

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

COMMENTARY NUMBER 420
Monetary Base, January Home Sales

February 24, 2012

**Monetary Base Surge to Record High
Suggests Intensifying Systemic-Solvency Crisis**

January Home Sales Numbers Continued Bottom-Bouncing

Unstable Seasonal Adjustments in Existing Home Sales?

PLEASE NOTE: The next regular Commentary is scheduled for Thursday, March 1st, covering the second estimate of fourth-quarter GDP, January new orders for durable goods and the January PCE deflator.

Best wishes to all — John Williams

Opening Comments and Executive Summary. In a week generally shy of significant economic releases, the January data on home sales showed no meaningful monthly changes. The ongoing bottom-bouncing suggested no pending turnaround in the housing industry or recovery in the broad economy.

New-Home Sales. The headline monthly contraction of 0.9% for January new-home sales was statistically meaningless, as was the year-to-year growth of 3.5%. Upside revisions to prior months all were in the realm of normal volatility and were consistent with the current three-year pattern of stagnation seen in this and the housing-starts series. The extensive period of bottom-bouncing followed the two-to-three-year period of collapse in industry activity. Those patterns are shown in graphs in the *New-Home Sales* section.

Existing-Home Sales. Separate from unusual revisions, the 4.3% headline monthly gain in the January the National Association of Realtors (NAR) existing-home sales was not meaningful and neither was the 0.7% year-to-year gain.

With the series having been revamped in a major “correction” two months ago, the latest existing homes sales data were of unusually questionable quality. The headline monthly gain of 4.3% was an artifact of new annual seasonal-adjustment revisions that mirrored shifting and unstable seasonal-adjustment patterns currently seen in so many of the government’s series. The potentially faulty revisions put the January monthly sales change into the plus column, where otherwise it would have been a minus. The warped revisions likely were the direct result of a seasonal-adjustment system that never was designed to handle an economic downturn of the severe depth and length experienced at present. The plots of the latest revisions and the updated “corrected” series are included in the *Existing-Home Sales* section.

Ongoing Problems. That said, there were other indications from the NAR of continuing problems related to existing-home sales. Distressed sales accounted for 35% of January’s activity. That was up from 32% in December and 29% in November. Of reporting NAR members, 33% experienced contract failures in January 2012, up from 9% in January 2011. Problems primarily were tied to failed mortgage applications and appraisal values. The issues mentioned here all are suggestive of the ongoing structural income and credit problems besetting consumers, and of the ongoing systemic-solvency crisis in the banking and financial systems.

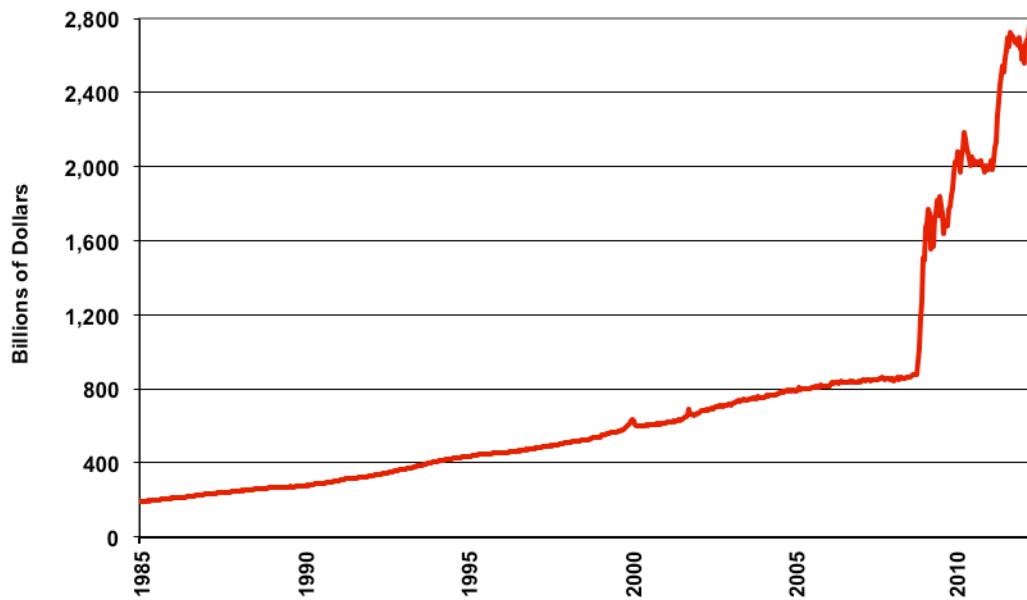
Suggestions of a deepening systemic solvency crisis are discussed in the *Hyperinflation Watch*.

