflation Special Report \(2011\)](#) and [Commentary No. 394](#) for example), sustained positive real growth in consumption is not possible without sustained positive real growth in income. Where short-term growth can be borrowed from the future with debt expansion or liquidation of savings, those options, at present, however, are constrained at their practical limits.

***More-Reliable Indicators of Economic Activity.*** Among some of the more-reliable economic indicators of business activity, payroll employment shows no sign of economic recovery and the consumer confidence measures have fallen to levels never seen outside of the worst recessions and indicate an unfolding a double-dip downturn.

Despite the seasonal-factor and monthly-upside-reporting-bias issues with the birth-death model, the nonfarm payroll employment series probably is the best-quality government series published as an indicator of broad economic activity. It is a coincident indicator of business activity. Its pattern in the current economic downturn has been one of initial collapse and then bottom-bouncing, while recent monthly “gains” have lacked statistical significance. Payrolls as of September 2011 still were 4.8% shy of topping the pre-2007 recession peak. What is more, the current payroll employment is 0.9% below the payroll levels of December 2000, the pre-2001 recession peak! With employment below where it was a decade ago, there is no economic recovery in the works here. The payroll circumstance will be updated in next week's *Commentary*

Consumer confidence and sentiment also tend to be coincident indicators of economic activity that tie to the consumer (some will contend these series lead retail sales, etc., reflecting consumer willingness to purchase goods and services). As shown in the following graphs, both the University of Michigan sentiment series, which is not seasonally adjusted, and the Conference Board confidence series, which is seasonally adjusted (the unadjusted series is not made available), are suggesting double-dips in business activity.

In the case of Consumer Sentiment, the sentiment level historically has dropped to the current level only three times since the series was established in 1952. Those periods were during the worst economic downturns of the post-World War II era: the 1973-1975 recession, the double-dip recession in the early-1980s, and in the 2007 recession, when the risk of systemic failure came to a head in 2008 and 2009. The current level now has fallen back to that 2008 level.



Consumer Confidence hit the lowest levels ever recorded in 2008 and 2009, and although not quite back to the trough of the current cycle, the latest reading on consumer confidence still is below anything ever seen outside of the current economic collapse.

***No Surprises in Durable Goods Orders or Home Sales.*** New orders for durable goods (not adjusted for inflation) fell by 0.8% in September, but that was well within the normal volatility of the series. The small 3.0% decline in existing home sales and the 5.7% gain in new home sales also were within the ranges of normal monthly volatility, as home sales continued a protracted period of bottom-bouncing. One developing trend worth watching, though, is that year-to-year change has started to slow markedly in both the durable goods orders and home sales series.

**Hyperinflation Watch—As Circumstances Unfold, the Outlook Remains the Same.** As discussed frequently in this section, the euro crisis has appeared frequently as a likely foil, distracting global market attention from the potential financial-system-busting crises unfolding with the U.S. dollar and the related, effective long-term U.S. government insolvency. As we go to press, the markets are hyperventilating over the latest solution to the Greek crisis—at least temporarily—with U.S. equities soaring. Those equity gains, however, largely are being offset for those outside the U.S. dollar by renewed heavy selling of the U.S. dollar against the other major Western currencies. U.S. economic activity continues to falter, with increasingly negative implications for financial-market stability and systemic solvency. The financial system remains highly vulnerable to potential negative surprises.

Repeated from the prior *Commentaries*, there are no happy solutions available here to remedy the crises, only tools—devil’s choices—for the Fed and the U.S. government to buy a little extra time. From the Fed’s standpoint, keeping the banking system afloat remains its primary concern, although needs for economic growth and contained inflation will be given as the rationale behind any overt change in policy. The ultimate cost in propping the system, however, remains inflation. The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the [Hyperinflation Special Report \(2011\)](#) and in recent *Commentaries*, continue to unfold with outlooks that remain unchanged.

The root source of current global systemic instabilities largely has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent a euro-area crisis from triggering a systemic collapse in the United States. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

The financial markets still are roiled by deepening crises of confidence in the U.S. dollar and in the long-term outlook for U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of any further near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold, the stronger currencies and precious metals remain the fundamental hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets may start at anytime, with little or no further warning. With a U.S. government unwilling to balance or even to address its

uncontainable fiscal condition; with the federal government and Federal Reserve standing ready to prevent a systemic collapse, so long as it is possible to print and spend whatever money is needed; and with the U.S. dollar at risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.

