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

COMMENTARY NUMBER 513
Individual Income and Investments,
GDP Revision, February Durable Goods Orders and New Home Sales

March 28, 2013

Even the Modest Headline CPI-U Inflation Is Troubling for
Flagging Personal Income and Investments

Fourth-Quarter GDP Estimates Remained Statistically Insignificant

Patterns of Low-Level Stagnation Continued in
Durable Goods Orders and New Home Sales

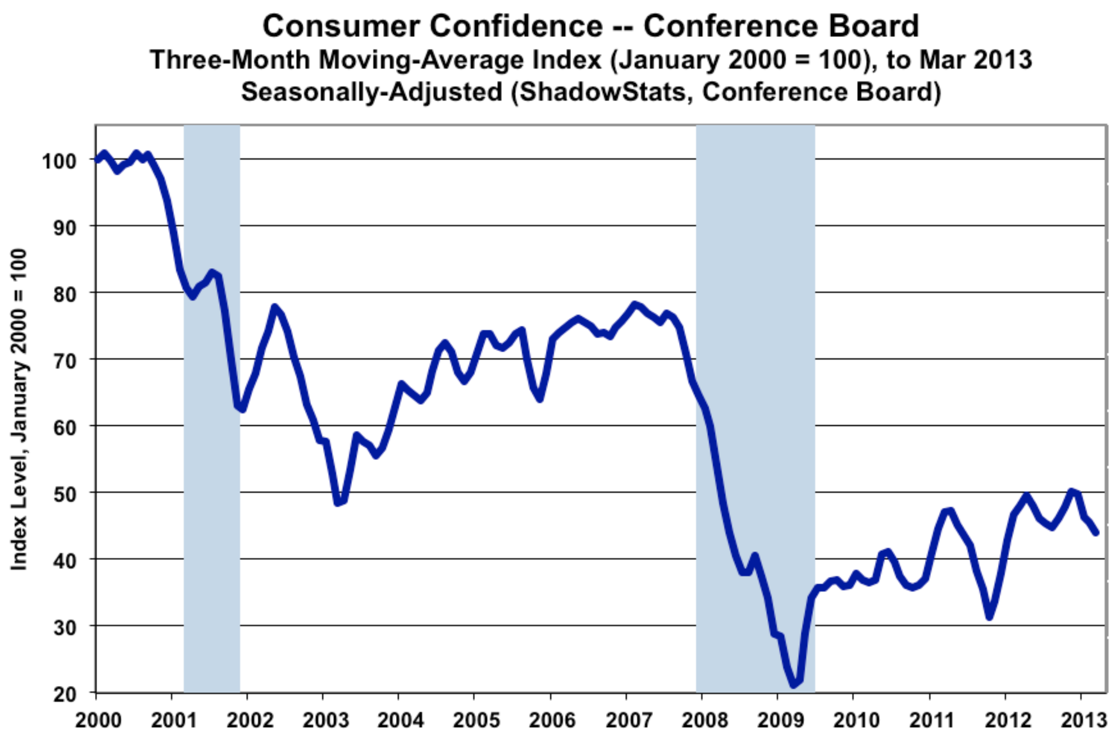
PLEASE NOTE: The next regular Commentary *is scheduled for Friday, April 5th, covering March employment and unemployment, February construction spending and the trade deficit.*

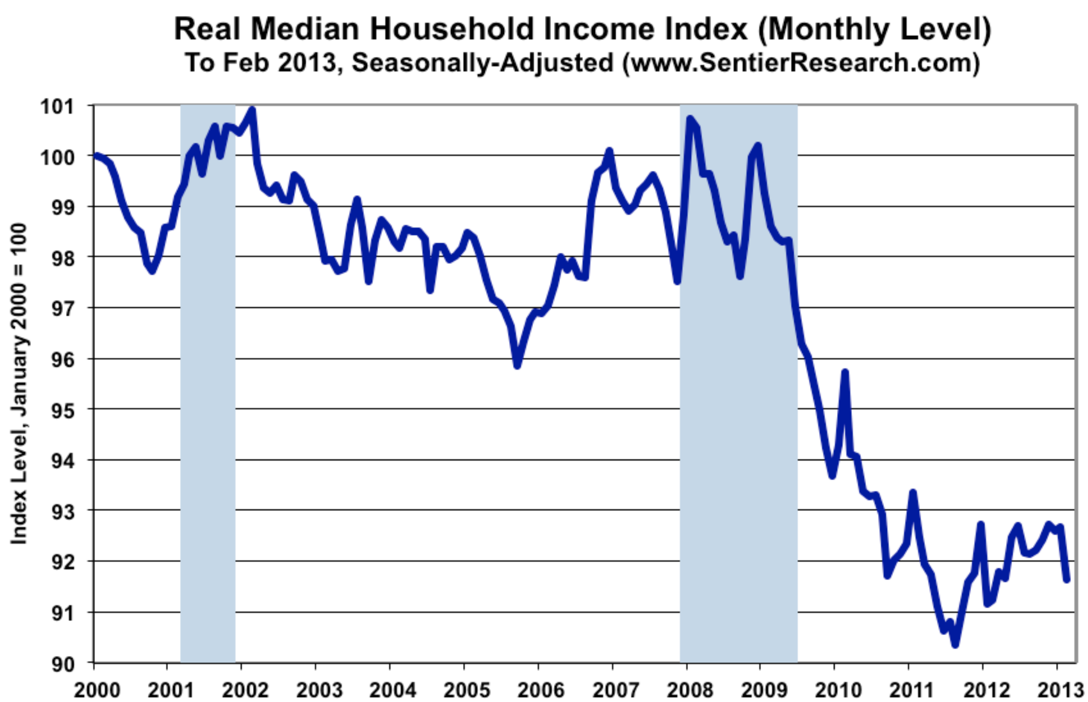
Best wishes to all — John Williams

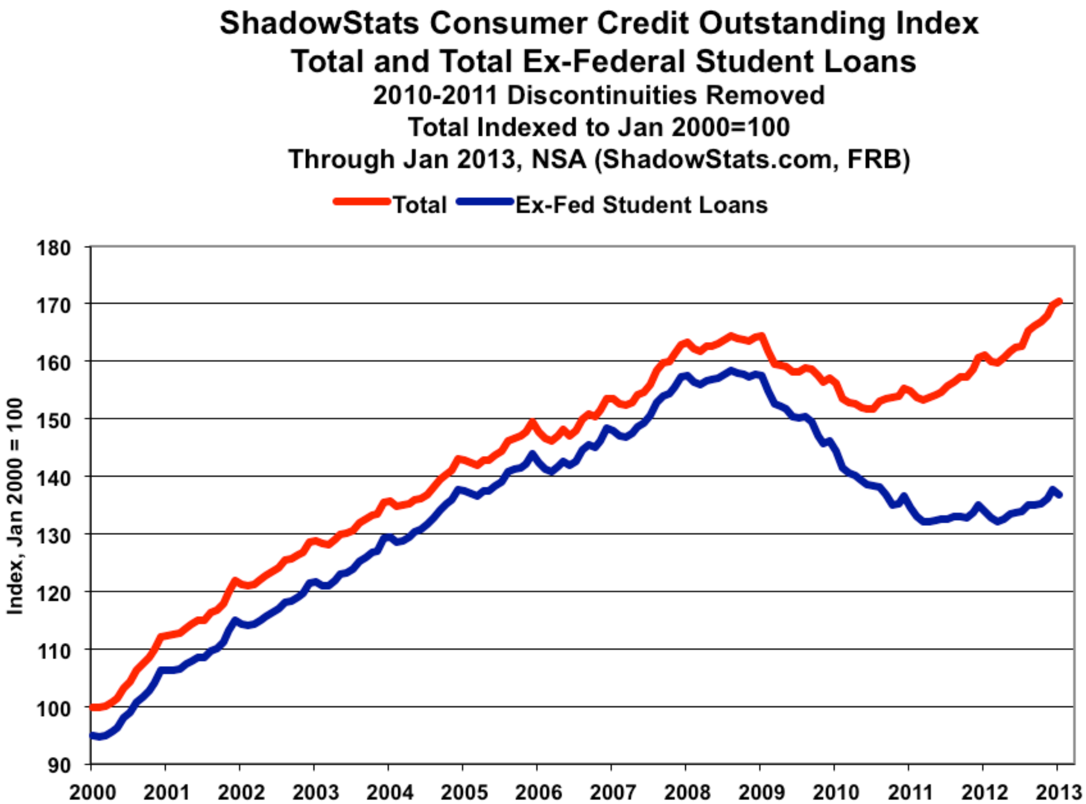
OPENING COMMENTS AND EXECUTIVE SUMMARY.

