

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

**COMMENTARY NUMBER 536**  
**Gold, GDP Revision, May 2013 Household Income**

**June 26, 2013**

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**May Household Income Remained Stuck Near Cycle Low—No Recovery**

**Unusually Large GDP Revision So Late in Cycle  
Could Be Suggestive of Pending Benchmark Impact**

**Fed Policies Should Intensify Market Reactions to Economic Surprises**

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*PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, July 3rd, covering estimates of the May trade balance and of May construction spending and the annual benchmark revision. A subsequent Commentary on July 5th will cover June 2013 employment and unemployment.*

*Best wishes to all — John Williams*

**OPENING COMMENTS AND EXECUTIVE SUMMARY**

**Weaker Data Should Shift Market Expectation Towards Greater Fed Easing.** The unexpected downward revision to headline first-quarter GDP growth could begin to lower market expectations for U.S. economic activity over the near term. Given another negative economic surprise or two, market

reactions could become quite volatile. This potential outcome is based on the circumstances under which the Federal Reserve would pull back from its QE3 quantitative easing program. As discussed in yesterday's (June 25th) *Opening Comments* of [Commentary No. 535](#), the late-2013 pullback and mid-2014 cessation of QE3, currently envisioned by the markets, is fully contingent on the economy matching the relatively rosy economic forecasts of the Fed. The odds, however, strongly favor reporting of significant economic deterioration in the months ahead, which first should shift sentiment towards ongoing QE3, and then towards expanded QE3.

Today's (June 26th) stock-market rally could be reflecting that, partially, but the coincident heavy selling in the gold market appears well removed from such sentiments. Nonetheless, the underlying fundamentals have not changed and remain extraordinarily positive for gold and silver, and they should help to push the prices of the monetary precious metals much higher, once the current market turmoil has been worked through.

The broad ShadowStats outlook is unchanged, although the *Hyperinflation Outlook* in the *Hyperinflation Watch* section has been updated.

The GDP and real median household income numbers released today confirmed the troubled nature of GDP reporting, and showed no improvement whatsoever in consumer liquidity conditions that are so important for fueling consumption growth in any broad-based economic activity.

**Gross Domestic Product—GDP (Third Estimate, Second Revision).** Second revisions to quarterly GDP data usually are minimal. Although still no more than statistical noise, today's downside revision in headline first-quarter 2013 GDP growth from 2.4%, to 1.8%, was unusually large. While the change is not particularly meaningful, in the context of consistently, statistically-insignificant headline growth, the revision may be somewhat indicative of what lies ahead in the July 31st comprehensive revisions to the GDP series.

The current GDP estimate is the final one before the benchmarking. Statistical agencies tend to report the last pre-benchmark growth rate at close to what will be estimated along with the benchmark revision. As a result, significant prior-period revisions are not quite as visible to the casual observer. Accordingly, there is a suggestion here of possible downside revisions ahead for recent GDP reporting.

**GDP Reporting.** The third estimate (second revision) of first-quarter 2013 GDP showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 1.78% (previously 2.39%, initially 2.50%). That was against a 0.38% headline gain in fourth-quarter 2012. Year-to-year real change in first-quarter 2013 GDP was 1.62% (previously 1.78%, initially 1.80%). That was revised to a level lower than the 1.67% in fourth-quarter 2012.

**Implicit Price Deflator.** First-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was reported at a revised annualized pace of 1.26% (previously 1.17%, initially 1.20%), versus 0.97% in the fourth-quarter. Year-to-year IPD inflation was a revised 1.62% (previously and initially at 1.60%) in the first-quarter, versus 1.84% in the fourth-quarter.

**Gross Domestic Income (GDI).** The second estimate of first-quarter 2013 GDI, which is the income-side reporting equivalent of the consumption-side GDP, came in at a revised headline growth rate of 2.48% (previously 2.50%), versus a 5.47% gain in fourth-quarter 2012. This reporting reflected wild gyrations

in income numbers that BEA is not otherwise offsetting. First-quarter 2013 year-to-year growth held at 2.17%, versus 2.50% in fourth-quarter 2012.

*Gross National Product (GNP).* The GNP is the broadest measure in the national income accounts, where GDP is GNP net of trade in factor-income (interest and dividend payments). Headline first-quarter 2013 GNP was a revised 1.23% (previously 1.46%), versus the revised headline GDP growth of 1.78%. The revised 1.23% GNP growth was against a 0.93% gain in the fourth-quarter. On a year-to-year basis, first-quarter annual growth was a revised 1.78% (previously 1.84%), versus 1.62% in the fourth-quarter.

