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

COMMENTARY NUMBER 506
Revised GDP, January Durable Goods Orders and New Home Sales

February 28, 2013

Fourth-Quarter GDP Revision from 0.1% Contraction to 0.1% Growth
Was Just Statistical Noise at Already Insignificant Levels

Official Double-Dip Recession
Should Be Clocked from Second- or Third-Quarter 2012

Ongoing Year-to-year Contractions in Real Durable Goods Orders
Signal Renewed Economic Downturn

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, March 8th, covering February employment and unemployment, the January trade deficit and January construction spending.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Outside of disappointing the market's expectations for perhaps 0.5% growth, this morning's (February 28th) first revision to fourth-quarter 2012 GDP was not meaningful either terms of the magnitude of reported growth or of the magnitude of the reported revision. The revised 0.1% annualized GDP growth rate was statistically indistinguishable between serious recession and solid economic growth. Unfortunately, that usually is true for most GDP reporting in the first year or two of government estimates.

Whether the headline GDP rate of change was the initial annualized 0.14% headline contraction, or the revised 0.13% annualized headline gain, the difference is nothing but statistical noise, at a reporting level that is statistically insignificant. As it stands, the final growth estimate for fourth-quarter 2012 eventually will end up somewhere between an annualized 3.5% contraction and 3.5% gain, 95% of the time. One-in-twenty times (5% of the time), the final growth rate will end up outside that range, in this most-worthless of major economic series.

As suggested by somewhat better-quality reporting in series such as retail sales, industrial production, durable goods orders and housing starts, official economic accounting eventually should reflect a double-dip recession, with the second-dip starting in second- or third-quarter 2012. The continuing economic woes are a byproduct of the unfolding crises in play since 2006 and before.

Indeed, as discussed with the "corrected" GDP graph, shown later in these *Opening Comments*, the renewed economic slump simply is a continuation of the extraordinary economic downturn that began as early as 2006. Activity collapsed into 2009, which was followed by a period of low-level stagnation (not recovery) and, subsequently, renewed downturn (see *No. 485: Special Commentary*). A sustainable recovery could not have taken place since 2009, and it will not be forthcoming until the consumer's structural income problems are resolved, and until the nation's extreme fiscal imbalances are addressed (see *Hyperinflation 2012*).

A general pattern of ongoing economic turmoil can be seen in the graphs of real (inflation-adjusted) new orders for durable goods and of consumer confidence, also shown later in these *Opening Comments*. The nominal (not-adjusted-for-inflation) monthly change in January durables was a 5.2% contraction, which more than offset December's defense-spiked gains, in this regularly volatile series.

The reporting of January new-home sales activity, which continued to be unstable in a broad pattern of stagnation, showed a statistically-insignificant monthly headline gain of 15.6%, which more than offset a sharp decline in December's reporting (see the *Reporting Detail* section for specifics and graphs).

Fourth-Quarter GDP Revision. For fourth-quarter 2012, the nominal (not-adjusted-for-inflation) GDP revised from an initial annualized growth rate of 0.46% to 1.02%. The GDP inflation rate (implicit price deflator or IPD), revised from an initial annualized rate of 0.60% to 0.89%, with the effect of real (inflation-adjusted) annualized GDP change revising from a 0.14% contraction (0.46% nominal growth minus 0.60% inflation) to a 0.13% gain (1.02% growth minus 0.89% inflation).

Here is how the revised real growth was distributed. Growth in all the major categories contributing to fourth-quarter 2012 GDP reporting revised to the downside in the first revision, second estimate, except for the net-export account. Without the upside impact of revised trade data, the GDP revision would have been negative, showing a greater quarterly contraction in the fourth-quarter, not a revised shift from minimal contraction to minimal gain. The upside pressure from the trade data reflected unusual December 2012 reporting that possibly was tied to Hurricane Sandy disruptions of the flow of trade and related paperwork (see *Commentary No. 501* and the *Week Ahead* section).

As indicated today (February 28th) by the BEA, the first-revision of headline fourth-quarter GDP growth to 0.13% reflected the following aggregation of contributed growth. Please note that the growth number in each subheading is the additive contribution to the aggregate, revised headline change in GDP, where 1.47% - 0.20% + 0.24% - 1.38% = +0.13%.

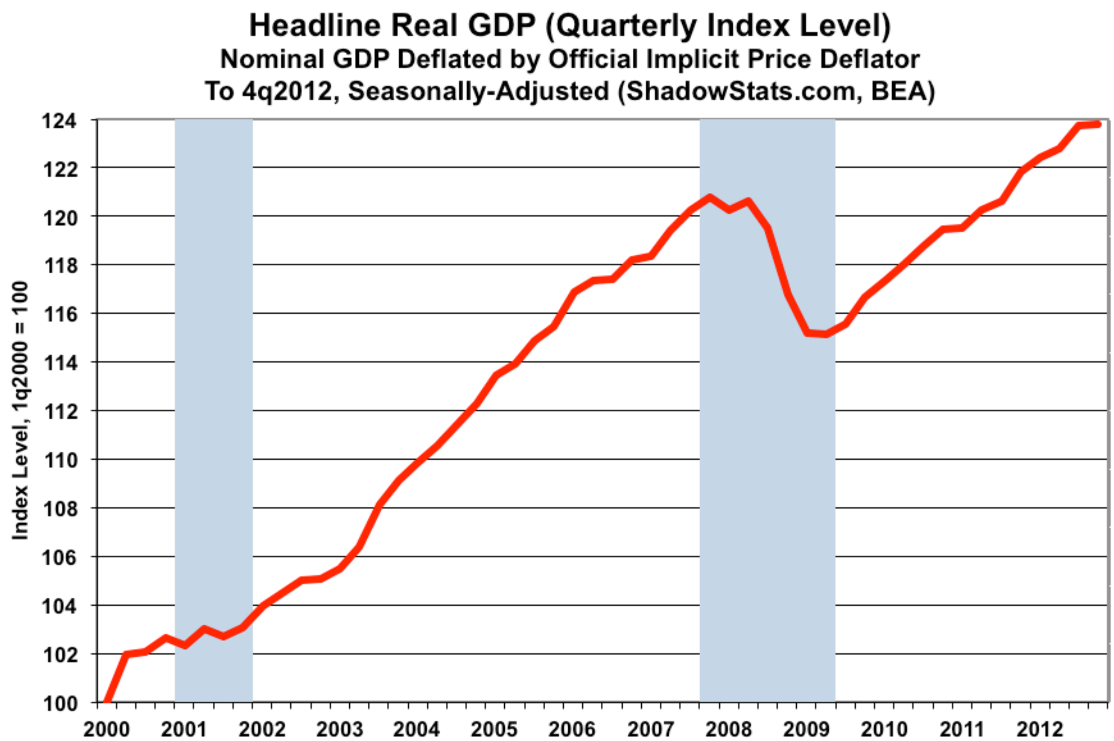
As previously reported by the BEA (January 30th), the headline, initial 0.14% fourth-quarter GDP contraction reflected the growth patterns marked in parentheses as "previously." Please note that the previous growth number in each subheading is the additive contribution to the aggregate, initial headline change in GDP, where 1.52% - 0.08% - 0.25% - 1.33% = -0.14%:

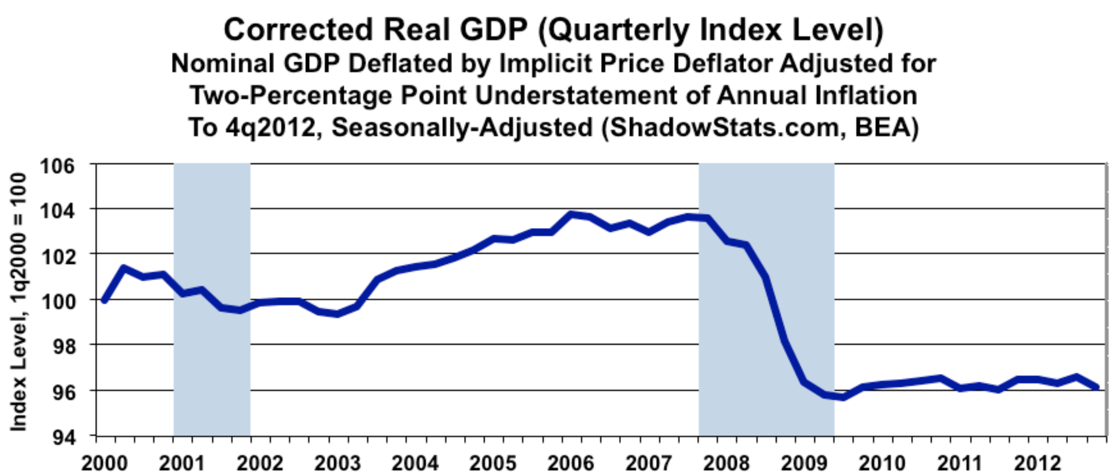
- ***Consumer Spending Contributed 1.47% (Previously 1.52%) to Growth.*** The annualized 2.1% (was 2.2%) quarterly growth in personal consumption expenditure was dominated by 13.8% (was 13.9%) growth in durable goods, such as automobiles and household furnishings. To the extent that those estimates were realistic, they were spiked by the replacement demand for autos and goods destroyed by Hurricane Sandy. That pattern should tend to reverse in first-quarter 2013.
- ***Business Investment Subtracted 0.20% (Previously 0.08%) from Growth.*** The annualized 1.5% (was 0.6%) contraction in gross private demand (including residential investment) was dominated by a liquidation of private inventories, which by itself subtracted 1.55% (previously 1.27%) from the annualized growth rate. Final sales (GDP net of inventory change), accordingly, reflected revised annualized quarterly growth of 1.70% (previously 1.13%).
- ***Net Exports Added 0.24% to (Previously Subtracted 0.25% from) Growth.*** As suggested by the sharp and unusual narrowing of the December trade deficit, the fourth-quarter trade deficit narrowed in revision, providing a boost to, rather than a drain from, fourth-quarter economic growth.
- ***Government Spending Subtracted 1.38% (Previously 1.33%) from Growth.*** Dominated by an annualized 22.0% (was 22.2%) plunge in defense spending, the 6.9% (was 6.6%) decline in government spending was the largest negative contributor to fourth-quarter GDP activity. This reporting, however, still appears to run counter to the 107.3% (previously 110.4%) monthly surge in December 2012 defense capital goods orders. As discussed in the reporting of January 2013 durable goods orders in the *Reporting Detail* section, however, defense orders fell by 69.5% in month-to-month in January.

Although the second estimate of fourth-quarter GDP showed 0.13% annualized quarter-to-quarter growth, that gain still was statistically insignificant. It was no more meaningful than the reporting of the otherwise insignificant quarterly gains in recent quarters. Irrespective of next month's revision to fourth-quarter 2012 GDP, first-quarter 2013 remains a candidate for a formal quarterly contraction. Along with the annual GDP revisions due in July 2013, revamped numbers should show quarterly contractions extending well backwards into 2012, including a more-informed final accounting for the fourth-quarter 2012 growth estimate.

In terms of year-to-year real growth, fourth-quarter 2012 GDP increased by a revised 1.61% (previously 1.54%), down from 2.60% in third-quarter 2012, and from 1.97% in fourth-quarter 2011. Annual average real GDP growth was a revised 2.20% (previously 2.18%) in 2012, versus 1.81% in 2011.

The BEA revised the fourth-quarter GDP implicit price deflator to 0.89% (previously 0.60%), versus 2.72% in the third-quarter.





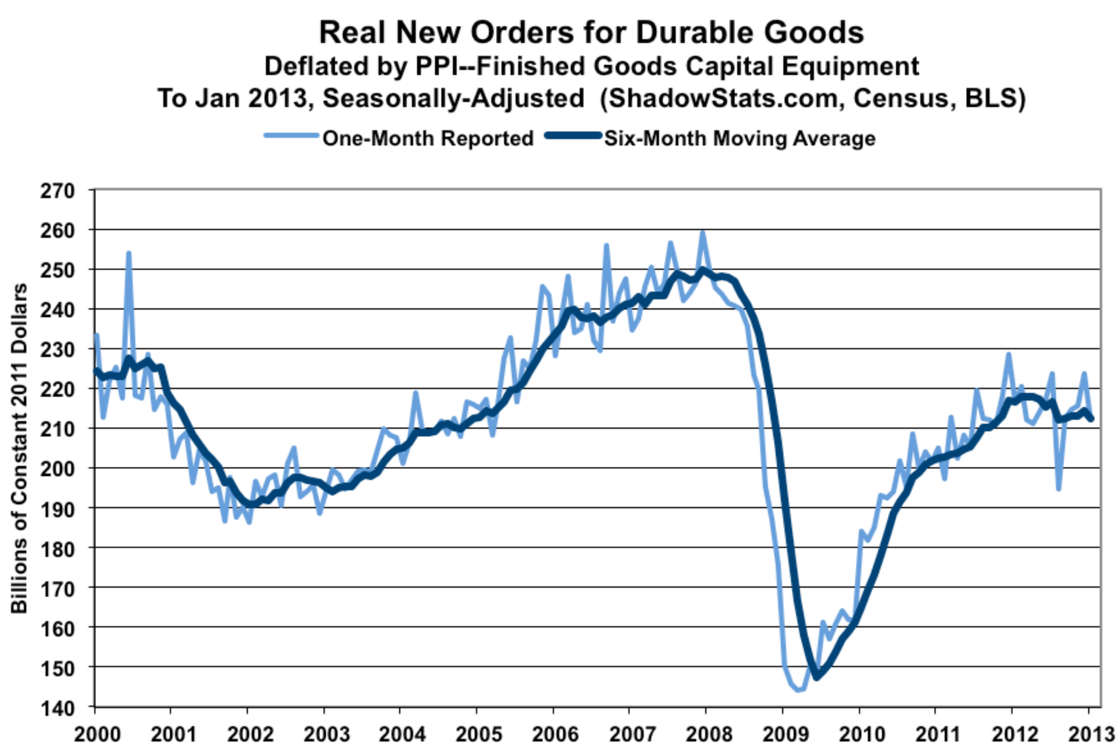
Corrected Gross Domestic Product. As usually discussed in the *Commentaries* covering the monthly GDP reporting and revisions, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. The preceding two graphs tell that story, updated for the second reporting of fourth-quarter 2012 GDP.

