

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

COMMENTARY NUMBER 484
Preview of Special Commentary, Housing Starts

November 20, 2012

**Barreling Down the Road, Big-Government Spending
Tries Careening Around the Pothole of the “Fiscal-Cliff,” and then
Accelerates, Blithely Ignoring the “Road-Closed” Sign Ahead**

**Do or Die,
Incoming Government Is Last Frail Hope for Avoiding Hyperinflation**

Economy Already in Renewed Contraction

Four-Year High in October Housing Starts Still Is 61% Below 2006 Peak

PLEASE NOTE: The next regular Commentary is scheduled for Thursday, November 29th, covering the second estimate (first revision) of third-quarter 2012 GDP, and October new orders for durable goods and new home sales.

A preview of some of the major points in the Special Commentary—updating the broad economic, systemic and inflation outlooks, in the context of the 2012 election and the latest detail on the economy, federal government fiscal operations, and Federal Reserve monetary activities—is included in here as the first segment of today’s Commentary. The full report will be published post-Thanksgiving, on Monday, November 26th. It updates and supplements [Hyperinflation 2012](#) and [Special Commentary No. 445](#).

This week’s regular Commentary follows as the second segment.

Happy Thanksgiving! — John Williams

Preview of No. 485 *SPECIAL COMMENTARY* (November 26, 2012)

Outlook for U.S. Economic Activity, Systemic and Currency Stability, and Inflation In the Context of Domestic Political, Fiscal and Monetary Conditions

Hyperinflation by End of 2014

Physical Gold Remains Ultimate Hedge

By 2004, the U.S. budget deficit was out of control, it had become unsustainable and uncontainable. Using generally accepted accounting principles (GAAP-accounting), the deficit for just the one fiscal-year of 2004 exploded to \$11.0 trillion (versus a headline \$412 billion gimmicked cash-basis deficit), reflecting, among other issues, the impact of the overhaul of the Medicare system. Corrected for distortions from one-time accounting changes, the actual, or GAAP-based, federal deficit has run roughly \$5 trillion per year since 2004, and likely topped \$7 trillion in 2012.

No amount of spending cuts, outside of the so-called “entitlement” programs—that remain politically untouchable—and no amount of tax increases, ever could bring the actual annual deficits into balance. As of 2004, the United States had been doomed to a hyperinflation by 2019, where the U.S. government would have no practical choice but to the print the money it needed to cover its obligations. The U.S. dollar would become so inflated as to be worthless, reflecting a full loss of purchasing power.

The U.S. financial and political system had been running amuck for decades, with the government and consumers living well beyond their means, supported by excessive and unsustainable growth in debt. Faced with structural impairments to individual income growth, the Federal Reserve (under Chairman Alan Greenspan) actively encouraged the excessive growth of consumer debt as a way to support economic activity, continuously borrowing economic growth from the future.

A day of reckoning had to come, and the U.S. financial and banking systems came to the brink of collapse in September 2008. To prevent the unthinkable, the Federal Reserve and the U.S. government created, spent, loaned, guaranteed, and gave away whatever money was necessary, and otherwise bailed out whatever was needed, to keep the system afloat. Those actions forestalled the systemic collapse, but they did not resolve the major problems. An economic downturn at the time deepened into something of an economic collapse, and, contrary to GDP reporting, there was no subsequent economic recovery.

Those economic and systemic-solvency crises still are ongoing and now are deteriorating anew. The ultimate costs for saving the system in 2008 and beyond, will come down to inflation, eventual full debasement of the U.S. dollar. Accordingly, the actions taken in the crisis containment of 2008, and later, brought the outside timing for the hyperinflation of 2019, into 2014. With 2013 little more than month away, time has run out to avoid the ultimate demise of the U.S. dollar.

These issues are detailed in [Hyperinflation 2012](#), which remains the base document for the hyperinflation outlook discussed here. While the broad outlook has not changed, the system has kept moving along the path to the hyperinflation. Accordingly these preview comments, and the pending *Special Commentary*, update and supplement that hyperinflation report.

No More Kicking the Can Down the Proverbial Road. President Barack Obama in his second term, and the U.S. Congress to be seated on January 3, 2013, are the last and only (albeit negligible) hope for preventing severe economic, financial and social disruption in the United States within the next two years. A hyperinflationary great depression should be in the works by the end of 2014, where disruptions to the normal flow of commerce, from the hyperinflation, would push the economy into a great depression.