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## REPORTING DETAIL

### GROSS DOMESTIC PRODUCT—GDP (Third-Quarter 2011, “Advance” or First Estimate)

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#### **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 it generally is not followed by the popular press. 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 2005 Dollars,” at present, where the 2005 is the base year for inflation, and “chained” refers to the methodology which gimmicks the reported numbers so much that the total of the deflated GDP sub-series misses the total of the deflated total GDP series by nearly \$40 billion in “residual” as of second-quarter 2010.

**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  $4 \times 1\% = 4\%$ .

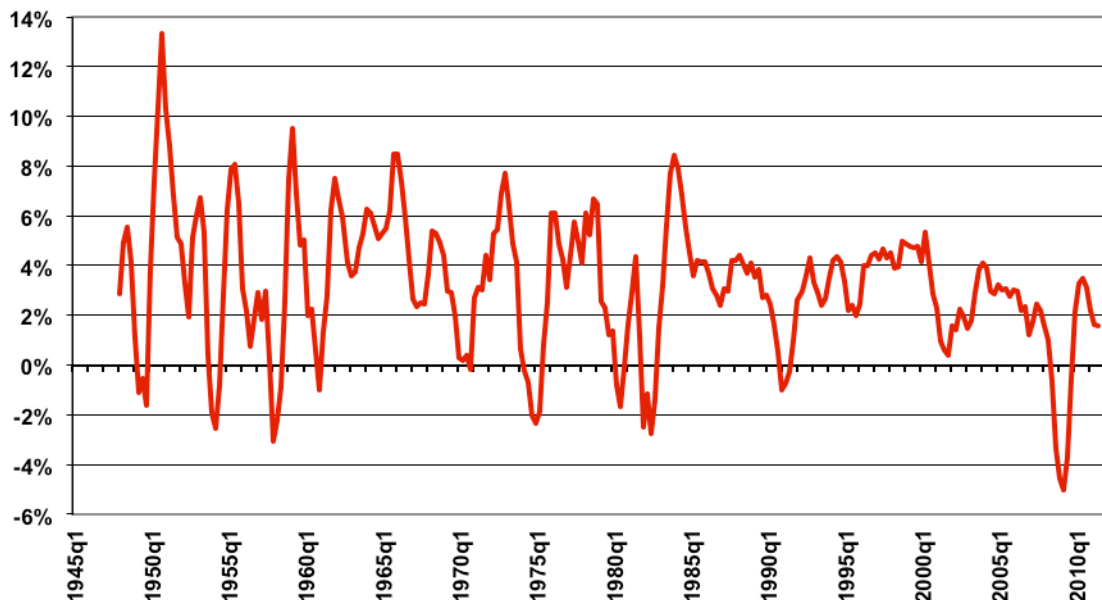
**Annual** growth refers to the year-to-year change of the referenced period versus the same period the year before.

### Confidence Interval Around Reported GDP Change Allows for Contraction as well as Expansion.

As discussed in the *Opening Comments and Executive Summary* the reported gain in third-quarter GDP ran counter to better-quality reporting in underlying fundamental series. The headline 2.5% “advance” third-quarter GDP growth hit the consensus forecast, but it was statistically insignificant for the third consecutive quarter. The BEA often targets the consensus estimate in initial reporting, because the underlying data rarely are more than guesstimates. With more-reliable indicators suggesting ongoing, severe economic contraction, there is no economic rebound or recovery other than in political or Wall Street hype. The GDP series remains the most heavily politicized of the government’s popularly followed economic reports.

**GDP.** Published today, October 27th, by the Bureau of Economic Analysis (BEA), the “advance” or first estimate of third-quarter 2011 gross domestic product (GDP) showed annualized real quarterly growth of 2.46% +/- 3% (95% confidence interval), versus an estimated annualized gain of 1.33% for second-quarter 2011. Not annualized, third-quarter GDP growth was 0.61%, against 0.33% in the second-quarter. In this most worthless of major economic series, the reported annualized growth rates for the last three quarters are little more than statistical noise around the unchanged level. They possibly have been massaged to keep the quarterly growth rates in minimally-positive as opposed to minimally-negative territory. The quarterly GDP gain purportedly was dominated by personal consumption, business investment in computers and an improved trade deficit, with some offset from inventory liquidation.

