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

COMMENTARY NUMBER 530
Trade Deficit and Benchmark Revision, Money Supply, Construction Spending

June 4, 2013

Benchmarked Trade Deficit Generally Worse Than Previously Estimated;
Revisions Should Alter Quarterly Growth Patterns in 2012 GDP

Surging Monetary Base and Slowing M3 Signal
Banking-System Woes and No Quick End to QE3

Construction Spending Continued Pattern of Stagnation;
Benchmark Revisions Loom

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, June 7th, covering the May 2013 employment and unemployment data.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Revised Trade Data Could Trigger Reporting of Renewed GDP Recession in 2012. With the real (inflation-adjusted) trade data often contributing significantly to the reported pace of quarterly change in related gross domestic product (GDP), benchmark revisions to the trade data often alter the patterns of previously-estimated GDP growth. Today's (June 4th) trade revisions should put downside pressure on the growth estimates for the two middle quarters of 2012, possibly showing an official, outright—though at the moment short-lived—new recession.

The April trade deficit generally was in line with market expectations, as was the continued stagnation in April construction spending. Surprising the markets, however, was the sharp decline in the May estimate of the ISM purchasing managers manufacturing survey.

The trade revisions are covered in this section, along with summary details on the April deficit and construction numbers and the regular coverage in the *Reporting Detail* section. as to the ISM, the sharp declines in the key indices into economic-contraction territory (below a reading of 50.0) for the overall index (to 49.0 from 50.7), and for the component series of new orders (to 48.8 from 52.3) and production (to 48.6 from 53.5) indeed were negative signals for the economy. Further, employment was at 50.1, down from 50.2, which is not a happy signal for the May jobs report.

In more-normal economic times, those readings would have many economists discussing a possible recession. Unfortunately, the reliability of the purchasing managers survey has been limited in recent years by poor-quality seasonal factors provided to the ISM by the Commerce Department. As discussed frequently (see the *Week Ahead* section), the unprecedented nature of the severity of the recent contraction, both in terms of depth and length, has distorted meaningfully the normal seasonal-adjustment process.

The monetary base just jumped significantly higher, again, both in terms of level and annual growth, while annual growth in the broad money supply appears to be slowing again. These contradictions remain suggestive of ongoing or intensifying liquidity issues in the banking system (see *Hyperinflation Watch* section).

Trade Balance for April and as Revised. The slight widening of the trade deficit in April was released in the context of the annual benchmark revisions to the monthly trade data for goods and services. The new data suggest that the economy—as measured by the GDP—indeed may have turned down in the middle two quarters of 2012, with the official GDP growing again in the quarters since. As was discussed in *No. 527: Special Commentary*, however, the GDP generally is a worthless measure of economic activity. Properly corrected for reporting distortions, resulting from the use of too-low inflation in deflating the GDP, the actual economy still has not recovered from the recession that began in 2006.

April Deficit. The nominal (not adjusted for inflation), seasonally-adjusted monthly trade deficit in goods and services for April 2013, on a balance-of-payments basis, widened to $40.3 billion from a benchmark-revised $37.1 (previously $38.8) billion in March. The April 2013 deficit also narrowed from a benchmark-revised $49.6 (previously $49.7) billion in April 2012.

The monthly trade deterioration reflected both imports and exports increasing for the month, by $5.4 and $2.2 billion respectively, with the $3.2 billion greater jump in imports accounting for the larger monthly deficit. Part of the increase in imports was attributable to activity surrounding the oil market, with both higher prices and greater, daily physical-import volume coming into play on a not-seasonally-adjusted basis.

Annual Benchmark Revisions. The annual benchmark revisions to the trade data generally showed historical trade deficits to have been larger than previously estimated. As with other recent benchmark revisions seen, for example, with retail sales and durable goods, where better data became available the economic news was revised more negatively, while the most-recent data surged anew, based on continuing overly-optimistic assumptions.

Where the pattern of the revisions shifted from year-to-year, the aggregate of the revisions was small, but the shifting patterns of the trade shortfall had implications for the "comprehensive" benchmark revisions to the GDP series, due for release on July 31st. If the trade deficit is revised so that it is wider than before, the reporting impact on related GDP growth is negative, and vice versa. Specifically, based solely on the trade revisions (on a real, or inflation-adjusted basis), following is how the patterns of recent GDP growth should be affected.

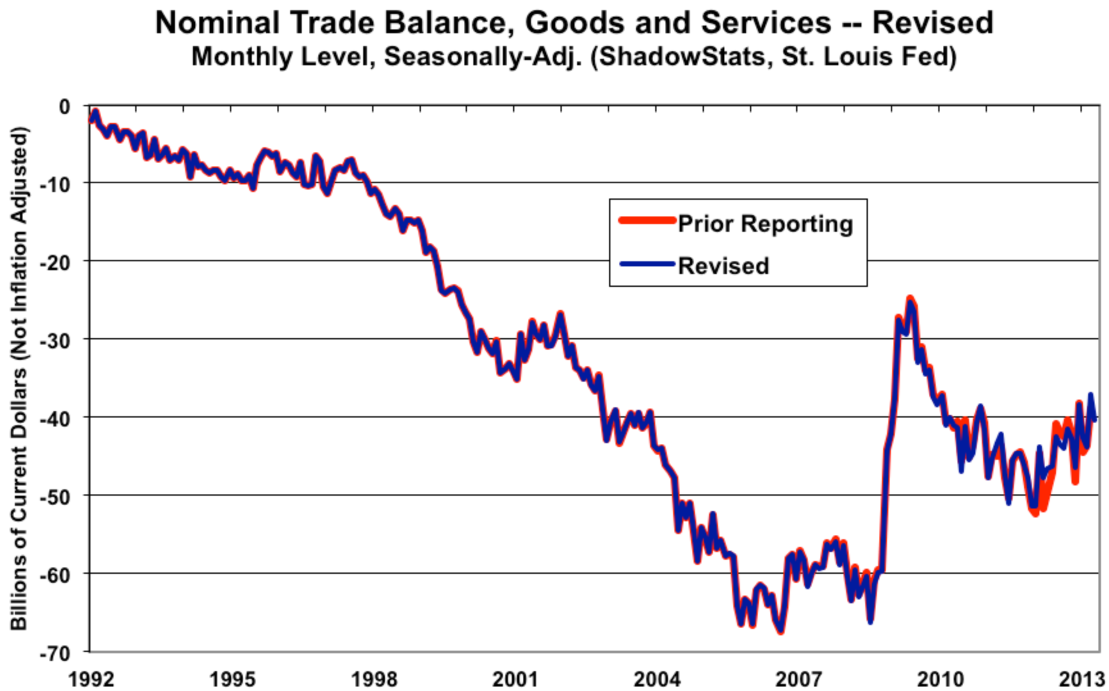
First-quarter 2012 current headline GDP growth of 2.0% should revise higher; second-quarter 2012 growth of 1.3% should revise lower; third-quarter 2012 growth of 3.1% should revise lower; fourth-quarter 2012 growth of 0.4% should revise higher; as should the first-quarter 2013 (second-estimate) GDP growth of 2.4%. These changes open the possibility of second- and third-quarter 2012 showing back-to-back quarterly contractions, as has been hinted at in the industrial production and real retail sales data. Such GDP contractions should constitute a formal recession. Except for possibly some of the first-quarter 2013 upside, none of these changes should be reflected in the upcoming June 26th third-estimate of first-quarter 2013 GDP, the earlier-period revisions will be seen only in the July 31st GDP benchmark.

