

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

COMMENTARY NUMBER 512
Budget Proposals, Industrial Production Revisions,
Monetary Base and Existing Home Sales

March 25, 2013

Revised Industrial Production Shows Somewhat Shallower “Recovery”

Suggestions of Downside Revisions in Headline GDP Growth
From Third-Quarter 2010 to Date

Signs of Mounting Stress in Existing Home Sales

PLEASE NOTE: The next regular Commentary is scheduled for Thursday, March 28th, covering the third estimate of fourth-quarter 2012 GDP, February new orders for durable goods and February new home sales.

Best wishes to all — John Williams

Opening Comments and Executive Summary. All is not right with the global financial system, as seen quite openly with the Cyprus crisis and its aftershocks. More-subtle evidence can be seen domestically, whether it is in mounting distressed and all-cash existing-home sales, or in softening money-supply growth in the face of expanded Federal Reserve easing and a rapidly spiking monetary base. Combine that circumstance with what soon should be a refocusing of global financial markets on U.S. sovereign-solvency issues and a renewed U.S. economic downturn, and the ingredients are in place for disorderly financial markets, including a run against the U.S. dollar.

On the fiscal front, last week, both Houses of Congress put forth ten-year budget-proposal outlines that were well shy on detail. At least moving in the needed fiscal direction, the ten-year plan by the Republican-controlled House proposed to balance the cash-based federal deficit, as well as to address issues related to unfunded liabilities. The plan put forth by the Democrat-controlled Senate did not propose to balance even the cash-based deficit.

Given continued political contentiousness, and the use of overly-optimistic economic assumptions to help the budget projections along, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of pending negotiations. With these issues now scheduled to come to a head in April or May, there still appears to be no chance of a near-term substantive, budget-balancing agreement. Risks are increasing for the global-financial markets to take up the cause for U.S. fiscal prudence.

On the economic front, the annual benchmark revision to industrial production showed activity to have been weaker than previously reported, since 2010. The revised numbers are suggestive of pending downside revisions to headline GDP growth of recent years, when the grand revision to historical GDP data is published on July 31st. The production revisions are detailed in this *Opening Comments* section.

The pattern of activity in existing home sales has trended higher in recent months, but the headline 0.8% monthly gain in February sales was within the normal scope of volatility and instability in this series. The February numbers suggested increasing economic and banking-system stress, with a sharp increase the portion of sales that were distressed and/or that were all-cash. Existing home sales specifics are found in the *Reporting Detail* section.

Discussed and graphed in the *Hyperinflation Watch* section, the monetary base keeps jumping to successive record highs with each passing two-week reporting period.

Industrial Production Benchmark Revision. The revisions to the index of industrial production indeed suggested that recent economic activity was weaker than previously reported, particularly in 2011 and 2012. The level of production now is estimated as slightly higher coming into the 2007 economic peak, before the business crash, and also slightly higher at that trough in 2009 and into 2010. Based on the new accounting for the 2011 surveys of manufacturers and mining, however, growth in 2011 and 2012 was slower than previously reported, as reflected in the accompanying graphs.

The timing of the great downturn was not altered, but the peak-to-trough decline, from December 2007 to June 2009 was revised to a contraction of 16.92%, from the prior estimate of a 17.66% drop.

Downside GDP Revisions. In terms of annualized quarterly growth, a general effect of the revisions was an indication that nine-out-of-ten quarters of GDP growth, including and subsequent to third-quarter 2010, through fourth-quarter 2012, face downside revisions to their headline growth rates; second-quarter 2012 is the exception.

Of the four preceding quarters in the “recovery” period, from third-quarter 2009 to second-quarter 2010, three of the four face upside revisions to headline GDP growth; third-quarter 2009 is the exception.

These revisions were inconsistent with the patterns seen the upside February benchmark revisions to payroll employment, but the production numbers likely will be confirmed by the still pending annual revisions to retail sales and new orders for durable goods, and ultimately with the recasting of the GDP reporting in July.