Consumer and Investor Problems. The *Opening Comments* section focuses first on the intensifying liquidity and investment crises for individuals in the United States, with a series of updated and new graphs. The latest economic numbers are covered in the latter portion of this section.

The first three graphs following show consumer confidence updated to March, household income updated to February and consumer credit outstanding as last published for January.


Consumer Confidence -- Conference Board
Three-Month Moving-Average Index (January 2000 = 100), to Mar 2013
Seasonally-Adjusted (ShadowStats, Conference Board)
Index Level, January 2000 = 100
100
90
80
70
60
50
40
30
20
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Real Median Household Income Index (Monthly Level)
To Feb 2013, Seasonally-Adjusted (www.SentierResearch.com)
Index Level, January 2000 = 100
101
100
99
98
97
96
95
94
93
92
91
90
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013

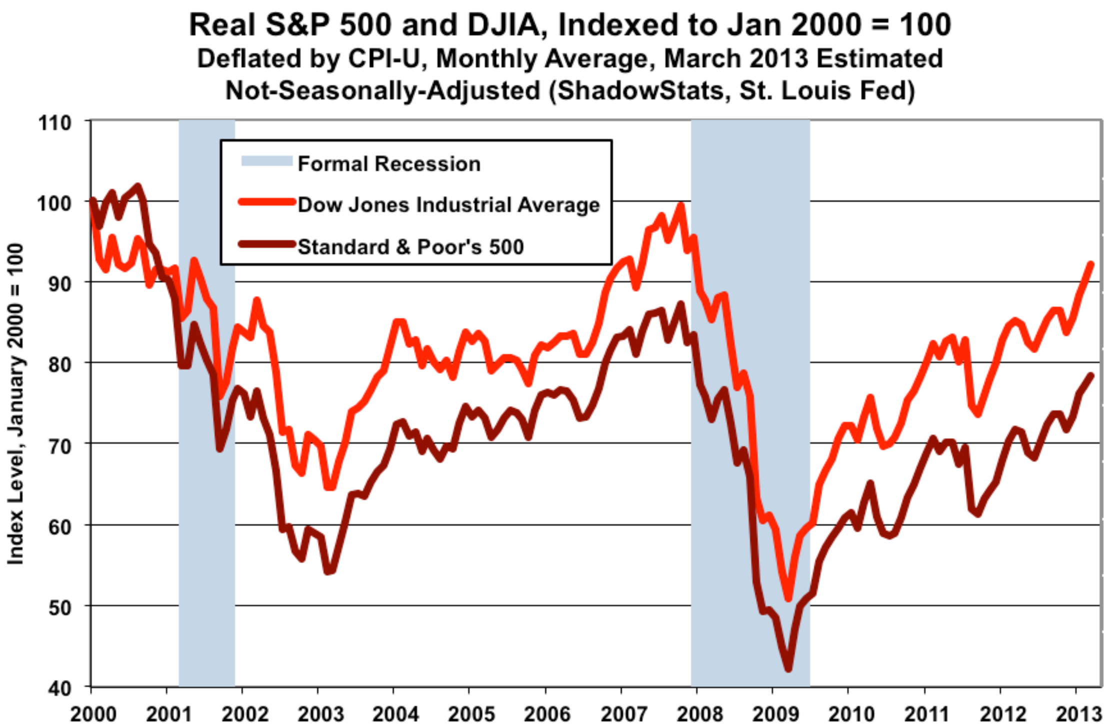


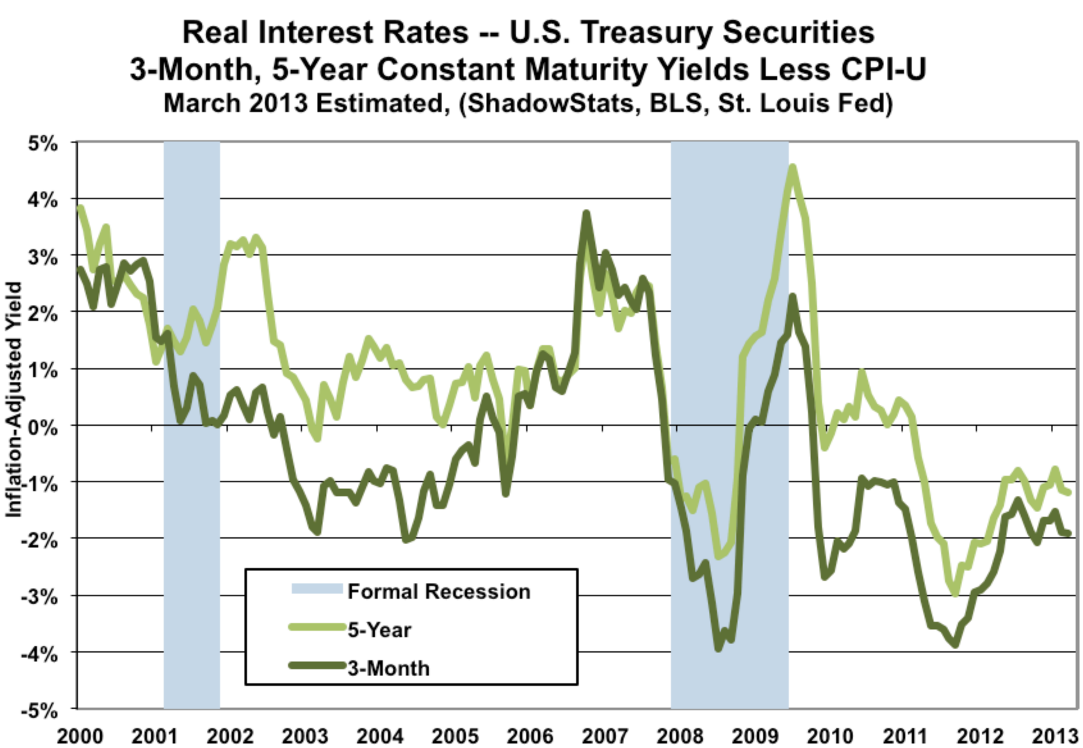
The consumer confidence and household income numbers have just been updated, and both series have turned sharply lower in the latest monthly reporting. The confidence numbers are shown smoothed with a three-month moving average through March 2013. That series continues to reflect no economic recovery. Although it is off bottom, confidence remains at levels seen only during the depths of the worst post-World War II recessions.