Hyperinflation Watch. Beyond the monthly economic and monetary data covered in this *Commentary*, the broad economic, inflation and hyperinflation outlooks in [Hyperinflation 2012](#) are not changed. There has been an indication, however, of something of a pick-up in broad money supply.

Monetary Base and Money Supply. The seasonally-adjusted St. Louis Fed Adjusted Monetary Base just jumped to an historic high level in the two-week period ended February 22nd, as shown in the following graphs. The movement here largely is under direct control of the Fed’s Federal Open Mark Committee (FOMC) and is suggestive of a deepening systemic solvency crisis. Adding liquidity to the system usually is contrary to the action that would be taken if the Fed were trying to reduce inflation. Indeed, the Fed is not trying to reduce inflation—despite inflation running significantly above its 2.0% inflation target—instead, the U.S. central bank continues its efforts to provide liquidity to a still severely-impaired U.S. banking system.

The extreme growth in the monetary base of recent years has not translated into rapid money supply growth and inflation, yet, because banks have been depositing their funds as excess reserves with the Fed, rather than lending the money into the normal flow of commerce.

St. Louis Fed Adjusted Monetary Base
Bi-Weekly through February 22, 2012, SA, St. Louis Fed



St. Louis Fed Adjusted Monetary Base
Yr/Yr %, Bi-Weekly through February 22, 2012, SA, SGS, St. Louis Fed



Nonetheless, direct monetization by the Fed of significant amounts of U.S. Treasury securities during QE2 did fuel some direct money supply growth. Treasury spending that is funded by the public is a wash in terms of money-supply effect, where the public lends the money to the Treasury, and the Treasury's payments enabled by the borrowed funds are sent back out to the public.