Revised February 2013 Monthly Reporting. Following the March 22nd benchmark revisions to the industrial production series, the revised headline, seasonally-adjusted monthly gain for February 2013 production was 0.75% (previously 0.71%), versus 0.15% (previously 0.05%) in January 2013, and against 0.14% (previously 0.27%) in December 2012. The revisions to annual growth were to the downside, with revised year-to-year gains of 2.46% (previously 2.52%) in February 2013, 2.19% (previously 2.28%) in January 2013 and 2.76% (previously 2.93%) in December 2012.

Industrial Production Graphs. Beyond the new surveys of manufacturing and mining, the benchmark revision included methodological changes and revised seasonal-adjustment factors. While the revisions purportedly were 1972 to date, the entire series back to 1919 was revised somewhat lower. That was an artifact of having the official index base-period of 2007 = 100 in the middle of the revisions. When the index period is revised, before and after graphs using the same index base are not comparable. That circumstance has been adjusted for in the graphs here.

Two sets of graphs follow that reflect the benchmark revisions. In the first set, official industrial production activity is shown in terms of index level; the second graph reflects year-to-year change. Revised reporting is shown as the red line, against the black line of the previous estimates.

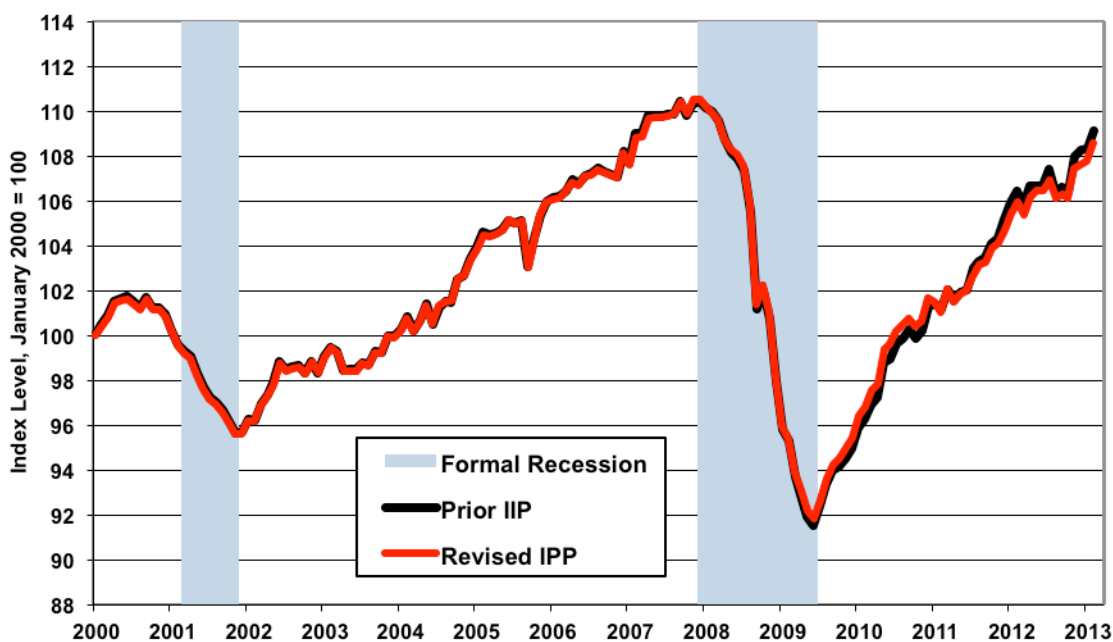
Please note that in the first graph of index level, the index is set to January 2000 = 100 for the revised series (official reporting is with an index of 2007 = 100), the patterns shown here are identical, irrespective of index base, with the old series shown at a level that is corrected for the index inconsistencies discussed earlier.

The second set of two graphs reflects the first two graphs, corrected for inflation problems. Here the revised reporting is shown as the blue line, against the black line of the previous estimates.

