

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

COMMENTARY NUMBER 458
June Durable Goods Orders, Home Sales, Household Income

July 26, 2012

Durable Goods Orders in Second Straight Quarterly Contraction

Household Income Still Bottom-Bouncing

June Home Sales Fall-Off, Quarterly Growth Slows/Contracts

PLEASE NOTE: The next regular Commentary is scheduled for tomorrow, Friday, July 27th. It will review the first-estimate of second-quarter 2012 GDP and the annual revisions to the series.

Best wishes to all — John Williams

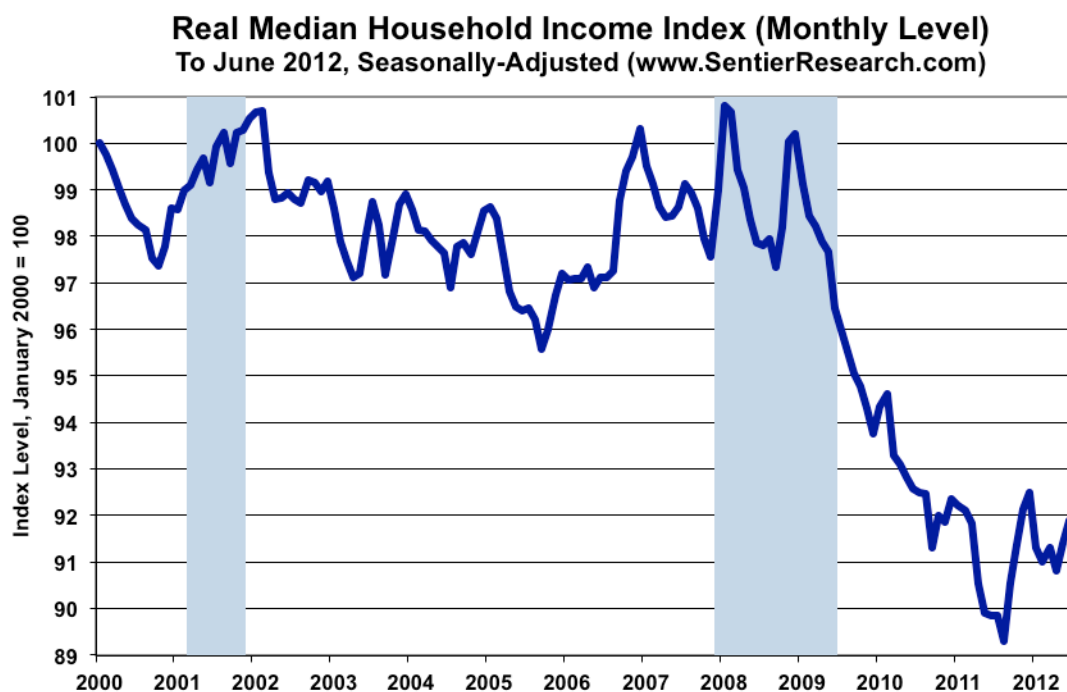
Opening Comments and Executive Summary. When the *New York Times* runs a lead article entitled “Fragile Economy Said to Push Fed to Weigh Action,” as happened yesterday (July 25th), the story could be viewed as one planted by the Administration, goading the Federal Reserve into an “easing” action; or as one planted by the Federal Reserve, trying to adjust market expectations before taking action at next week’s FOMC meeting (the scheduled statement is for Wednesday, August 1st). Any Fed action likely would be intended to aid primarily the banking system, under the guise of “helping” the economy.