**Real Quarterly Gross Domestic Product**  
Year-to-Year % Change, 1948q1 to 2011q3 (BEA)





Year-to-year real change in third-quarter 2011 GDP slowed minimally to 1.62%, effectively flat versus the 1.63% annual growth in the second-quarter. Current annual growth remained well off the near-term peak in reported growth of 3.51% during third-quarter 2010.

The estimate of the third-quarter GDP implicit price deflator (IPD) was 2.52%, versus 2.59% in the second-quarter. In contrast, annualized seasonally-adjusted quarterly inflation for the CPI-U in the third-quarter eased to 3.07% from 4.09% in the second-quarter. On a year-to-year basis, the third-quarter IPD was up by 2.40%, versus 2.10% in the second-quarter. In contrast, annual growth in third-quarter CPI-U jumped to 3.76% versus 3.43% in the second-quarter.

The lower the inflation rate used in deflating the GDP, the stronger is the resulting inflation-adjusted number and vice versa. A slightly more realistic inflation number would have flattened the reported third-quarter GDP growth rate.

The SGS Alternate-GDP estimate for third-quarter 2011 is an approximate annual contraction of 2.9% versus the official estimate of a 1.6% gain. Such is slightly more negative than the alternate 2.8% annual contraction (1.6% official gain) estimate for the second-quarter (see the [Alternate Data](#) tab). While annualized real quarterly growth is not estimated formally on an alternative basis, a quarter-to-quarter contraction appears to have been realistic for the third-quarter, as it was in both the first- and second-quarters, in what generally has been a protracted period of business bottom-bouncing.

**GNP and GDI.** Third-quarter estimates of the gross national product (GNP) and gross domestic income (GDI) will not be published until the second estimate of the third-quarter GDP, next month. The series traditionally are delayed due to lack of meaningful data. The same principles minimally should be applied to the heavily guesstimated GDP, with initial reporting delayed until more-complete information is available.

## NEW ORDERS FOR DURABLE GOODS (September 2011)

**Annual Growth Slowed Sharply for September Durable Goods Orders.** The Census Bureau reported yesterday, October 26th, that the regularly-volatile, seasonally-adjusted new orders for durable goods fell by 0.8% (down 0.7% before prior-period revisions) for the month of September 2011, following an unrevised 0.1% monthly decline reported for August. September's monthly contraction included a 25.5% decline in irregular, long-term nondefense aircraft orders, a category that showed a revised 25.2% (previously 23.5%) jump in August. Airplane orders usually are placed years in advance of delivery and rarely impact near-term economic activity. Current durable goods reporting remains subject to many of the same sampling and concurrent-seasonal-adjustment problems that are seen with retail sales and payroll reporting. The numbers are not adjusted for inflation.

Unadjusted, year-to-year growth in total September 2011 new orders slowed sharply to 4.3%, versus a revised 14.2% (previously 14.1%) annual gain in August.

The widely followed nondefense capital goods orders declined in September by 2.3% (down by 2.7% before prior-period revisions) for the month, versus a revised monthly 5.0% (previously 5.2%) increase in August. For September, the unadjusted year-to-year growth in the series also softened markedly, a gain of 3.7%, versus August's revised 24.2% (previously 25.4%) annual growth estimate.

## EXISTING AND NEW HOME SALES (September 2011)

**Home Sales Continued Bottom-Bouncing in September.** Combined existing and new home sales in September 2011 basically remain the same level they were in August 2008 (first month following the initial housing-stimulus enactment), and also as averaged over the intervening period. As noted in last month's analysis (see [Commentary No. 392](#)), whatever sales were borrowed from the future by stimulus measures have been lost back fully in the depressed activity that followed the stimulus expirations, with the monthly sales numbers averaging out to what otherwise would have been three-years of bottom-bouncing.

**Existing Home Sales Decline A Little.** The October 20th release of September existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly loss of 3.0%, versus August's revised gain of 8.4% (previously up by 7.7%). On a year-to-year basis, September sales rose by 11.3%, versus a revised 19.3% (previously 18.6%) annual gain in August. The volatility in annual growth still reflects a waning of the variability a year ago of the end-of-stimulus effects.