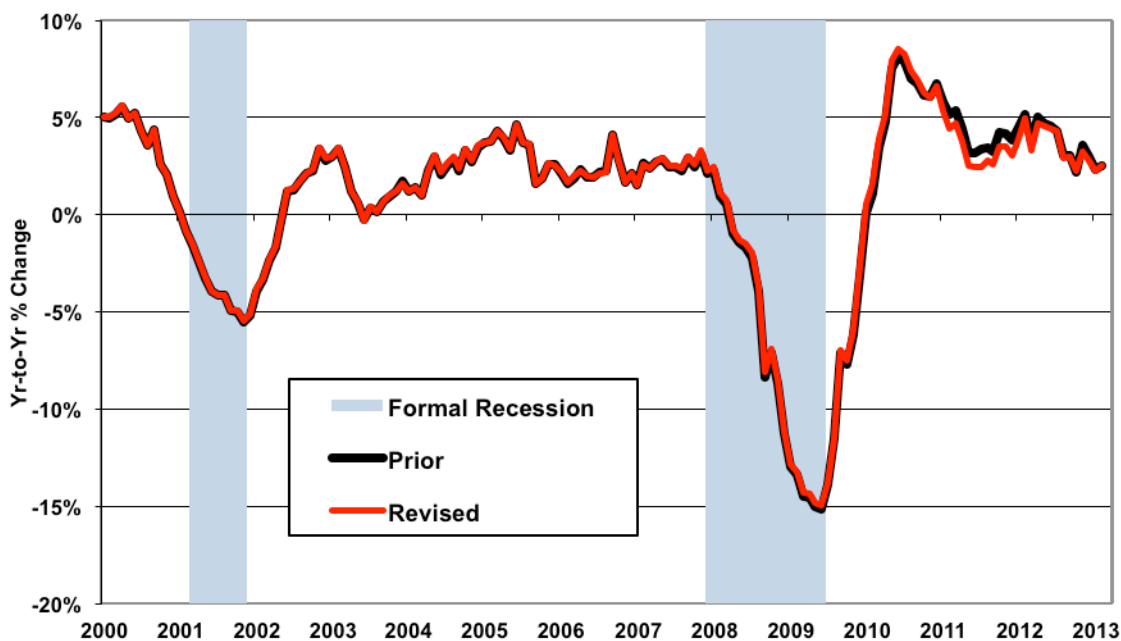
Hedonic quality adjustments understate the inflation used in calculating components of industrial production, with the effect of overstating the inflation-adjusted growth reported in the headline industrial production series (see [Special Commentary \(No. 485\)](#) and [Public Comment on Inflation](#)). This second set of graphs reflects corrected versions of the first, with estimated hedonic-inflation adjustments backed-out of the official deflator. The “corrected” first graph of index level still shows some growth in the period following the official June 2009 near-term trough in production activity. Yet, that upturn has been far shy of the full recovery reported in the GDP and now appears to be flatter than it was before.