Other data revisions and redefinitions, though, also will impact the GDP revisions. ShadowStats will publish a formal estimate of likely significant GDP reporting shifts well in advance of the July 31st changes.

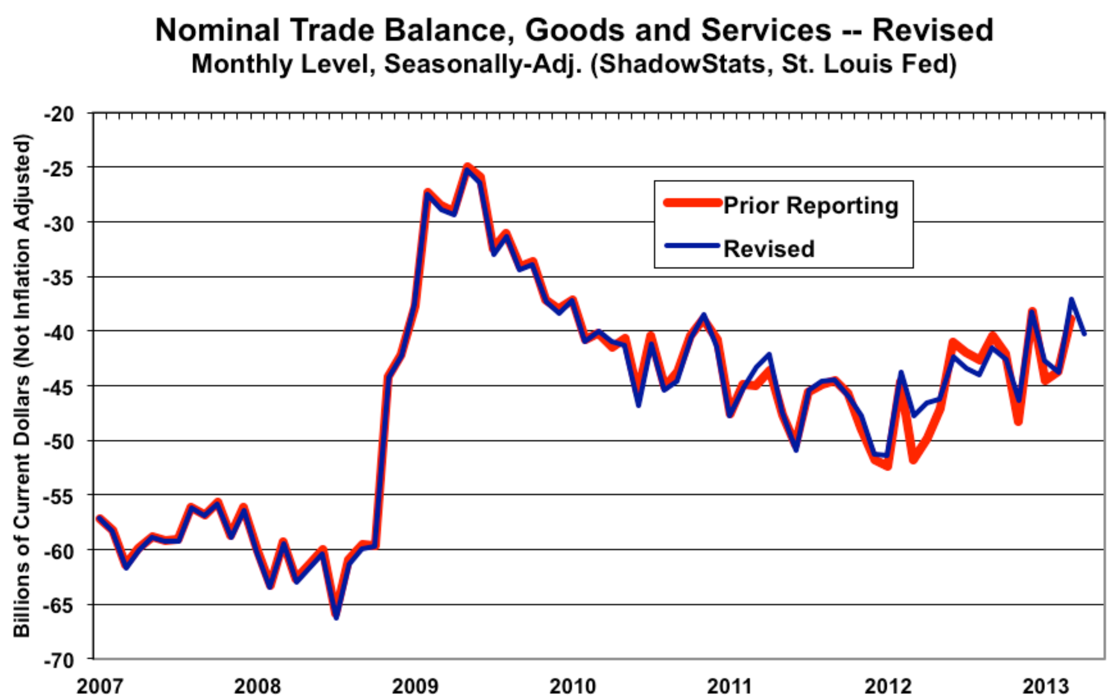
Following are two sets of graphs of the revised trade data versus prior reporting. The first graph in each series shows the full new series, as reported by the Census Bureau. The second graph in each series shows greater detail of the more-recent numbers, so that the relative revisions are more visible.

Based on better-quality information, redefinitions and the recasting of seasonal-adjustment factors, changes were published back to 1992 for the headline deficit in goods and services, and back to 1994, for the inflation-adjusted merchandise trade deficit. The deflation measure shifted to a 2009 chain-weighted deflator (fully substitution based, and also as will be recast for the GDP series) from the prior 2005-base. The first series is somewhat more important for purposes of the currency markets. The second series is the more important one in terms of GDP and related economic reporting, but it also impacts the currencies.

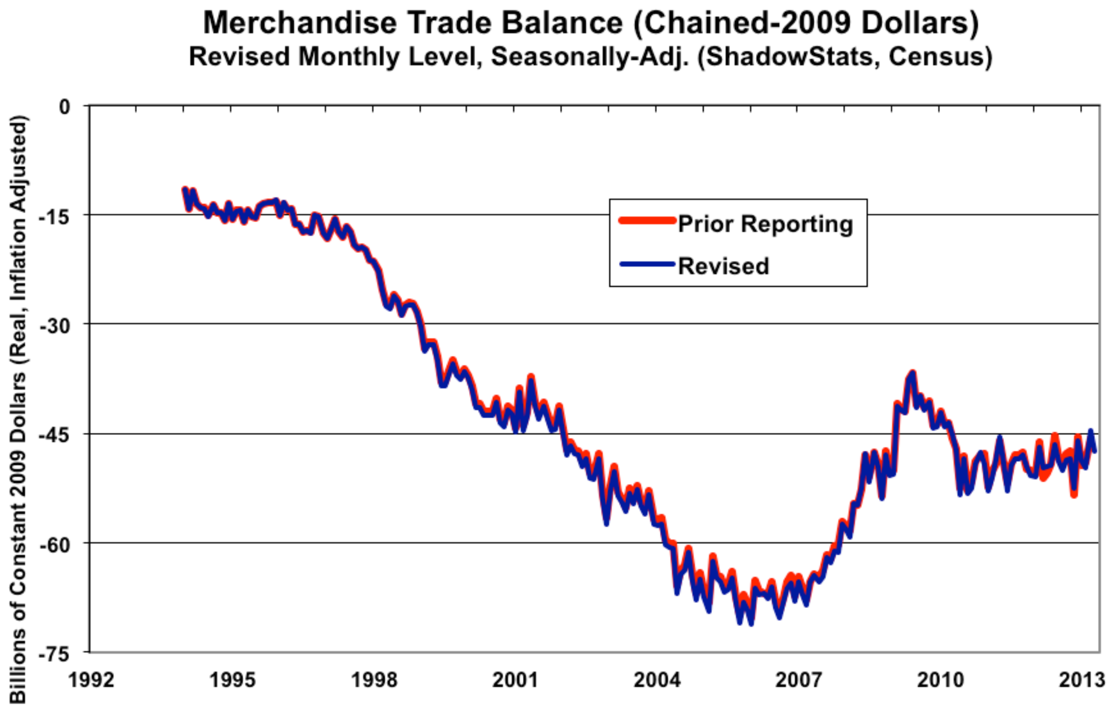
The graphs of the inflation-adjusted series (second set) have been recast so that the prior-reporting series is set equal to the revised series, as of January 1994, with consistent, proportionate increases going forward for the old series.