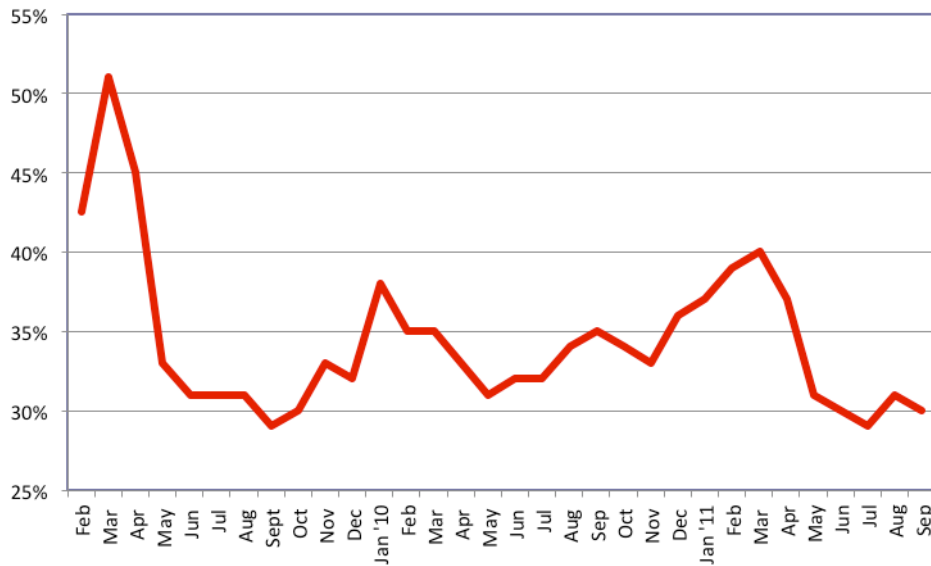
Foreclosure activity remained a major distorting factor for home sales, with "distressed" activity accounting for an estimated 30% of existing sales in the NAR's September reporting, down from the 31% estimated in August.

**New Home Sales Gain Was Statistically Insignificant.** Consistent with the long-term negative trends in housing starts (see the prior [Commentary No. 395](#) for September details), the October 26th release of September new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of a bottom-bouncing, despite a monthly gain. September's monthly gain of 5.7% (up 6.1% before prior-period revisions) +/- 21.5% (95% confidence interval) versus August was statistically insignificant. In turn, August's decline was revised to a 0.4% decline (previously down by 2.3%) versus July. The year-to-year change in September 2011 new-home sales turned down, with a statistically-insignificant 0.9% +/- 19.0% (95% confidence interval) decline. August's annual gain was revised to 6.5% (previously 6.1%).

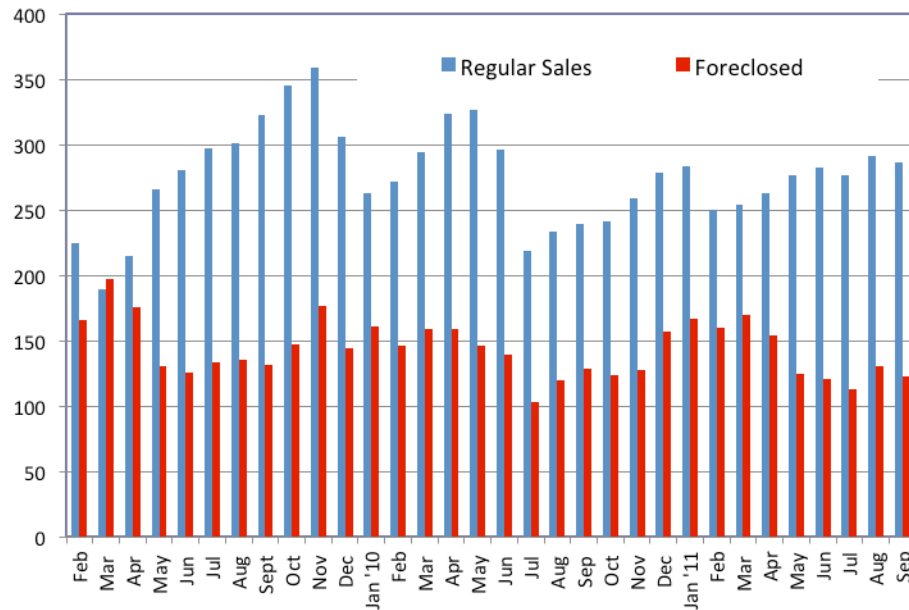
As with existing homes sales, the large volatility in change is due to the effects of the lapsing of housing stimulus efforts a year ago. As with existing home sales, part of the new sales volume is due to foreclosure activity, but the Census Bureau does not provide an estimate of foreclosure volume.