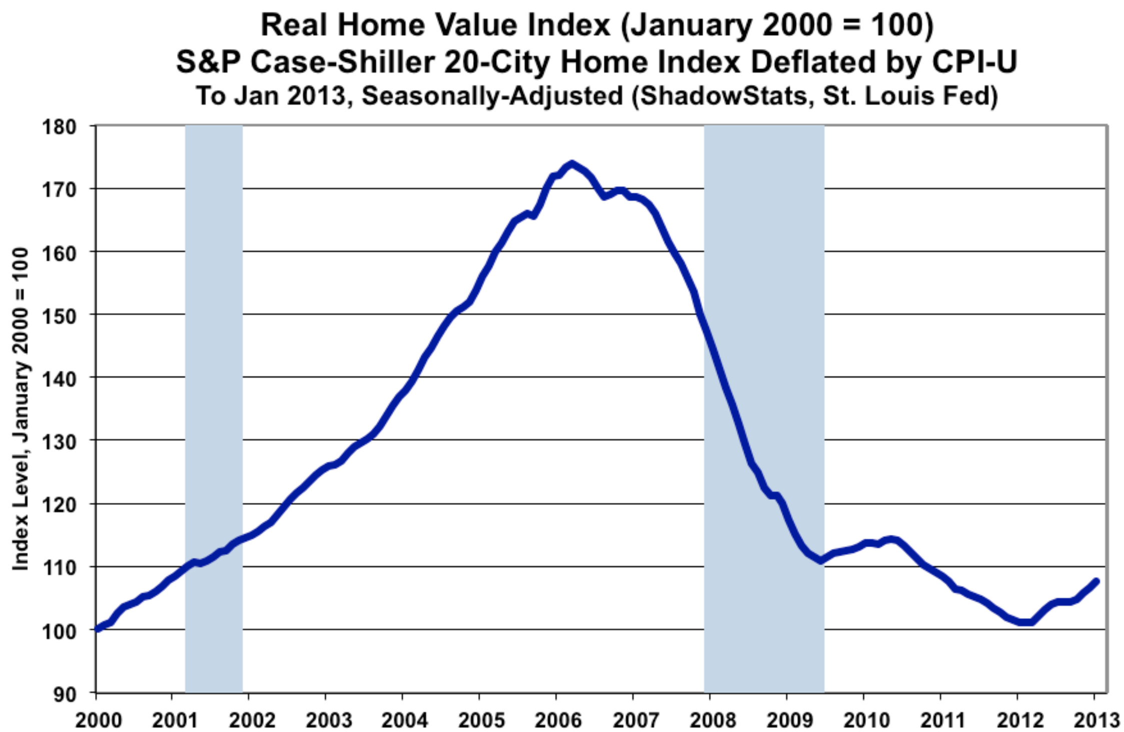
Real (adjusted for CPI-U inflation) median household income fell sharply in February 2013, reflecting both lower income and gasoline-spiked inflation. Allowing for normal series volatility, income is at or near the low of its cycle. Without real growth in income, and without the ability to expand credit, the consumer cannot fuel a sustainable recovery in consumption. The consumer-credit outstanding graph reflects limited credit, where nearly all post-2008 Crisis growth has been just in Federal student loans.

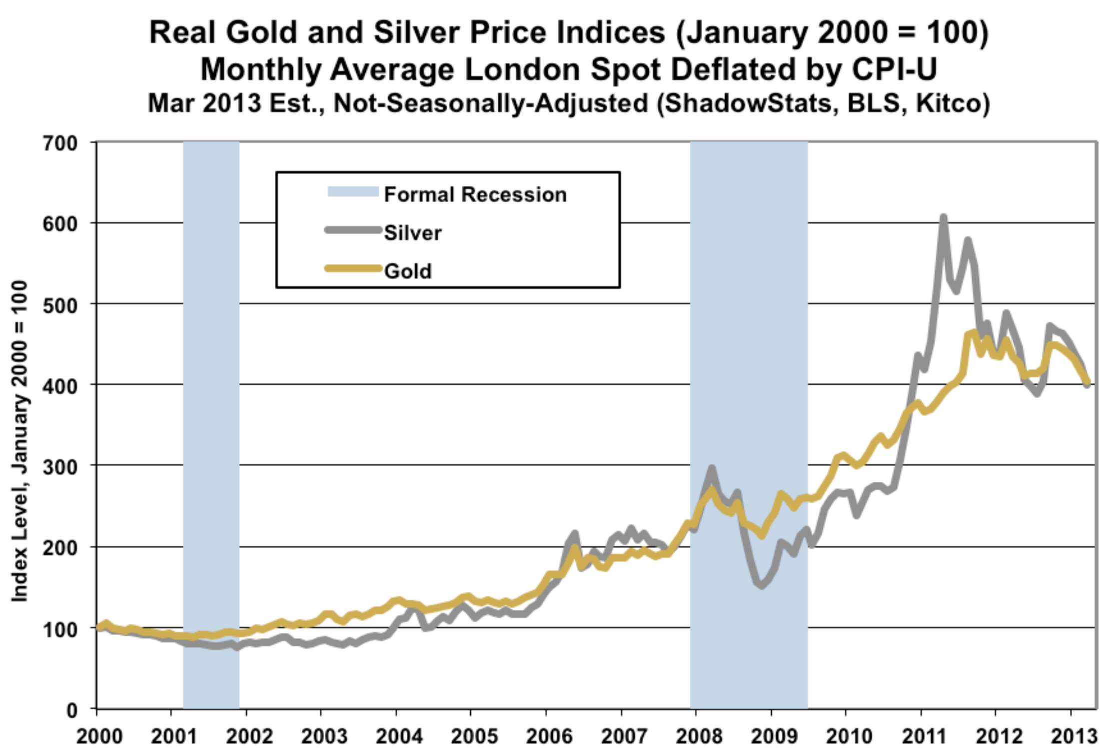
The next four graphs suggest that individuals in the U.S. have not been able to get adequate or safe "traditional" investment returns that beat even the government's modest and understated headline inflation measure, the CPI-U. The first graph shows CPI-U-adjusted levels of the S&P 500 and Dow Jones Industrial Average, which are down from January 2000 and have yet to hit their real (inflation-adjusted) prior highs.

The second graph shows the "safe" three-month Treasury bill and five-year Treasury note constant-maturity yields. Net of CPI-U inflation, current yields are negative. With long-term interest rates likely to move much higher in the next year, longer-term maturities face considerable downside pricing risk.


Real S&P 500 and DJIA, Indexed to Jan 2000 = 100
Deflated by CPI-U, Monthly Average, March 2013 Estimated
Not-Seasonally-Adjusted (ShadowStats, St. Louis Fed)
Formal Recession
Dow Jones Industrial Average
Standard & Poor's 500
Index Level, January 2000 = 100
110
100
90
80
70
60
50
40
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Real Interest Rates -- U.S. Treasury Securities
3-Month, 5-Year Constant Maturity Yields Less CPI-U
March 2013 Estimated, (ShadowStats, BLS, St. Louis Fed)
Inflation-Adjusted Yield
5%
4%
3%
2%
1%
0%
-1%
-2%
-3%
-4%
-5%
Formal Recession
5-Year
3-Month
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Real Home Value Index (January 2000 = 100)
S&P Case-Shiller 20-City Home Index Deflated by CPI-U
To Jan 2013, Seasonally-Adjusted (ShadowStats, St. Louis Fed)
Index Level, January 2000 = 100
180
170
160
150
140
130
120
110
100
90
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Real Gold and Silver Price Indices (January 2000 = 100)
Monthly Average London Spot Deflated by CPI-U
Mar 2013 Est., Not-Seasonally-Adjusted (ShadowStats, BLS, Kitco)
Index Level, January 2000 = 100
Formal Recession
Silver
Gold
700
600
500
400
300
200
100
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013

The third graph uses the Stand & Poor's Case-Shiller Home Index, deflated by the CPI-U, as a surrogate for relative home values. Despite the boom into 2006, prices are now much closer to 2000, although moving somewhat higher again.

Nonetheless, with broad weakness in the economy and incomes, standard investments have not been able to keep up with official CPI-U inflation, currently at 2.0%. The circumstance looks much worse, when viewed from the standpoint of more realistic, higher inflation, where, for example the ShadowStats alternate inflation measures currently stand at 5.4% (1990-based) and 9.6% (1980-based).

The circumstance will tend to deteriorate, as inflation is pushed higher from likely near-term weakness in the U.S. dollar, which will spike oil, gasoline and other commodity prices. The happier, strong-economic-demand-induced type of inflation is not a realistic risk for some time.

In this troubled environment of the last decade or so, however, precious metals have done well. As shown in the fourth and final graph of the preceding series, gold and silver prices (again deflated by headline CPI-U) are up about 300% since the beginning of 2002, even though they are off their highs.

All the preceding graphs have been indexed to January 2000 = 100, for purposes of ease of comparison. Where a series has been deflated for inflation, the government's official CPI-U has been used.