With longer-range U.S. sovereign-solvency risks unaltered—actually deteriorating—the U.S. dollar, as we know it, is not likely to survive until the next congressional election in 2014, let alone the next presidential election in 2016. The circumstance now for the U.S. government simply is to do or die.

In order to prevent the existing broad loss of global market confidence in the U.S. dollar from evolving into a hyperinflationary collapse of the U.S. currency, the federal budget needs to be balanced, not just in terms of the cash-based and gimmicked deficit reporting that showed a \$1.1 trillion annual operating shortfall in 2012, but also, more importantly, in terms of GAAP-based accounting that likely showed a \$7.0-plus trillion annual operating shortfall in 2012.

Yet, the odds of the outgoing or the incoming (largely re-elected) political establishment taking the actions necessary to bring the U.S. fiscal system into balance are nil. The lack of response here is due to the extreme economic pain that would follow such moves, and a related lack of political will to take actions that would dampen economic activity or touch the government's social programs.

Still, there is no possible way of balancing the GAAP-based deficit without a major restructuring of the “entitlement” programs. Again, there simply are not enough taxes that can be raised, or enough spending that can be cut otherwise, that would balance the actual deficit. Also, in a structurally-impaired economy, there is no chance of generating enough new economic activity to grow out of the deficit. Instead, meaningful deficit cutting would mean taking a meaningful hit on economic activity. Such is the price and catch-up for a nation living beyond its means for decades.

Accordingly, talks of really cutting or balancing the federal deficit “this time,” are little more than the usual political hype—pabulum for the domestic markets—but global investors, who have been holding U.S. dollars and Treasuries since the panic of 2008, are running thin on patience. The economic and systemic-solvency crises of the last five years continue; the U.S. government has not shown any meaningful willingness to address, let alone to recognize its long-range solvency problems; and the Federal Reserve has set up a system for monetizing U.S. Treasury debt at will, so as to be able to handle ongoing banking-system solvency issues and to handle upcoming problems with U.S. Treasury auctions. As an aside, the Fed claimed that the purpose of its monetization program was to reduce the unemployment rate. There is nothing the Fed can do to boost the economy, at present; it simply is using the weak economy as political cover for setting up its monetization machinery.

The rest of the world demonstrated its willingness to dump the dollar, following the budget-deficit negotiations fiasco of July/August 2011. The stage now is set for a dollar panic. With central banks having reduced their relative dollar-reserve holdings in recent years, the U.S. dollar likely will lose its global currency reserve status, as the crisis intensifies.

A subscriber suggested that I estimate odds for the hyperinflation forecast coming to pass. Accordingly, I assess the chances of a U.S. hyperinflation being underway by the end of 2014 at more than 90%, by the end of 2013 at more than 40%. A likely trigger event here, again, would be panic selling of the U.S.

dollar and dumping of dollar-denominated paper assets such as U.S. Treasuries. The initial trigger event could be seen literally at any time. As the dollar crisis unfolds, government reactions with controls on capital flows and/or direct currency-market intervention would be likely and could buy a little time, but the ultimate demise of the dollar also would have been locked in at the same time.

“Fiscal Cliff” Is A Relatively Minor Issue. If left intact, the components of the “fiscal cliff” would reduce economic activity. They also would reduce the budget deficit some, but not meaningfully. The heavily massaged ten-year deficit projections used by the government are dependent on the underlying economic assumptions used in forecasting the spending shortfalls. The Congressional Budget Office (CBO) predicts a recession in 2013, if the “fiscal cliff” is not removed, but, at the same time, it still shows 4.7% booming GDP growth by 2015 in its underlying assumptions. Annual GDP growth has not been above 4.0% since the 1990s, and, as discussed below, a new official recession already has started. The stronger the GDP growth assumptions made by those modeling the deficit numbers, the greater will be the estimated deficit reduction. Where the economy actually is weaker than consensus expectations, or overly-positive government assumptions, federal deficits will be worse than projected, and U.S. Treasury funding needs will be greater than expected.

Beyond that, the deficit numbers involved in the current negotiation process are not meaningful in the context of the annual GAAP-based deficits of \$5 trillion or more. The bigger problem is not being considered or discussed seriously.