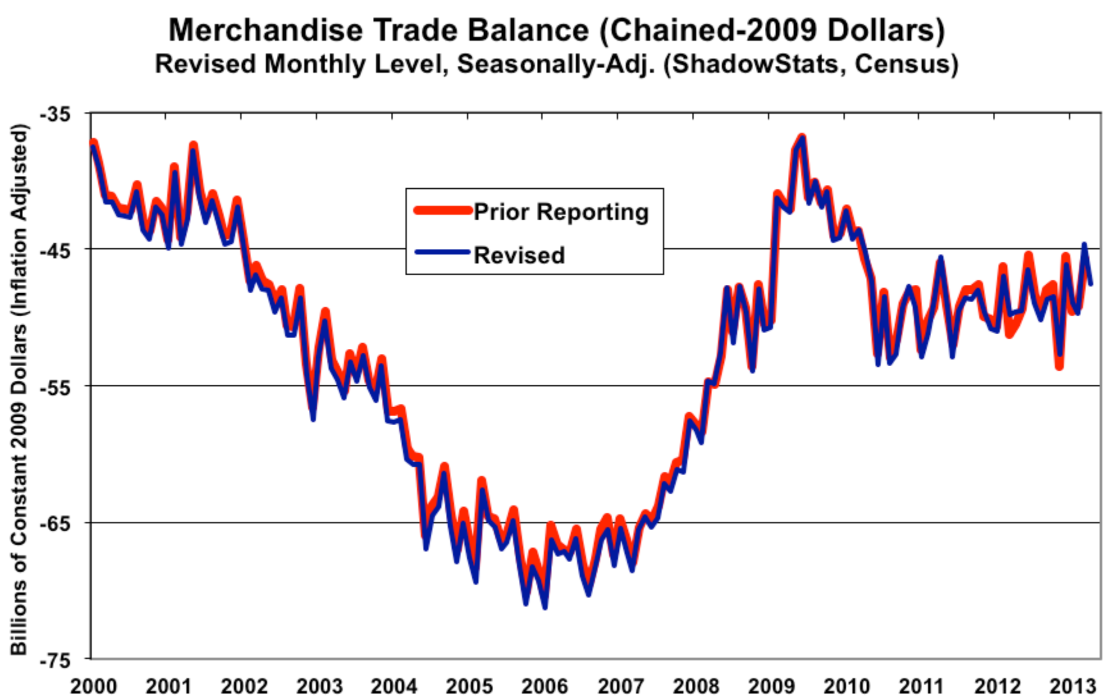


Nominal Trade Balance, Goods and Services -- Revised
Monthly Level, Seasonally-Adj. (ShadowStats, St. Louis Fed)
Billions of Current Dollars (Not Inflation Adjusted)
0
-10
-20
-30
-40
-50
-60
-70
1992
1995
1998
2001
2004
2007
2010
2013
Prior Reporting
Revised



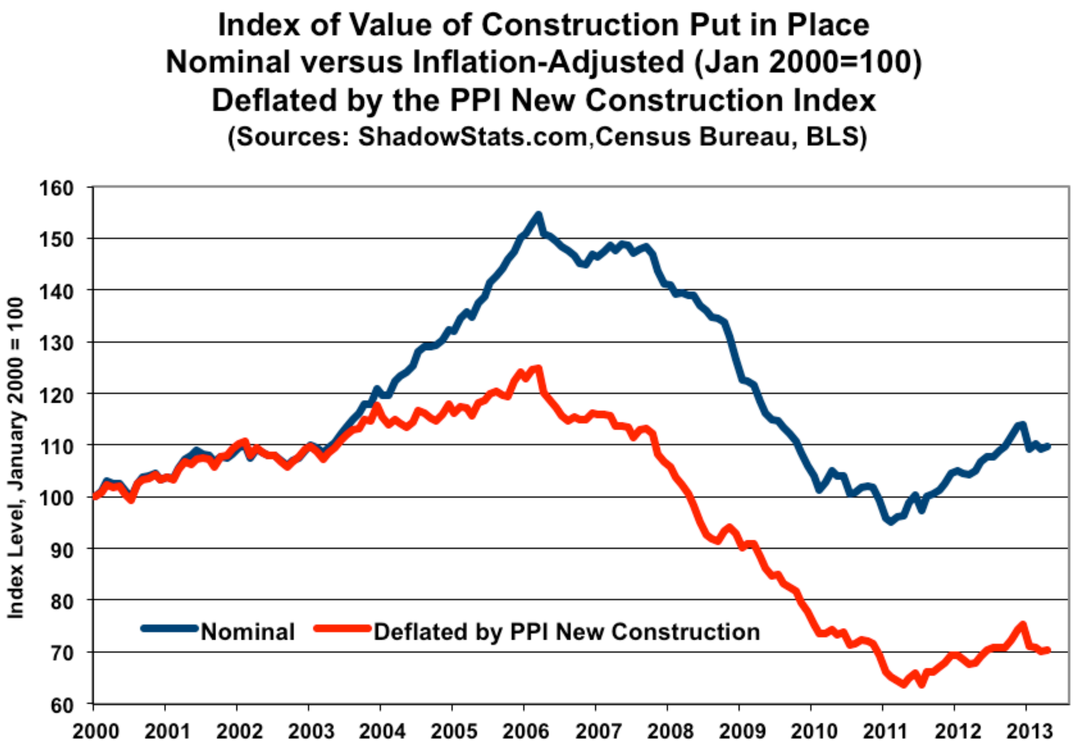
Nominal Trade Balance, Goods and Services -- Revised
Monthly Level, Seasonally-Adj. (ShadowStats, St. Louis Fed)
Billions of Current Dollars (Not Inflation Adjusted)
-20
-25
-30
-35
-40
-45
-50
-55
-60
-65
-70
2007
2008
2009
2010
2011
2012
2013
Prior Reporting
Revised


Merchandise Trade Balance (Chained-2009 Dollars)
Revised Monthly Level, Seasonally-Adj. (ShadowStats, Census)
Billions of Constant 2009 Dollars (Real, Inflation Adjusted)
0
-15
-30
-45
-60
-75
1992
1995
1998
2001
2004
2007
2010
2013
Prior Reporting
Revised


Merchandise Trade Balance (Chained-2009 Dollars)
Revised Monthly Level, Seasonally-Adj. (ShadowStats, Census)
Billions of Constant 2009 Dollars (Inflation Adjusted)
-35
-45
-55
-65
-75
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Prior Reporting
Revised

Construction Spending in April. April construction spending continued a pattern of renewed stagnation. The monthly gain of 0.4% was not statistically-significant, following a revised and equally insignificant 0.8% (previously 1.7%) monthly contraction in March. The graphed patterns of activity, both before and after inflation adjustment, show downside or stagnant activity (see *Reporting Detail* section). All these numbers will change in the next report, when the annual revisions to the series also are due for release on July 1st. Downside revisions to recent history, since 2011, would be the expectation.

Adjusted for PPI new construction inflation, aggregate real spending in April also was up by 0.4%, but down by 0.9% in March, as reflected in the accompanying graph. April 2013 nominal construction spending was up year-to-year by a statistically-significant 4.3%, with March's annual growth revising to 4.9% (previously 4.8%). Net of construction costs, indicated by the PPI current construction index, year-to-year growth in real spending was 3.8% in April 2013, the same as in March.



[For further detail on May money supply, see* Hyperinflation Watch*;
for further detail on the April trade deficit and construction spending, see* Reporting Detail.*]

HYPERINFLATION WATCH

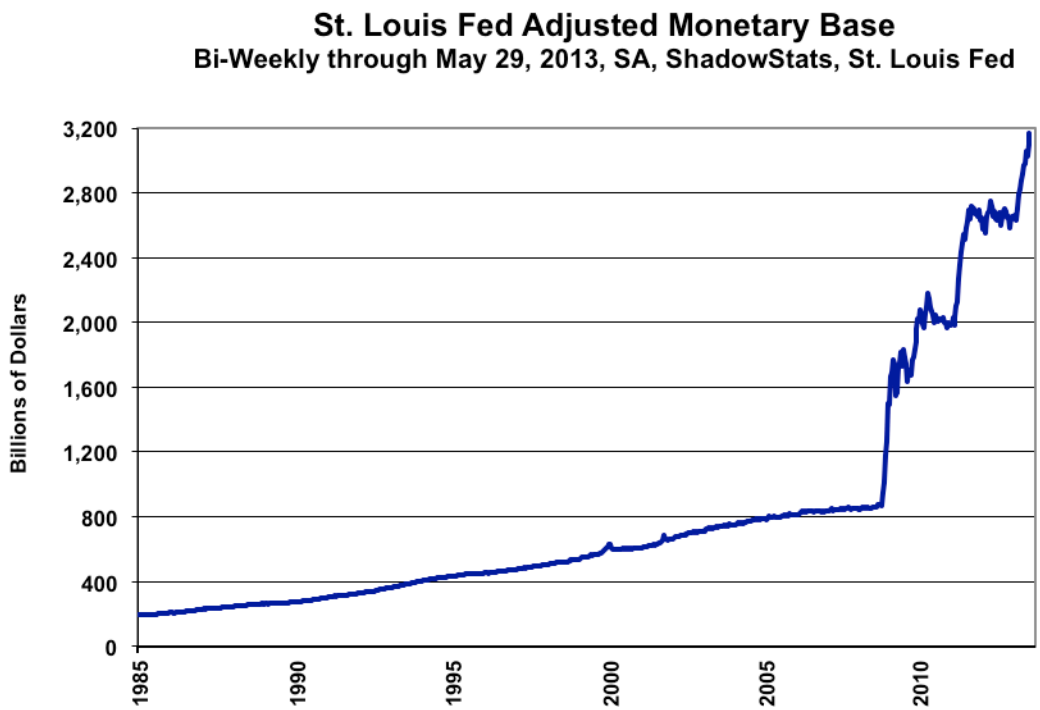
Money Supply Growth Weakens. Based on roughly three weeks of reported data, the preliminary estimate of year-to-year growth in the ShadowStats Ongoing-M3 Estimate for May 2013 is on an early track to fall to 4.2%, from 4.4% in April 2013. On a monthly basis, that reflects virtually no month-to-month change.

