

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

COMMENTARY NUMBER 442
GDP Revision, Election Impact

May 31, 2012

**First-Quarter GNP Headline Growth Fell to 1.3%,
Weakest Since Second-Quarter 2009 Official End of Recession**

Major Revisions to Income and Implications for the Presidential Election

PLEASE NOTE: The next regular Commentary is scheduled for tomorrow, Friday, June 1st, covering May 2012 employment and unemployment, the April PCE deflator and April construction spending. A Special Commentary is planned for Friday, June 8th, to review the broad economic outlook and implications for systemic stability, inflation and hyperinflation.

Best wishes to all — John Williams

Opening Comments and Executive Summary. It has been my observation over decades that most people have a pretty good sense of economic and inflation reality, and that the sentiment on Main Street U.S.A. usually sets the tone for pocketbook issues that can determine an election outcome, whether or not those issues are reflected meaningfully in government reporting.

In the years before methodological gimmicks—such as hedonic adjustments—were used to reduce estimated inflation, the government's reporting of growth in real (inflation-adjusted) aggregate national disposable income (effectively take-home pay) was a solid predictor of the outcome of U.S. presidential

paces. While the restated history of disposable income does not work as well as the older version, it still generates useful signals in terms of pocketbook issues that may impact presidential elections.

As shown in the following table, in every presidential election since 1932 (the first year for which consistent estimates now are available), whenever real disposable income growth fell below 3.0% in the year of an election, the incumbent party lost the White House. Of the 20 election years, there were only four where income growth was below 3.0%. The 2012 election year may join that list.

For 2012, the circumstances are not developing in a positive manner for the incumbent party. As indicated in data published along with the GDP revision, first-quarter 2012 real disposable income was just 0.2% above first-quarter 2011, and for the year-ended first-quarter 2012, annual growth was at 0.6%. If real growth holds in the below-one-percent range, that would be a worse economic environment than seen for Jimmy Carter's re-election bid of 1980, and the worst environment faced by any incumbent party holding the White House since Herbert Hoover's re-election bid in 1932.

Pocketbook Issues versus Presidential Elections
Presidential Elections (Since 1932) Where
Real Disposable Income Growth
Was Less Than 3.0%

Election Year	Yr/Yr Change in Real Disposable Income	Incumbent Party Result
1932	-13.28%	Hoover Lost
1960	+2.64%	Nixon Lost
1980	+0.96%	Carter Lost
2008	+2.42%	McCain Lost
2012	(1) +0.61% (2) +0.20%	?

(1) Growth for year-ended 1q2012.

(2) Yr/Yr change in disposable income for 1Q2012.

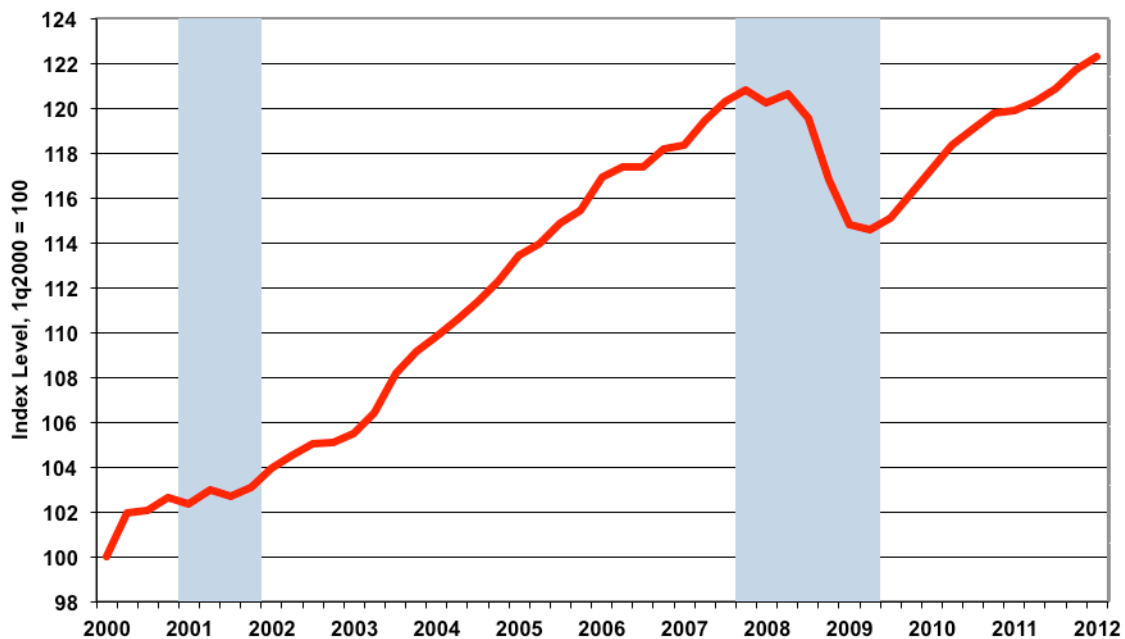
Sources: ShadowStats.com, BEA.