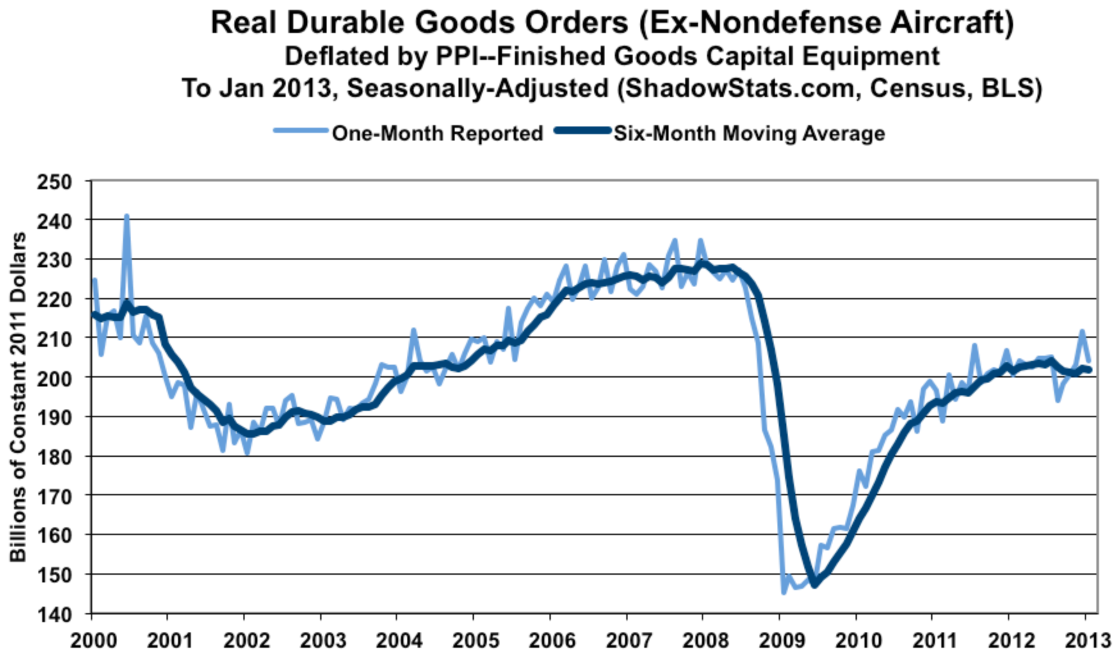
In the first graph, the official real GDP activity has been reported above pre-2007 recession levels—in full recovery—since fourth-quarter 2011. No other major economic series has shown a parallel pattern of full economic recovery and beyond (although uncorrected real retail sales are close to that full-recovery point, as discussed in Commentary No. 505). 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 and private surveys, which attempt to survey real-world activity. Flaws in the GDP inflation methodologies have created the "recovery."

The second graph plots the GDP corrected for the understatement inherent in official inflation estimates, with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in Hyperinflation 2012, No. 485: Special Commentary and Public Comment on Inflation. Both graphs are indexed to first-quarter 2000 = 100, with the plots to consistent scales.

January 2013 Durable Goods New Orders. Hit heavily by plunging commercial-aircraft and defense orders that reversed a December surge, January 2013 new orders for durable goods dropped by 5.2%, more than reversing the downwardly-revised 3.7% monthly gain seen in December 2012.

On a year-to-year basis, the inflation- and seasonally-adjusted year-to-year change on the aggregate new orders series contracted for a third month, down by 2.1% in January, 2.0% in December, and 0.9% in November. That is a pattern that would be signaling a renewed economic downturn during normal economic times.





Previously shown and discussed in the regular *Commentaries* that cover the reporting of new orders for durable goods, the preceding two graphs plot new orders for durable goods, adjusted for inflation (using the PPI finished goods capital equipment index, December 2011 = 100) and smoothed.

These graphs plot the monthly as well as a six-month moving average of activity levels. The first graph shows the aggregate new orders series; the second series is net of the extremely volatile commercial-aircraft order sector. As reflected in these graphs, the durable goods series appears to be in a renewed economic downturn.

In terms of inflation-adjusted level, these series have shown a slowing uptrend and flattening-out in the last two-to-three years—now in a pattern of downturn—clearly not the recovery that is seen in official GDP reporting. The real (inflation-adjusted) level of orders in January 2013 remained below both the pre-2001 and pre-2007 recession highs.

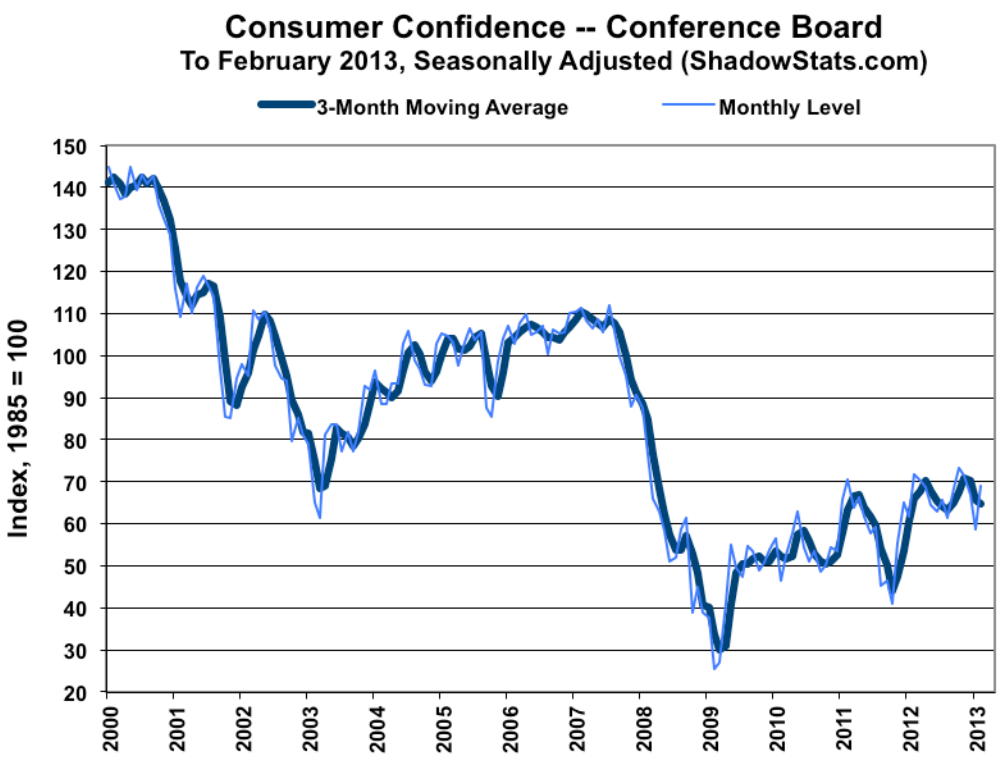
As with the consecutive declines seen in annual change in the real series, the pattern of declining sales unfolding in the smoothed, monthly new orders series in these historical graphs is one that usually precedes or is coincident with a recession.