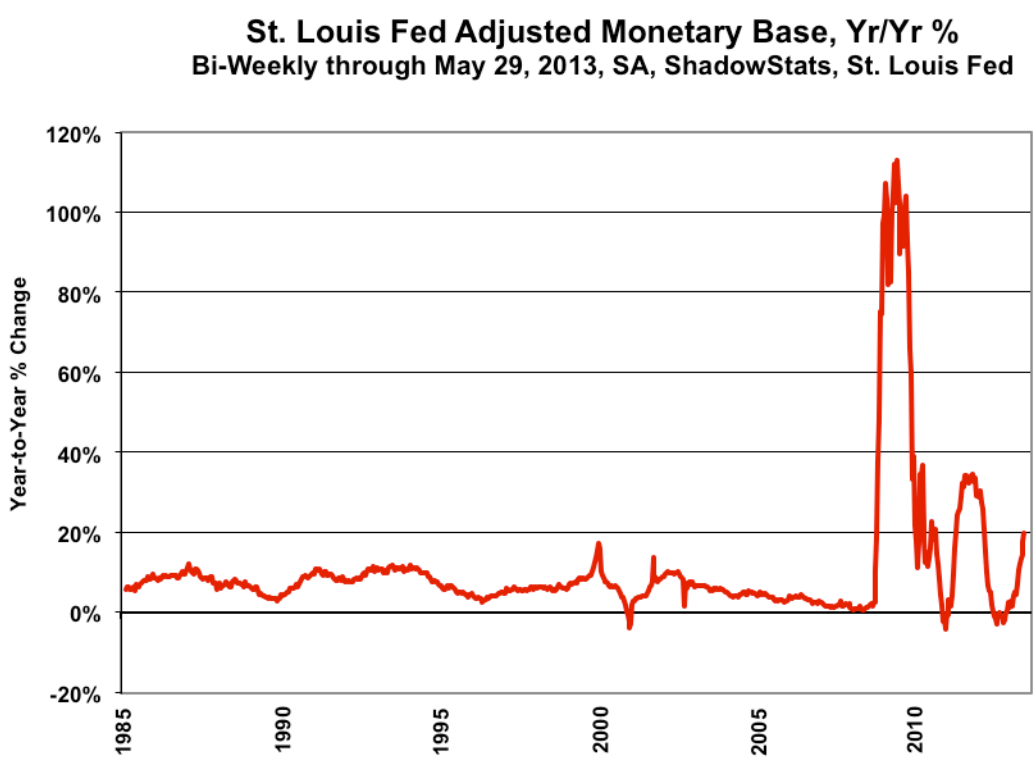
Full estimates for M1, M2 and M3 (M2 includes M1, M3 includes M2) will be updated in the June 7th *Commentary*, and published with the latest detail, on June 8th, in the Alternate Data tab of www.shadowstats.com. Full definitions of the money supply series are found in the *Money Supply Special Report*.

In contrast, as shown in the next section, QE3, with the Fed's increasing monetization of U.S. Treasury debt, has been reflected in a soaring monetary base, both in terms of annual growth, as well as level. The variance between the behavior of M3 and the monetary base is the lack of normal lending by the banking system, and the nature of the increasing variance is suggestive of mounting systemic instabilities. It is in the promotion of banking system stability, not in attempting to lower unemployment or to contain inflation, that Mr. Bernanke introduced his quantitative easing (see *No. 527: Special Commentary*). Accordingly, there is nothing here to suggest an imminent end to QE3.

Monetary Base. Mirroring the ongoing, expanded QE3 by the Federal Reserve, the monetary base has been setting successive historic highs, both in terms of level, and in terms of year-to-year growth in the new cycle. As shown in the accompanying graphs, the monetary base was at a seasonally-adjusted (SA) two-week average level of $3,172.7 billion as of May 29th, a record-high. The 21.1% pace of rising year-to-year growth has not been seen in two years, when QE2 was exploding.

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*). Traditionally, the Federal Reserve has used the monetary base to increase or decrease growth in the money supply, but such has not had its normal impact in the post-2008 crisis period. Instead, financially troubled banks have been holding 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 year-to-year broad money supply growth in this circumstance, as seen at present, tends to be an indication of mounting systemic stress in the banking industry.


St. Louis Fed Adjusted Monetary Base
Bi-Weekly through May 29, 2013, SA, ShadowStats, St. Louis Fed
Billions of Dollars
3,200
2,800
2,400
2,000
1,600
1,200
800
400
0
1985
1990
1995
2000
2005
2010


St. Louis Fed Adjusted Monetary Base, Yr/Yr %
Bi-Weekly through May 29, 2013, SA, ShadowStats, St. Louis Fed
Year-to-Year % Change
120%
100%
80%
60%
40%
20%
0%
-20%
1985
1990
1995
2000
2005
2010

Hyperinflation Outlook. The current hyperinflation outlook was revised and updated with new detail in the May 29th *No. 527: Special Commentary*. Given the length of time needed in reviewing the trade revisions today (Census actually had some wrong history data published on its site), the regular synopsis of the general outlook will be revamped with the next regular Commentary on June 7th, instead of today, reflecting the content of the *Special Report*. Nothing in the ShadowStats outlook has changed since the May 29th piece. For the current broad outlook, please read or link back to *No. 527*, or to *Commentary No. 525* for the prior synopsis.

REPORTING DETAIL

U.S. TRADE BALANCE (April 2013, Annual Benchmark Revisions)

Sharp Increase in Imports Widened the April Trade Deficit. On balance, the annual benchmark revisions to the trade data were negative in economic terms, as discussed and graphed in the *Opening Comments.*

In the context of those revisions, the April 2013 trade deficit widened to $40.3 billion, from a revised $37.1 billion in March. Both imports and exports increased for the month, but a much larger increase in imports accounted for the monthly increase in the deficit. The first reporting for second-quarter 2013, April did not show a large enough shift in the monthly real deficit level, versus the monthly average for the first-quarter, to suggest a meaningful trend, yet, for the new quarter's GDP growth.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported this morning, June 4th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for April 2013, on a balance-of-payments basis, widened to $40.3 billion from a benchmark-revised $37.1 (previously $38.8) billion in March. The April 2013 deficit also narrowed from a benchmark-revised $49.6 (previously $49.7) billion in April 2012.

The monthly trade deterioration reflected both imports and exports increasing for the month, by $5.4 and $2.2 billion respectively, with the $3.2 billion greater jump in imports accounting for the larger monthly deficit. Part of the increase in imports was attributable to activity surrounding the oil market.