In either event, the story likely was planted and, if so, it was suggestive of unhappy news in tomorrow’s (July 27th) release of second-quarter 2012 GDP and annual revisions, and possibly the August 3rd release

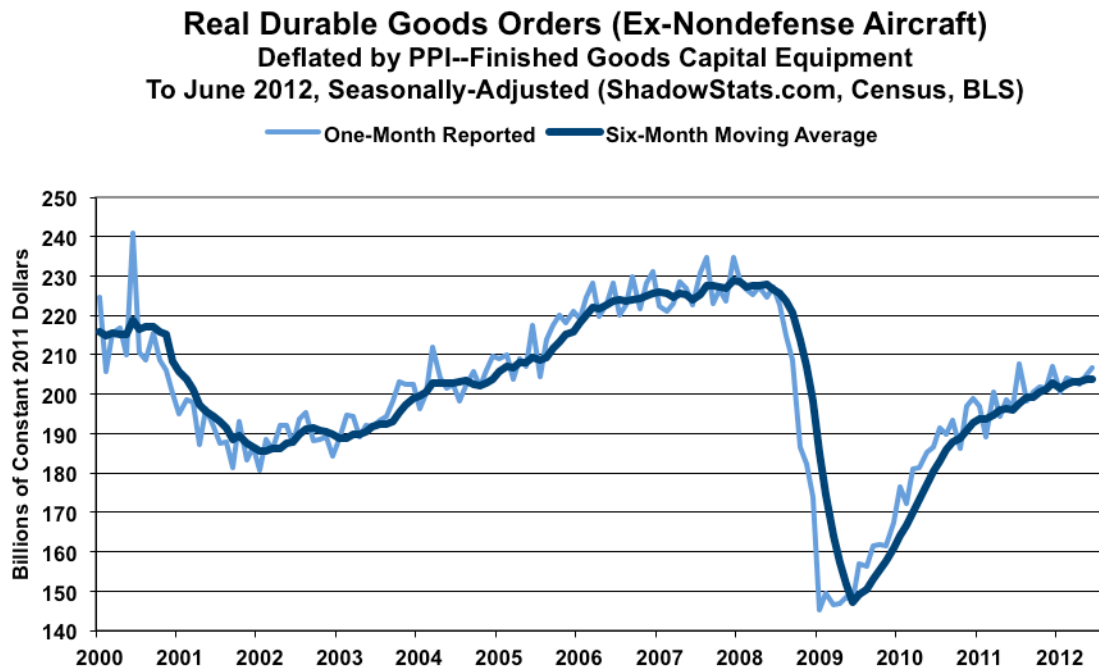
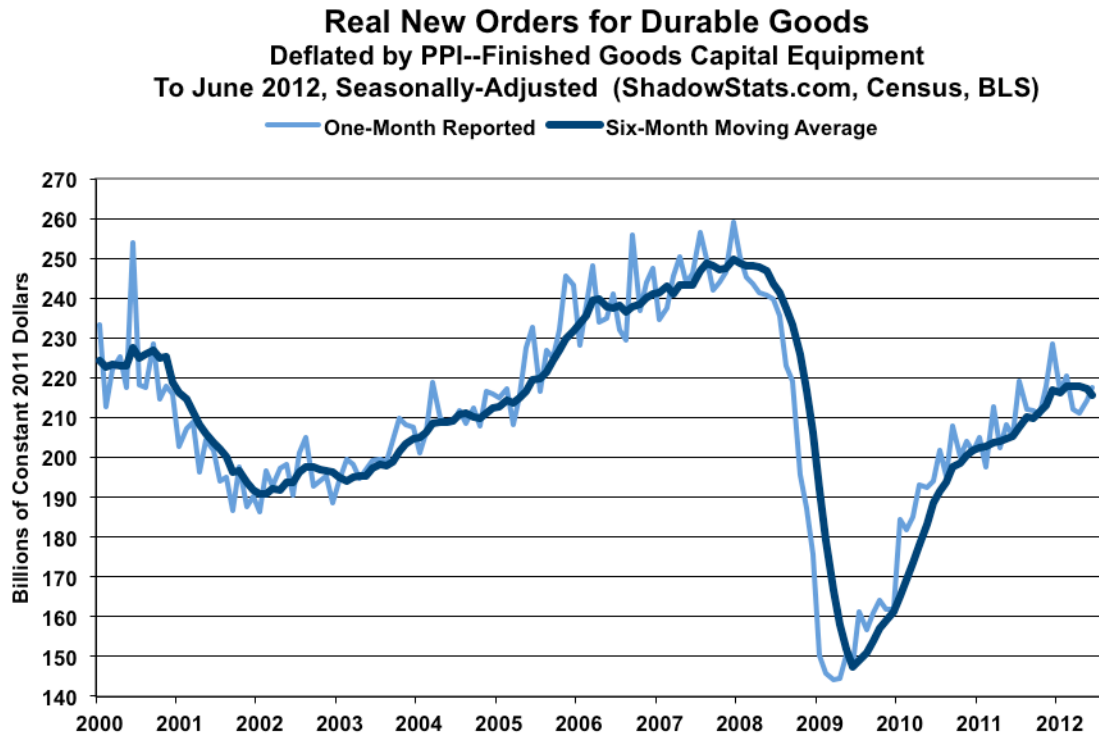
of the July employment and unemployment numbers. The GDP number certainly was known in advance of the *Times's* story, as was the likely reporting of July labor conditions.