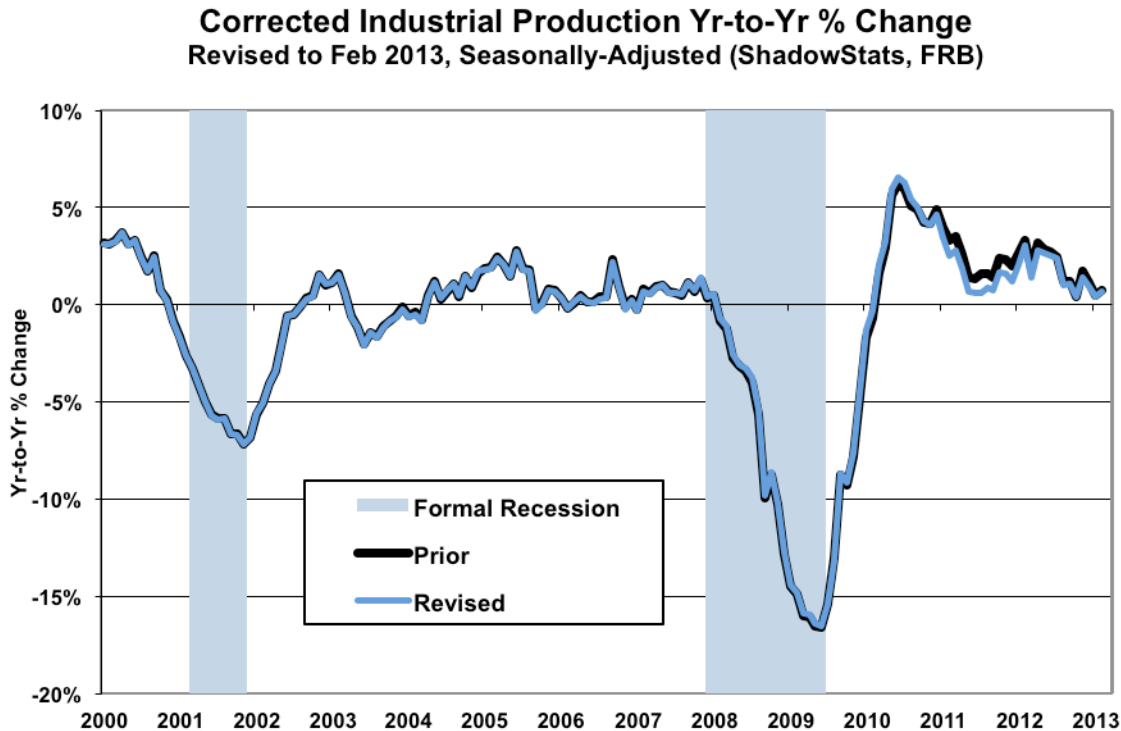
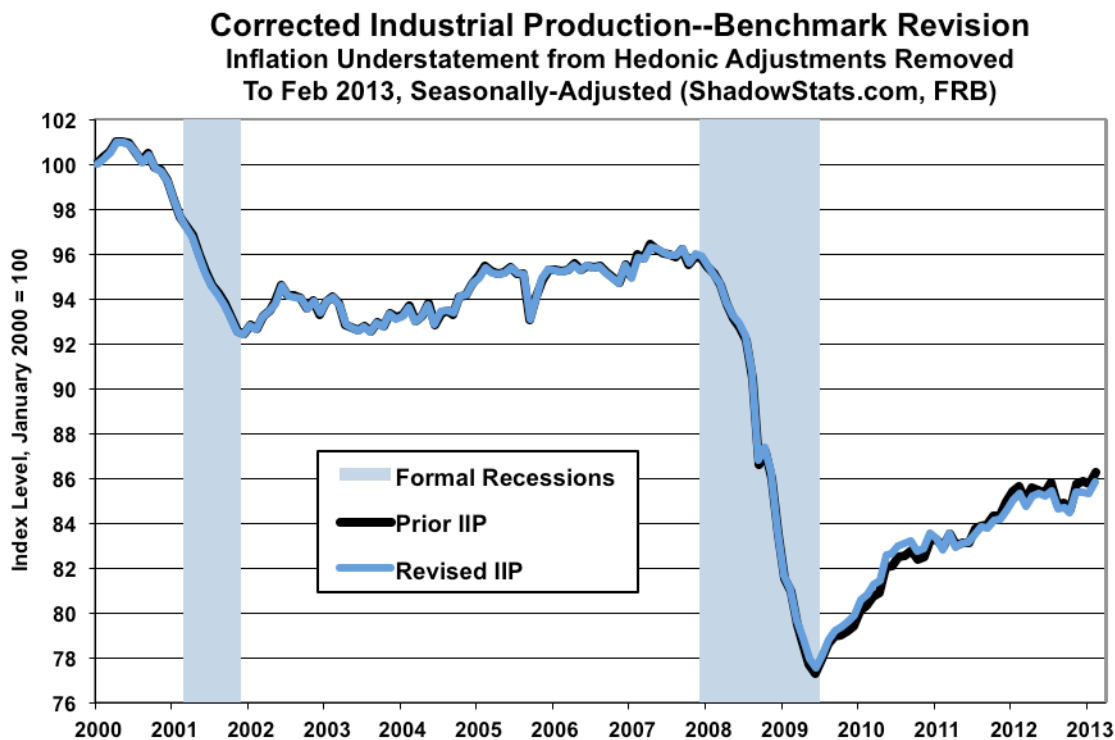
Unlike the GDP, production levels have not regained pre-recession highs (even uncorrected), but, instead, entered a period of protracted low-level stagnation in 2012, with a new quarterly contraction in third-quarter 2012, followed by continued bottom-bouncing.