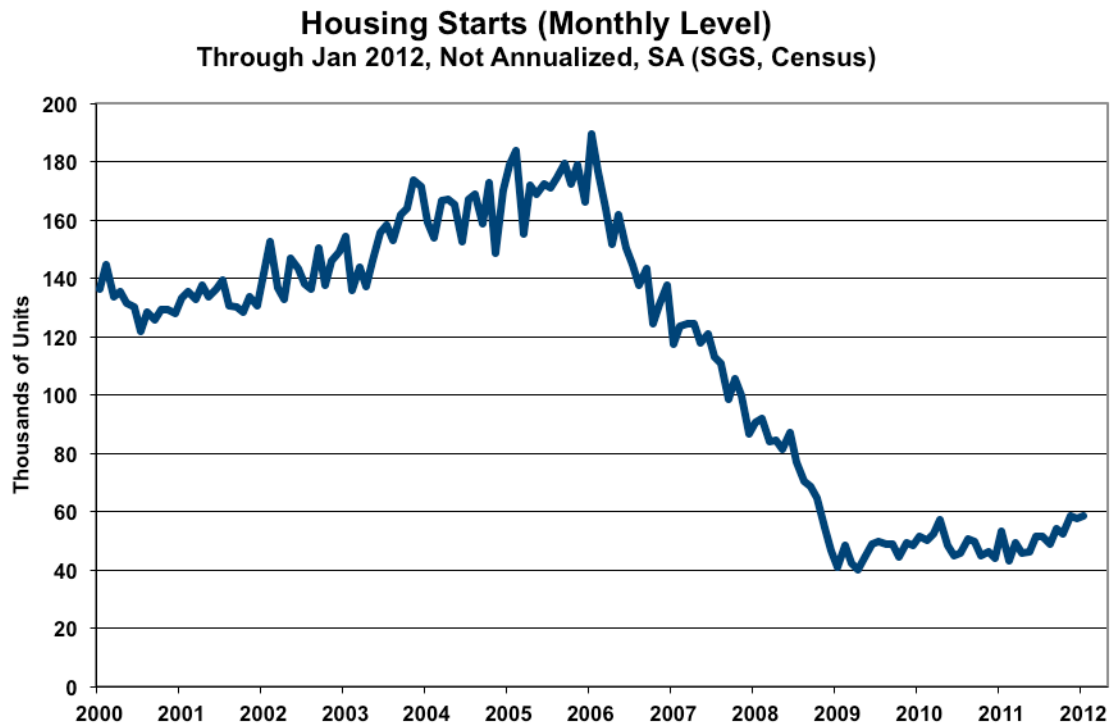
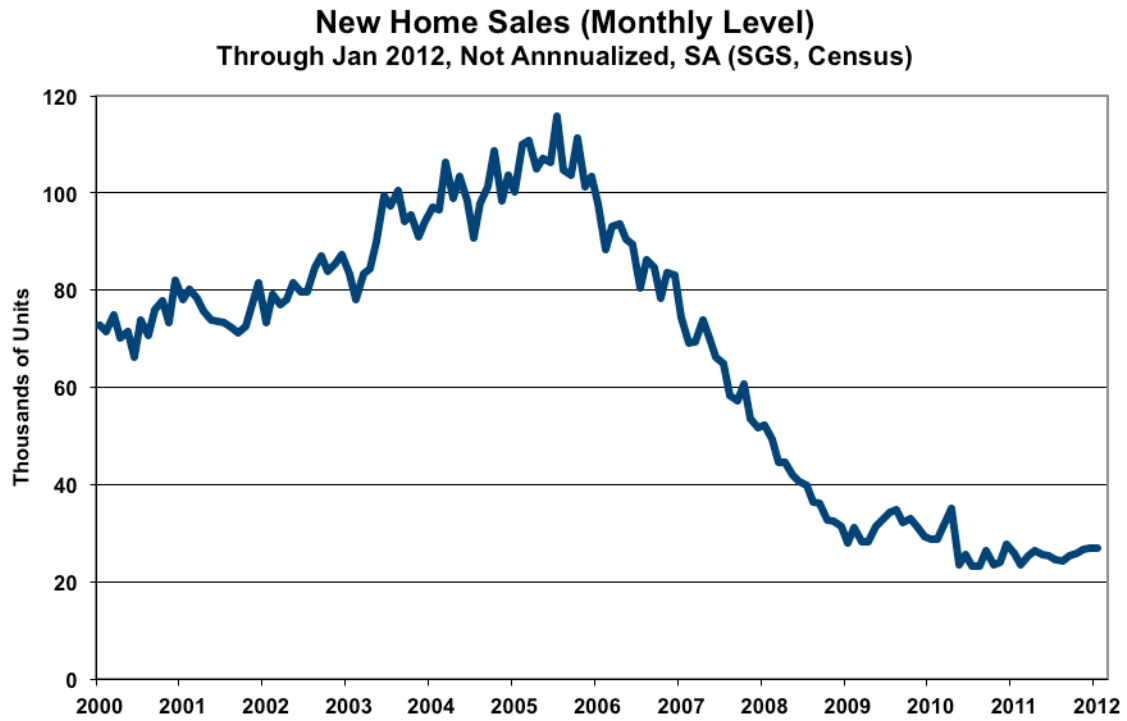
When the Treasury spending is funded by the Fed's money creation, however, cash does not come from the public. Treasury payments, enabled by the Fed, flow into private bank accounts with new money being put into the system. The effect would be magnified if banks were then lending the deposited funds in a normal fashion, but that is not the case. The reduced-impact monetization, however, has been reflected recently in some upturn in the broad money supply. As measured by the SGS-Ongoing M3 Estimate, annual M3 growth rose to 3.9% in January 2012, the strongest annual growth seen in 30 months.

REPORTING DETAIL

NEW AND EXISTING HOME SALES (January 2012)