Tomorrow's (July 27th) *Commentary* will update the economic picture. Nothing in the economic reporting of the last week or so, however, has altered the outlook of an economy in low-level stagnation that has started to deteriorate anew. Home sales are in monthly decline, with slowing quarterly growth; new orders for durable goods, though up for the month, contracted for the second straight quarter; and household income is stagnating near cycle lows.

Median Household Income. As shown in the following graph, and as reported on July 24th by www.SentierResearch.com, real median household income for June 2012 (deflated by the CPI-U) rose by a statistically-insignificant 0.5% on a monthly basis, versus May, where May was up by 0.7% from April. Recent monthly gains primarily have reflected weakness in the seasonally-adjusted CPI-U, due to declining gasoline prices. Nonetheless, the series continued to bottom-bounce near the current cycle low.



New Orders for Durable Goods. As usually has been the case, the monthly gain of 1.6% in June durable goods orders and the upwardly revised 1.6% (previously 1.2%) gain in May orders were not meaningful in this highly volatile series. Shown in the following graphs (the aggregate durable goods orders series and that series net of aircraft orders), adjusted for inflation and smoothed over time, orders have flattened out at levels below those seen going into the 2001 recession, let alone the 2007 economic collapse. See the *Reporting Detail* section for more information.



New and Existing Home Sales. As has become the norm, the monthly changes in June home sales (a decline of 8.4% for new homes, a decline of 5.4% for existing homes) were not meaningful. Both series continued patterns of low-level stagnation.

Nonetheless, in tandem with the pattern of slowing quarterly growth in housing starts (see [Commentary No. 457](#)), the annualized pace of quarter-to-quarter homes sales growth in the second quarter slowed for new home sales, at 13.1% in the second-quarter, versus 35.3% in the first, and contracted for existing home sales, down by 2.6% in the second-quarter, versus a 17.5% gain in the first. Keep in mind that these rates of change are against historically volatile and low levels of activity.

Some of the current weakness in homes sales has been blamed on too-low inventories of houses for sale. While that may be an issue, there is something a self-feeding cycle involved, where low prices likely are keeping some houses off the market. Also constraining activity for both purchasers and sellers are ongoing consumer liquidity and credit issues (see [Special Report No. 445](#)).

Although inventories of homes for sale are relatively low at the moment, the 6.6 months supply in June for existing home sales was up by 3.1% from May and was at its highest since December 2011. For new home sales, June inventories reflected a 4.9 months supply, up by 8.9% from May, and at the same levels seen in March and April, which last were exceeded in January 2012.

Hyperinflation Watch. *Note: The following text in this section is repeated from the last several Commentaries, but it will be updated following tomorrow's GDP release. General circumstances have not changed, with the broad outlook discussed in detail in [Special Report No. 445](#) (June 12th), which updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That Special Report supplemented [Hyperinflation 2012](#) (January 25th), which remains the primary Commentary detailing the hyperinflation story.*

Official GDP reporting shows a plunge in economic activity from fourth-quarter 2007 to second-quarter 2009, with an ensuing upturn in activity that led to a full recovery as of third-quarter 2011. In contrast, I contend the economy began turning down in 2006, plunging in 2008 into 2009 and subsequently stagnating—bottom-bouncing—at a low level of activity ever since. There has been no recovery, and the economic downturn is intensifying anew.