Index of Industrial Production--Benchmark Revision
To Feb 2013, Seasonally-Adjusted (ShadowStats.com, FRB)



Industrial Production Year-to-Year % Change--Revised
To Feb 2013, Seasonally-Adjusted (ShadowStats.com, FRB)



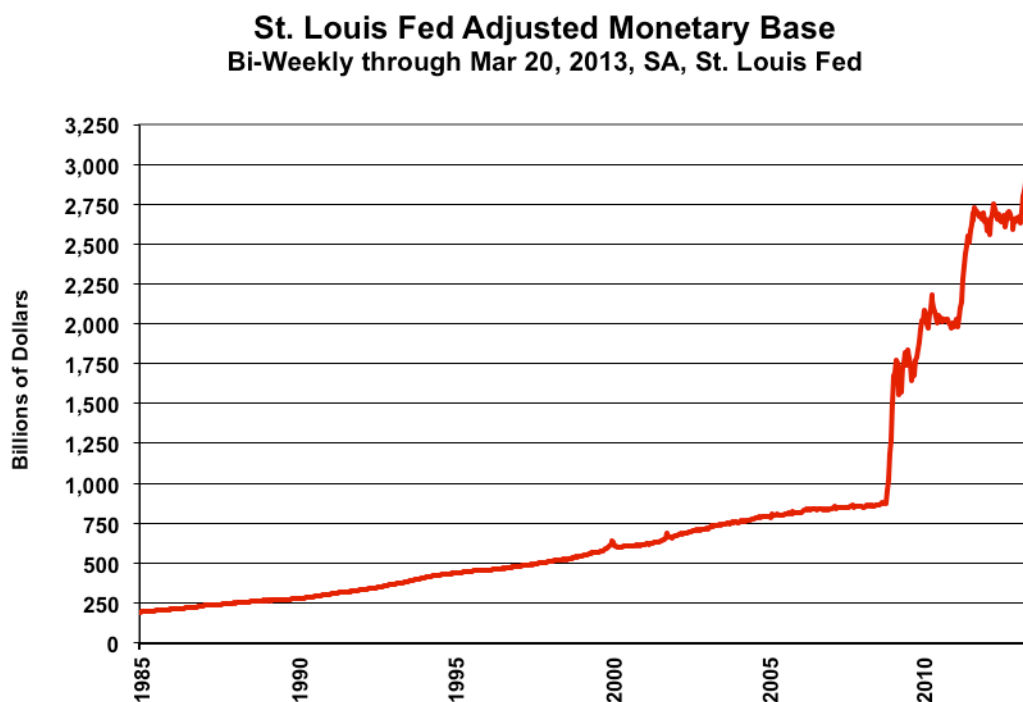


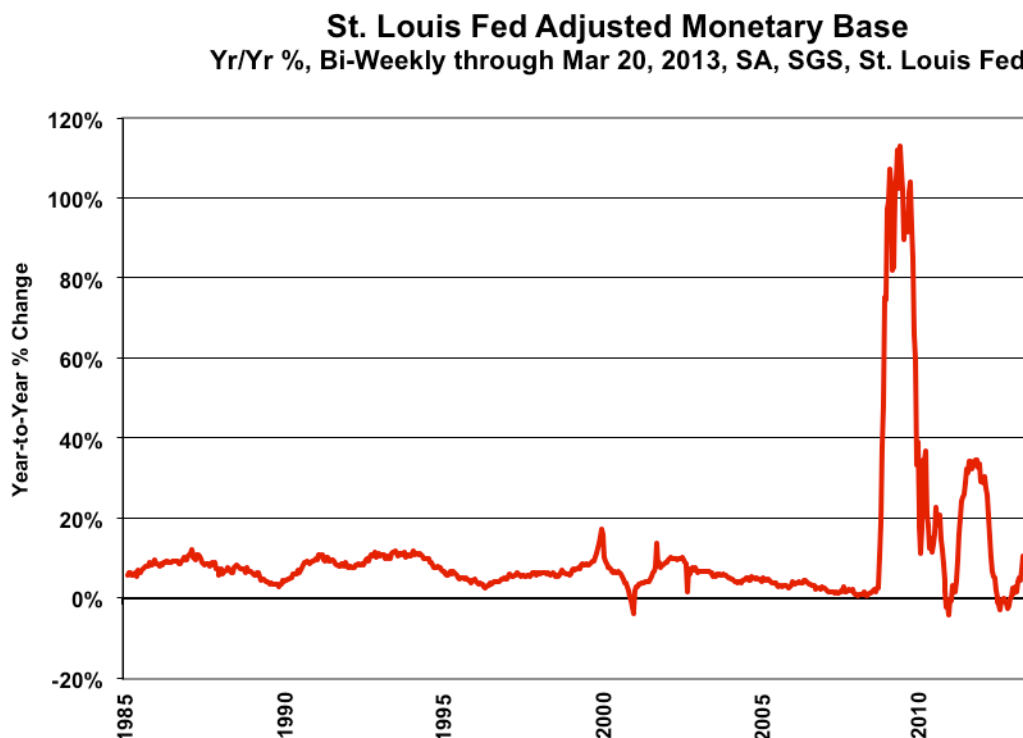
[Details on the February existing home sales are found in the Reporting Detail section.]