If the deflation measure here were corrected meaningfully for the hedonic-adjusted understatement of inflation, the post-2009 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 the most recent reporting turning increasingly negative.

February 2013 Consumer Confidence Gained, But Downside Trend Remained. Other series that are highly volatile month-to-month, and that benefit from being viewed in terms of smoothing, in addition to the reporting of the raw data, include the Conference Board's consumer confidence measure and the University of Michigan's consumer sentiment series. Unlike the sentiment series, the confidence series is seasonally-adjusted each month, while the unadjusted series never is released by the Conference Board. There always has been some question as to the propriety of seasonally adjusting "confidence."

That said, consumer confidence rose sharply month-to-month in February 2013, following a sharp monthly decline in January 2013, with the results shown in the accompanying graph. The three-month moving average, however, continued to move lower. February consumer sentiment will be published tomorrow, Friday, March 1st, and will be included in the next regular *Commentary* on March 8th.

Consumer confidence and sentiment still remain at levels not seen outside of the depths of the most-severe historical recessions. Intensifying consumer liquidity problems remain primary constraints on confidence and on the ability and indeed the willingness of the consumer to fuel sustainable growth in consumption.



[More-complete details on the second estimate of fourth-quarter 2012 GDP, January new orders for durable goods and details on existing home sales are found in the* Reporting Detail *section.]

HYPERINFLATION WATCH

Hyperinflation Outlook: Summary. This summary is intended for new subscribers or for those who otherwise are not familiar with the hyperinflation report or recent special commentaries, linked below. Those documents are suggested as background reading on the financial turmoil and currency upheaval facing the United States in the next year or two. The following Text is unchanged from the prior *Commentary No. 505*, of February 22nd.

The November 27, 2012 *Special Commentary (No. 485)* updated *Hyperinflation 2012* and the broad outlook for the economy and inflation, as well as for systemic stability and the U.S. dollar. These remain the two primary articles outlining current conditions and the background to the hyperinflation forecast. The basics have not changed here, other than events keep moving towards the circumstance of a domestic hyperinflation by the end of 2014. Nonetheless, a fully updated hyperinflation report is targeted for publication in the March to April time-frame.

The economic and systemic solvency crises of the last eight years continue. There never was an actual recovery following the economic downturn that began in 2006 and collapsed into 2008 and 2009. What followed was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012. The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series. Nonetheless, the renewed downturn likely will gain recognition as the second-dip in a double- or multiple-dip recession.

What continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 panic and near-collapse of the system at the time. All the extraordinary actions and interventions bought a little time, but they did not resolve the various crises. That the crises continue can be seen in deteriorating economic activity and in the panicked actions by the Federal Reserve, where it proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise. As discussed in the *Opening Comments* section [*Commentary No. 505*], hoopla to the contrary in the popular press, that the Fed might pull-back on its "easing," most likely is designed to help firm-up the U.S. dollar and to soften gold in the immediate period running up to the looming crises in the federal-budget and debt-ceiling negotiations.

The Fed's recent and ongoing liquidity actions also can be viewed as a signal of deepening problems in the banking system. As Mr. Bernanke admits, the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Nonetheless, the Fed's easing moves have been an ongoing effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury.

Despite the near-term political hype that Congress will come up with a plan to balance the budget in a ten-year time frame, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of the negotiations. Ongoing and deepening economic woes assure that the usual budget forecasts—based on overly-optimistic economic projections—will fall far short of fiscal balance and propriety. Furthermore, chances remain nil for the government addressing the GAAP-based deficit that hit $6.6 trillion in 2012, instead of the popularly followed, official cash-based accounting deficit in 2012 of $1.1 trillion, as discussed in *No. 500: Special Commentary*.

Efforts at delaying meaningful fiscal action, and at briefly postponing conflict over the Treasury's debt ceiling, have bought the politicians in Washington minimal time in the global financial markets, but the patience in the global markets is near exhaustion. The continuing unwillingness and political inability of the current government to address seriously the longer-range U.S. sovereign-solvency issues, only pushes along the regular unfolding of events that eventually will trigger a domestic hyperinflation, as discussed in *Commentary No. 491*. The unfolding fiscal collapse, in combination with the Fed's direct monetization of Treasury debt, eventually will savage the U.S. dollar's exchange rate, boosting oil and gasoline prices, and boosting money supply growth and domestic U.S. inflation. Relative market tranquility likely will not last much longer, despite the tactics of delay by the politicians and obfuscation by the Federal Reserve. This should become increasingly evident as the disgruntled global markets begin to move sustainably against the U.S. dollar, despite any near-term gyrations. A dollar-selling panic is likely this year, with its effects and aftershocks setting hyperinflation into action in 2014.

REPORTING DETAIL

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

Minimal Revision and Minimal Growth in Fourth-Quarter GDP Were Not Meaningful. The revised headline estimate of 0.13% growth, versus an initial estimate of a 0.14% contraction, was not of substance, either in terms of the magnitude of the revision, or in terms of the official level of annualized quarterly growth for fourth-quarter 2012 GDP.