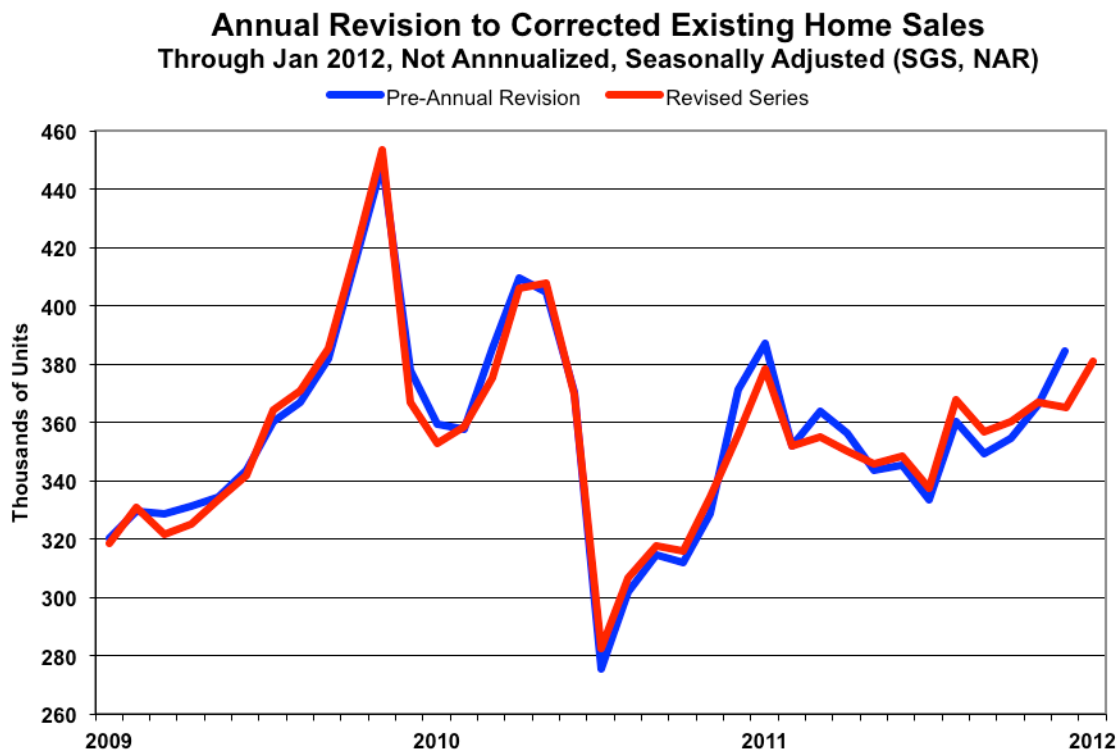
January New-Home Sales Still Bottom-Bouncing. January 2012 new home sales continued bottom-bouncing, in line with January housing starts, as shown in the following graphs. See [Commentary No. 419](#) for details on the latest housing starts reporting. There remains no indication, in either new or existing home sales data, or in underlying fundamentals that drive the housing industry, of pending industry turnaround or of a developing economic recovery.

Today's (February 24th) release of January new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of stagnation at an historically-low level of activity. As usual, January's 0.9% monthly contraction (a gain of 4.6% before prior-period revisions) +/- 19.4% (95% confidence interval) versus December was statistically meaningless. In turn, December's monthly change was revised to a gain of 1.9%, from an initially-reported 2.2% monthly contraction. The year-to-year change in January 2012 new-home sales also was statistically-insignificant, a gain of 3.5% +/- 20.6% (95% confidence interval). December's annual gain was revised to a 2.1% (previously 7.3%) decline. Recent volatility in annual change still reflects the effects of lapsing housing stimulus efforts a year ago.