HYPERINFLATION WATCH

Monetary Base. Reflecting the active and expanded quantitative easing (QE3) by the Federal Reserve, the monetary base continues to soar to successive new highs, as shown in the accompanying graphs, updated through March 20th.

The monetary base is currency in circulation (part of M1 money supply) plus bank reserves (not part of the money supply) (see a more-complete definition in the [Money Supply Special Report](#)). Banks are parking their excess reserves with the Federal Reserve, not lending the available cash into the normal flow of commerce. When the Fed monetizes U.S. Treasury securities, as it has been doing, that usually adds directly to the broad money supply, and it contributes to selling pressure against the U.S. dollar. Faltering money supply growth in this circumstance, which appears to have continued in March, tends to indicate mounting systemic stress in the banking industry.





Hyperinflation Outlook—Updated. Updated primarily to reflect recent federal-budget developments, as covered in the underlined text below, this summary otherwise is as published in March 15th's [*Commentary No. 510*](#). It is intended for new subscribers and for readers looking for a condensed version of the broad outlook or 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 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 April.

Nothing is normal: not the economy, not the financial system, not the financial markets and not the political system. The system remains still in the throes and aftershocks of the 2008 panic and the near-systemic collapse, and from the ongoing responses to same by the Federal Reserve and federal government. Further panic is possible and hyperinflation is inevitable.

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, given the nature of official reporting, the renewed downturn likely will gain recognition as the second-dip in a double- or multiple-dip recession.

Indeed, what continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 turmoil. 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 [of [Commentary No. 505](#)], hoopla to the contrary in the popular press, that the Fed might pull-back on its “easing,” most likely was designed to help jawbone and firm-up the U.S. dollar and to soften gold in the immediate period running up to the imminent 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 system. Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Nonetheless, the Fed’s easing moves appear to have been an ongoing effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury. Mounting signs of intensifying stress also are seen in the global banking system, as reflected in the ongoing Cyprus crisis.

Both Houses of Congress recently put forth outlines of ten-year budget proposals that are shy on detail. The ten-year plan by the Republican-controlled House proposes to balance the cash-based deficit as well as to address issues related to unfunded liabilities. The plan put forth by the Democrat-controlled Senate does not look to balance the cash-based deficit. Given continued political contentiousness and the use of positive economic assumptions to help the budget projections along, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of upcoming negotiations. With these issues slated to come to a head now in April or May, there still appears to be no chance of a substantive agreement.