If current “fiscal cliff” and debt-ceiling negotiations turn as negative as they did in 2011, that event could provide the trigger for a sell-off in the dollar. If the negotiations go well, as currently is being hyped, then movement toward dollar deterioration still should begin to accelerate, post-agreement, as underlying reality hits the markets. Very simply, any package put together now, as was the case in 2011, will not address the deficit problem meaningfully, irrespective of the hype that is put forth to the public.

Official Economic Activity Has Turned Down Anew. Some Wall Street and government contentions that the currently-planned “fiscal cliff” spending cuts and tax increases would push the economy into a new recession may be aimed at setting up a scapegoat, where a renewed downturn already is underway.

The official second-dip of a double-dip recession likely will be timed from third-quarter 2012, in line with recent reporting of official real retail sales, industrial production and new orders for durable goods. Hurricane Sandy and the “fiscal cliff” may exacerbate early weakness in the intensifying downturn, but neither circumstance will have caused the new recession.

Reality is that the economy never recovered from its collapse, from early 2006 into 2009, but rather it stagnated at a low level of activity from 2009 into 2012. As was discussed in the hyperinflation report and as will be updated fully in the *Special Commentary*, the official recovery simply has been a statistical illusion created by the government’s use of understated inflation in deflating the GDP, which overstates deflated economic growth. Consumer liquidity remains severely impaired, and that is preventing growth in consumption. As income conditions continue to deteriorate for many consumers, so too has the level of consumption resumed its decline. There has been no recovery and none is pending. Instead, economic activity is turning down anew.

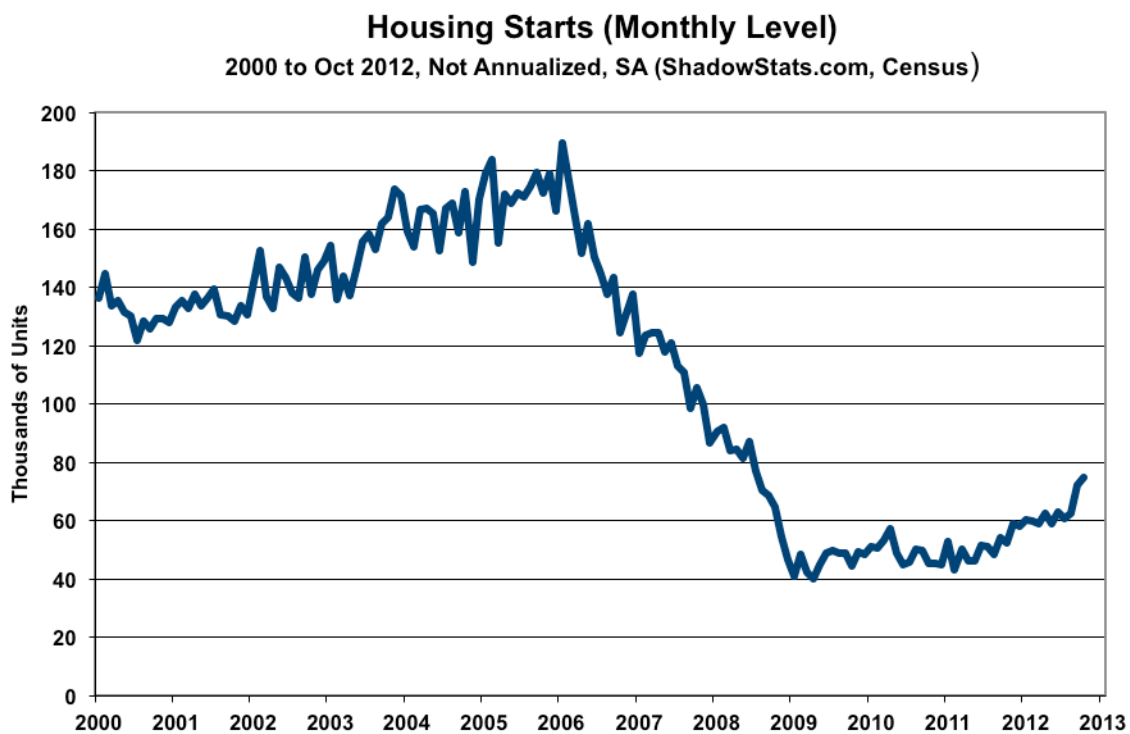
Gold Remains the Primary Hedge Against the Oncoming Dollar Crisis. Where there is little the federal government or the Federal Reserve can do to avoid a hyperinflation, there is much an individual can do to