Economic Reporting. The revised 0.38% headline growth for the third-estimate of fourth-quarter 2012 GDP generally was statistical noise, both in the magnitude of revision and level of reported growth. The upside revision from the 0.13% was dominated by an upside revision to construction spending. These numbers will change, however, with major revisions and redefinitions to the GDP on July 31st. The official recovery in GDP reporting has been nothing but a statistical illusion created by the use of too-low inflation in generating the headline numbers. A corrected graph is shown later in this section.

The headline 5.7% gain in February durable goods orders was dominated by a monthly surge in the extremely irregular activity of commercial aircraft orders. A general pattern of ongoing economic turmoil and stagnation can be seen in the graphs of real (inflation-adjusted) new orders for durable goods, also shown later in this section.

The reporting of February new-home sales activity remained unstable in a broad pattern of low-level bottom-bouncing. Neither the 4.6% monthly decline nor the 12.3% year-to-year gain was statistically significant. The continuing state of depressed stagnation, in the aftermath of the housing-industry collapse from 2006 into 2009, remained consistent with the ongoing difficulties in the recent reporting of February housing starts (*Commentary No. 511*) and February existing-home sales (*Commentary No. 512*). Details and graphs for this and the related series are found in the *Reporting Detail* section.

Third Estimate of Fourth-Quarter 2012 GDP. Fourth-quarter headline GDP growth revised to 0.38%, from a previous estimate of 0.13% and initial reporting of a 0.14% contraction. None of those annualized, real (inflation-adjusted) growth rates was statistically-significant. Although, dominated by revised construction spending and somewhat larger than usual for a third revision, the aggregate growth change also was of no substance. Detail of GDP growth by major segment is shown in the *Reporting Detail* section.

The fourth-quarter annualized real growth rate of 0.38% still was down sharply from 3.11% in the third-quarter. Fourth-quarter 2012 year-to-year GDP growth revised to 1.67%, down from 2.60% growth in the third-quarter.

On the inflation front, the fourth-quarter implicit price deflator (IPD or GDP inflation) revised to an annualized pace of 0.97%, versus 2.72% in the third-quarter, while fourth-quarter year-to-year IPD inflation revised to 1.84%, versus 1.63% in the third-quarter.

Initial headline reporting of fourth-quarter gross domestic income (GDI)—the income-side equivalent of the consumption-side GDP—was 2.63% annualized real quarterly growth, versus 1.55% in the third-quarter. Initial headline reporting of fourth-quarter gross national product (GNP)—where GDP is GNP net of international flows in interest and dividend income—was 0.93% versus 2.92% in the third-quarter.

Comprehensive Revision (Redefinitions) to GDP**.** The July 31st GDP overhaul will reflect more than revisions to existing GDP data, based on the availability of better-quality underlying data, and a restating of the real or inflation adjusted numbers from a 2005 to a 2009 base. New definitions will add about $430 billion or 2.7% to the current GDP level, along with recalculation of the series back to 1929 (see *Reporting Detail* section).

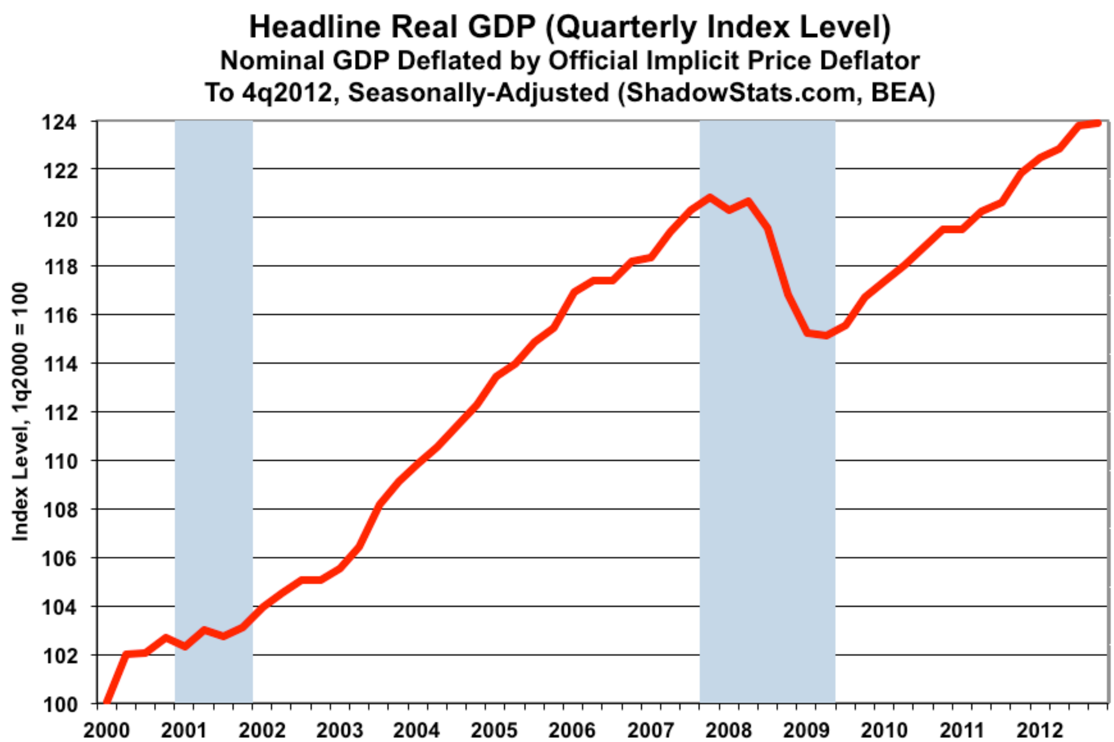
Economic Reality. From the standpoint of revisions tied to better-quality underlying data, however, the revamped numbers should show quarterly contractions extending backwards into 2012, including the fourth-quarter, which went through its last revision today, prior to the July 31st benchmark. Such revisions 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.

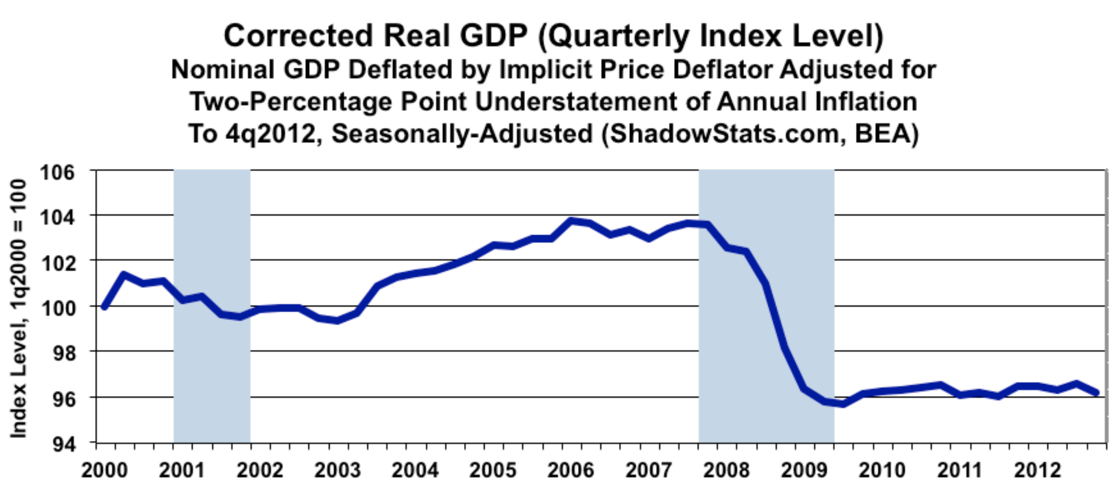
This most-worthless and most-heavily-politicized of government economic series does not reflect properly or accurately the changes to the underlying fundamentals that drive the numbers. Underlying real-world economic activity suggests that the broad economy began to turn down in 2006 and 2007, plunged 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*). That pattern is shown in the "corrected" GDP graph in the next sub-section.

As suggested by the consumer-liquidity charts in the *Opening Comments*, a sustainable recovery could not have taken place since 2009, and it will not be forthcoming until the consumer's structural income and liquidity problems are resolved.