Indeed, 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. Chances also remain nil for the government fully addressing the GAAP-based deficit that hit \$6.6 trillion in 2012, let alone balancing the popularly-followed, official cash-based accounting deficit that was \$1.1 trillion in 2012 (see [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 time largely has run out and 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 catastrophe, in combination with the Fed’s direct monetization of Treasury debt, eventually (more likely sooner rather than later) 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

EXISTING-HOME SALES (February 2013)

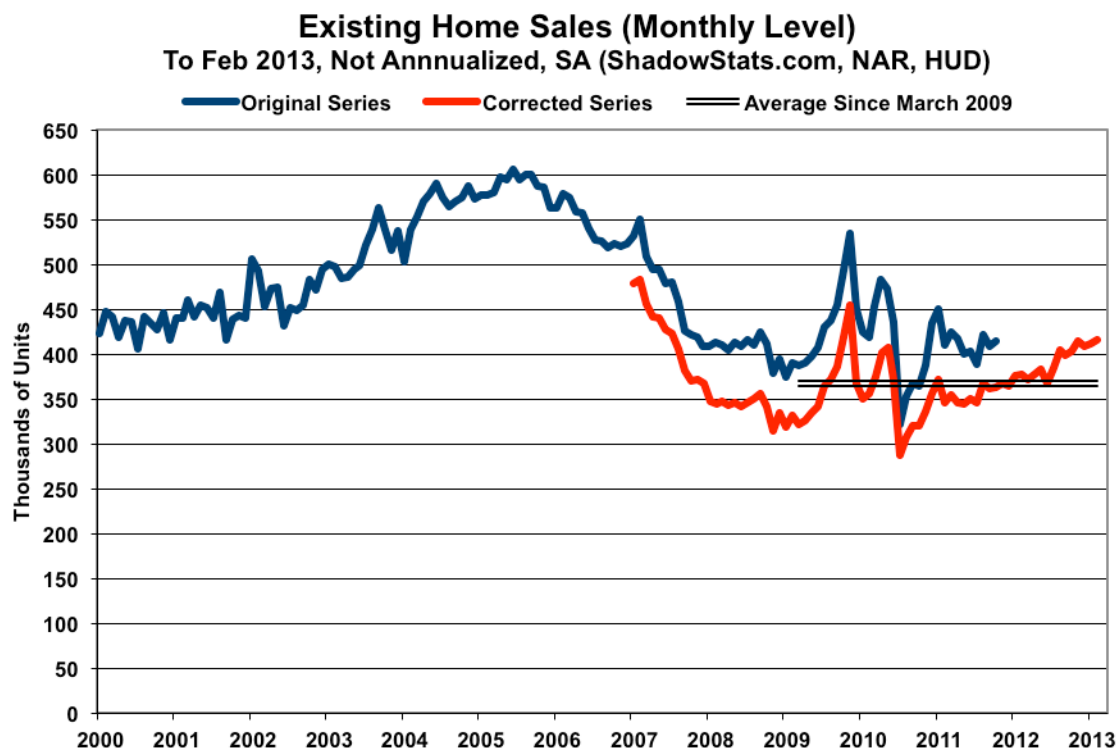
Increased Distressed and All-Cash Activity in February Existing-Home-Sales Gain of 0.8%. The pattern of activity in existing home sales has trended higher in recent months, but the pattern is not outside the normal irregularity and instabilities inherent in the series. The headline 0.8% gain in February followed a similar gain in January. The February sales data, however, reflected sharp increases in the portion of sales that were distressed and/or that were all-cash, suggestive of continuing stress among the home-selling public and in the banking system.

February 2013 Existing Home Sales Reporting. The March 21st release of February 2013 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly gain of 0.8% (a gain of 1.2% before prior-period revisions). February's 0.8% sales gain to a seasonally-adjusted monthly-unit sales pace of 415,000 (an annualized pace of 4,980,000), was well within the normal month-to-month volatility for this series. The monthly change in January 2012 sales was a revised increase of 0.8% (previously a gain 0.4%).

On a year-to-year basis, February 2013 sales rose by 10.2%, versus a revised 9.5% (previously 9.1%) annual gain in January. Smoothed for irregular distortions, the series remains statistically consistent with an ongoing pattern of broad stagnation.

The portion of distressed properties in existing sales increased in the latest reporting. The NAR estimated “distressed” sales in February 2013 were at 25% (15% foreclosures, 10% short sales), versus 23% (14% foreclosures, 9% short sales) in January. Reflecting ongoing lending issues within the banking industry, the NAR also estimated that all-cash sales in February were 32% of the total, up sharply from 28% in January.