As discussed in the *Opening Comments*, however, with the annual GDP revisions due in July 2013, revamped numbers should show quarterly contractions extending backwards into 2012, including the fourth-quarter, which went through its first revision today (February 28th). That would be consistent with what likely will become recognized as the second-dip in a double-dip recession, co-joined with the formal 2007 to 2009 recession

This most-worthless and most-heavily-politicized of government economic series still does not reflect properly or accurately the changes to the underlying fundamentals that drive the series. The GDP remains the only major economic series to show a full economic recovery and renewed expansion, since the onset of official recession in December 2007. Either the GDP numbers are wrong, or all the other major economic releases are wrong. As discussed and graphed in the *Opening Comments*, the real GDP's upswing in activity since mid-2009 has been no more than a statistical illusion resulting from the use of bad-quality inflation data.

Underlying real-world economic activity suggests that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in second- and third-quarter 2012 (see *Special Commentary (No. 485)* and *Hyperinflation 2012*).

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%.*

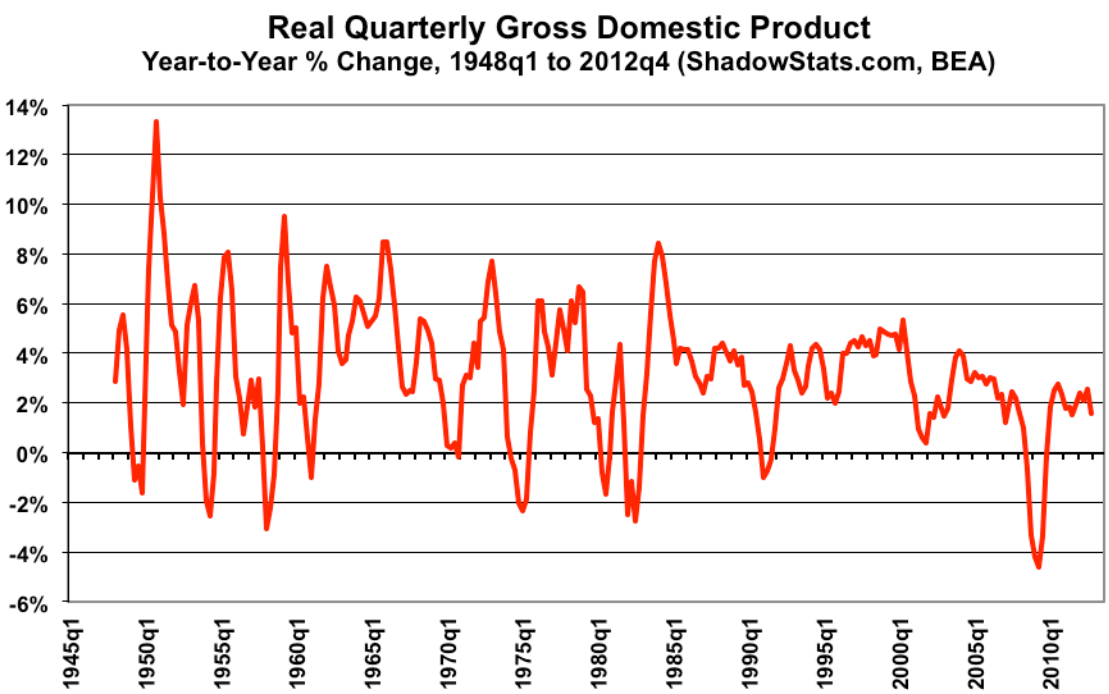
Annual *growth refers to the year-to-year change of the referenced period versus the same period the year before.*

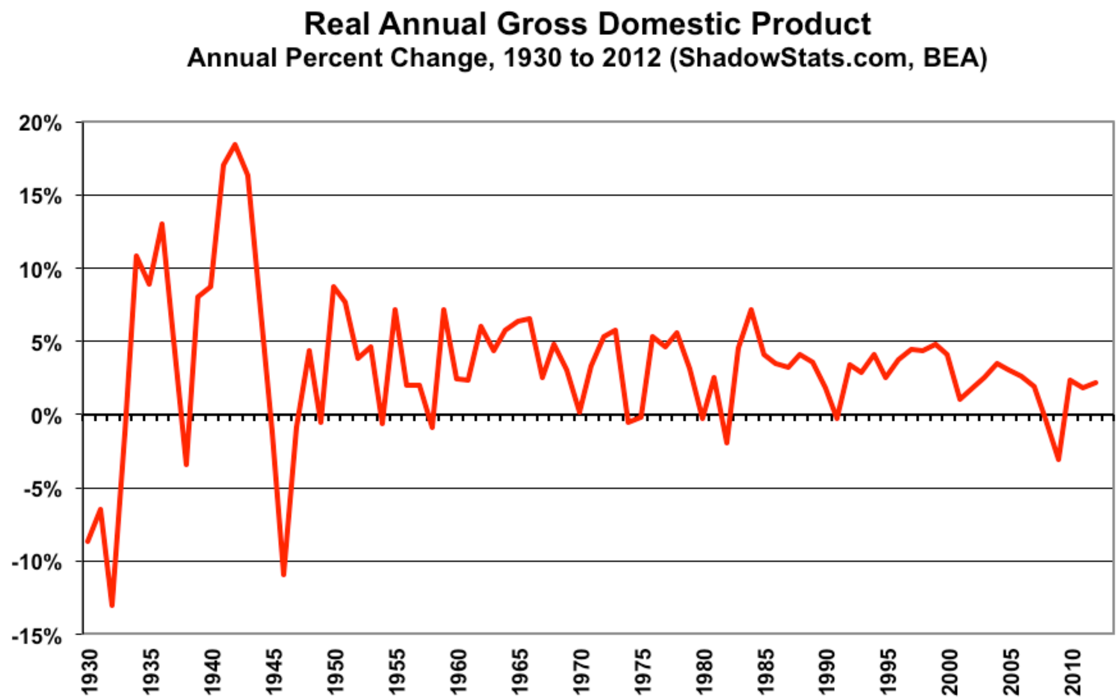
GDP. Published this morning, February 28th, by the Bureau of Economic (BEA), the second estimate and first revision of fourth-quarter 2012 gross domestic product (GDP) showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 0.13% (previously a 0.14% contraction) +/- 3.5% (95% confidence interval). The revised headline fourth-quarter estimate was against an annualized 3.11% headline gain in the third-quarter, 1.25% growth in the second-quarter, and 1.96% growth in the first-quarter.

For seven of the eight 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 were massaged to keep the quarterly growth rates in politically-desirable territory.

Updated in the accompanying graphs are revised estimates of year-to-year real change in fourth-quarter 2012 GDP, as well as in the estimated annual real growth for 2012. As shown in the first graph, revised fourth-quarter year-to-year growth was 1.61% (previously 1.54%), versus 2.60% in the third-quarter, 2.14% in second-quarter, and 2.45% in first-quarter. The latest year-to-year growth remains off the near-term peak 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. That was the deepest annual contraction seen for any quarterly GDP in the history of the series, which began with first-quarter 1947.