The official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP. Use of understated inflation in such a manner results in overstated economic growth.

The long-term fiscal solvency issues of the United States—where GAAP-based accounting shows annual deficits running in the \$5 trillion range—are not being addressed, and the politicians currently running the government lack the political will to address those issues. That circumstance initially suggested a hyperinflation crisis by the end of this decade, but the systemic-solvency crisis of 2008 accelerated the process, indicating a hyperinflation problem by no later than the end of 2014.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions. With the economy weak enough to provide cover for further Fed accommodation to the still-struggling banking system, the next easing by the Fed likely will trigger a massive dollar selling crisis and begin the process of a rapid upturn in domestic consumer inflation.

REPORTING DETAIL

NEW ORDERS FOR DURABLE GOODS (June 2012)

Durable Goods Orders in Second Straight Quarter-to-Quarter Decline, Both Before and After Inflation Adjustment. The small increase reported in nominal (not-adjusted-for-inflation) June new orders for durable goods was well within the range of regular monthly volatility and revisions, and was boosted partially by an increase in nondefense aircraft orders. On a real (inflation-adjusted) basis, the unfolding pattern of activity is one of a flattening level of new orders that remains below the levels seen in 1999 and 2000. Viewed on a quarterly basis, aggregate durable goods orders contracted in the second-quarter at annualized rates of 3.8% (real) and 2.2% (nominal), versus first-quarter contraction rates of 4.8% (real) and 2.1% (nominal).

Historical graphs of the real series, both aggregate and net of nondefense aircraft, are shown in the *Opening Comments and Executive Summary*. The data there are smoothed and adjusted for inflation. Net of inflation adjustment (2011-dollars based on the PPI finished goods capital equipment index), the seasonally-adjusted level of June 2012 new orders stood at \$217.4 billion, still below the annual-average level of new orders in 1999—thirteen years ago—of \$218.3 billion. The latest level of orders not only remained well below the peak seen before the 2001 recession, but also was 16.1% below the peak of activity preceding the 2007 downturn.

Note: As described in [Special Commentary No. 426](#), there is no fully appropriate inflation measure available for deflating durable goods. The one used here is the PPI's inflation measure for finished goods capital equipment (PPI-FGCE), an official inflation measure. The problem with that measure is in the hedonic quality adjustments to prices, where nebulous "quality improvements," which cannot be measured directly and are not consistently applied to all products, are modeled in incredibly imprecise efforts by the government to reduce reported inflation versus real-world experience. The same issues are part of the methodological problems that significantly understate the CPI and the GDP implicit price deflator inflation measures.

In terms of smoothing, the graphs in the Opening Comments and Executive Summary section reflect a six-month moving average, as well as the raw monthly data. The detail also is graphed net of nondefense aircraft orders, a significant cause of month-to-month volatility in the series.

Official, Nominal May Reporting. The Census Bureau reported today, July 26th, that the regularly-volatile, seasonally-adjusted nominal (not adjusted for inflation) new orders for durable goods in June 2012 rose by 1.6% (up by 2.1% net of prior-period revisions), following a revised 1.6% (previously 1.1%) monthly gain in May. Adjusting for the impact of a relatively small increase in nondefense aircraft orders, June aggregate orders were up by 1.0% for the month.

The irregular and highly volatile long-term nondefense aircraft orders rose by 14.3% in June, following a revised 7.6% (previously 4.9%) monthly gain in May. Aircraft orders usually are placed years in advance of delivery and rarely impact near-term economic activity.

Unadjusted, year-to-year growth in total June 2012 new orders was 6.7% versus a revised 6.2% (previously 5.9%) in May.

