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

COMMENTARY NUMBER 472
GDP Revision, August Durable Goods, Household Income, New Home Sales

September 27, 2012

Unusually Large 2nd-Quarter Revisions: Headline GDP Growth Dropped to 1.3% from 1.7%, Theoretically Equivalent GDI Dropped to 0.2% from 0.6%

Plunging Automobile and Commercial Aircraft Sales Savaged Durable Goods Orders

August Household Income Took a Hit

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, October 5th, covering September employment and unemployment numbers, August construction spending and PCE deflator.*

The Special Commentary *reviewing economic, inflation and systemic conditions is planned for the week of October 8th, which otherwise is a period light in major economic reporting.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. The economy continues to look like it is slipping into an official double-dip recession. Today's (September 27th) *Opening* section includes summary analyses and related graphs tied to the downside-reporting surprises in the GDP revision and in August's new orders for durable goods, as well as new consumer data on August median household income and September consumer confidence. The *Reporting Detail* section covers in greater detail the GDP and durable goods orders, as well as detail on the ongoing and unsurprising bottom-bouncing in August new-home sales.

In general, the downside revision in headline GDP growth to 1.3% from 1.7% was unusually large for a second revision, but the reporting remains statistically insignificant and highly flawed. The official economic recovery remains a statistical illusion created by the use of too-low inflation estimates in deflating the GDP reporting. When understated inflation is used in deflating series, the resulting inflation-adjusted or real growth is overstated.

Median household income took a significant hit in August, suggesting no relief to the ongoing liquidity crisis that impairs the consumer's ability either to have driven the purported recovery, or to fuel an economic recovery in the near future. A monthly jump in September consumer confidence did not move the index into new territory, and it likely reflected some seasonal-adjustment issues.

The sharp drop in durable goods orders reflected a one-month collapse in non-defense aircraft orders, but, even net of the volatile aircraft orders, activity was down sharply in nearly all major categories (particularly autos). The series has started to look like it either is in or leading into a recession.

Gross Domestic Product. Although still in the category of statistical noise, the magnitude of the downside revision to headline second-quarter 2012 GDP growth from 1.73% to 1.25% was unusually large for a third estimate. The primary contributor to that downside re-estimation of growth was a downside revision to farm inventories. First-quarter GDP headline growth was 1.96%. Year-to-year growth was 2.16% in the second-quarter, versus 2.45% in the first-quarter. "Headline growth" here for GDP-related series refers to the annualized, quarter-to-quarter real (inflation-adjusted) growth rate.

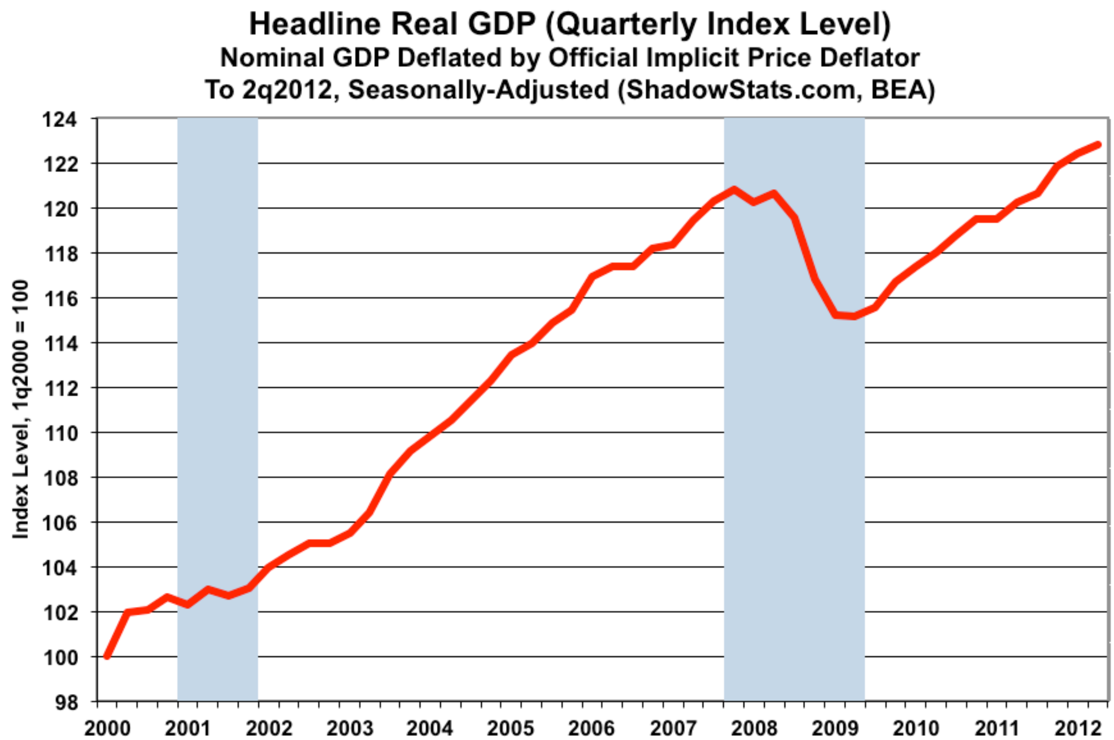
Where GDP is the consumption-side measure of the broad economy, it has an income-side equivalent, gross domestic income (GDI), but the two series rarely show the same results. Separately surveyed, the GDP gets more statistical massaging, while the GDI gets a statistical-discrepancy category added to it so that the two series end up at equal levels. Net of the statistical discrepancy, second-quarter GDI headline growth was revised to 0.16% from initial reporting of 0.57%. Not annualized, and reported to just the first decimal point (the way the Bureau of Economic Analysis prefers to report its numbers), the GDI was unchanged (up by 0.04%) in the second-quarter. First-quarter headline GDI growth was 3.82%. Year-to-year growth was 2.03% in the second-quarter, versus 1.95% in the first-quarter.