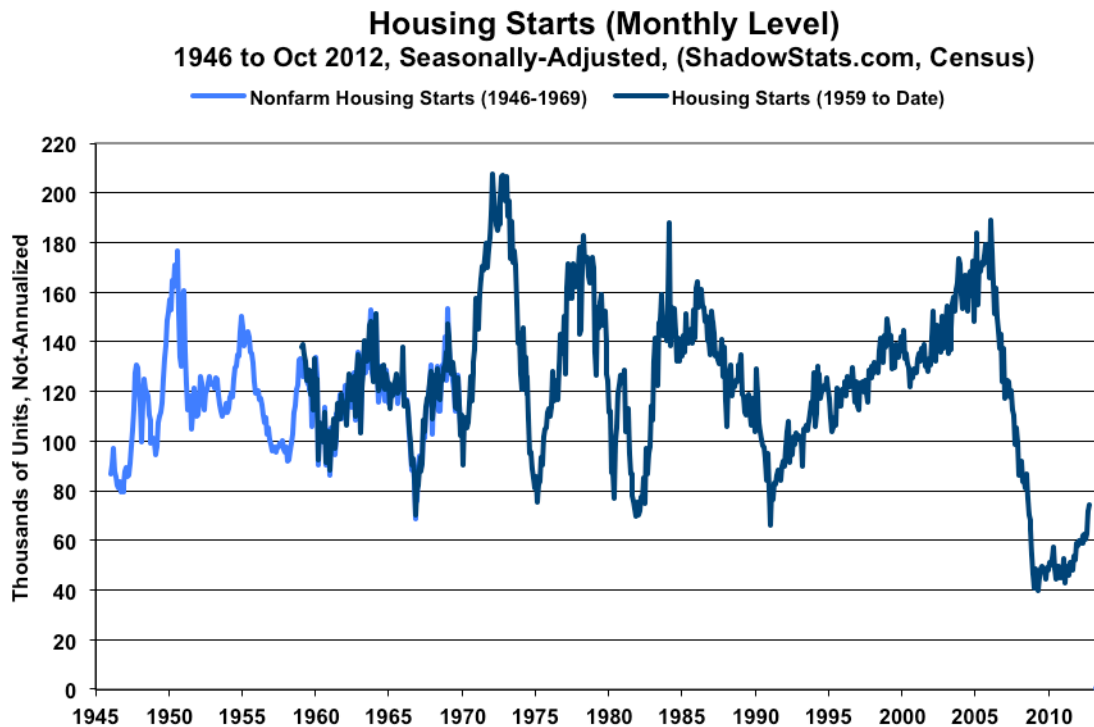
protect the purchasing power of his or her assets. The options are discussed more fully in [Hyperinflation 2012](#), and they remain unchanged. Holdings of physical gold and silver, as well as assets in the stronger Western currencies such as the Canadian and Australian Dollars and the Swiss franc should act as stores of wealth through the difficult times ahead. These comments will be expanded significantly in the upcoming full *Commentary*, reviewing longer-term hedges such as real estate and gold-mining stocks.

Please Note: The preceding limited comments are expanded upon, with back-up material and graphics in the full Special Commentary, to be published November 26th. The new report also includes new material on the currency markets and currency reserves, federal deficit and debt analyses and projections, a new stress signal for the U.S. banking system, along with a review of the inflation/deflation debate.

Regular *COMMENTARY NO. 484*

Opening Comments and Executive Summary. The headline 3.6% monthly gain in October 2012 housing starts was not statistically-significant and was in the context of downside revisions to August and September reporting. As shown in the accompanying graphs, October activity was at the highest level since July 2008, when the market was in free-fall, but it still was 61% off the 2006 peak in housing starts.





Hurricane Sandy appears to have had minimal impact on October's activity, but disruptions from the storm should have meaningful impact on November reporting, with subsequent rebuilding certain to provide a temporary boost to building-permit and housing-starts activity in December and into first-quarter 2013. Nonetheless, given the underlying economic fundamentals, there is no longer-term recovery or relief in sight, and the relatively strong reports of September and October likely will revise sharply lower or be balanced in later reporting by offsetting seasonal adjustments.

The downside revisions to third-quarter data in this highly volatile series offer some downside pressure on the upcoming November 29th first-revision to third-quarter 2012 GDP. As revised, annualized quarter-to-quarter growth for third-quarter 2012 slowed to 26.6%, from initial reporting of 30.3%, versus the unrevised annualized quarterly growth of 12.3% in the second-quarter.