Crude Oil and Energy-Related Petroleum Products. For the month of April 2013, the not-seasonally-adjusted average price of imported oil rose to $97.82 per barrel, from $96.95 in March, but it was down from an average of $109.94 in April 2012.

Not-seasonally-adjusted, the value of monthly oil imports increased in April, with higher prices exacerbating rising physical volume. Not-seasonally-adjusted physical oil import volume in April 2013 averaged 7.774 million barrels per day, up from 6.959 million in February 2013, but down from a revised 9.012 (previously 9.000) million barrels per day in April 2012.

Cautions on Data Quality. Potentially heavy distortions in headline data continue from seasonal adjustments, much as has been seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. As has been discussed frequently (see Hyperinflation 2012 *for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not rely heavily on the accuracy of the monthly headline data.*

Real (Inflation-Adjusted) Trade Deficit. As just revised in the annual benchmark, adjusted for seasonal factors and net of oil-price swings and other inflation (2009 [revised from 2005] chain-weighted dollars as used in reporting real GDP as of July 31st), the April 2013 merchandise trade deficit (no services) came in at $47.6 billion. That was against a recast $44.6 billion in March 2013 and against the $49.6 billion monthly deficit estimated for April 2012.

That $47.6 billion reading for April, the first-month of second-quarter 2013, was against a first-quarter 2013 monthly average of $47.8 billion, too close to make an early estimate of the reporting pressure here on second-quarter GDP.

Implications of the benchmark trade revisions for the pending July 31st comprehensive benchmark revisions are discussed in the *Opening Comments* section.

CONSTRUCTION SPENDING (April 2013)

April's Insignificant Monthly Gain Continued a Pattern of Stagnation. Construction spending continued a pattern of renewed stagnation. The monthly gain of 0.4% was not statistically-significant. The graphed patterns of activity, both before and after inflation adjustment, show patterns of downside or stagnant activity. All these numbers will change in the next report, when the annual revisions to the series also are due for release, on July 1st. Downside revisions to recent history, since 2011, would be the expectation.

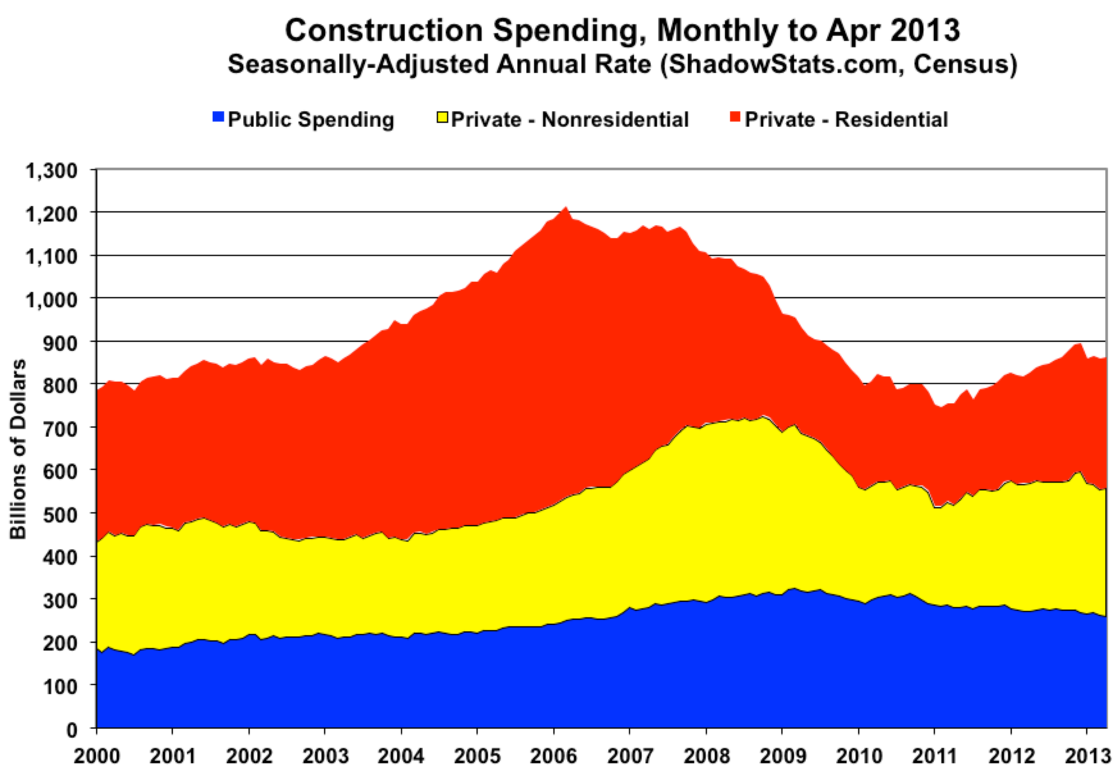
Official Reporting. The Census Bureau reported June 3rd that the total value of construction put in place in the United States during April 2013 was $860.8 billion, on a seasonally-adjusted—but not inflation-adjusted—annual-rate basis. That estimate was up by a statistically-insignificant 0.4% +/- 1.9% (all confidence intervals are at a 95% level) for the month, versus an upwardly revised $857.7 (previously $856.7) billion in March, and versus a downwardly revised $864.7 (previously $871.2) billion in February. Before prior-period revisions, the monthly April increase was 0.5%.

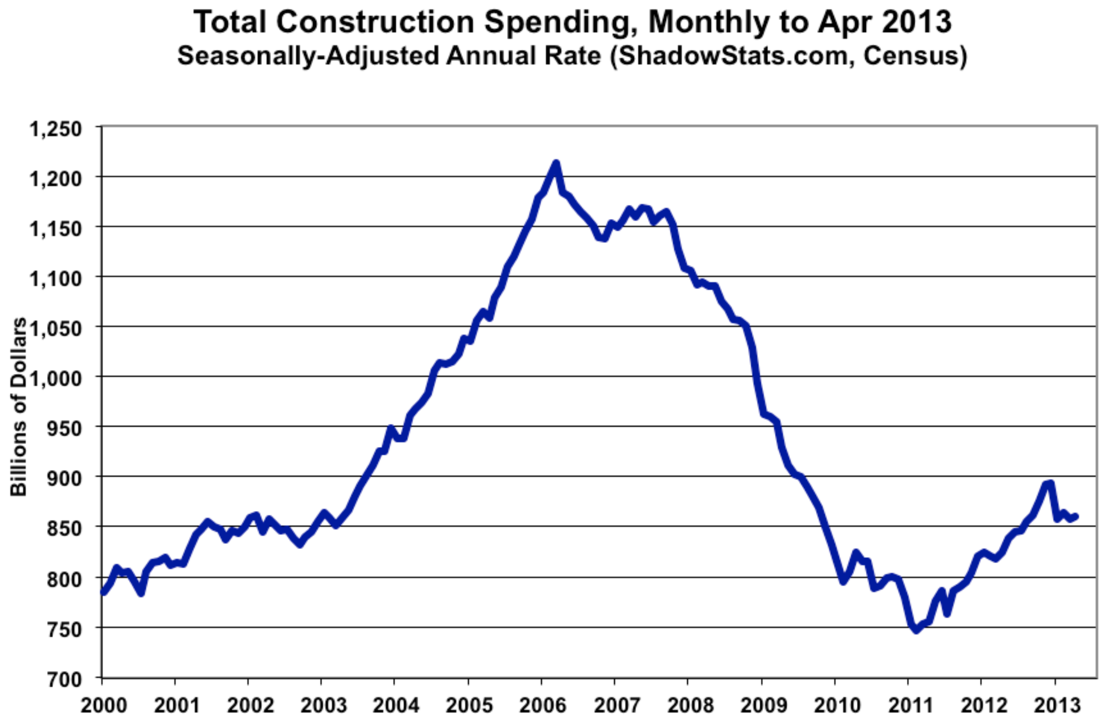
The March level of monthly activity showed a revised contraction of 0.8% (previously 1.7%).