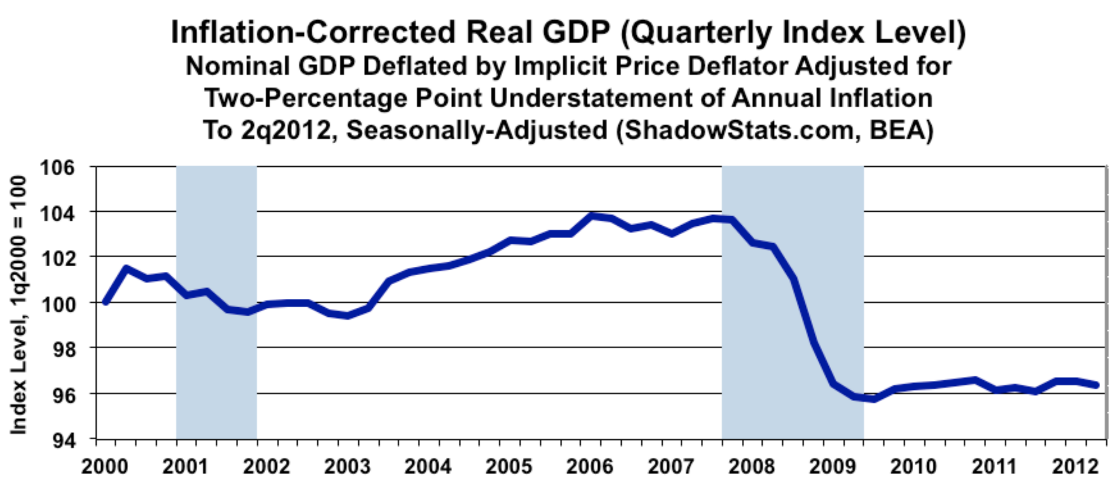
Headline growth for second-quarter gross national product (GNP) revised to 2.05% from 2.21%, versus 2.45% in the first-quarter. Year-to-year growth was 2.06% in the second-quarter, versus 2.24% in the first-quarter. GDP is GNP net of trade flows in factor income (interest and dividend payments).

Shown in the first graph following, the official level of real GDP activity has been reported at above pre-2007 recession levels—in full recovery—since fourth-quarter 2011. As has been discussed previously, no other major economic series has shown a parallel pattern of full economic recovery. Either the GDP reporting is wrong, or all other major economic series are wrong. While the GDP is heavily modeled, imputed, theorized and gimmicked, it also encompasses reporting from those various major economic series, which attempt to survey real-world activity. Flaws in the GDP have created the "recovery."

The second graph suggests that the full GDP recovery has been nothing more than an illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. When the inflation rate is understated, growth in a related inflation-adjusted series is overstated. The inflation-corrected GDP reflects deflation by the implicit price deflator (IPD) corrected for understatement of roughly two-percentage points of annual inflation in the IPD from hedonic-quality adjustments, as discussed in *Hyperinflation 2012*, *Special Report No. 445* and *Public Comment on Inflation*.

Both graphs are indexed to first-quarter 2000 = 100, with the plots to consistent scales.



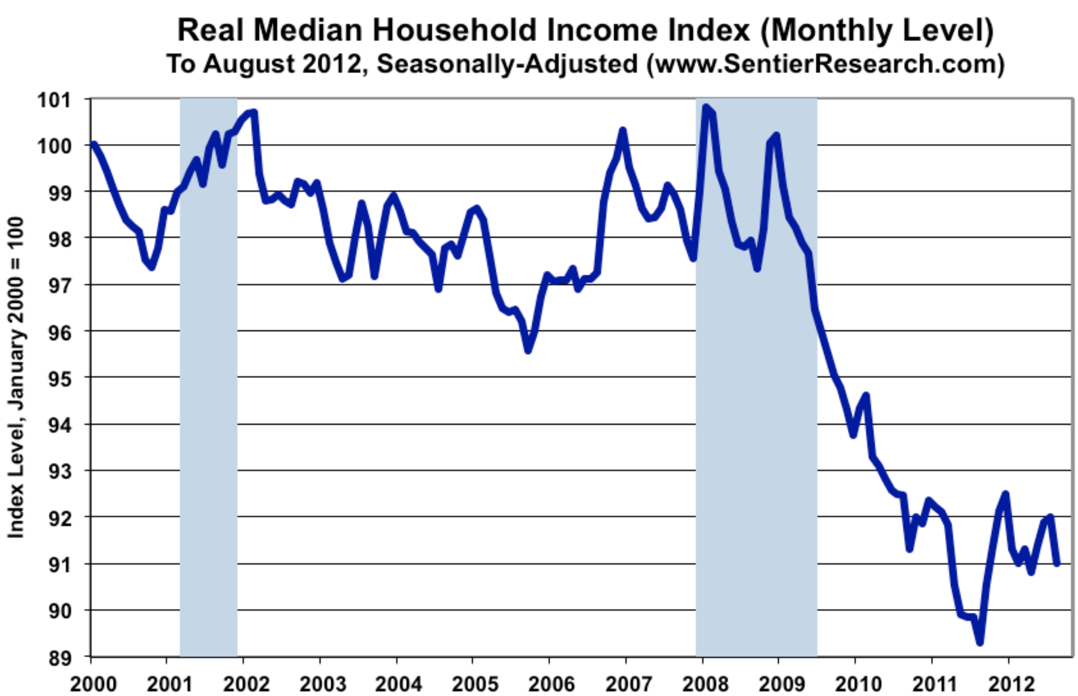


When good-quality current economic reporting is not available—as is the present circumstance—consideration of the underlying fundamentals is of some value. If the underlying fundamentals are not improving, it is likely that the broad economy also is not improving.

New Consumer Data. The consumer accounts directly for 73% (personal consumption and residential investment) of the GDP, and indirectly for much of the remainder of economic activity. A variety of surveys have indicated that consumer income growth is not keeping up with headline inflation (see for example annual real median household income and real average weekly earnings discussed in *Commentaries No. 469* and *No. 470*), as well as below. Where the lack of real income growth has been an issue for decades, debt expansion was encouraged by the Fed as an easy way for the consumer to cover the shortfall otherwise seen in maintaining living standards. As reflected in consumer credit outstanding (see *No. 469*), however, in the post-2008 panic era, easy debt expansion has not been an option. Contrary to what would be needed to have created an economic recovery, neither the real income growth nor credit growth has been or currently is available.