[More detail on the October housings starts and the detail and graphics on October existing home sales numbers are found in the Reporting Detail section.]

REPORTING DETAIL

RESIDENTIAL CONSTRUCTION (October 2012)

At a Four-Year High, October Housing Starts' Monthly Gain Was Not Statistically Significant. The aggregate housing starts number was the highest monthly level reported since July 2008, when the series was in free-fall. The headline number of 894,000 annualized starts (74,500 actual monthly starts) in October was up by a statistically-insignificant 3.6%, versus a September number that had been revised lower by 1.0%, and an August number that had been revised lower by 1.1%.

Hurricane Sandy appears to have had minimal impact on October activity, but it will effect November reporting, with rebuilding certain to provide a temporary boost to building-permit and housing-starts activity in the months ahead.

Nonetheless, with the downside revisions to third-quarter data in this highly volatile series, the annualized quarter-to-quarter growth for third-quarter 2012 slowed to 26.6%, from initial reporting of 30.3%, versus unrevised annualized quarterly growth of 12.3% in the second-quarter. Annualized quarterly growth rates are used here, because that is the way the GDP is reported. The housing starts revisions suggest some downside pressure on the upcoming November 29th first-revision to third-quarter 2012 GDP.

As reported, the October 2012 number still was 61% below the January 2006 series high. This series remains particularly volatile and tends to suffer large monthly revisions, as well as irregular monthly distortions from a host of other factors, as discussed in [Hyperinflation 2012](#), and as will be reviewed fully in the upcoming *Special Commentary*.

Protracted stagnation in housing starts at historically-low levels of activity has continued well into its fourth year of activity, still averaging 73% below 2006's record-high construction level. Nonetheless, within the normal scope of volatility for the series in the last four years, a slightly higher plateau of activity has developed in the twelve months, through October 2012, that is 67% below the 2006 high. Given the underlying economic fundamentals, there is no recovery or relief in sight, other than a temporary rebuilding boost from hurricane impact, and the relatively strong reports of September and October likely will revise sharply lower or be balanced by offsetting seasonal adjustments in the months ahead.

Housing Starts October 2012 Reporting. The Census Bureau reported today (November 20th) a statistically-insignificant, month-to-month headline gain in seasonally-adjusted October 2012 housing starts of 3.6% (a gain of 2.5% before prior-period revisions) +/-15.3% (all confidence intervals are at the 95% level). September housing starts activity revised to a 15.1% gain, from initial reporting of a 15.0% monthly increase, but that was against a 1.1% downside revision to August's level.

All the October growth was in starts for apartment buildings. Starts for single-unit structures in October declined by a statistically-insignificant 0.2% +/- 12.1%, following a revised 10.6% (previously 11.0%) gain in September.

Activity in starts for apartment buildings remained volatile, but, as usual, it was no more than statistical noise. Month-to-month, apartment starts rose by a statistically-insignificant 10.0% +/- 37.0% in October, after a revised 26.3% (previously 25.0%) gain in September.

The year-to-year change in aggregate October 2012 housing starts was a statistically-significant increase of 41.9% +/- 18.6%, following a revised 33.4% (previously 34.8%) annual gain in September, but, again, that remains in the continued context of what has been a protracted period of low-level bottom-bouncing.

For the last 47 months, the pattern of housing starts generally has remained one of stagnation at an historically low-level plateau of activity. Since December 2008, housing starts have averaged a seasonally-adjusted monthly rate of 51,700. In that period, monthly readings have been within the normal range of monthly variability for the aggregate series, around that average, except for the respective September and October 2012 readings of 71,900 and 74,500, which were beyond the upper end of that range. Nonetheless, activity appears to have moved to a somewhat higher plateau since November 2011, with the average of the monthly housing starts at 62,400 for the twelve months through October 2012.