The second graph shows average annual real GDP growth by year, with 2012 up by a revised 2.20% (previously 2.18%) versus 2011, which, in turn, was up by 1.81% from 2010, and where 2010 was up by 2.39% from 2009. The annual decline of 3.07% seen in 2009, versus 2008, was the steepest fall-off in activity since the post-World War II production shutdown in 1946.





Implicit Price Deflator (IPD) and PCE Deflator. Fourth-quarter 2012 GDP inflation, or the implicit price deflator (IPD), revised to an annualized pace of 0.89% (previously 0.60%), versus 2.72% in the third-quarter, 1.53% in the second-quarter and 2.17% in the first-quarter. Fourth-quarter year-to-year IPD inflation was revised to 1.83% (previously 1.75%), versus 1.63% in the third-quarter, 1.70% in the second-quarter and 1.98% in the first-quarter.

For comparison purposes, revised annualized seasonally-adjusted quarterly inflation for the CPI-U in fourth-quarter 2012 was 2.19%, versus 2.09% in the third-quarter, 1.01% in the second-quarter and 2.31% in the first-quarter, with year-to-year fourth-quarter CPI-U at 1.89%, versus 1.70% in the third-quarter, 1.89% in the second-quarter and 2.82% in the first-quarter.

For the year of 2012, GDP average annual inflation was a revised 1.79 (previously 1.77%), versus 2.13% in 2011. The comparable numbers for the CPI-U were 2.07% and 3.16%, respectively.

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

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for fourth-quarter 2012 is a 2.2% year-to-year contraction versus the official estimate of a 1.6% gain. The alternate fourth-quarter estimate is a deeper contraction than the 2.1% estimated for third-quarter 2012, versus the official estimate of 2.6% 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 fourth-quarter 2012, as it has been for seven of the last eight quarters, a period of protracted business bottom-bouncing in the real world. Although fourth-quarter 2012 GDP initially was reported in a minimal contraction and revised to a minimal gain, the current quarter-to-quarter change is no more statistically meaningful than seven out of the eight last quarters (fourth-quarter 2012 included).

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 corrected real GDP graph (see the *Opening Comments and Executive Summary* section and *Hyperinflation 2012* and *No. 485: Special Commentary*) is based on the removal of the impact of hedonic quality adjustments that have reduced the reporting of official annual GDP inflation by roughly two-percentage points. It is not the same measure as the ShadowStats-Alternate GDP, which reflects the impact of reversing additional methodological distortions of recent decades.

GDI and GDP. The BEA's advance and second estimates of fourth-quarter gross domestic product (GDP) growth largely are guesses. That said, the BEA does not even try to put out early estimates of gross domestic income (GDI), which is the income-side reporting equivalent of the consumption-side GDP; or of gross national product (GNP), which is the broadest measure of U.S. economic activity, where GDP is GNP net of trade in factor-income (interest and dividend payments). Nonetheless, in today's reporting, the BEA revised its headline estimate of third-quarter 2012 GDI growth to 1.55% (previously 1.36%), versus a 0.72% contraction in the second-quarter.

The BEA will not publish fourth-quarter estimates of the GDI and GDP for another month. The BEA's rationale for not publishing early estimates here is that it lacks the data needed to make those measures meaningful (particularly for the fourth-quarter and annual numbers). Unfortunately, those same qualifications should apply to the early GDP reporting. Still, the markets demand some hyped data to increase trading volatility, and the politicians need some happy or not-so-happy news for their budget talks, so this most-worthless of major government series has been guessed at a second time and published, today, for a quarter that ended just 60 days ago.

NEW ORDERS FOR DURABLE GOODS (January 2013)

Plunge in January 2013 Durable Goods Orders Reversed the December Surge in Defense Orders. The 5.2% tumble in January 2013 durable goods orders more than offset the downwardly-revised 3.7% gain in December's orders, where January defense orders collapsed, following an abnormal surge in December. Exacerbating the aggregate order decline also was a sharp relative decline in commercial aircraft orders. Despite complications from regular instabilities created by the use of concurrent seasonal factors, the monthly decline in the series still was within the scope of normal volatility.

Still, the recent broad patter of downturn has continued, with year-to-year change for the aggregate nominal series in contraction for the second consecutive month. The slowing of activity is of a nature that usually precedes or coincides with a recession (contracting, broad economic activity), as suggested in the historical graphs of the real (inflation-adjusted) series, both aggregate and net of nondefense aircraft, published in the *Opening Comments* section. The level of January 2013 real new orders remained below 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 January Reporting. The Census Bureau reported February 27th that the regularly-volatile, seasonally-adjusted nominal (not adjusted for inflation) level of January 2013 new orders for durable goods fell by 5.2% (down by 6.0% before prior-period revisions) month-to-month, following a revised 3.7% (previously a 4.6%) monthly gain in December 2012. A downside 0.7% revision to aggregate December orders largely was in commercial aircraft.

The irregular and highly volatile long-term nondefense aircraft orders fell month-to-month by 34.0% (down by 42.0% before prior-period revisions) in January 2013, following a monthly decline, in revision, of 3.2% (initially reported as a 10.1% monthly gain) in December 2012. Aircraft orders usually are placed years in advance of delivery and rarely impact near-term economic activity. Net of the unstable commercial aircraft orders, aggregate new orders still fell by 3.5% in January, following a revised 3.8% (previously 4.2%) gain in December.

The dominant factor in January's report, however, was a 69.5% plunge in defense capital goods orders, which more than offset the revised 107.3% (previously 110.4%) in year-end defense capital goods orders in December.

Year-to-year change in seasonally-adjusted January 2013 aggregate nominal new orders was a 1.0% contraction, versus a revised 0.7% contraction (previously an annual gain of 0.2%) in December 2012. Such was the second consecutive month of contracting annual growth.

Seasonally-adjusted new orders for nondefense capital goods fell by 0.1% for the month of January, versus a revised 1.4% (previously 3.8%) monthly gain in December. For January 2013, the unadjusted year-to-year change in the series was "unchanged," versus a revised 7.7% (previously 7.5%) annual decline in December 2012.

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 5.2% contraction in aggregate monthly January 2013 orders also was a real (inflation-adjusted) decline of 5.2%, after adjusting for a minimal monthly gain in the PPI finished goods capital equipment deflator. The revised nominal 3.7% gain in December also was 3.7% after inflation-adjustment. On a year-to-year basis, though, the inflation- and seasonally-adjusted year-to-year change contracted for a third month, down by 2.1% in January, 2.0% in December, and 0.9% in November.

In terms of inflation-adjusted level, however, as indicated in the two graphs in the *Opening Comments*, both the smoothed aggregate new orders and aggregate orders net of commercial aircraft series, have shown a slowing uptrend and flattening-out in the last two-to-three years—now in a pattern of downturn—clearly not the recovery that is seen in official GDP reporting. The real (inflation-adjusted) level of orders in January 2013 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 post-2009 uptrend in seen in the graphs of real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity, with the recent pattern of downturn now well entrenched.