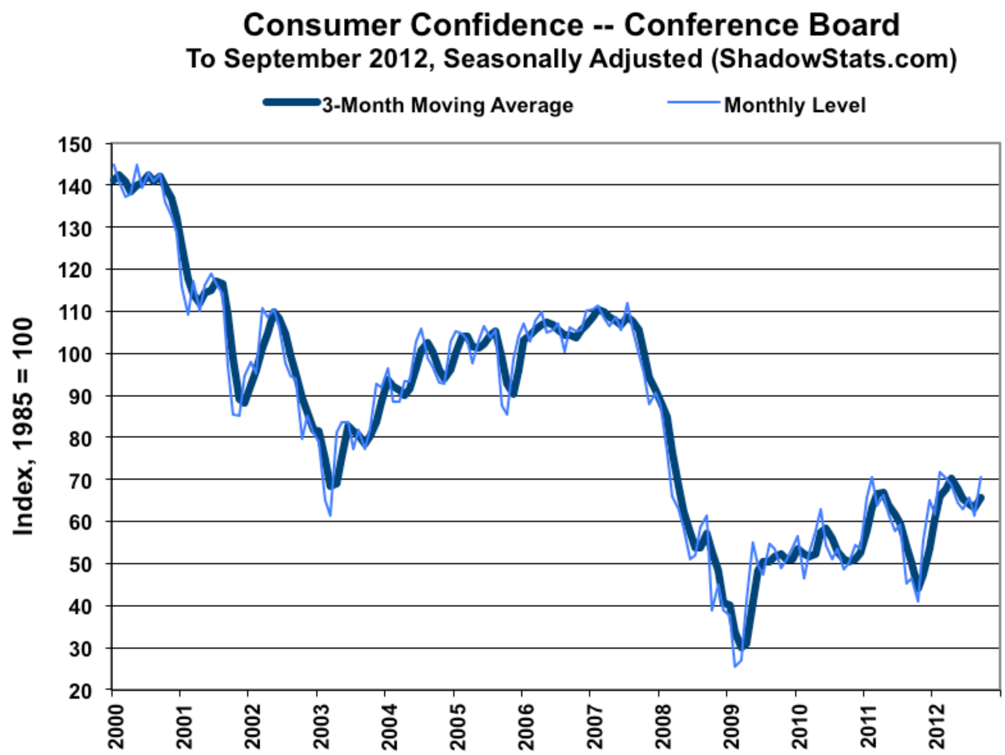
There has been no recovery, and there is no recovery looming in the immediate future.

Among recent economic releases, is real median household income for the month of August from www.SentierResearch.com. The 1.1% monthly decline in the index was statistically-significant at the 90% level per Sentier.



Also, the Conference Board has published its consumer confidence measure for September, showing a sharp monthly spike, but the monthly spike was not outside the volatility of the last year, and the smoothed series remained at levels generally not seen outside of the depths of the worst post-World War

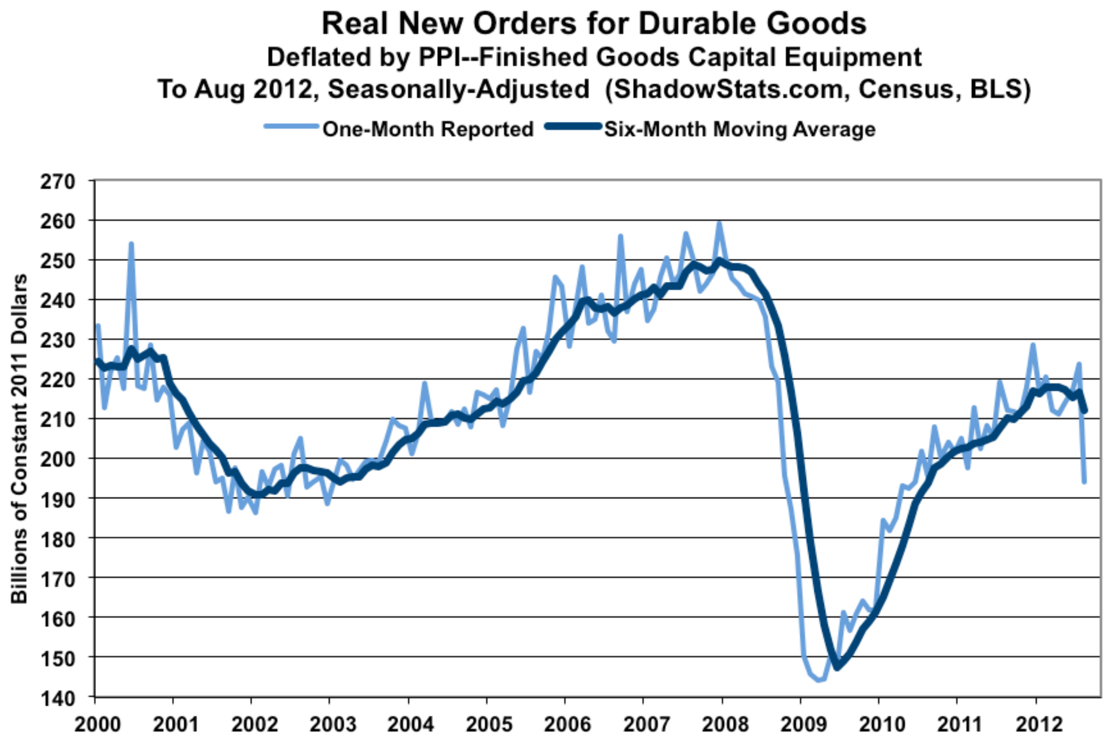
II recessions. Nonetheless, unlike the University of Michigan series, the Conference Board numbers are seasonally-adjusted and likely are suffering some adjustment distortions due to the extreme economic and systemic difficulties of recent years. Michigan's still-to-be-published September consumer sentiment measure will be updated with the October 5th *Commentary.*



New Orders for Durable Goods. While 8.5% of the 13.2% monthly drop in August new orders for durable goods (on top of downside revisions to July orders) was accounted for by a 101.8% monthly plunge—including outright cancellations—in commercial aircraft orders, half of the remaining decline in aggregate orders was due to a 10.9% monthly decline in orders for motor vehicles and parts, with the balance spread across nearly all other major categories. The difference in meaning for the economy is that the aircraft orders usually are booked years in advance, affecting the longer range economic outlook; automobile and other orders tend to affect more the outlook for near-term production and economic activity.