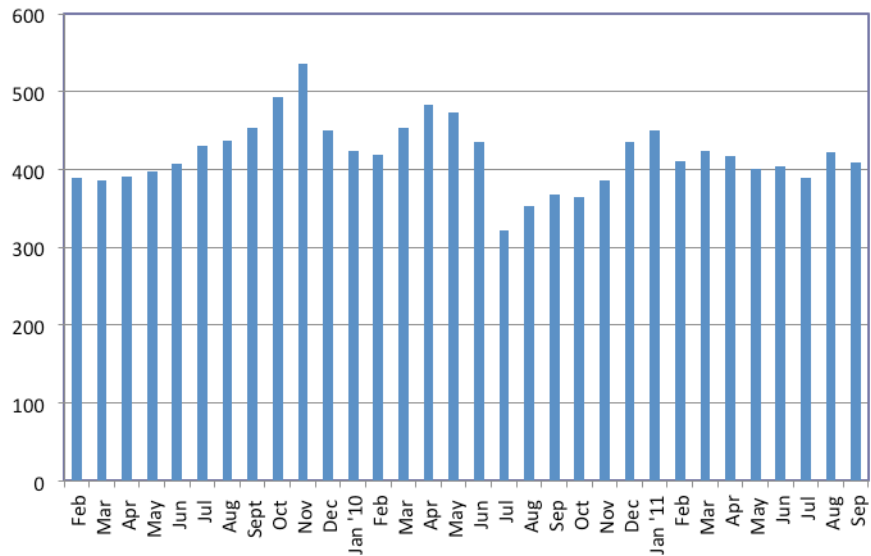
### Foreclosures as % of Existing Home Sales Sources: SGS, NAR



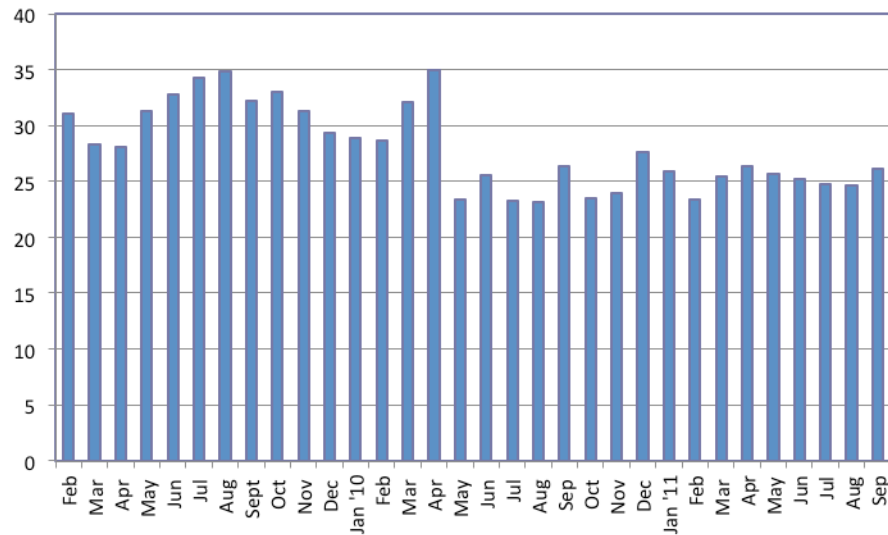
### Existing Home Sales - Foreclosed and Not Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR



**Existing Home Sales - Total**  
**Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR**



**New Home Sales**  
**Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, Census**



**Week Ahead.** Although still not fully acknowledged, there is both an intensifying double-dip recession and an escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

***Unemployment Rate and Payroll Employment (October 2011).*** Nonfarm payrolls and the unemployment rate for October 2011 are due for release on Friday, November 4th. This first major indicator of October economic activity likely will confirm ongoing deterioration in broad economic conditions. A pattern of weaker-than-expected reporting, against likely somewhat stronger consensus expectations for the labor market, is a fair bet for October reporting.

Payrolls remain at risk of showing an outright monthly contraction, with the unemployment rate notching higher. Yet, as seen with last month's change in headline payrolls and unemployment rate, whatever is reported likely will include a payroll contraction and higher unemployment rate within the 95% statistical reporting confidence intervals (+/- 129,000 for payroll change, +/- 0.2% for the unemployment rate). As has been the case for some time, unstable seasonal adjustments can distort the reported monthly changes in these series meaningfully.

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