NEW-HOME SALES (January 2013)

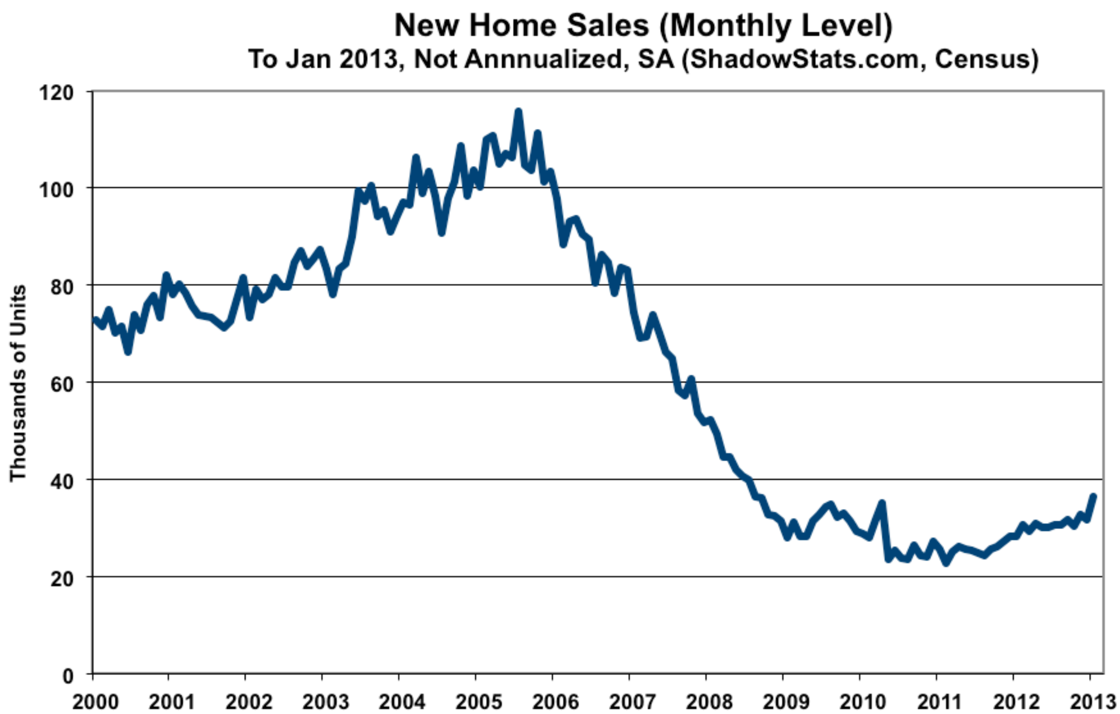
New-Home Sales Activity Remained Unstable but Stagnant in January. January 2013 new home sales continued in a state of depressed stagnation, or bottom-bouncing, in the ongoing aftermath of the housing-industry collapse from 2006 into 2009. Having dropped by a revised 3.8% in December, sales bounced higher by 15.6% in January, but neither monthly change was statistically significant. A similar pattern has been seen consistently with the housing starts data. The first two graphs following show the largely parallel patterns of new-home sales activity versus housing starts.

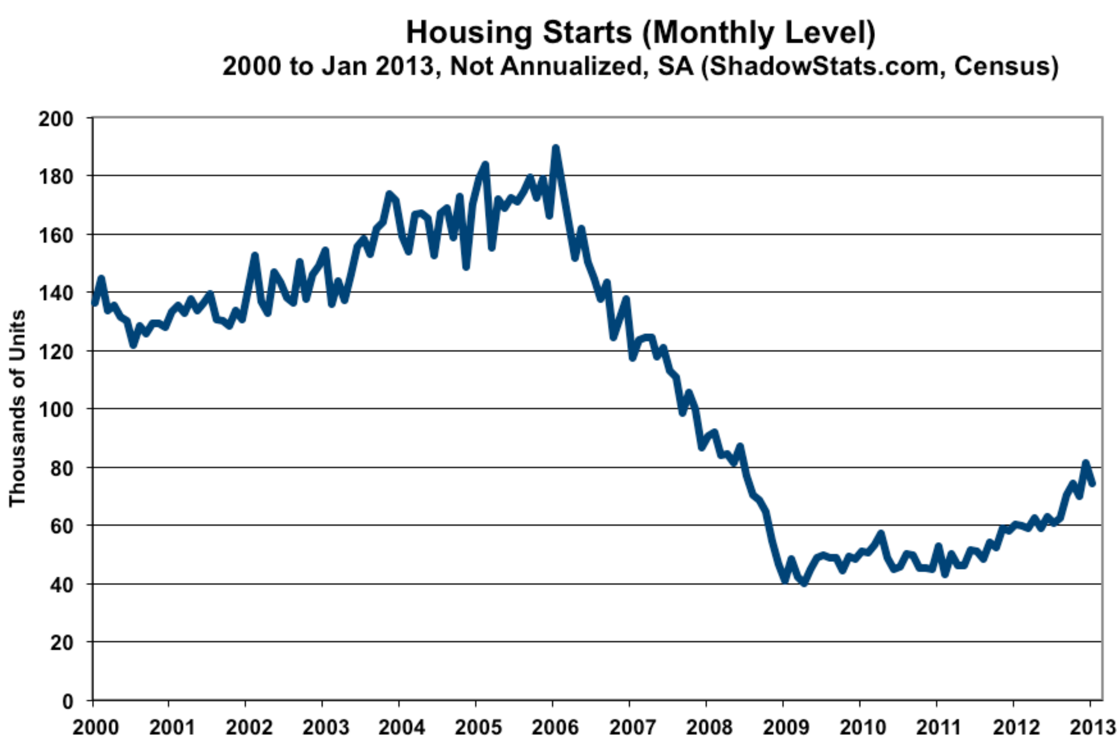
Some of the relative monthly variance in direction of activity for the two series is due partially to the inclusion of apartments in the starts, and to bad-quality seasonal adjustments. Apartments boosted December starts and lowered January starts, opposite the monthly changes in in new-home sales. Still, monthly changes in both series were statistically insignificant (see *Commentary No. 504* for reporting detail on January housing starts). The graph reflecting January 2013 existing-home sales also is included (see *Commentary No. 505* for detail). Note that all three graphs here (including existing-home sales) are expressed in monthly sales of thousands of units, rather than annualized rates of millions of units).