Seasonally-adjusted nondefense capital goods new orders rose by 1.2% in June, following a revised monthly gain of 2.7% (previously 1.3%) in May. For June 2012, the unadjusted year-to-year change in the series was 2.6%, versus a revised 0.3% increase (previously a decline of 0.2%) in May.

Note: 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. Unusual seasonal-factor volatility raises issues as to the significance of reported seasonally-adjusted monthly changes.

Inflation-Adjusted and Smoothed. The nominal 1.6% monthly gain in June orders effectively was a gain of 1.4% after inflation adjustment, where the nominal 1.6% gain May was 1.5% on the same basis. Seasonally-adjusted, year-to-year real growth rose to 6.0% in June from 2.9% in May.

As indicated in the graphs in the *Opening Comments and Executive Summary*, these series have shown a slowing uptrend in the last two-to-three years—now a flattening-to-down pattern—clearly not the recovery that is seen in official GDP reporting. As discussed above, the real (inflation-adjusted) level of orders in June 2012 remained below both the pre-2001 and pre-2007 recession highs.

If the deflation measure here could be corrected meaningfully for its hedonic-adjusted understatement, the uptrend in real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity (see [Special Report No. 445](#)).

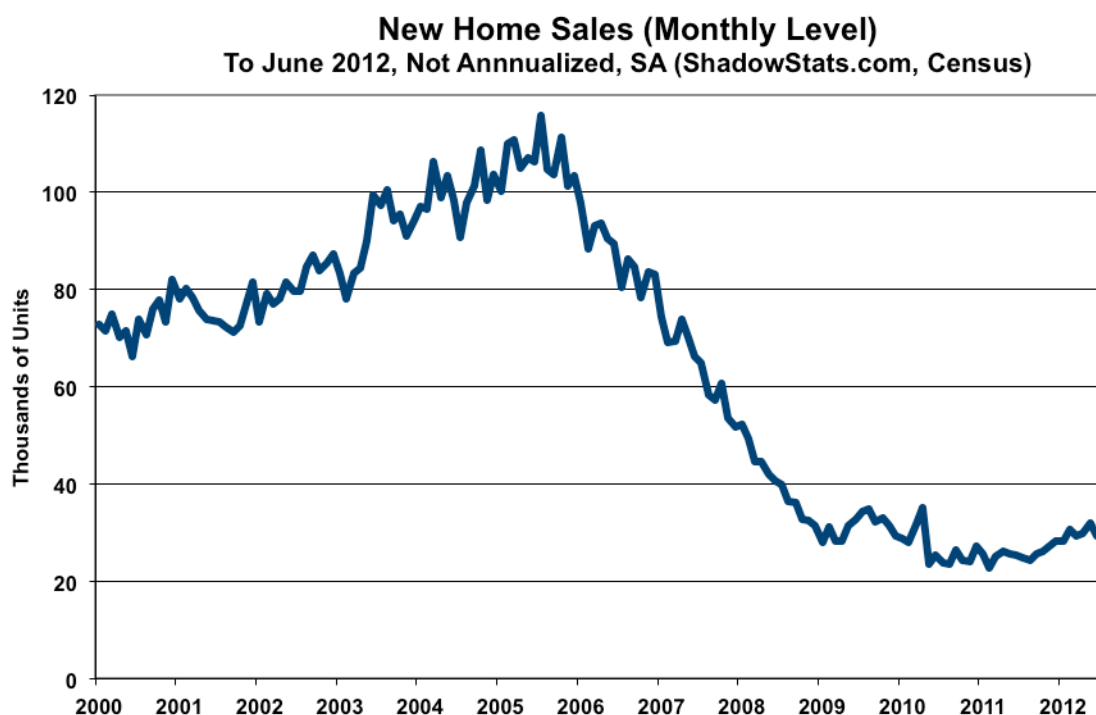
NEW AND EXISTING HOME SALES (June 2012)