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 following two graphs tell that story, updated for the third 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, and showing sustained growth since. No other major economic series has shown a parallel pattern of full economic recovery and beyond (although uncorrected real retail sales are just at that full-recovery point, but not beyond, a year later, as discussed in *Commentary No. 510*). 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."



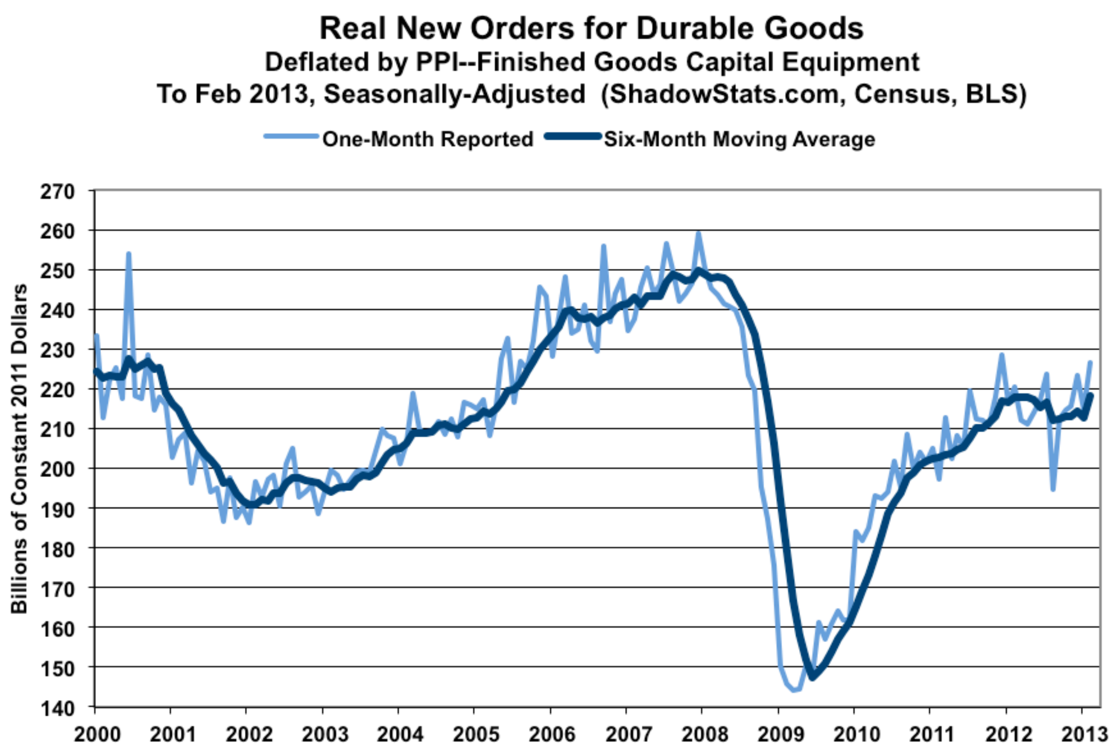


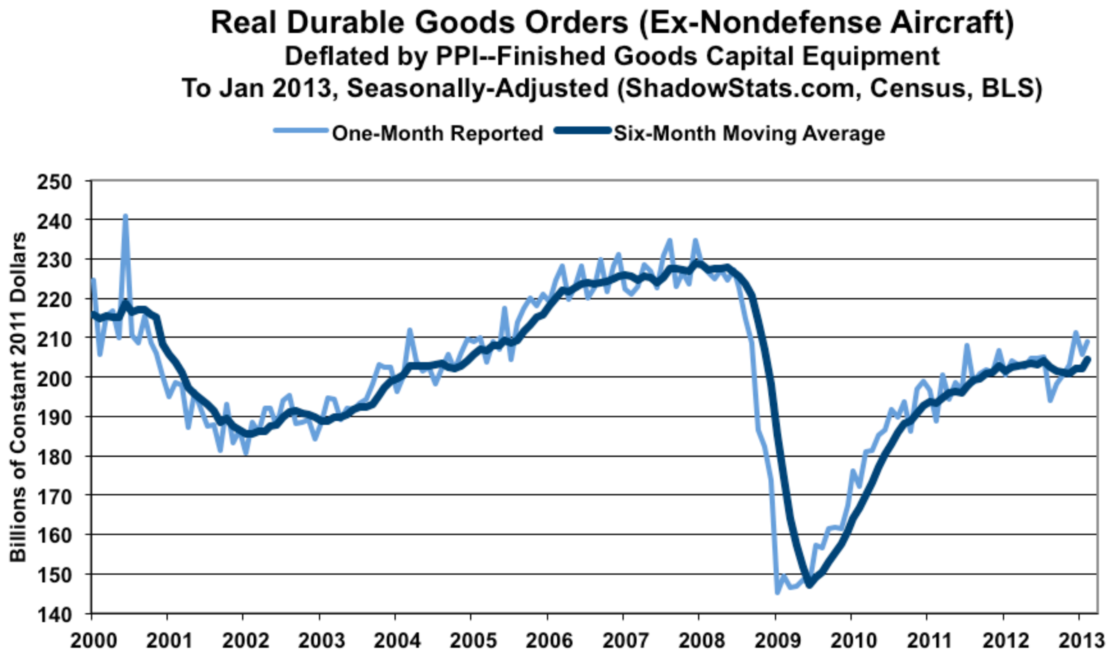
The second graph plots the GDP corrected for the understatement inherent in official inflation estimates, with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation. The inflation understatement has resulted from hedonic-quality 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.

February 2013 New Orders for Durable Goods. The 5.7% monthly gain in February durable goods orders was dominated by a monthly surge in the extremely irregular activity of commercial aircraft orders. That followed a revised 3.8% (previously 5.2%) monthly decline in aggregate January orders. January's aggregate orders and revisions, also largely resulted from shifting activity in the aircraft sector. Aircraft orders rarely impact near-term economic activity, due to their nature of having long-lead times.

Along with consideration of regular reporting complications from instabilities created by the use of concurrent seasonal factors, the aircraft-order driven monthly gain in the aggregate series for February was within the scope of normal volatility. As a result, the pattern of slowing activity remains in place and is of a nature that usually precedes or coincides with a recession (contracting, broad economic activity).

Previously shown and discussed in the regular *Commentaries* that cover the reporting of new orders for durable goods, the following 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 of still-irregular activity, the durable goods series appears to be in a renewed economic downturn.

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

[Further details on the third estimate of fourth-quarter GDP, February new orders for durable goods and reporting details for new home sales are found in the **Reporting Detail** *section.]*

HYPERINFLATION WATCH

Hyperinflation Outlook—Unchanged. Unchanged from the text published in the prior *Commentary No. 512*, this summary 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

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

Another Minimal Revision and Still-Minimal Growth in Fourth-Quarter GDP Were Not Meaningful. The revised headline estimate of 0.38% annualized, real (inflation-adjusted) growth for fourth-quarter 2012 (previously estimated at 0.13% growth, initially estimated as a 0.14% contraction), was not statistically significant—accordingly not of substance—either in terms of the magnitude of the revision, or in terms of the official level of annualized quarterly growth. The upside revision was on the larger side, however, for a third estimate, dominated by upside revisions to commercial construction activity. Such moves are suggestive of instabilities in the early underlying data used by the Bureau of Economic Analysis (BEA) in its preliminary estimates.

Here is how the revised real GDP growth was distributed by major sub-category:

As reported by the BEA today (March 28th), the second-revision of headline fourth-quarter GDP growth to 0.38% 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 1.28% + 0.17% + 0.33% - 1.41% = +0.37% (a rounding difference with 0.38%).

As previously reported (February 28th), the first-revision of headline fourth-quarter GDP growth to 0.13% reflected the growth patterns marked in parentheses as "previously." Please note that the growth number in each subheading is the additive contribution to the aggregate, previous headline change in GDP, where 1.47% - 0.20% + 0.24% - 1.38% = +0.13%.