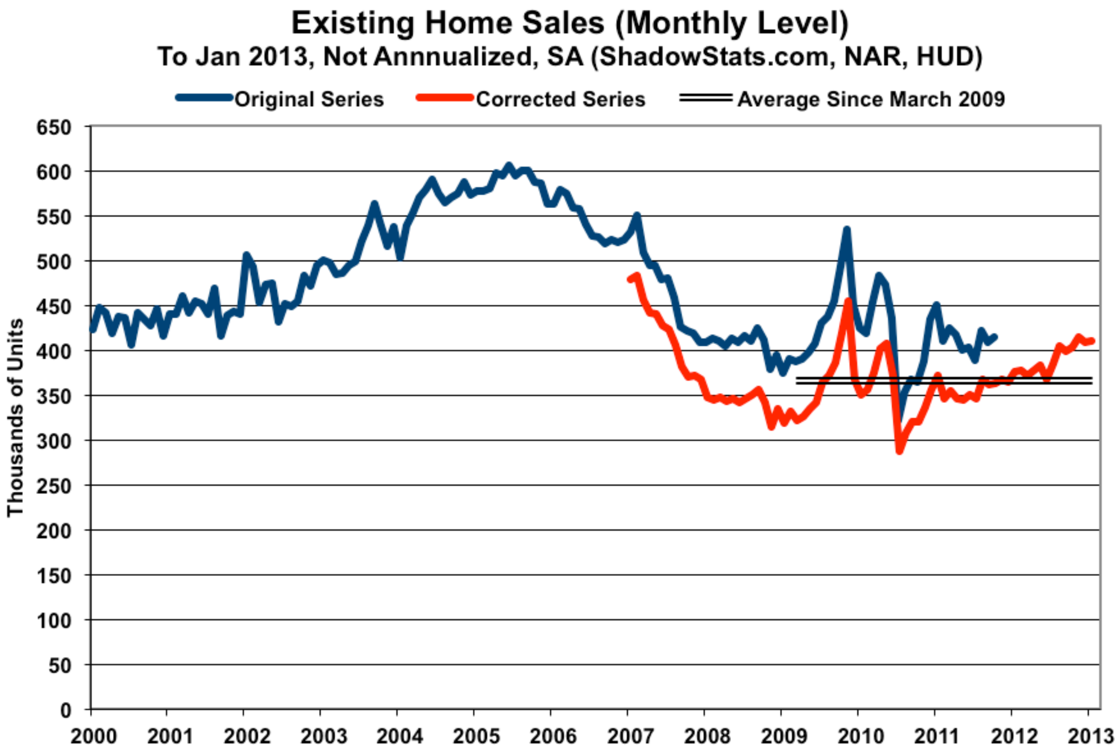
There have been no developments in underlying economic fundamentals that would suggest a pending housing-industry turnaround or broad economic recovery, as discussed in *No. 485: Special Commentary*.

January Reporting. The February 26th release of January 2013 new-home sales (counted based on contract signings, Census Bureau) showed a statistically-insignificant 15.6% month-to-month gain (up by 18.4% before prior-period revisions) +/- 22.1% (all confidence intervals are at the 95% level). Lack of statistical significance in month-to-month change for this series has been a common circumstance for more than three years. In turn, December's monthly contraction was revised to 3.8% (previously a 7.3% decline).

January's year-to-year gain of 28.9% +/- 25.4% in new-home sales was marginally statistically-significant. The December annual gain revised to a still-statistically-insignificant 11.5% (previously 8.8%). Volatility in annual change increasingly reflects the monthly volatility and instability in the series.


New Home Sales (Monthly Level)
To Jan 2013, Not Annnualized, SA (ShadowStats.com, Census)
Thousands of Units
0
20
40
60
80
100
120
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Housing Starts (Monthly Level)
2000 to Jan 2013, 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
2013



WEEK AHEAD

Weaker Economic and Stronger Inflation Data Are Likely. *Beyond the dissipating effects of the repair, replacement and reconstruction activity generated by Hurricane Sandy, and in anticipation of the likely negative impact of expanded QE3 and the ongoing fiscal crisis/debt-ceiling negotiations on the currency markets, reporting in the months and year ahead generally should reflect higher-than-expected inflation and indicate weaker-than-expected economic results. Increasingly, previously unreported economic weakness should continue to show up in prior-period revisions.*

Significant reporting-quality problems continue with most major economic series. Headline reporting issues remain 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 reported 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 by the Fed's monetary policies. The political system would like to see the issues disappear, and it still appears to be trying to work numerical slight-of-hand with series such as the GDP and related projections of the federal budget deficit. The media do their best to avoid publicizing unhappy economic news or, otherwise, they put a happy spin on the numbers. Pushing *the politicians and media, the financial markets and related spinmeisters 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* Hyperinflation 2012 *and* No. 485: Special Commentary.

Construction Spending (January 2013). Due for release on Friday, March 1st, by the Commerce Department, January construction may have backed off a little from an unseasonably-mild-weather boost in December. Net of any short-term storm-recovery impact from Hurricane Sandy, and catch-up from mild-weather impact, the basic trend in this series should continue in stagnation, particularly after adjustment for inflation. As usually is the case, reported monthly changes are not likely to be statistically significant.

U.S. Trade Balance (January 2013). The January trade deficit detail is scheduled for release on Thursday, March 7th. With the U.S. trade deficit continuing in fundamental deterioration, the January numbers are at fair risk of showing a sharp deterioration versus the existing December deficit estimate.

Any significant narrowing or widening of the January trade deficit—beyond developing market expectations of some widening—would tend to boost or impair the outlook for expectations of first-quarter 2013 GDP growth. In like manner, any significant revision to the December trade numbers would impact the next revision to fourth-quarter 2012 GDP.

Employment and Unemployment (February 2013). The February labor data are due for release on Friday, March 8th, from the Bureau of Labor Statistics (BLS). Most commonly, the consensus jobs estimate settles around the trend estimate that comes out of the BLS seasonal-adjustment models. The February 2013 payroll trend number is for a 158,000 jobs gain, as discussed in in *Commentary No. 499*, and the early consensus appears to be settling in around that number, not much changed from January's headline gain of 157,000. The markets appear to be expecting the unemployment rate to hold at the 7.9% headline U.3 number of January 2013.

Where underlying fundamental economic activity remains weaker than consensus, the employment and unemployment numbers should be weaker than market expectations, perhaps within the usual reporting-error margin of zero +/- 129,000 jobs for payrolls. The unemployment rate should move higher, but as discussed frequently with this series (see *Commentary No. 451* and *Commentary No. 487*, for example), the month-to-month comparisons of the unemployment data cannot be compared legitimately, where the headline change in rate is of no meaning, other than in misguided-media and market reactions to same. Specifically, the all the recent historical unemployment rates are re-calculated each month as part of the concurrent seasonal adjustment process, but where the BLS publishes the new headline unemployment rate, it does not publish and does not make available the revised number from the month before.