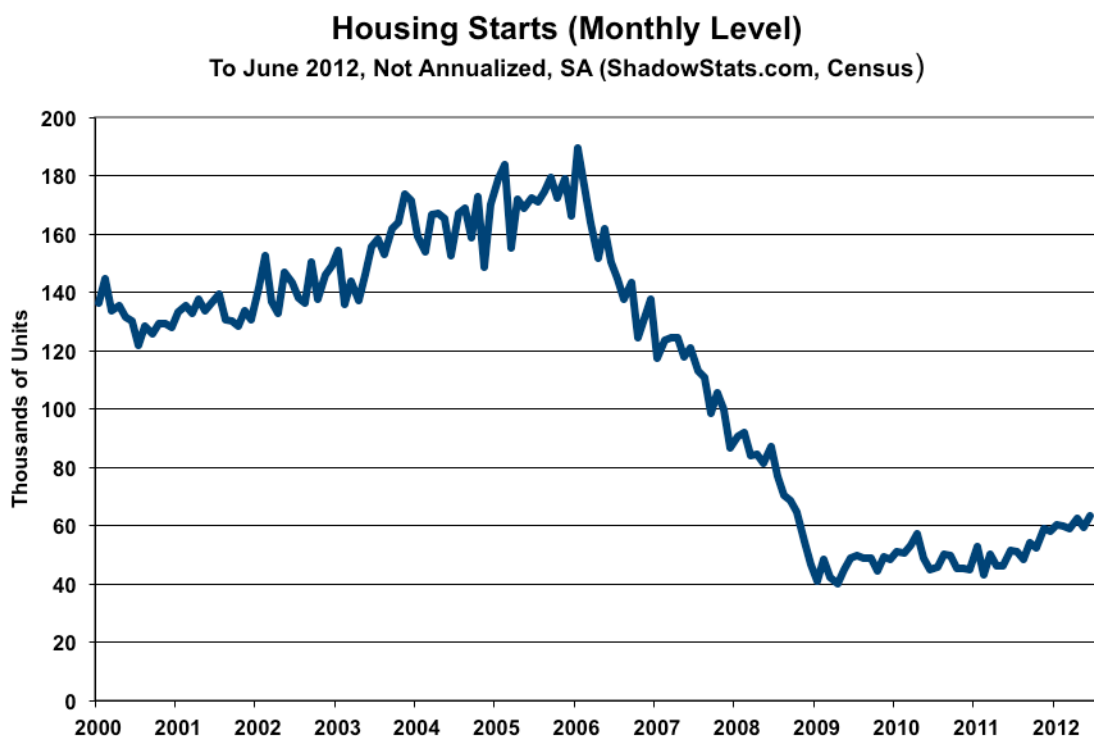
Home Sales Growth is Slowing Anew. Both the new- and existing-home sales series showed monthly contractions in June, although the changes in the monthly numbers generally were not statistically meaningful. On a quarterly basis, however, the pace of growth in the second-quarter weakened versus the first-quarter. The annualized pace (in keeping with the initial second-quarter GDP estimate, due for release tomorrow, July 27th) of quarter-to-quarter growth for new home sales, slowed to 13.1% in the second-quarter, versus 35.3% in the first-quarter, while the quarterly pace for existing home sales contracted, down by 2.6% in the second-quarter, versus a 17.5% gain in the first-quarter. Keep in mind that these volatile rates of change are against historically low levels of activity.

Some of the current slowness in sales has been blamed on too-low inventories. While that may be an issue, it involves something of a self-feeding cycle. Nonetheless, although inventories of homes for sale are relatively low at the moment, the 6.6 months supply in June for existing home sales was up by 3.1% from May and was at its highest since December 2011. For new home sales, June inventories reflected a 4.9 months supply, up by 8.9% from May, and at the same levels seen in March and April, which last were exceeded in January 2012.

June New Home Sales Still in Pattern of Low-Level Stagnation. In the wake of the great housing-market crash of 2006 to 2008, June 2012 new home sales continued in a state of depressed bottom-bouncing, generally moving in tandem with June housing starts, as shown in the following two graphs (see [Commentary No. 457](#) for housing starts reporting details). There have been no developments in underlying economic fundamentals that would suggest a pending industry turnaround or an unfolding, broad economic recovery.