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

- ***Consumer Spending Contributed 1.28% (Previously 1.47%, Initially 1.52%) to Growth.*** Where growth in fourth-quarter consumer spending remained dominated by motor vehicles, the downside revision to this category was accounted for by relatively weaker growth in the services sector.
- ***Business Investment Contributed 0.17% (Subtracted Previously 0.20%, Initially 0.08% from) to Growth.*** The dominant upside revision to this sector, and to the aggregate headline GDP growth was primarily in nonresidential (commercial) construction. This sector also includes residential construction.
- ***Net Exports Added 0.33% (Previously 0.24%, Initially Subtracted 0.25% from) to Growth.*** Not evident yet in trade reporting, the fourth-quarter trade deficit showed a revised relative narrowing of the deficit.
- ***Government Spending Subtracted 1.41% (Previously 1.38%, Initially 1.33%) from Growth.*** The small downside revision in government spending was at the level of state and local consumption.

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 last revision today, prior to the benchmark. 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 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 meaningful 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%.*

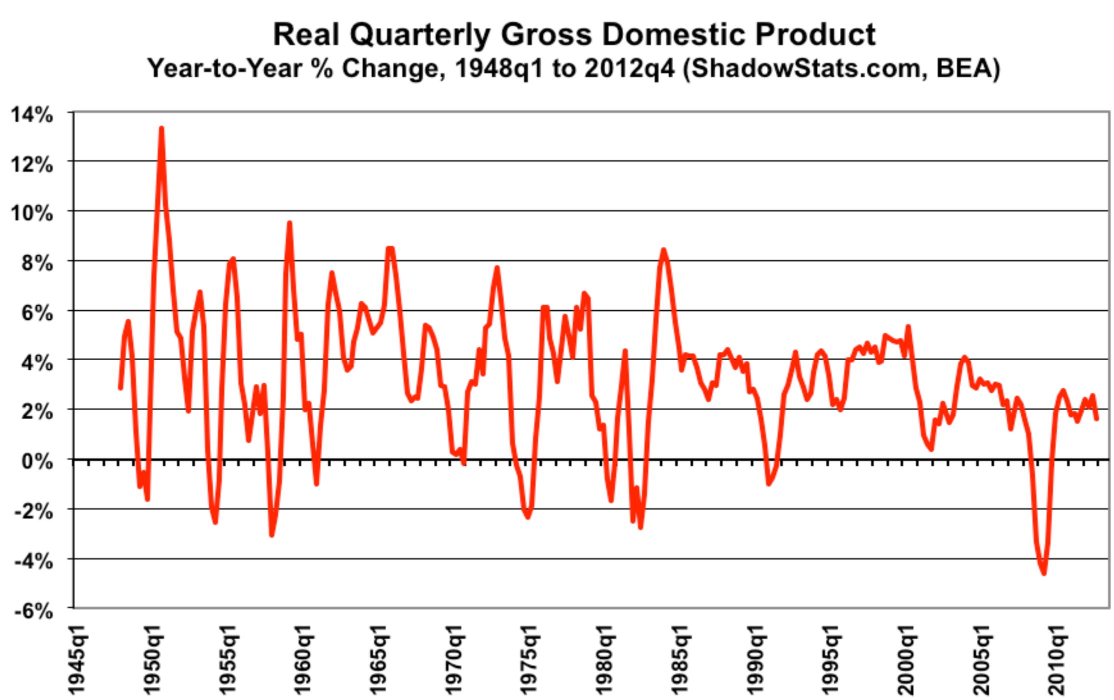
***Annual** growth refers to the year-to-year change of the referenced period versus the same period the year before.*

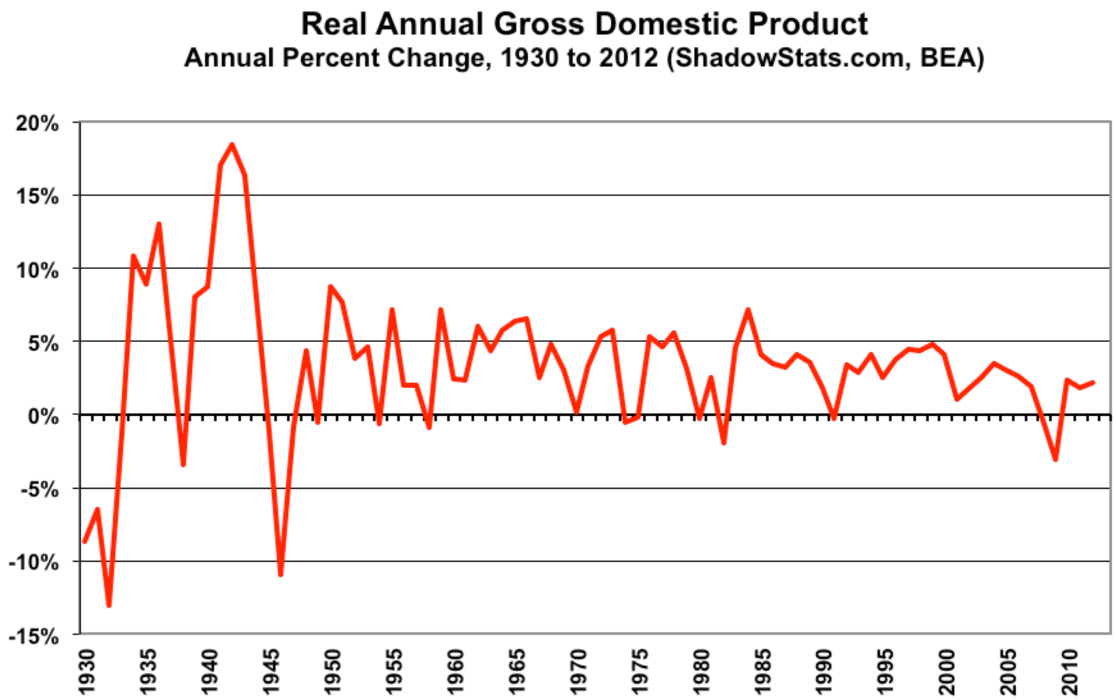
GDP. Published this morning, March 28th, by the Bureau of Economic (BEA), the third estimate and second revision of fourth-quarter 2012 gross domestic product (GDP) showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 0.38%, (previously 0.13%, initially a 0.14% 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. All those numbers will change with the July 31st “comprehensive revision” to, and redefinition of the GDP, with growth rates recalculated back to 1929.

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 1.67% (previously 1.61%, initially 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 well 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 2.21% (previously 2.20%, initially 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. Again, all the numbers will change with the July revisions and redefinitions.





GDP "Comprehensive Revision," Including Redefinitions, to Boost GDP Level. The July 31st GDP overhaul will reflect much more than revisions to existing GDP data, based on the availability of better-quality underlying data, and a restating of the real or inflation-adjusted numbers from a 2005 to a 2009 base.

The BEA also is redefining and recalculating the GDP back to 1929, so as to include "capitalization of research and development expenditures," "capitalization of entertainment, literary and other artistic originals," and "capitalization of ownership transfer costs of residential fixed assets." Those three items previously were expensed. By themselves, they are estimated to add about $430 billion or 2.7% to the current GDP level, per the BEA.

The better-quality underlying data for the current GDP series should be reflected in downside revisions to reported economic activity of recent years. The impact of redefinitions and other changes on estimated quarterly growth rates, however, most likely will be positive. The BEA description of the pending changes can be found here: *GDP Comprehensive Revision*.

Implicit Price Deflator (IPD). Fourth-quarter 2012 GDP inflation, or the implicit price deflator (IPD), revised to an annualized pace of 0.97% (previously 0.89%, initially 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 1.84% (previously 1.83%, initially 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 unrevised at 1.79% (initially 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. Again, all these numbers will change on July 31st.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for fourth-quarter 2012 is a 2.2% year-to-year contraction versus the revised official estimate of a 1.7% 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 still-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* 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. Gross domestic income (GDI) is the income-side reporting equivalent of the consumption-side GDP. Free of most of the media hype that helps to shape the GDP reporting, the GDI can be more meaningful in its separate surveying and lack of relative political massaging. Where the GDI and GDP have to equal each other from a bookkeeping standpoint, that rarely happens. The difference is made up by the use of a statistical-discrepancy account that is included on the GDI side to establish GDP-GDI parity.