***Distribution of Headline GDP Growth.*** Despite the limited significance of the following detail, it is included for those subscribers interested in the reported shifting patterns of GDP growth, as guessed at by the BEA. The downwardly revised, statistically-insignificant headline first-quarter GDP growth of 1.78% (previously 2.39%, initially 2.50%) reflected the following aggregation of contributed growth. Please note that the growth number in each sub-category is the additive contribution to the aggregate, headline change in GDP, where  $1.83\% + 0.96\% - 0.09\% - 0.93\% = 1.77\%$ , a rounding difference versus the headline 1.78%:

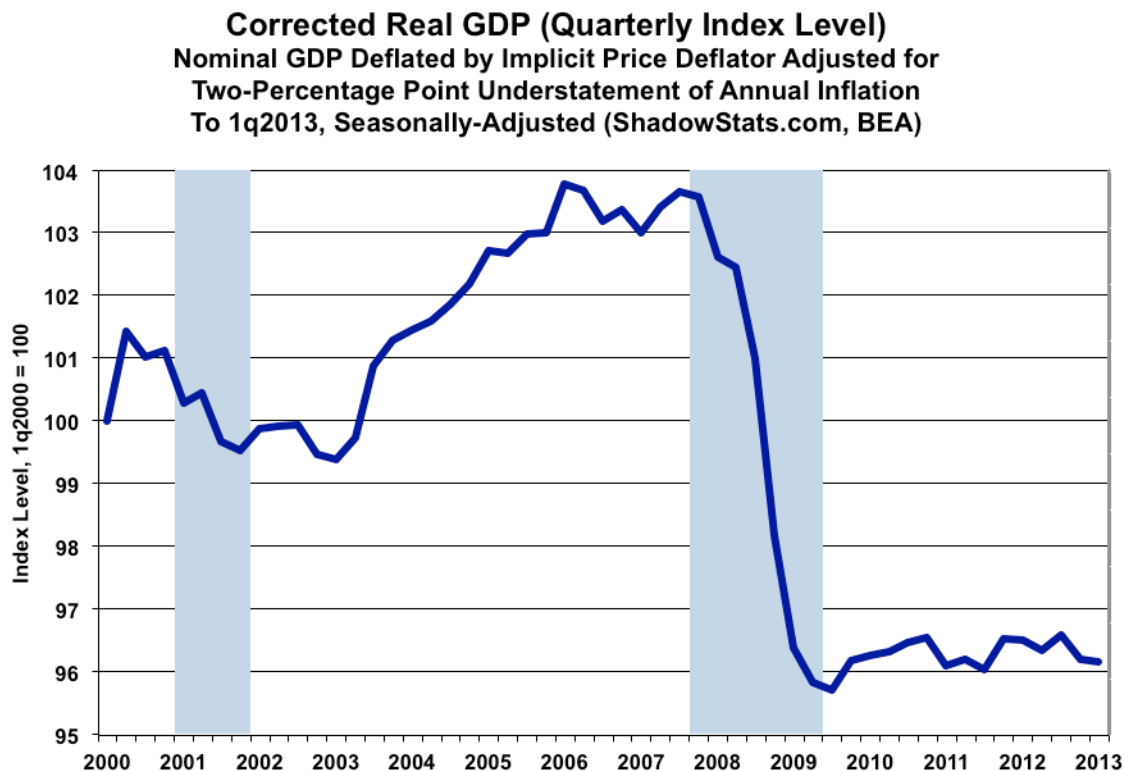
- ***Consumer Spending Contributed 1.83% (Previously 2.40%, Initially 2.24%) to Growth.*** Reduced growth in personal consumption accounted for the bulk of the downside revision to aggregate headline GDP growth. The downside revisions were in the heavily-modeled and guessed-at services sector, which contributed a revised 0.80% (previously 1.42%, initially 1.58%) of the headline GDP gain. The largest categories taking hits in the services area were “health care” and “other,” which included net dental care, foreign travel, legal and personal care services, and also in the nonprofit institutions area (the output of hospitals).
- ***Business/Residential Investment Contributed 0.96% (Previously 1.16%, Initially 1.56%) to Growth.*** The revised slowing of the business sector also contributed to the downside revision, particularly in the area of nonresidential construction.
- ***Net Exports Subtracted 0.9% (Previously 0.21%, Initially 0.50%) from Growth.*** The smaller subtraction from the widening trade deficit was a positive offset to the other downside revisions in growth.
- ***Government Spending Subtracted 0.93% (Previously 0.97%, Initially 0.80%) from Growth.*** Little changed from previous reporting, of the 0.93% reduction to aggregate GDP growth from cuts in government consumption, included an unrevised 0.63% (initially 0.60%) that was attributed to reduced defense spending. The balance of government cuts largely was at state and local government levels.