Such an environment will tend to be difficult for all incumbents seeking re-election. As a result, renewed weakness in key underlying economic data should intensify pressure on Congress to provide some form of high-profile stimulus effort, irrespective of other political pressures favoring fiscal prudence.

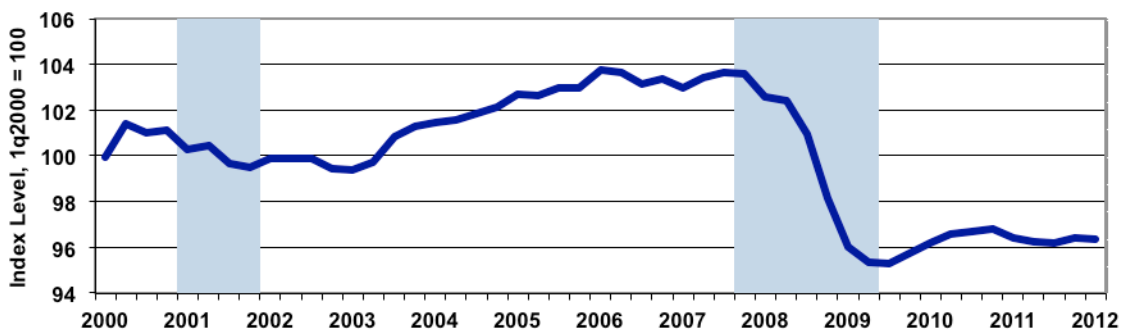
The following graphs reflect today's (May 31st) revision of first-quarter GDP. The first graph shows the headline, real GDP level, as deflated by the implicit price deflator (IPD) or GDP inflation. Note that the

recent recovery of activity versus pre-recession levels remains in place, although that may change in the upcoming July 27th benchmark revision to the series. The second graph is inflation-corrected. It is the same as the first graph, but the IPD has been adjusted to add back roughly two-percentage points of annual inflation estimated to have been lost due to methodological changes of recent decades (see discussion in [Hyperinflation 2012](#)). Both graphs are to the same scale.

Headline Real GDP (Quarterly Index Level)
Through 1q12, Seasonally-Adjusted (SGS, BEA)



Inflation-Corrected Real GDP (Quarterly Index Level)
Through 1q12, Seasonally-Adjusted (SGS, BEA)



GDP, GNP and GDI Reporting. The downward revision in first-quarter 2012 GDP headline growth to 1.9%, from 2.2%, was about as expected by the markets. It reflected downside impact from revisions to personal consumption, inventories, net exports and state- and local-government spending, along with some offset from stronger business investment. Fourth-quarter headline growth remained at 3.0%. Year-to-year first-quarter growth now is at 2.0% (previously 2.1%) versus 1.6% in the fourth-quarter.

Gross national product (GNP) is the broadest national income measure of U.S. economic activity, where GDP is GNP net of trade in factor-income, or interest and dividend payments. Today's initial headline growth rate for first-quarter 2012 GNP was 1.3%, down from 1.8% in the fourth-quarter, and at the lowest headline growth rate seen since a 0.5% contraction in second-quarter 2009, which was the formal end of the 2007 recession. Year-to-year growth was 1.8%, unchanged from the fourth-quarter.

The recent relative weakness in U.S. GNP versus GDP reflects an ongoing surge in interest and dividend payments to the rest of the world from the United States, which holds net-debtor status.

Gross domestic income (GDI) is the income-side reporting equivalent of the consumption-side GDP. Today's initial headline growth rate for first-quarter 2012 GNP was 2.7% (1.0% net of prior-period revisions), versus a revised 2.6% (previously 4.3%) gain in the fourth-quarter. Year-to-year growth was estimated at 2.0% in the first-quarter, versus a revised 2.0% (previously 2.4%) annual gain in the fourth - quarter.