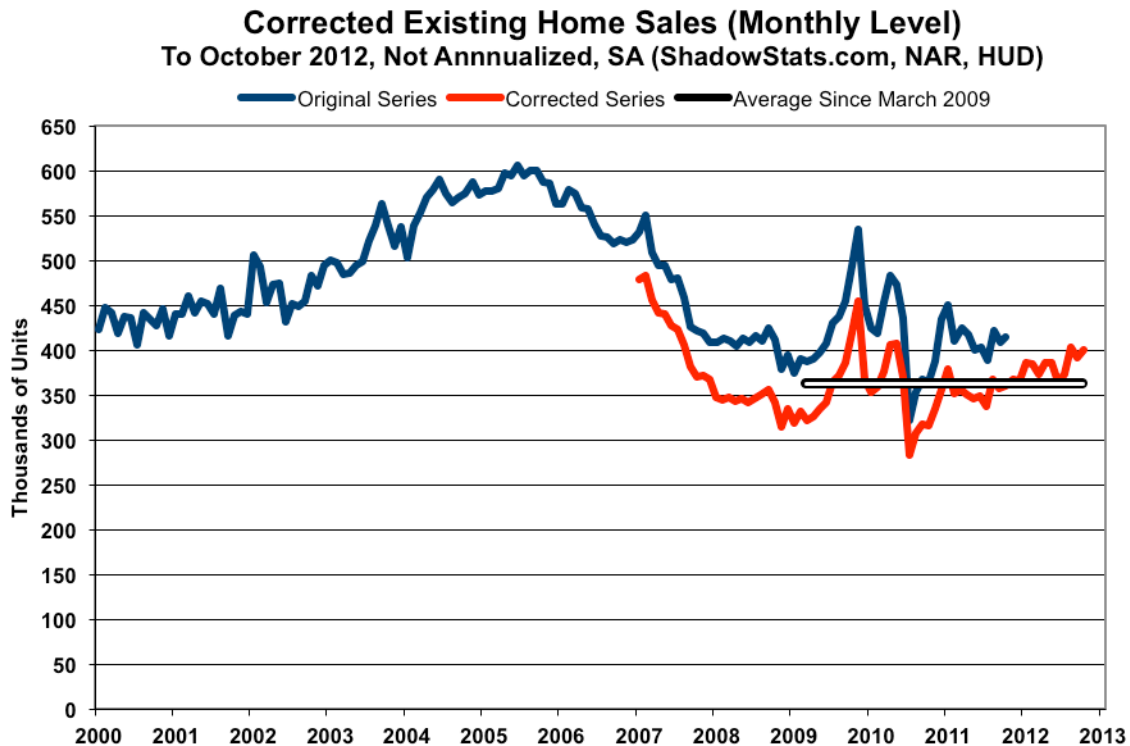
The official reporting of monthly housing starts is expressed at an annualized monthly pace, which was 894,000 for October 2012. Due to regular, extreme monthly volatility in this series, however, it is my preference to use the actual, non-annualized monthly number. The graphed patterns are the exactly same, it is just that the monthly levels tend to be a little more realistic.

The regular graphs for this series are shown in the *Opening Comments and Executive Summary* section. Current monthly housing starts activity is at a four-year high, well off the record monthly low seen for the present series in April 2009. Since September 2012, monthly levels of activity have notched just above the levels of activity seen at the troughs of the most severe post-World War II declines in housing starts shown in the current series, or in the predecessor nonfarm housing starts series.

EXISTING HOME SALES (October 2012)

October Existing-Home Sales Gain Boosted by Prior-Period Downside Revision. Beyond the massive downside corrections to the existing-home sales series—published with the November 2011 data—reporting for the existing home sales series remains subject to significant seasonal-factor instabilities, as also has been seen 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, effectively a discontinuity in the series. 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—as shown in the graph—the pattern of activity resembles the bottom-bouncing seen otherwise in the new-home sales, and in housing-starts activity discussed in the prior section, although the existing home sales peak-to-trough contraction never was as severe as that seen in the sales tied to new construction.



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

Existing Home Sales October 2012 Reporting. The November 19th release of October 2012 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly gain of 2.1% (up by 0.8% net of prior-period revisions), against a revised 2.9% (previously 1.7%) decline in September. The seasonally-adjusted October monthly pace of 399.8 thousand was the second-strongest monthly showing this year (after August), despite little apparent negative impact from Hurricane Sandy. That said, given the previously-discussed instabilities in seasonal factors and in underlying reporting, there is little significance, if any, that can be attributed to the headline monthly number for October, at this time.

On a year-to-year basis, October 2012 sales rose by 10.9%, versus a revised 9.6% (previously a 11.0%) gain in September. Recent volatility in annual change reflects partially the effects of lapsing housing stimulus efforts the year before.