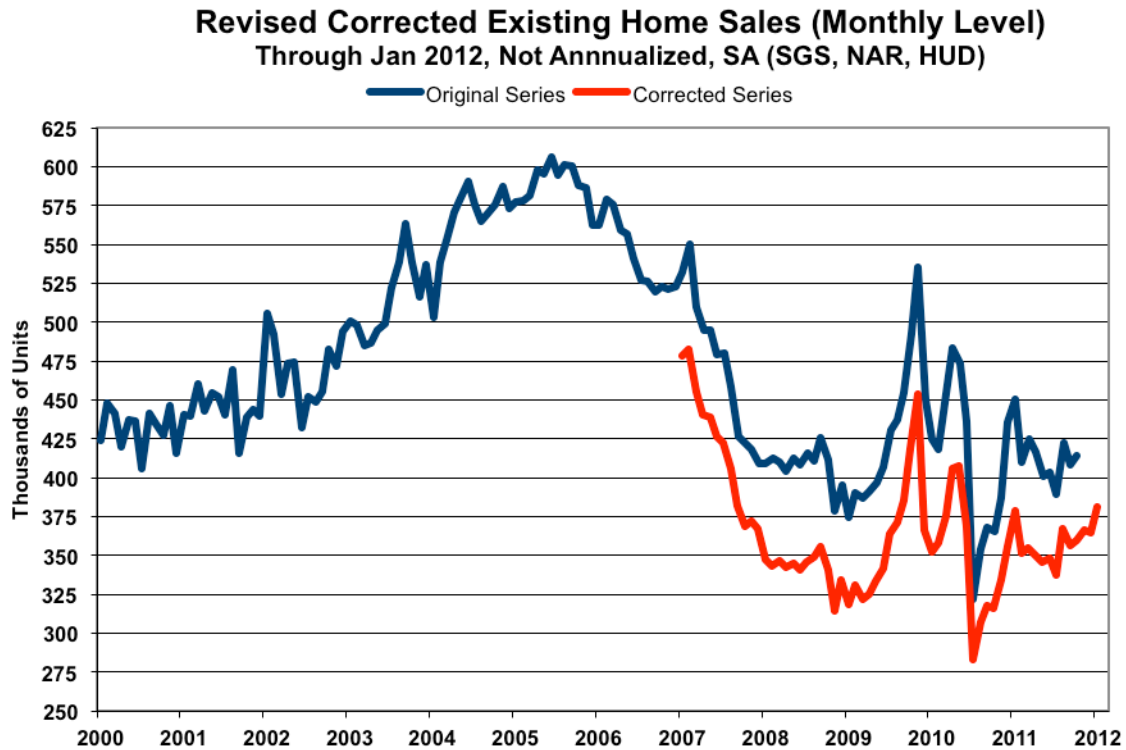


Existing-Home Sales Reporting Instabilities Suggest Limited Usefulness of January Data. Although the January 2012 existing-home sales estimate was just the second estimate since the series was “corrected” for significant reporting errors in November 2011, the release of January 2012 data on February 22nd was revised for further corrections and recast seasonal adjustments.

As shown in the following graph, the latest revisions lowered recent reporting, with the January reporting showing a small gain. Unrevised, the data would have shown a monthly contraction in January. At best, the revamped pattern suggests significant instabilities in the seasonal-adjustment process, as has been seen recently in a number of government series. Those seasonal-factor distortions were a result of the severe depth and length of the economic contraction, a circumstance that post-World War II, or modern economic reporting never was designed to handle.



The second graph reflects the corrected series, as just revised. The old (pre November 2011) and corrected series do not appear to be consistent or comparable. For those interested in the latest detail, however, we continue to look at the regular reporting of the new series, although a heavy caution is offered on the quality of what is being published.



The February 22nd release of January 2012 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly gain of 4.3%, in the context of annual revisions to the previously “corrected” series. The January gain would have been a contraction of 0.9%, but for those revisions. As revised, December showed a 0.5% monthly contraction. Previously, December had been reported with a 5.0% annual gain.

On a year-to-year basis, January 2012 sales rose by 0.7%, versus a revised 2.6% (previously 3.6%) annual gain in December. Distressed properties were an increasingly important contributor to existing home sales activity. The NAR reported “distressed” sales in January at 35% (22% foreclosures, 13% short sales), up from December’s 32% (19% foreclosures, 13% short sales), and November’s 29% (19% foreclosures, 10% short sales). While foreclosures remain a factor in new-home sales, the Census Bureau does not provide an estimate of foreclosure volume.

As an indication of ongoing structural liquidity (income and credit) problems facing consumers, the NAR press release noted that, “Forty-seven percent of NAR members report that contracts settled on time in January; 21 percent had delays and 33 percent experienced contract failures. Contract cancellations are unchanged from December but were only 9 percent in January 2011; they are caused largely by declined mortgage applications and failures in loan underwriting from appraisals coming in below the negotiated price.”

Week Ahead. Recognition of an intensifying double-dip recession as well as an escalating inflation problem remains sporadic. The political system would like to see the issues disappear until after the election; the media does its best to avoid publicizing unhappy economic news; and the financial markets will do their best to avoid recognition of the problems for as long as possible, problems that have horrendous implications for the markets and for systemic stability.

Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

New Orders for Durable Goods (January 2012). The January 2012 new orders for durable goods release is scheduled for Tuesday, February 28th. As has been the case in recent months, whatever change is reported for this regularly volatile series (a decline appears to be expected), it likely will not be meaningful, remaining well within the regular monthly swings.

Gross Domestic Product—GDP (Fourth-Quarter, Second Estimate, First Revision). The first revision to fourth-quarter GDP is due for release on Wednesday, February 29th. Consensus expectation, per MarketWatch.com, is for a slight downside revision in the initial annualized growth estimate of 2.8% to 2.7%.

Reporting risk would favor a downside surprise. The initial Bureau of Economic Analysis (BEA) growth estimate likely was boosted artificially in an effort to get the “advance” estimate as close as possible to the an initially stronger consensus estimate. Retail sales revisions and trade reporting should put some downside pressure on the estimate, while industrial production revisions should put upside pressure on the estimate. The numbers are of such poor reporting quality at this point, that the BEA likely will not hazard a guess in this reporting for the closely-related gross domestic income (GDI) and gross domestic product (GDP) for the quarter, waiting instead for the third estimate, due for release on March 29th.

Personal Consumption Expenditure Deflator—PCE Deflator (January 2012). The first guesstimate of the January 2012 PCE deflator—the Federal Reserve’s newly targeted inflation measure—will be published on Thursday, March 1st. The 2.0% annual inflation target should be exceeded, again, with the concept of the inflation target serving only as pabulum for the financial markets, not as a priority driving-factor behind Fed policy.