June Reporting. Yesterday's (July 25th) release of June 2012 new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of volatile stagnation and bottom-bouncing, with the headline growth being statistically-insignificant, as generally has been the case on a monthly basis for more than three years. The headline monthly decline for June was 8.4% +/- 14.5% (all confidence intervals are at the 95% level). In turn, the May monthly gain revised to 6.7% (previously a 7.6% gain). The year-to-year gain of 16.7% +/- 17.6% in June new-home sales, also was not statistically-significant. The May annual gain was revised to 24.0% (previously 19.8%). Recent volatility in annual change reflects partially the effects of lapsing stimulus efforts a year ago.





June Existing-Home Sales Also Continue Low-Level Stagnation. As has been noted regularly in the monthly *Commentaries* covering existing-home sales series—despite recent massive corrections and revisions to the series—reporting remains subject to significant seasonal-factor instabilities, as also has been seen recently in a number of government series. Those seasonal-factor distortions are 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.

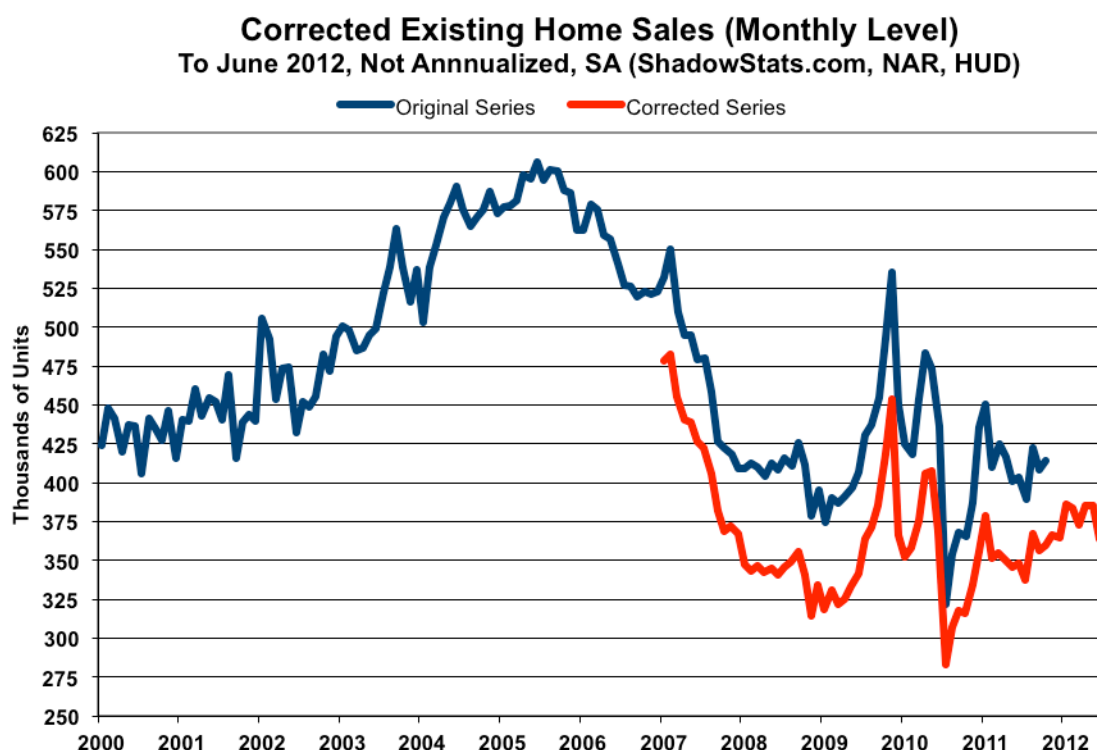
Further, as shown in the accompanying graph, the old (pre-November 2011) and corrected series do not appear to be consistent or comparable. Seasonal-factor distortions have been skewed, not only by protracted, collapsing activity, but also by the impact of various stimulus/tax-incentive packages, which pulled some future sales activity into the periods of the incentives. With the sales swings generated by the stimulus packages, and lapsing of same, averaged out, the pattern in the graph would resemble the bottom-bouncing seen otherwise in the new home-sales and housing-starts graphs.