The initial estimate of annualized, real fourth-quarter 2012 GDI was a headline growth rate of 2.63%, versus 1.55% in the third quarter and a 0.72% annualized contraction in the second-quarter. Year-to-year fourth-quarter 2012 GDI growth eased to 1.81%, versus 2.26% in the third-quarter and 1.80% in the second-quarter.

GNP. Gross national product (GNP) is the broadest measure of U.S. economic activity, where GDP is GNP net of trade in factor-income, or interest and dividend payments. In initial reporting, the headline fourth-quarter 2012 GNP growth rate was 0.93%, versus 2.92% in the third-quarter and 2.05% in the second-quarter. Year-to-year, fourth-quarter GNP growth was 1.62%, versus 2.42% in the third-quarter and 2.06% in the second-quarter.

NEW ORDERS FOR DURABLE GOODS (February 2013)

Non-Defense Aircraft Orders Boosted February 2013 Durable Goods Orders. The 5.7% monthly jump in February durable goods orders was dominated by a monthly surge in extremely irregular commercial, or non-defense, aircraft orders. Aircraft orders rarely impact near-term economic activity, due to the long-lead time nature of the orders. Despite reporting complications from regular instabilities created by the use of concurrent seasonal factors, the monthly gain in the series still was within the scope of normal volatility. Accordingly, the pattern of slowing activity remains in place and is of a nature that usually precedes or coincides with a recession (contracting, broad economic activity).

Official, Nominal February Reporting. The Census Bureau reported March 26th that the regularly-volatile, seasonally-adjusted nominal (not-adjusted-for-inflation) level of February 2013 new orders for durable goods rose by 5.7% (up by 7.0% before prior-period revisions) month-to-month, following a revised 3.8% (previously 5.2%) monthly decline in January orders. An upside revision of 1.2% to aggregate January orders largely was accounted for by upside revisions in commercial aircraft orders, reversing the prior month's reporting of downside revisions to December commercial aircraft orders.

The irregular and highly volatile long-term nondefense aircraft orders rose month-to-month in February 2013 by 95.3% (up by 124.8% before prior-period revisions), versus a revised monthly decline of 24.0% (previously 34.0%) in January. Aircraft orders commonly are placed years in advance of delivery and rarely impact near-term economic activity. Net of the highly unstable commercial aircraft orders, aggregate new orders still rose by 1.6% in February, following a revised 2.7% (previously 3.5%) decline in January.

Year-to-year change in seasonally-adjusted February 2013 aggregate nominal new orders was a 3.8% gain, versus a revised 0.3% gain (previously a 1.0% contraction in January) and a revised 0.8% gain (previously a 0.7% contraction, initially an annual gain of 0.2%) in December 2012.

Also dominated by commercial aircraft orders, seasonally-adjusted new orders for nondefense capital goods rose by 10.0% in February 2013, versus a revised 2.0% gain (previously a 0.1% decline) for the month of January. For February, the unadjusted year-to-year change in the series was 0.5%, versus basically an unrevised "unchanged" in January.

<u>Caution:</u> *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 5.7 % contraction in aggregate monthly February 2013 orders was a real (inflation-adjusted) gain of 5.6%, after adjusting for a 0.1% monthly gain in the PPI finished goods capital equipment deflator. The revised nominal 3.8% gain in January was a drop of 3.9% in real terms. On a year-to-year basis, the inflation- and seasonally-adjusted year-to-year change was a gain of 2.9% in February, versus a 0.8% contraction in January.

In terms of inflation-adjusted levels, as indicated in the two graphs in the *Opening Comments* section, 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 generally in a pattern of downturn, in spite of the February monthly gains, the series clearly is not in recovery as seen in official GDP reporting. The real (inflation-adjusted) level of orders in February 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 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.

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.

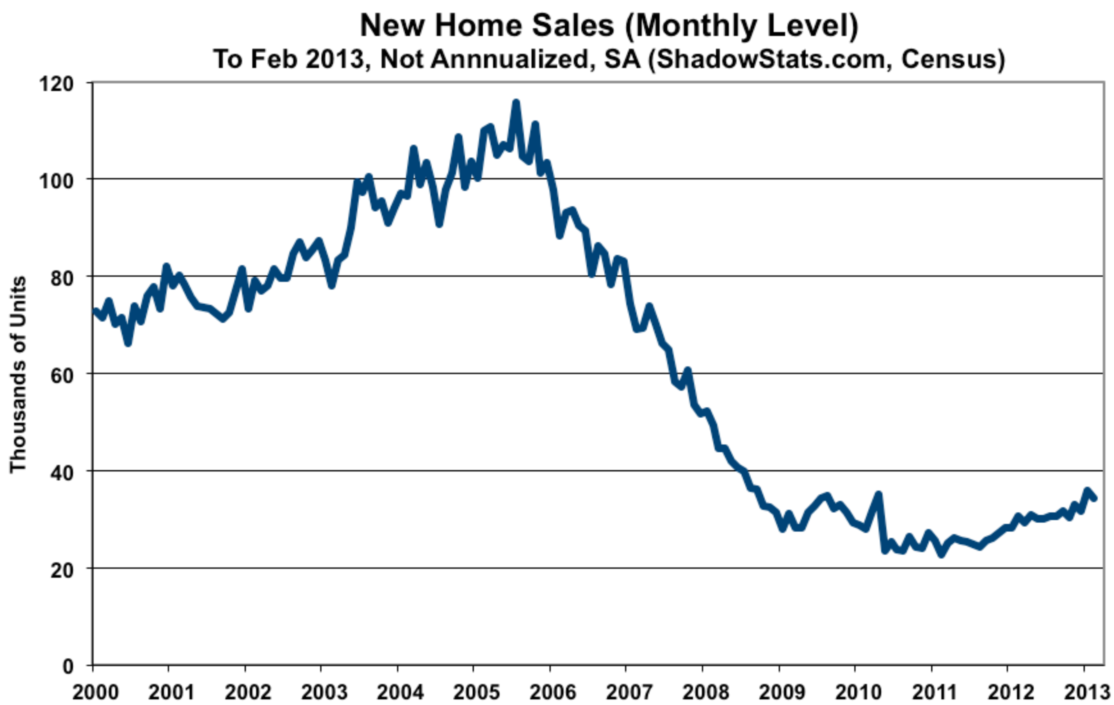
In terms of smoothing, the graphs in the Opening Comments *section reflect a six-month moving average, as well as the raw monthly data. The detail also is graphed net of nondefense aircraft orders, a significant cause of month-to-month volatility in the series.*

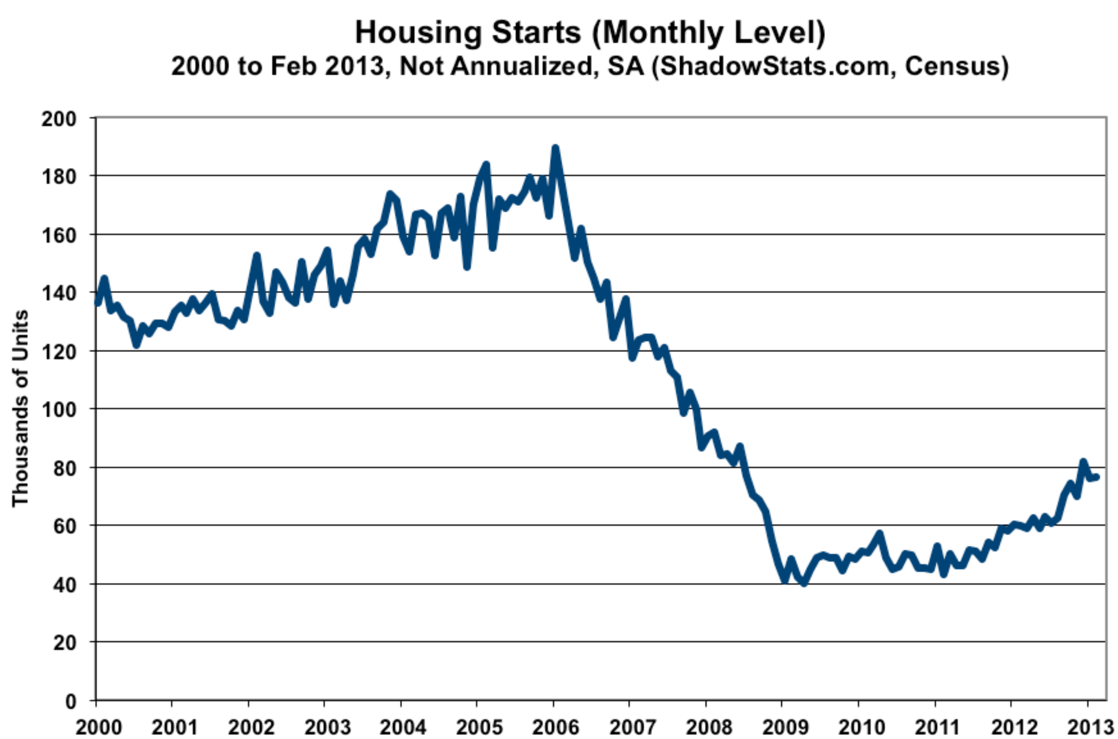
NEW-HOME SALES (February 2013)