The developing pattern of decline in new orders is one that usually precedes or indicates a recession, as suggested in the following two graphs of the real (inflation-adjusted) series, both aggregate and net of nondefense aircraft. The data here are smoothed and adjusted for inflation. August 2012 remained below both the pre-2001 and pre-2007 recession highs.

If the deflation measure here could be corrected meaningfully for hedonic-adjusted understatement of inflation, 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*).


Real New Orders for Durable Goods
Deflated by PPI--Finished Goods Capital Equipment
To Aug 2012, Seasonally-Adjusted (ShadowStats.com, Census, BLS)
One-Month Reported
Six-Month Moving Average
Billions of Constant 2011 Dollars
270
260
250
240
230
220
210
200
190
180
170
160
150
140
2000
2001
2002
2003
2004
2005
2006
2007
2008
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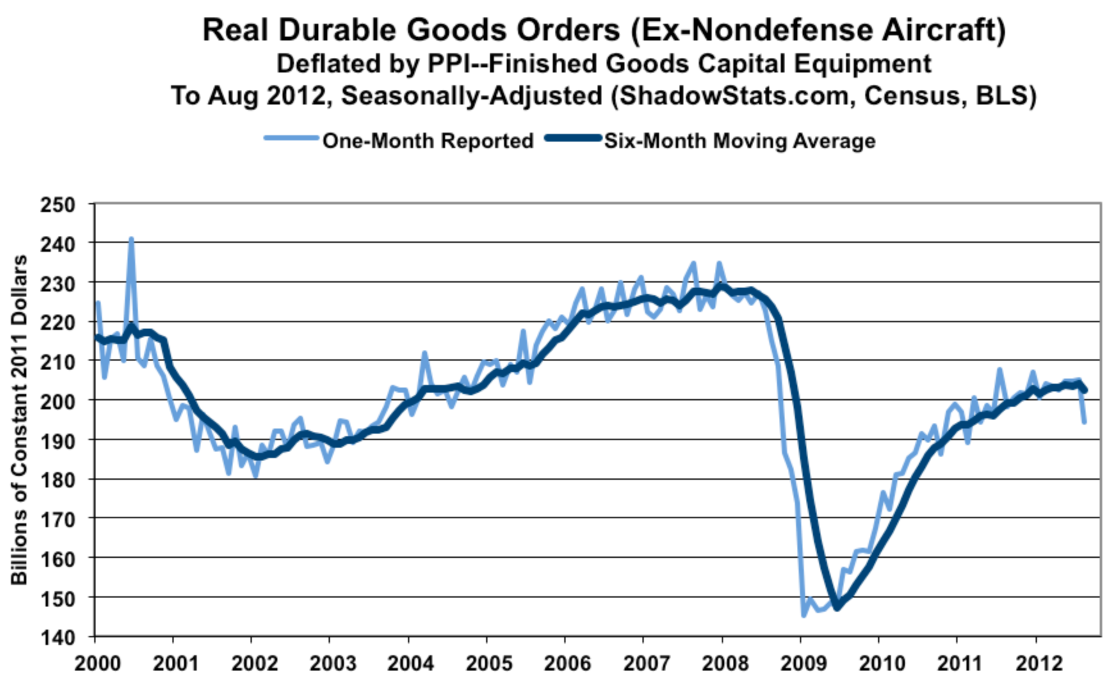
2012


Real Durable Goods Orders (Ex-Nondefense Aircraft)
Deflated by PPI--Finished Goods Capital Equipment
To Aug 2012, Seasonally-Adjusted (ShadowStats.com, Census, BLS)
One-Month Reported
Six-Month Moving Average
Billions of Constant 2011 Dollars
250
240
230
220
210
200
190
180
170
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140
2000
2001
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Hyperinflation Watch. The nature and implications of QE3—announced recently by the FOMC of the Federal Reserve Board—were discussed in the *Opening Comments* of *Commentary No. 470*. Specifically, while general circumstances have continued to advance towards the ultimate demise of the dollar, the general outlook is unchanged. While QE3 is an enabling action for the onset of massive inflation, the outside timing of 2014 for the ShadowStats.com hyperinflation forecast remains in place. The hyperinflation outlook will be reviewed and updated fully in a *Special Commentary* planned for the week of October 8th. The following summary of the broad outlook is has not changed since the September 14th *Commentary*.

The detail in Special Commentary No. 445 *(June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That* Special Commentary *supplemented* Hyperinflation 2012 *(January 25th), which remains the primary missive detailing the hyperinflation story. Those reports are suggested as background reading for new subscribers.*

Official GDP reporting shows plunging economic activity from fourth-quarter 2007 to second-quarter 2009, with an ensuing upturn in activity that has led to a full recovery as of fourth-quarter 2011, and that "recovery" has continued through second-quarter 2012 GDP reporting.

In contrast to the GDP reporting—and in line with patterns seen in better-quality economic series—I contend that 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 since mid-2009, and the economic downturn now is intensifying once again. The renewed slowdown is evident in the current reporting of nearly all major economic series. Not one of those series shows a pattern of activity that confirms the full recovery shown in the GDP series.

Federal Reserve Chairman Ben Bernanke has observed that broad aggregate measures of the U.S. economy, such as GDP, do not appear to be reflecting the common experience of the general public. Indeed, common experience suggests that the economy has not recovered. The official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP, which overstates deflated economic growth, as discussed in *Commentary No. 467*, *Special Commentary No. 445*, and *Public Comment on Inflation*.