For those interested in the latest detail, however, we continue to look at the regular reporting of the new existing-home sales series, although a heavy caution is offered on the quality of what is being published.

June Reporting. The July 19th release of June 2012 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly decline of 5.4% (down by 1.8% before prior-period revisions) to the lowest level of activity since December 2011. That followed a revised, monthly “unchanged” performance for May sales, which initially had been reported as a 1.5% monthly decline.

On a year-to-year basis, June 2012 sales rose by 4.5%, at less than half the pace of the revised 11.3% (previously 9.6%) annual growth estimate for May 2012. Recent volatility in annual change reflects partially the effects of lapsing housing stimulus efforts a year ago.

Distressed properties remained a significant portion of existing home sales activity. The NAR estimated “distressed” sales at 25% (13% foreclosures, 12% short sales), versus May at 25% (15% foreclosures, 10% short sales). While foreclosures also remain a factor in new-home sales, the Census Bureau does not provide an estimate of foreclosure volume.



Week Ahead. *Market recognition of an intensifying double-dip recession is taking a somewhat stronger hold, at the moment, while recognition of a mounting inflation threat remains sparse. 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 or to put a happy spin on the numbers; 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 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.

Gross Domestic Product—GDP (Second-Quarter 2012, First Estimate, and GDP Annual Revisions).

The annual revisions to the GDP (first-quarter 2009-to-date) are scheduled for release, along with the first-estimate of second-quarter 2012 GDP, for tomorrow, Friday, July 27th, by the Bureau of Economic Analysis.

Indications of rapidly slowing economic activity in the second-quarter have pummeled market expectations. With GDP growth estimates initially well over two-percent for headline growth, the markets now appear to be looking at a second-quarter number of somewhat over one-percent, versus the most-recent estimate of 1.9 percent headline growth for the first-quarter. Not widely recognized is the circumstance that first-quarter GDP is subject to the benchmark revision.

There is a fair shot at weaker-than-expected growth for the second-quarter, and a very good chance of some meaningful downside revisions to the historical GDP. The annual revisions rarely are speculated over by the markets or followed by the popular media. A more-detailed outlook for the second-quarter GDP and for the benchmark revisions was discussed in the *Opening Comments and Executive Summary* of [Commentary No 457](#).

Personal Consumption Expenditure (PCE) Deflator (June 2012, Annual Revisions). The Bureau of Economic Analysis is scheduled to release the June 2012 PCE deflator and annual revisions to it and related monthly series on Tuesday, July 31st. The Federal Reserve's targeted inflation (target of 2.0% tear-to-year inflation) measure likely will hold around May's annual inflation estimate of 1.5%, paralleling the reporting patterns of the various CPI measures. 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.

Construction Spending (June 2012). Due for release on Wednesday, August 1st, by the Census Bureau, July construction spending likely will show ongoing stagnation at low levels of activity, particularly after inflation-adjustment. Once again, monthly changes should not be statistically significant.

Employment and Unemployment (July 2012). July labor data are due for release on Friday, August 3rd, from the Bureau of Labor Statistics (BLS). The consensus jobs estimate usually ends up around the trend estimate that comes out of the BLS seasonal-adjustment models. The payroll trend number for July is 108,000 as discussed in [Commentary No. 453](#).

Nonetheless, the July numbers, once again, should disappoint market expectations, given intensifying underlying weakness in related fundamentals. Payroll growth could be well below 100,000. While an actual upside tick in the unemployment rate—to 8.3%—was likely, the inconsistent concurrent-seasonal-factor reporting makes reported month-to-month changes in the headline unemployment rate absolutely meaningless (see the unemployment concurrent-seasonal-factor discussion in [Commentary No. 453](#)).