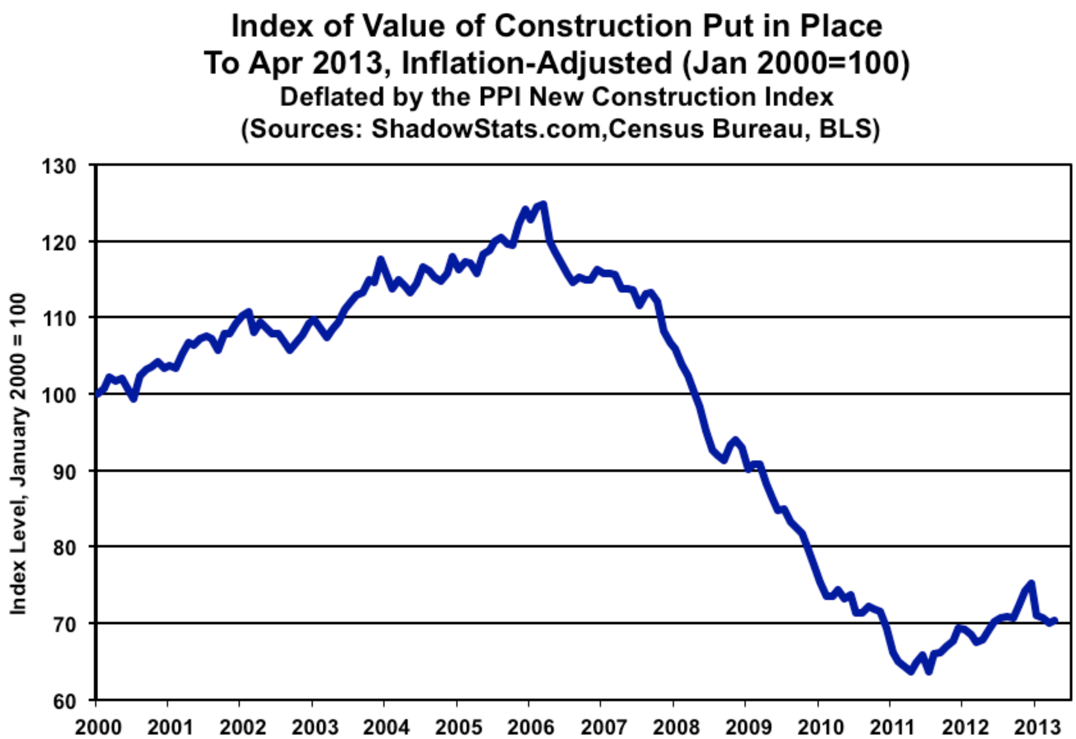
Adjusted for PPI new construction inflation, aggregate real spending in April also was up by 0.4% but down by 0.9% in March.

April 2013 construction spending was up year-to-year by a statistically-significant 4.3% +/- 2.3%, with March's annual growth revising to 4.9% (previously 4.8%). Net of construction costs indicated by the PPI current construction index, year-to-year growth in spending was 3.8% in April 2013, the same as in March.

The statistically-insignificant 0.4% gain in monthly April 2013 construction spending included a 1.2% contraction in public construction spending, which had revised to a 2.9% (previously a 4.1%) drop in March. April private construction rose by 1.0% for the month, versus a revised 0.1% gain (previously a 0.6% decline) in March. The accompanying graphs, including the first graph following, show the 0.4% monthly gain in April total construction, with private residential construction down by 0.1%, private nonresidential construction up by 2.2% and public construction down by 1.2% for the month.

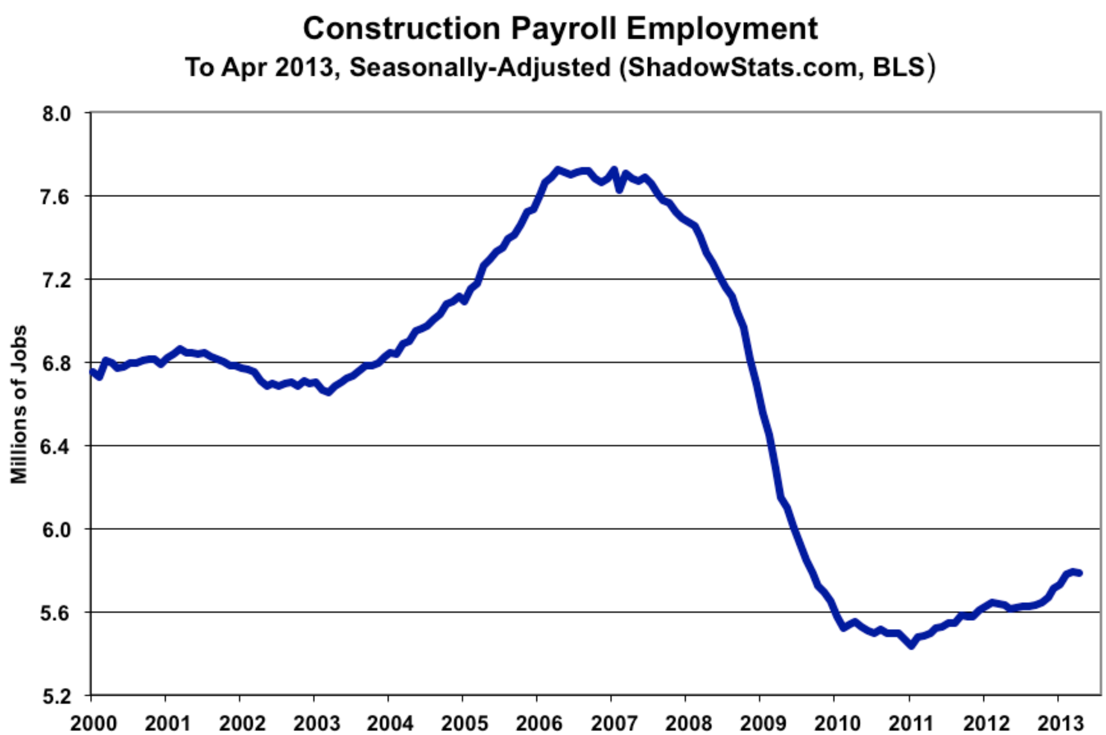



Total Construction Spending, Monthly to Apr 2013
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Billions of Dollars
1,250
1,200
1,150
1,100
1,050
1,000
950
900
850
800
750
700
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013