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 federal government and Federal Reserve actions—in response to the systemic-solvency crisis of 2008—accelerated the process, suggesting a hyperinflation problem by no later than the end of 2014. The continuing economic downturn is intensifying the fiscal- and systemic-solvency problems, and public awareness of this should grow rapidly in the months ahead.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions, and the most recent readings on income variance suggest that the worst is yet to be seen, as discussed in *Commentary No. 469*.

With the economy weak enough to provide political cover for further Federal Reserve accommodation to the still-struggling banking system, QE3 was introduced on September 13th. That action effectively provided for open-ended monetization of U.S. Treasury debt at the Fed's discretion. The mechanism for eventual full debasement of the dollar now is in place, and it likely will come into full play, as needed to support the banking system and as needed to assure "successful" auctions of Treasury debt.

QE3 likely will lead to a massive dollar-selling crisis, and that will begin the process of a rapid upturn in domestic consumer inflation. A near-term dollar-selling crisis is now of a much greater risk, post-QE3. Separately, though, a dollar-selling crisis could begin at any time, triggered by various economic, sovereign-solvency or political issues. With the guidelines set for QE3, even negative employment reports could trigger massive dollar selling.

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REPORTING DETAIL

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

From 1.7% to 1.3%, Though Unusually Large for a Second Revision, Still Was Little More than Statistical Noise. The third estimate of headline GDP growth for second-quarter 2012 was 1.25%, revised from a first revision of 1.73%. The latest revision reflected primarily a lowered estimate of the changes in farm inventories, with negative revisions to net exports, nonfarm inventories and personal consumption making up the balance. As usual, the data here are meaningless as indicators of underlying activity in the broad economy, with the annualized headline growth rate not statistically significant.

Gross domestic income (GDI) is the supposed income-side equivalent to the consumption-side GDP, but the two series rarely are close. Separately surveyed, the GDP gets more statistical massaging, while the GDI gets a statistical discrepancy category added to it so the series are equal. Second-quarter GDI headline growth was just revised to 0.16% from initial reporting of 0.57%. Not annualized, and reported to just the first decimal point the GDI was unchanged in the second quarter.

Headline growth in second-quarter gross national product (GNP) revised to 2.16% from 2.26%.

The markets and the media, however, focus on the GDP. As usually discussed and graphed in the *Opening Comments and Executive Summary* section of the monthly GDP *Commentary*, and as detailed in *Hyperinflation 2012* and *Special Report No. 445*, 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. Net of that inflation understatement, the revised "inflation-corrected" version of real GDP shows that economic activity has been virtually flat, at a low-level plateau activity since the economy crashed from 2006/2007 into 2009.

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. It remains the only major economic series to show a full economic recovery to be in place.

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.*

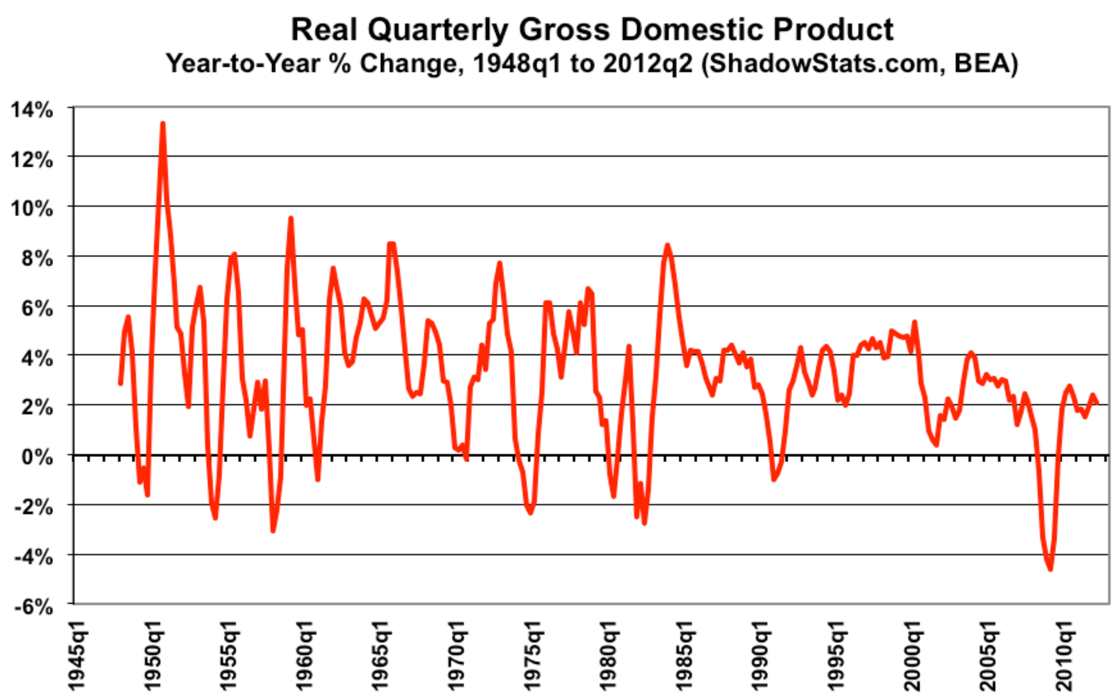
***Quarterly** growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by 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 x 1.01 x 1.01 x 1.01 = 1.0406 or 4.1%, instead of 4 x 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, September 27th, by the Bureau of Economic Analysis (BEA), the third estimate (second revision) of second-quarter 2012 gross domestic product (GDP) showed real (inflation-adjusted) quarterly growth at a statistically-insignificant 1.25% +/- 3% (95% confidence interval), revised from a second estimate of 1.73% and an initial estimate of 1.54%. The latest headline estimate remains weaker than the 1.96% growth reported in the first-quarter, and down from 4.10% in fourth-quarter 2011.

For five of the six quarters since first-quarter 2011 (fourth-quarter 2011 excepted), 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.