The gyrations in GDI reflected extraordinary stabilizing revisions to, and wild fluctuations in, estimations of personal income in the last several quarters, including disposable personal income, which was discussed in the opening comments.

Please note that all these GDP-related numbers are subject to benchmark revision on July 27th. Significant downside adjustments to reported GDP history since 2009 remain likely.

Hyperinflation Watch. The outlook for the U.S. economy, U.S. dollar, systemic solvency and inflation (hyperinflation) has not changed from what was discussed in the January 25th [Hyperinflation 2012](#), but conditions continue to evolve and regular review and updating are needed. Where reviews and updates are covered standardly in the regular *Commentaries*, the June 8th *Special Commentary* will provide a broad overview, supplanting [Special Commentary No. 426](#) and [Special Commentary No. 429](#).

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (First-Quarter 2012, Second Estimate, First Revision)

Lowered First-Quarter GDP Growth Estimate Still Is Not Statistically Significant. The second estimate of first-quarter 2012 GDP growth still was no more than statistical noise, with the downwardly revised headline growth of 1.9% (previously 2.2%) slowing from the 3.0% growth still estimated for the fourth-quarter. Of some interest in the latest reporting, however, was the initial headline reporting of first-quarter GNP—the broadest measure of the economy in the national income accounts—at 1.3%, down from 1.8%, and at the weakest level of quarterly growth seen since the official end of the recession in second-quarter 2009. Also, the initial headline second-quarter estimate of headline GDI growth rose to 2.7% from a revised 2.6%, but that was an artifact of unusual revisions to, and assumptions in, personal income growth.

As discussed and graphed in the *Opening Comments and Executive Summary* section and in [Hyperinflation 2012](#), the “recovery” is an illusion created by the use of understated inflation in deflating key dollar-denominated series, such as the GDP. The lower the rate of inflation that is used for the deflator, the stronger is the reported inflation-adjusted growth.

Consistent with this regular overstatement of broad economic activity by the Bureau of Economic Analysis (BEA), the GDP series remains the most worthless and the most heavily politicized of the government’s popularly followed economic reports.

All of these numbers are subject to annual revisions scheduled for July 27th. Downside restatements are likely for historical GDP reporting back through the first-quarter 2009, which is as far back as the revisions are due to go, at present.

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 \$107 billion in “residual” as of fourth-quarter 2011.

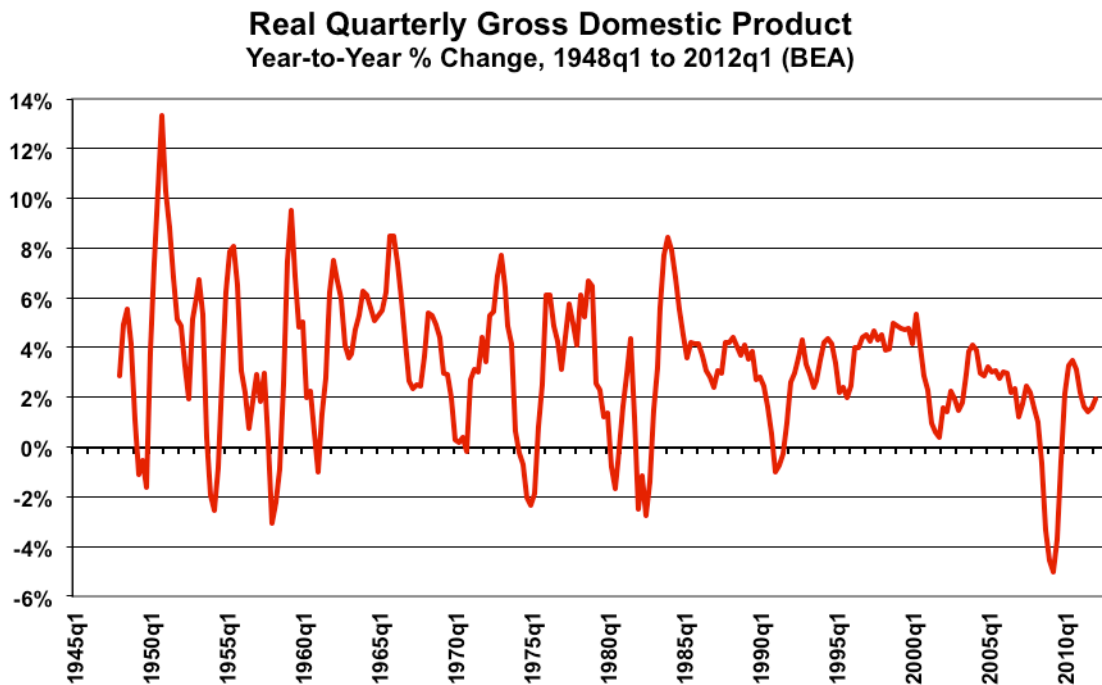
Quarterly growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by multiplying 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.