February New-Home Sales Activity Remained Volatile, Still in Pattern of Ongoing Stagnation. February 2013 new home sales continued in a state of depressed stagnation, or bottom-bouncing, in the aftermath of the housing-industry collapse from 2006 into 2009. Sales dropped by a statistically-insignificant 4.6% for the month, following a revised 13.1% gain in January. The year-to-year gain of 12.3% in February also was statistically-insignificant, versus a revised 21.7% annual gain in January.

February New Homes Sales Reporting. The March 26th release of February 2013 new-home sales (counted based on contract signings, Census Bureau) showed a statistically-insignificant 4.6% month-to-month decline (down by 5.9% before prior-period revisions) +/- 23.9% (all confidence intervals are at the 95% level). That followed a revised 13.1% (previously 15.6%) month-to-month gain in January. Lack of statistical significance in month-to-month change for this series has been a common circumstance for more than three years.

February's year-to-year gain of 12.3% +/- 27.3% in new-home sales also was statistically-insignificant. The January annual gain revised to a still marginally statistically-significant 27.1% (previously 28.9%). The volatility in annual change increasingly reflects the monthly volatility and instability in the series.

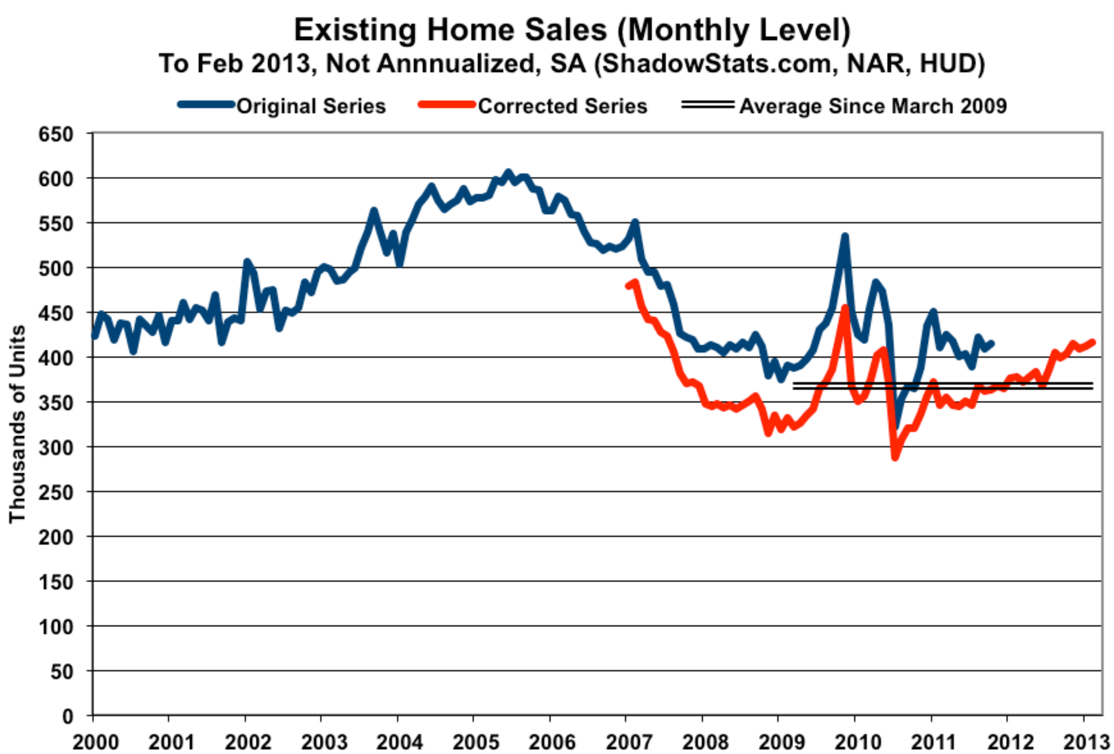

New Home Sales (Monthly Level)
To Feb 2013, Not Annnualized, SA (ShadowStats.com, Census)
Thousands of Units
0
20
40
60
80
100
120
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Housing Starts (Monthly Level)
2000 to Feb 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

Parallel patterns of activity have been seen consistently between the new-home sales and the housing starts data, as detailed in the first two graphs preceding.

Some of the relative monthly variance in direction of activity for the two series is due to the inclusion of apartments in the starts data, and to bad-quality seasonal adjustments. Still, monthly changes in both series in February were statistically insignificant on either side of zero (see *Commentary No. 511* for reporting detail on February housing starts). The graph reflecting February 2013 existing-home sales also is included, following (see *Commentary No. 512*). 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. To the contrary, as discussed in the *Opening Comments* (also see *No. 485: Special Commentary*), liquidity conditions for the consumer appear to be deteriorating anew.



WEEK AHEAD

Weaker Economic and Stronger Inflation Data Should Surface in the Near-Term. Reflecting the intensifying structural liquidity constraints on the consumer, and in anticipation of the likely negative impact, of the continuing and expanded QE3 and the still-pending 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, as was just seen for industrial production, and as pending for new orders for durable goods (May 17th), retail sales (May 31st) and GDP (July 31st—comprehensive overhaul and redefinition 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.

Construction Spending (February 2013). Due for release on Monday, April 1st, by the Commerce Department, February construction should follow its recent trend, continuing in stagnation, particularly after adjustment for inflation. As usually is the case, reported monthly changes are not likely to be statistically significant. Any upside surprises here likely would be tied to the repair and replacement activity generated by Hurricane Sandy.

Employment and Unemployment (March 2013). The March labor data are due for release on Friday, April 5th, 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 March 2013 payroll trend number is for a 190,000 jobs gain, as discussed in *Commentary No. 508*, and the early consensus indeed appears to be settling in around that number, somewhat softer than the initial reporting of a 236,000 headline monthly jobs gain in February. The markets appear to be expecting the unemployment rate to hold at or notch above the 7.7% headline U.3 number of February 2013.

Reflecting underlying fundamental economic activity that still is much weaker than consensus expectations, reporting risks are to the downside for payrolls and to the upside for the unemployment rate.

Although the unemployment rate should move higher, there is a problem that has been discussed frequently with this series (see *Commentary No. 451* and *Commentary No. 487*, for example). The month-to-month comparisons of the headline unemployment data cannot be compared legitimately. The headline change in the unemployment rate is of no meaning, other than in misguided-media and market reactions. 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, which would be consistent with the new number.

U.S. Trade Balance (February 2013). The February trade deficit detail also is scheduled for release on Friday, April 5th. With the U.S. trade deficit continuing in fundamental deterioration, and with possible reporting disruptions caused by Hurricane Sandy largely out of the way, the February numbers are at risk of showing a meaningful deterioration versus the existing January deficit estimate.

Any significant narrowing or widening of the February trade deficit—beyond developing market expectations of some narrowing—respectively would tend to boost or impair the outlook for expectations of first-quarter 2013 GDP growth.