Reflected in the following graph, the year-to-year real change in second-quarter 2012 GDP was revised to 2.14%, from the second estimate of 2.26% and from initial reporting of 2.21%, down from 2.45% in first-quarter 2012. The latest annual growth remains off the near-term peak growth of 2.80% reported during third-quarter 2010. The current cycle trough was in second-quarter 2009 at a 4.58% year-to-year decline, the deepest annual contraction seen for any quarterly GDP in the history of the series, which began with first-quarter 1947.



Implicit Price Deflator (IPD) and PCE Deflator. The second-quarter 2012 GDP implicit price deflator (IPD) was revised to an annualized quarterly inflation rate of 1.53%, versus the second estimate of 1.58% and the first estimate of 1.51%, against 2.17% reported for the first-quarter, and 0.13% in the fourth-quarter. Second-quarter year-to-year inflation was estimated at 1.70%, little changed versus the second estimate of 1.72% and the initial estimate of 1.70%, versus 1.98% in the first-quarter, and 1.96% in the fourth-quarter.

For comparison purposes, annualized seasonally-adjusted quarterly inflation for the CPI-U in the second-quarter was 0.75%, versus 2.48% in the first-quarter, and versus 1.30% in the fourth-quarter, with year-to-year CPI-U at 1.89%, versus 2.82% in the first-quarter, and versus 3.29% in the fourth-quarter.

The lower the inflation rate that is used in deflating the GDP, the stronger is the resulting inflation-adjusted number and vice versa.

Year-to-year change in the second-quarter personal consumption expenditures (PCE) deflator was revised to 1.64%, versus 1.65% in the first two estimates for the second-quarter, versus 2.36% in the first-quarter. The PCE deflator detail will be updated in the October 5th *Commentary*, which will cover the September 28th release of the August monthly data.

SGS-Alternate GDP. The SGS-Alternate GDP estimate for second-quarter 2012 is a 2.2% year-to-year contraction versus the official estimate of a 2.1% gain. The SGS second-quarter estimate is the same as the 2.2% contraction level estimated for first-quarter 2012, versus the official estimate of 2.4% year-to-year growth (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 second-quarter, as it has been for five of the last six 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* and *Special Report No. 445*) 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 second estimate of headline growth for second-quarter 2012 GNP was 2.05% (previously 2.21%), versus 0.61% in the first-quarter. Year-to-year growth in second-quarter GNP stood at a revised 2.06% (previously 2.10%), versus 2.24% in the first-quarter.

The recent relative weakness or strength in U.S. GNP versus GDP reflects unusual volatility in the post-2008 crisis environment of interest and dividend payments between the rest of the world and the United States, which holds largest net-debtor status of any sovereign state in the history of the world.

GDI. Gross domestic income (GDI) is the income-side reporting equivalent of the consumption-side GDP. Today's second estimate of headline growth rate for second-quarter 2012 GNP was 0.16% (previously 0.57%), versus 3.82% in the first-quarter. Year-to-year growth was revised to 2.03% (previously 2.13%) in the second-quarter, versus 1.95% in the first-quarter.

NEW ORDERS FOR DURABLE GOODS (August 2012)

Durable Goods Took a Meaningful Hit in August. Where nearly two-thirds of of the 13.2% drop in August new orders for durable goods (on top of downside revisions to July orders) was accounted for by a 101.8% monthly plunge—including outright cancellations—in commercial aircraft orders, the remaining decline in orders ex-aircraft was unusually large, spread across nearly all other major categories—particularly motor vehicles—and it was meaningful.

The difference in significance for the economy is that the aircraft orders usually are booked years in advance, affecting more the longer-range economic outlook, while automobile and other orders tend to affect more the outlook for near-term production and economic activity.

The developing pattern of decline in new orders is one that usually precedes or indicates a recession, as suggested in the historical graphs of the real (inflation-adjusted) series, both aggregate and net of nondefense aircraft, in the *Opening Comments and Executive Summary*. The level of real new orders in August 2012 remained below the both the pre-2001 and pre-2007 recession highs for the series.

Note on Deflating New Orders for Durable Goods: As described in Special Commentary No. 426*, there is no fully appropriate inflation measure available for deflating durable goods. The one used in the "real" graphs 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 August Reporting. The Census Bureau reported today, September 27th, that the regularly-volatile, seasonally-adjusted nominal (not adjusted for inflation) new orders for durable goods in August 2012 plummeted by 13.2% (fell by 14.0% net of prior-period revisions), following a revised 3.3% (previously 4.2%) monthly gain in July.

The irregular and highly volatile long-term nondefense aircraft orders declined in August by 101.8% (including cancellations), following a revised 51.1% (previously 53.9%) gain in July. Aircraft orders usually are placed years in advance of delivery and rarely impact near-term economic activity.

Adjusting for the short-term collapse in nondefense aircraft orders, August's orders still fell by a significant 4.7%, dominated by a 10.9% decline in orders for motor vehicles and parts. The weakness in the nondefense-aircraft orders suggests a potential major downturn in the economy.

Unadjusted, year-to-year change in total August 2012 new orders turned negative, down by 7.1%, versus a revised 6.5% (previously 6.7%) annual gain in July.

Seasonally-adjusted nondefense capital goods new orders plunged by 24.3% in August, following a revised 4.8% (previously 6.8%) gain in July. For August 2012, the unadjusted year-to-year change in the series turned negative, down by 24.0%, versus a revised 7.6% (previously 8.8%) gain in July.

Caution: 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 13.2% monthly contraction in August orders effectively was a drop of 13.3%, after inflation adjustment, while the nominal 3.3% gain in July was 3.0% on the same basis. Seasonally-adjusted, year-to-year real growth turned negative in August, down by 8.5%, versus an annual gain of 2.1% in July.