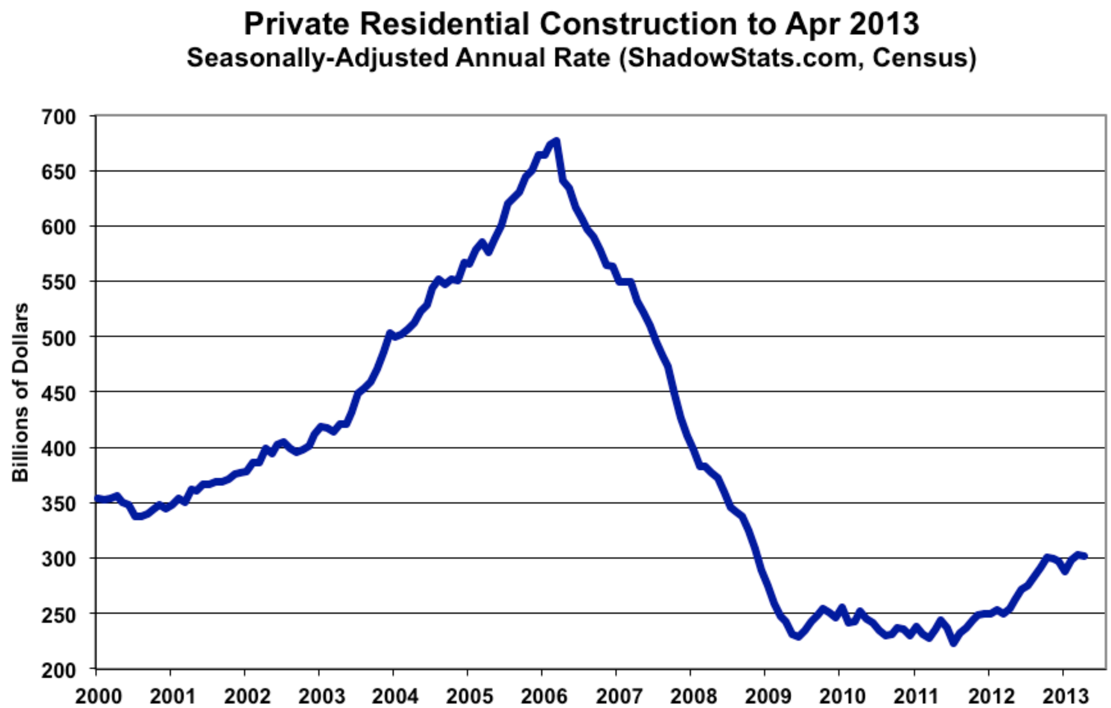

Index of Value of Construction Put in Place
To Apr 2013, Inflation-Adjusted (Jan 2000=100)
Deflated by the PPI New Construction Index
(Sources: ShadowStats.com,Census Bureau, BLS)
Index Level, January 2000 = 100
130
120
110
100
90
80
70
60
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013

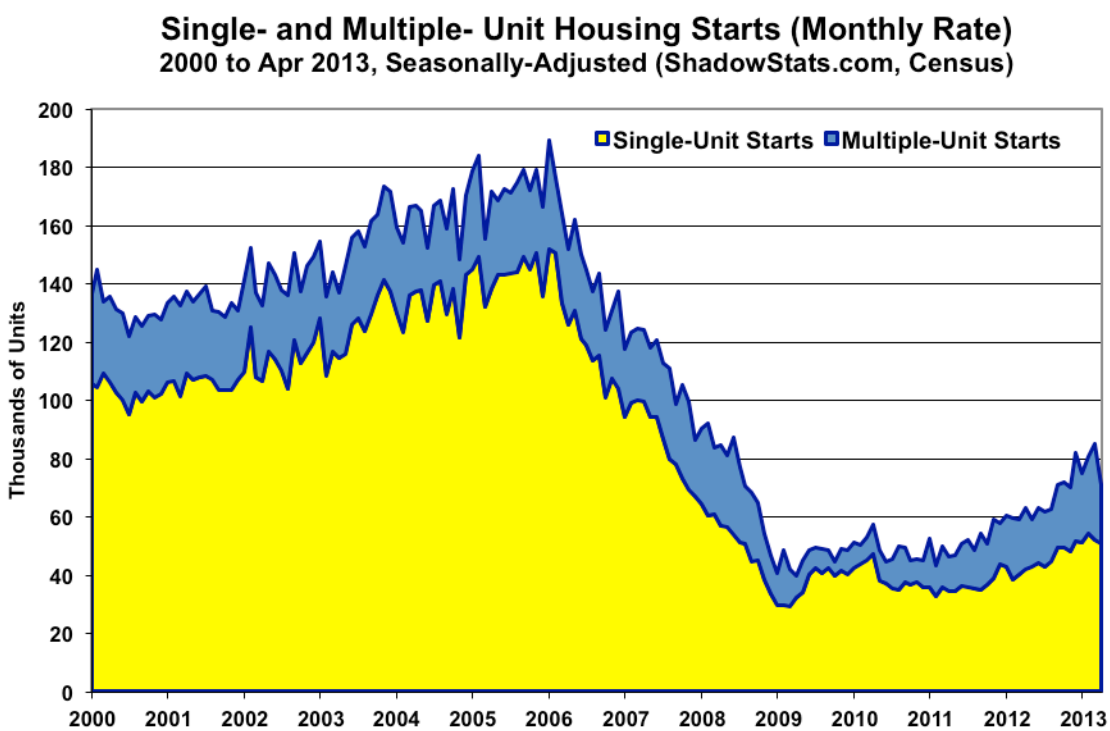
The preceding two graphs reflect total construction spending through April 2013, the first is before inflation adjustment; the second is an aggregate index reflecting inflation-adjusted data. The second graph (see also *Opening Comments)* shows the April 2013 ShadowStats estimation of an inflation-adjusted construction spending series. There is no perfect inflation measure for deflating construction, but the PPI new construction index is the closest found in publicly available series. Adjusted for the PPI measure, construction spending shows the economy slowing in 2006, plunging into 2011, turning minimally higher in an environment of low-level stagnation, and faltering anew in the most recent reporting. The pattern of inflation-adjusted activity here does not confirm the economic recovery shown in the headline GDP series (see *Commentary No. 528*). To the contrary, the latest construction reporting, both before and after inflation adjustment, shows a developing, renewed decline in activity.

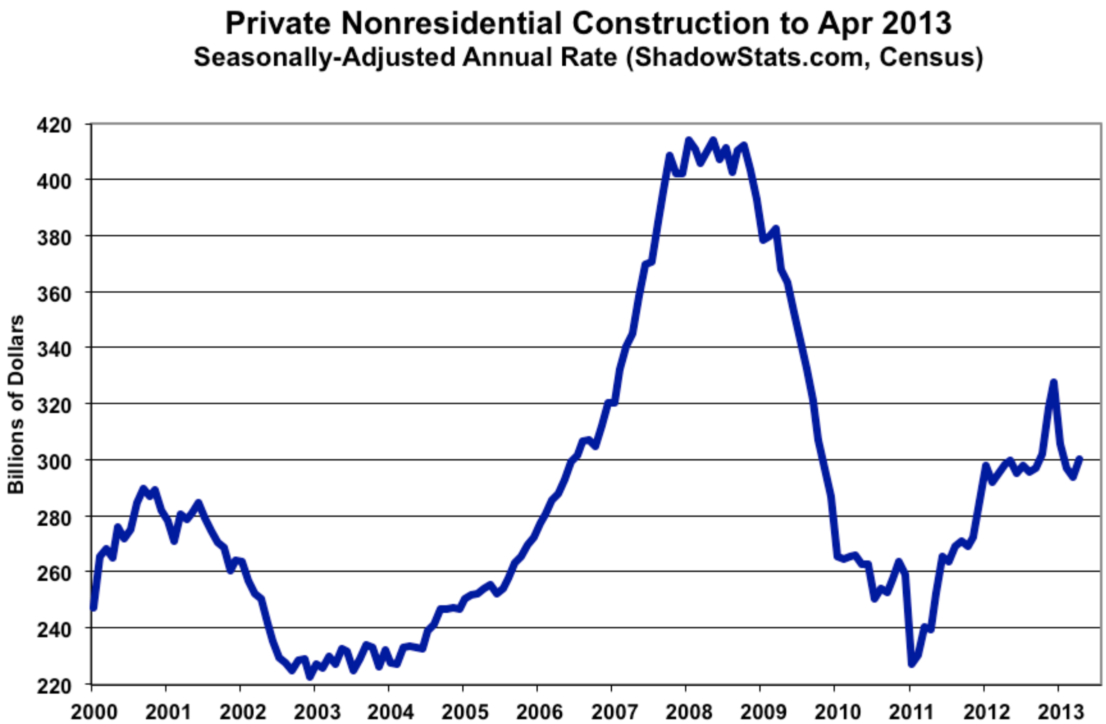
The next graph reflects the reporting of April 2013 construction employment, released May 3rd by the Bureau of Labor Statistics. The revised employment graph and data through May will be published in Friday's June 7th *Commentary*, which will cover the May employment report.