The portion of distressed properties in existing sales was unchanged for the month, in aggregate, remaining a significant component of sales activity. The NAR estimated October's "distressed" sales at 24% (12% foreclosures, 12% short sales), versus September's differently-distributed 24% (13% foreclosures, 11% short sales).

Both the median and average sales price data for existing homes (as with the government's estimates of home sales price data) tend to be of extremely limited usefulness, since they usually reflect shifting

patterns of home buying between differently-priced segments, more than they do changes in truly comparative prices. That said, median existing-home sales prices in October 2012 (not seasonally-adjusted) were reported up month-to-month, and year-to-year, with mean (average) prices down month-to-month, but up year-to-year.

Week Ahead. Until such time as financial-market expectations catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally should continue to show higher-than-expected inflation and indicate 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, as seen recently, for example, in the reporting of October retail sales, industrial production, housing starts and existing home sales.

Significant reporting-quality problems continue with most widely followed series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments, distortions that have been induced by the still-ongoing economic turmoil of the last five years. The recent economic collapse has been without precedent in the post-World War II era of modern economic reporting. These distortions have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series. In any event, where numbers are too far removed from common experience, they tend to be viewed by the public with extreme skepticism.

Still, recognition of an intensifying double-dip recession continues to gain, while recognition of a mounting inflation threat has been rekindled a bit by recent Fed monetary policies and rising headline inflation numbers. The political system would like to see the issues disappear; 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.

New Orders for Durable Goods (October 2012). The initial estimate for October 2012 new orders for durable goods is scheduled for release on Tuesday, November 27th, by the Commerce Department. Even with the sharp and irregular volatility in commercial aircraft orders, new orders have been trending lower, contracting quarter-to-quarter for third-quarter 2012. That trend likely will continue, even though a given month's results may not fall outside the bounds of normal variability.

In terms of the potential inflation contribution to the monthly and annual change in new orders, the seasonally-adjusted, month-to-month change in the October 2012 PPI finished goods capital equipment index was a decrease of 0.3%, with year-to-year unadjusted inflation at 1.4%. Due to hedonic-quality adjustments to this portion of the PPI series, however, as with the GDP numbers, those inflation data understate inflation reality and correspondingly overstate inflation-adjusted growth by perhaps two-percentage points per year.

New Home Sales (October 2012). The October new home sales report from the Census Bureau is due for release on Wednesday, November 28th. As with the recently-reported October housing starts and existing home sales, a entrenched pattern of stagnation likely has continued in both series, with the pending monthly results not likely to be statistically-significant.

Gross Domestic Product—GDP (Third-Quarter 2012, Second Estimate, First Revision). The second-estimate of third-quarter 2012 GDP is due for release by the Bureau of Economic Analysis (BEA) on Thursday, November 29th. In this first revision, the markets appear to be looking for a strong upside revision to the initial headline growth rate of 2.0%. I do not see that.

There is slight upside revision pressure from the most recent trade data ([Commentary No. 480](#)), but slight downside pressure from revised retail sales ([Commentary No. 482](#)), as well as from revised housing starts, as discussed in the *Reporting Detail* section. Reporting of October industrial production, as examined in [Commentary No. 483](#), showed an improved quarterly growth rate (much-less-negative) for the third-quarter, in revision. While that could be driving the upside GDP revision expectations, the relative upside quarterly-growth revision was due to a downside revision to second-quarter activity, not to enhanced activity in the third-quarter. Accordingly, those revisions should be seen in the annual revisions to the series in July 2013, not in the first-revision of third-quarter GDP. There is some risk of a downside reporting surprise for the new number, as a result.

Further, of some interest could be the initial reporting of third-quarter gross national product (GNP) and gross domestic income (GDI). The GNP is the broadest measure of the economy, where GDP is GNP net of trade in factor income (interest and dividend payments). Net debtor nations, such as the United States, tend to show weaker GNP growth than GDP growth. The GDI is the income-side equivalent of the consumption-side GDP, and usually does not support the hyped GDP growth rate (the difference is made up by adding a “statistical discrepancy” to the GDI side of the equation).

Reality remains in the direction of much weaker than the previously-reported headline growth. The new numbers most certainly still will not be statistically significant, with the GDP series remaining the most worthless, the most heavily politicized and the most misleading of any major government economic statistical release. This has been the case historically in both pre- and post-national election environments.