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

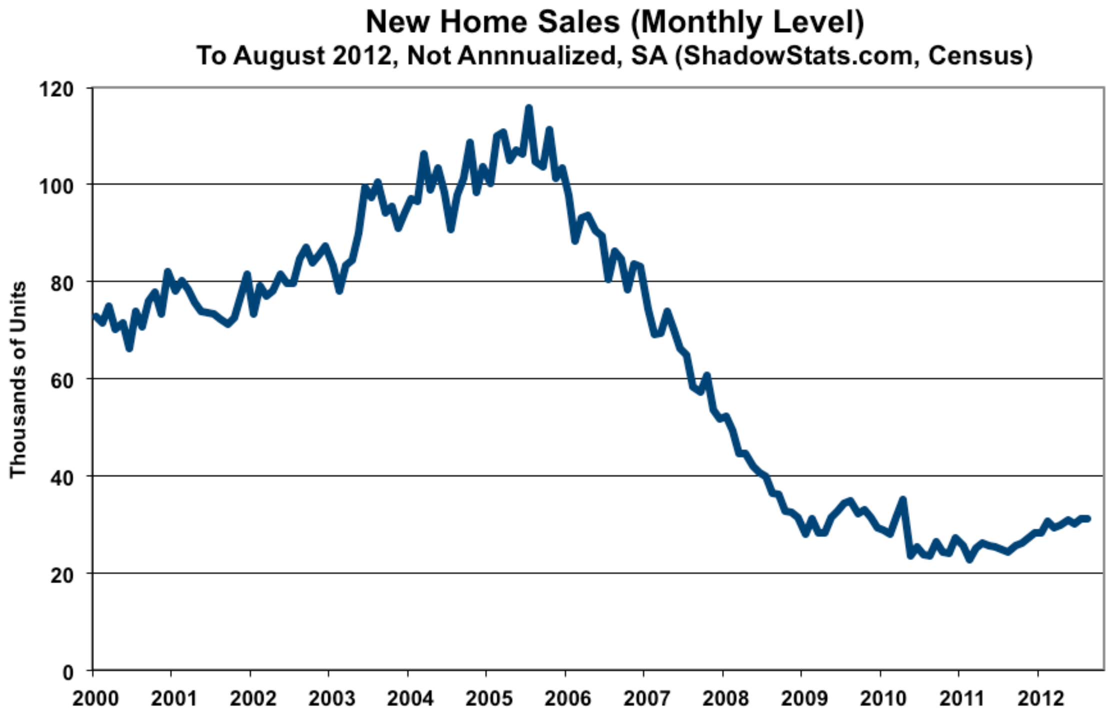
If the deflation measure here were corrected meaningfully for its hedonic-adjusted understatement, the uptrend in real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity, with a recent pattern of downturn now well entrenched (see *Special Report No. 445*).

NEW HOME SALES (August 2012)

August New Home Sales Activity Continued in Low-Level Stagnation, Decline Was Not Statistically Significant. August 2012 new home sales continued in a state of depressed bottom bouncing, generally moving in tandem with housing starts, as shown in the following two graphs. With significant smoothing, existing-home sales also are showing a similar, though less-severe pattern, as shown in the third graph following. Housing starts and existing-home sales were updated for August reporting the last *Commentary* (see *Commentary No. 471* for those reporting details). There have been no developments in underlying economic fundamentals that would suggest a pending industry turnaround or an unfolding, broad economic recovery.

August Reporting. The September 23rd release of August 2012 new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of volatile stagnation and bottom-bouncing, with the minimal headline decline being statistically-insignificant, as generally has been the case on a monthly basis for more than three years. The August headline monthly contraction was 0.3% (a gain of 0.3% before prior-period revisions) +/- 11.5% (all confidence intervals are at the 95% level). In turn, July's monthly gain of 3.6% was unrevised, although the level was raised by 0.5%.

The year-to-year gain of 27.7% +/- 22.0% in August new-home sales was statistically-significant. The July annual gain was revised to 25.9% (previously 25.3%). Recent volatility in annual change reflects partially the effects of lapsing stimulus efforts last year.