GDP. Published this morning, May 31st, by the BEA, the second estimate (first revision) of first-quarter 2012 gross domestic product (GDP) showed real (inflation-adjusted) quarterly growth at a statistically-insignificant 1.86% +/- 3% (95% confidence interval), down from the initial estimate for the quarter of 2.20%, and down from the 2.95% estimated for fourth-quarter 2011. For each of the five quarters since first-quarter 2011, estimated growth rates have been little more than statistical noise around the unchanged level, and these heavily guessed-at numbers possibly have been massaged to keep the quarterly growth rates in minimally-positive, as opposed to minimally-negative territory.

The downside revision to the first-quarter growth estimate reflected downside revisions to personal consumption, deterioration in the net-export account, a lowered estimate of inventory build-up, a greater contraction in spending by state and local governments, along with a partially offsetting relative gain in business investment.

As shown in the following graph, the year-to-year real change in first-quarter 2012 GDP was a revised 1.99% (previously) 2.08%, up from 1.61% currently estimated for fourth-quarter 2011. The relative pick-up in annual growth is against a first-quarter 2011 number that was virtually flat. Current annual growth continued well off the near-term peak growth of 3.51% reported during third-quarter 2010. Again, all these numbers likely will revise to the downside in the upcoming July 27th annual revisions.



Implicit Price Deflator (IPD) and PCE Deflator. The first-quarter 2012 GDP implicit price deflator (IPD) was revised to an annualized quarterly rate of 1.67% (previously 1.53%), up versus the 0.85% reported for the fourth-quarter, with year-to-year inflation of 1.92% (previously 1.88%) indicated for the first-quarter, versus 2.18% in the fourth-quarter.

For comparison purposes, annualized seasonally-adjusted quarterly inflation for the CPI-U in the first-quarter was 2.48%, versus 1.30% in the fourth-quarter, with year-to-year CPI-U at 2.82% in the first-quarter, versus 3.29% in the fourth-quarter.

For the first-quarter, the personal consumption expenditures (PCE) deflator rose at an annualized pace of 2.40% (previously 2.39%), up by an unrevised 2.30% year-to-year and above the Fed's 2.0% target. The fourth-quarter PCE deflator rose at an annualized pace of 1.17%, up by 2.67% year-to-year. The detail for April 2012 will be released tomorrow, Friday, June 1st, and covered in the regular *Commentary* of that date.

The lower the inflation rate that is used in deflating the GDP, the stronger is the resulting inflation-adjusted number and vice versa. Inconsistencies in the BEA's recent handling of the Bureau of Labor Statistics' revisions to CPI seasonal adjustments (discussed in [Commentary No. 421](#)), promise revamped deflators in the upcoming July 27th annual revisions.

SGS-Alternate GDP. The SGS-Alternate GDP estimate for first-quarter 2012 is an approximate annual contraction of 2.2% versus the official estimate of a 2.0% gain. Such is less-negative than the alternate 2.7% annual contraction estimate (1.6% official gain) for the fourth-quarter (see the [Alternate Data](#) tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, a quarter-to-quarter contraction once again appears to have been a realistic possibility for the first-quarter, as it has been for the last five quarters, a period of protracted business bottom-bouncing in the real world.

Adjusted for gimmicked inflation and other methodological changes, the business downturn that began in 2006/2007 is ongoing; there has been no meaningful economic rebound. The inflation-corrected GDP graph (see the *Opening Comments and Executive Summary* section and [Hyperinflation 2012](#)) is based on the removal of the impact of hedonic quality adjustments that have reduced the reporting of annual GDP inflation by roughly two-percentage points. It is not the same measure as the SGS-Alternate GDP, which reflects the impact of reversing additional methodological distortions of recent decades.