The published median and average sales price data for existing homes tend to be of limited usefulness, since they can reflect shifting patterns of home buying—between differently-priced segments—more than they do changes in truly comparative prices. That said, both median and mean existing-home sales prices in February 2013 (not seasonally-adjusted) were up month-to-month as well as year-to-year.



Beyond the massive downside corrections to the existing-home sales series—published with November 2011 data—reporting for the existing-home sales series remains subject to a high level of irregular volatility and 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. The monthly variability also has been exacerbated by the introduction of various government tax-incentive programs and expiration of same.

The horizontal line in the graph is the average monthly level for the period of extreme sales volatility. With those sales swings, averaged out, the pattern of activity resembles the bottom-bouncing seen previously in the new-home sales and in housing-starts activity (see [Commentary No. 511](#)), although the existing home sales peak-to-trough contraction never was as severe as that seen in the sales tied to new construction.

WEEK AHEAD

Weaker Economic and Stronger Inflation Data Should Surface in the Near-Term. Reflecting structural liquidity constraints on the consumer, and in anticipation of the likely negative impact, of expanded QE3 and the still-ongoing fiscal crisis/debt-ceiling negotiations, on the U.S. dollar in the currency markets,

reporting in the months and year ahead generally should reflect higher-than-expected inflation and weaker-than-expected economic results. Increasingly, previous estimates of economic activity should revise lower, particularly in upcoming annual benchmark revisions for industrial production (March 22nd—back to 1972), retail sales (May 31st) and GDP (July 31st—comprehensive overhaul back to 1929).

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](#).

New Orders for Durable Goods (February 2013). The reporting of February 2013 new orders for durable goods is scheduled for Tuesday, March 26th, by the Census Bureau. Despite the sharp and irregular volatility in commercial aircraft orders, new orders have been trending lower. That trend likely will continue, with a general intensification of downside movement in orders for at least the next several months.

In terms of the potential inflation contribution to the monthly and annual change in new orders, the seasonally-adjusted, month-to-month increase in the February 2013 PPI finished goods capital equipment index was 0.1%, with year-to-year unadjusted inflation at 0.9%. 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 (February 2013). The February new-home sales report from the Census Bureau also is due for release on Tuesday, March 26th. As with February existing home sales (see *Reporting Detail*) and housing starts (see [Commentary No. 511](#)), an entrenched pattern of stagnation likely has continued in the series, with the pending report of monthly change in sales activity not likely to be statistically-significant.

Gross Domestic Product—GDP (Fourth-Quarter 2012, Third Estimate, Second Revision). The third estimate (second revision) of fourth-quarter 2012 GDP growth is due for release by the Bureau of Economic Analysis (BEA) on Thursday, March 28th. The just-released downside revisions to industrial production activity for 2011 and 2012 are solid indicators of pending downside revisions to GDP in recent

years, including to fourth-quarter 2012. Those revisions, however, loom in the grand restatement of GDP activity back to 1929 to be published in the July 31st annual revisions to the series. The second revision to fourth-quarter GDP on March 28th reporting should not be affected significantly by the new data.

Market expectations appear to be settling around a fairly large upside revision for a third estimate, somewhere around three or four tenths of a percentage point, following an “advance” estimate of an annualized, quarterly inflation-adjusted contraction of 0.1%, and a second estimate of a 0.1% gain. There just is not that much obvious new information to support that type of upside revision. Separately, the economy appears already to have turned down, where a second- or third-quarter 2012 contraction in GDP actually could surface in the July 2013 annual GDP revisions, marking the onset of a formal second-dip in a double-dip recession.

Irrespective of the GDP reporting, initial estimates for fourth-quarter growth in GDP surrogates, gross domestic income (GDI) and gross national GNP, will be published with this release. GDI is the theoretically-equivalent income-side measure to the GDP’s consumption-side measure. The GNP is the broadest economic measure, where GDP is GNP net of the trade balance in factor income, such as interest-rate and dividend payments. In recent years, reported growth rates in both GDI and GNP have tended to be weaker than growth in GDP. Whatever is reported, the latest numbers most certainly still will not be statistically significant, with the GDP series generally remaining the most worthless, the most heavily politicized and the most misleading of any major government economic statistical release.