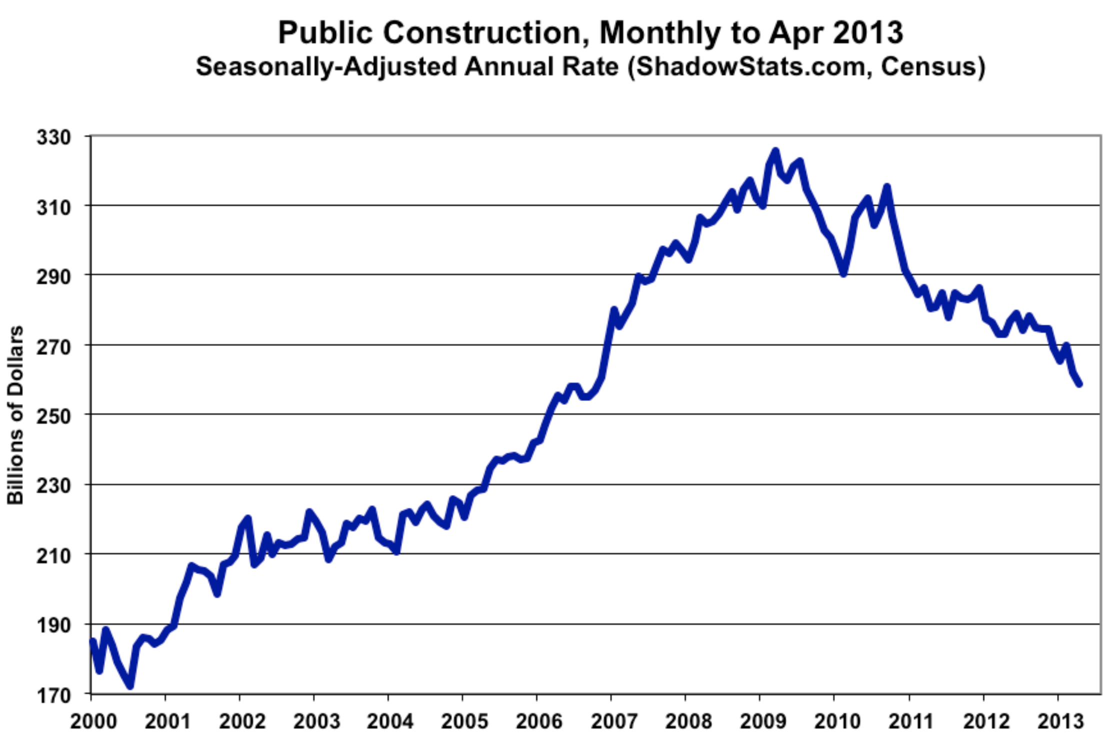


The next two graphs cover private residential construction, including housing starts, as reported for April 2013 (see *Commentary No. 525* for detail). The difference in the graphs is the smoother pace of actual spending (not-adjusted-for-inflation), instead of the more-irregular monthly variation in the count of physical monthly starts.


Private Residential Construction to Apr 2013
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Billions of Dollars
700
650
600
550
500
450
400
350
300
250
200
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Single- and Multiple- Unit Housing Starts (Monthly Rate)
2000 to Apr 2013, Seasonally-Adjusted (ShadowStats.com, Census)
Single-Unit Starts
Multiple-Unit Starts
Thousands of Units
200
180
160
140
120
100
80
60
40
20
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Private Nonresidential Construction to Apr 2013
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Billions of Dollars
420
400
380
360
340
320
300
280
260
240
220
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Public Construction, Monthly to Apr 2013
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Billions of Dollars
330
310
290
270
250
230
210
190
170
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013

The last two graphs of the preceding series show the patterns of the monthly level of activity in private nonresidential construction spending and in public construction spending. The public construction spending is 98% nonresidential.

WEEK AHEAD

Weaker Economic and Inflation Data Are Likely for Data Published in June. [New or revised text in this section is underlined.] As seen in the last two months of consumer inflation reporting, May 2013 consumer inflation also should be muted by seasonally-adjustment constraints on oil and gasoline prices. That said, the highly irregular, unadjusted oil and gasoline price movements turned somewhat higher in May. Distortions from increasingly irrelevant, shifting and severely-negative gasoline and oil price seasonal adjustments should flip to positive-side distortions with June and July's adjusted CPI reporting, and to neutral in May and then to positive in June for the PPI. Going forward, reflecting the still-likely negative impact on the U.S. dollar in the currency markets from continuing QE3 and the still-festering fiscal crisis/debt-ceiling debacle, reporting in the ensuing months and year generally should reflect much higher-than-expected inflation (see *No. 527: Special Commentary*).

Where expectations for economic data in the months and year ahead should tend to soften, weaker-than-expected economic results still remain likely, given intensifying structural liquidity constraints on the consumer. Increasingly, previous estimates of economic activity should revise lower, particularly in upcoming annual benchmark revisions, as has been seen already in industrial production, new orders for durable goods, retail sales, and the trade deficit, and as pending for construction spending (July 1st) and the GDP (July 31st—comprehensive overhaul and redefinition back to 1929). A ShadowStats estimate of the net shift in GDP reporting patterns will be published before that revision.

Reporting Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-ongoing economic turmoil of the last six-to-seven years, which has been without precedent in the post-World War II era of modern economic reporting. These impaired reporting methodologies provide particularly unstable headline economic results, where concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data), and they have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

With an increasing trend towards downside surprises in near-term economic reporting, recognition of an intensifying double-dip recession should continue to gain. Nascent concerns of a mounting inflation threat, though muted, increasingly have been rekindled by the Fed's monetary policies. Again, though, significant inflation shocks are looming in response to the fiscal crisis and a likely, severely-negative response in the global currency markets against the U.S. dollar.

The political system and Wall Street would like to see the issues disappear, and the popular media do their best to avoid publicizing unhappy economic news, putting out happy analyses on otherwise negative numbers. Pushing the politicians and media, the financial markets and their related spinmeisters do their best to hype anything that can be given a positive spin, to avoid recognition of serious problems for as long as possible. Those imbedded, structural problems, though, have horrendous implications for the markets and for systemic stability, as discussed in *Hyperinflation 2012*, *No. 485: Special Commentary* and *No. 527: Special Commentary*.

Updated—Employment and Unemployment (May 2013). The May labor data are due for release on Friday, June 7th, from the Bureau of Labor Statistics (BLS). Most commonly, the consensus jobs estimate settles around the trend estimate from the BLS seasonal-adjustment models. The May 2013 payroll trend number is for a 204,000 jobs gain, versus April reporting of 165,000 (see *Commentary No. 521*). The early consensus appears to be below the trend, at about 175,000. Separately, the markets appear to be expecting the May unemployment rate to hold at the 7.5% headline U.3 level reported in April.

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

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