GNP. Gross national product (GNP) is the broadest measure of U.S. economic activity, where GDP is GNP net of trade in factor-income, or interest and dividend payments. Today's initial headline growth rate for first-quarter 2012 GNP was 1.35% (1.3% rounded to the first decimal point), down from 1.80% in fourth-quarter 2011, and at the lowest annualized quarterly growth rate seen since a 0.47% contraction in second-quarter 2009, the formal end of the 2007 recession. Year-to-year growth in first-quarter GDP stood at 1.80%, versus 1.83% in the fourth-quarter.

The recent relative weakness in U.S. GNP versus GDP reflects an ongoing surge in interest and dividend payments to the rest of the world from the United States, which holds net-debtor status.

GDI. Gross domestic income (GDI) is the income-side reporting equivalent of the consumption-side GDP. Today's initial headline growth rate for first-quarter 2012 GNP was 2.68% (0.97% net of prior-period revisions), versus a revised 2.62% (previously 4.35%) in the fourth-quarter. Year-to-year growth was estimated at 2.01% in the first-quarter, versus a revised 1.96% (previously 2.38%) annual gain estimated for the fourth-quarter.

The gyrations in GDI reflected extraordinary revisions to, and wild fluctuations in, estimations of personal income in the last several quarters. The revisions do appear to have been somewhat stabilizing in nature and in a direction consistent with weaker income growth.

Real Disposable Income. Reflecting the extraordinary volatility in fourth- and first-quarter BEA estimates (based on BLS reporting) of wages and salaries, annualized real quarterly growth in disposable income for first-quarter 2012 was 0.44% (revised from 0.39%), with year-to-year growth of 0.20% (revised from 0.58%), but that was against a revised fourth-quarter estimate of 0.16% (virtually no growth) previously reported at 1.73%. Fourth-quarter annual growth revised to 0.40% from 0.79%.

Since the first publication of annual disposable income data in 1929, no incumbent party has retained the White House, when real disposable income growth has been below 3.0% in a presidential election year. So far, the current circumstance is developing against the incumbent party for the 2012 election, as discussed in the *Opening Comments and Executive Summary*.

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.

Personal Consumption Expenditures (PCE) Deflator (April 2012). Following on today's GDP release, which covered the revised first-quarter 2012 PCE Deflator (2.3% year-to-year), the BEA is scheduled to release the April 2012 PCE deflator guesstimate tomorrow, Friday, June 1st. The Federal Reserve's newly targeted inflation measure could come in close to the 2.0% annual growth target in April. Nonetheless, as discussed previously, the current concept of an inflation target serves only as pabulum for the financial markets, not as a defining priority that drives Fed policy.

Employment and Unemployment (May 2012) [Updated]. May labor data are due for release tomorrow, Friday, June 1st, from the Bureau of Labor Statistics (BLS). The expectation for May payroll employment is a gain of 170,000, up from the initial reporting of a 115,000 gain in April, with the headline unemployment rate for May expected to hold at 8.1%, the same level as reported for April, per MarketWatch.com. Consensus estimates indicated by Briefing.com, as we go to press, are 150,000 for payrolls, 8.1% for the headline unemployment rate.

The consensus jobs estimate basically is the trend estimate that comes out of the BLS seasonal-adjustment models. The trend number for May is 168,000 (see [Commentary No. 435](#) and [Payroll Trends](#)).

Given reporting in the last day or so, including a sharp monthly decline in new help-wanted advertising online (Conference Board), a weaker-than-expected ADP number (not particularly meaningful), and a bigger-than-expected jump in the latest jobless claims (meaningless, given the Department of Labor's demonstrated inability to seasonally-adjust weekly data around holidays, such as Memorial Day), the consensus outlook likely is softening.

Nonetheless, May data should disappoint expectations, given underlying weakness in related economic fundamentals, and likely reversals in systemic distortions inherent in the seasonal adjustments being made to both series.

Construction Spending (April 2012). Due for release tomorrow, Friday, June 1st, by the Census Bureau, April construction spending likely will show ongoing patterns of bottom-bouncing at low levels of activity for the series, particularly after inflation-adjustment. Once again, monthly changes should not be statistically significant.

Trade Balance (April 2012). Due for release on Friday, June 8th, by the Census Bureau and the Bureau of Economic Analysis, the April trade deficit likely will be wider than consensus estimates. The new numbers will be published along with, and in the context of, an annual benchmark revision to the series back to January 2009.