New Home Sales (Monthly Level)
To August 2012, Not Annnualized, SA (ShadowStats.com, Census)
Thousands of Units
0
20
40
60
80
100
120
2000
2001
2002
2003
2004
2005
2006
2007
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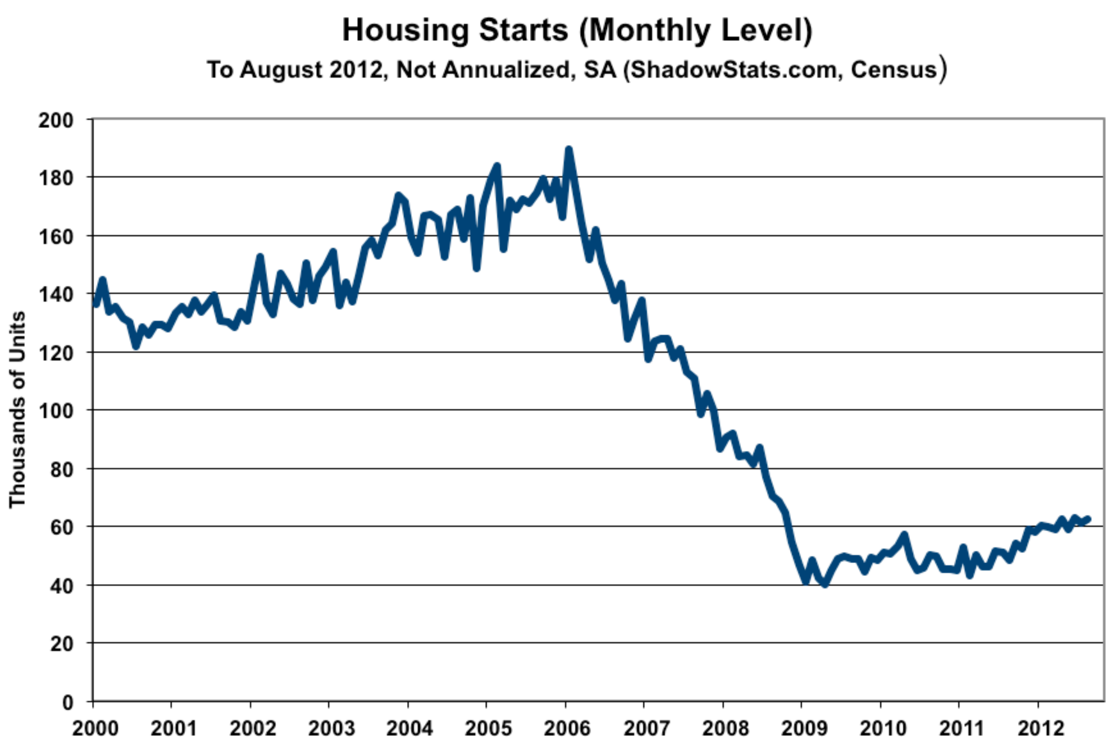
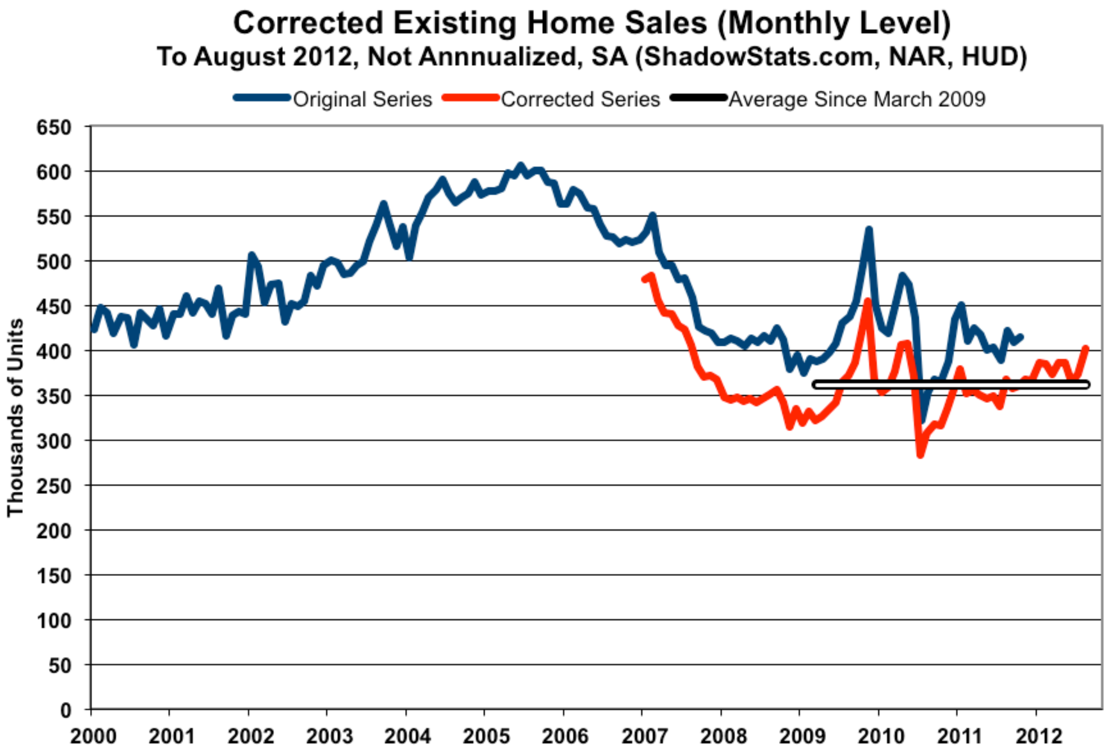
2011
2012


Housing Starts (Monthly Level)
To August 2012, Not Annualized, SA (ShadowStats.com, Census)
Thousands of Units
0
20
40
60
80
100
120
140
160
180
200
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012



Week Ahead. *Market recognition of an intensifying double-dip recession has taken stronger hold, at the moment, while recognition of a mounting inflation threat has been rekindled a bit by recent Fed monetary policy announcements and rising headline inflation numbers. 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, otherwise, it puts a happy spin on the numbers; and the financial markets 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, as discussed in the* Hyperinflation Watch *section.*

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 continue to show up in prior-period revisions.

Personal Consumption Expenditure (PCE) Deflator (August 2012). The Bureau of Economic Analysis is scheduled to release the August 2012 PCE deflator tomorrow, Friday, September 28th. The Federal Reserve's targeted inflation measure (target of 2.0% year-to-year inflation) likely will come in above July's annual inflation estimate of 1.3%, but hold below the 2.0% target, paralleling the reporting patterns of the various CPI measures in August (see *Commentary No. 470*). Nonetheless, as discussed previously, the current concept of an inflation target serves only as Pablum for the financial markets, not as a defining priority that drives Fed policy.

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

Employment and Unemployment (September 2012). September labor data are due for release by the Bureau of Labor Statistics (BLS) on Friday, October 5th. As often is the case, the consensus jobs estimate should settle around the trend estimate that comes out of the BLS seasonal-adjustment models. The September payroll trend number was a 104,000 gain, as discussed in *Commentary No. 468*.

Nonetheless, the September numbers should disappoint market expectations, given intensifying underlying weakness in related fundamentals. Payroll growth could be well below 100,000 (initial August reporting was a gain of 96,000). While the *actual* U.3 unemployment rate could be notching higher to 8.2% or 8.3%, versus August's headline 8.1% number, the September *headline* number could come in anywhere. Inconsistent, concurrent-seasonal-factor adjustments make the reported month-to-month changes in the headline unemployment rate absolutely meaningless (see the unemployment concurrent-seasonal-factor discussion in the *Opening Comments* of *Commentary No. 461*).

Simply put, the headline September unemployment rate will be calculated in the context of a set of seasonal factors unique to September's reporting. That same calculation also will generate revised unemployment rates for August, and earlier, which would be consistent with the September estimate, but the BLS will not publish the revised, consistent August or earlier numbers, so as "to avoid confusing data users."

As a result, that uniquely-calculated September unemployment rate will be published and compared with the unrevised August unemployment rate that was uniquely calculated and published last month. The headline September and August numbers put before the public will be inconsistent and, accordingly, not comparable.

This all is despite the BLS knowing what actually is the consistent August number. If used, the consistent number could affect the headline monthly change in the unemployment rate by several tenths of a percentage point, in either direction, conceivably markedly different from what the mainstream media will be touting, and around which the financial markets most likely will be gyrating nonsensically.