The preceding numbers are official detail, subject to a full revamping and restatement in the comprehensive GDP benchmark revision on July 31st.

***Comprehensive GDP Benchmark Revision on July 31st.*** The third estimate of first-quarter 2013 GDP was the last release for the current GDP series. The “advance” estimate of second-quarter 2013 GDP will be published coincident with, and as part of the upcoming benchmark revision. As more-fully discussed in the *Reporting Detail* section, the “comprehensive” GDP revisions due for release on July 31st will redefine the GDP series and restate historical information back to 1929. Revised economic data of recent years should show the severe recession to have been more protracted and more intense than previously reported, along with a fair chance of suggesting that the official GDP started to turn down anew, in 2012.

Such revisions would be consistent with what eventually should be recognized as the second dip in a double- or multiple-dip recession, co-joined with the formal 2007-to-2009 recession.

**Economic Reality.** The GDP remains the most-worthless and most-heavily-politicized of government economic series. It does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. 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](#)). Most-recent reporting suggests ongoing quarterly contractions. That pattern is shown in the accompanying “corrected” GDP graph, which is described in the next sub-section, where it also is shown again, plotted to the same scale as an accompanying, comparative graph of the headline GDP.



Please note that the pattern of activity shown here is much closer to the pattern shown in the graph of real median household income (at the end of the *Opening Comments*), than is the plot of headline GDP growth (red line) shown in the following *Corrected GDP* subsection.

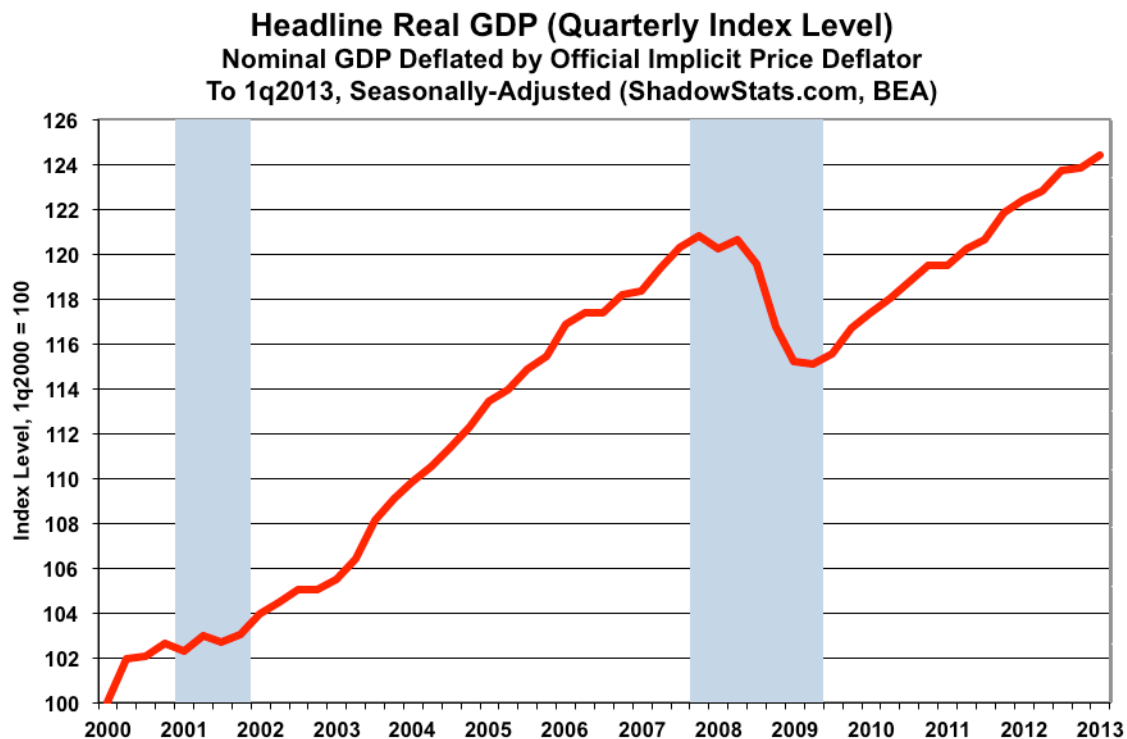
As suggested by the latest detail on household income and consumer liquidity, as graphed and discussed later in these *Opening Comments* and in [No. 527: Special Commentary](#), a sustainable business recovery

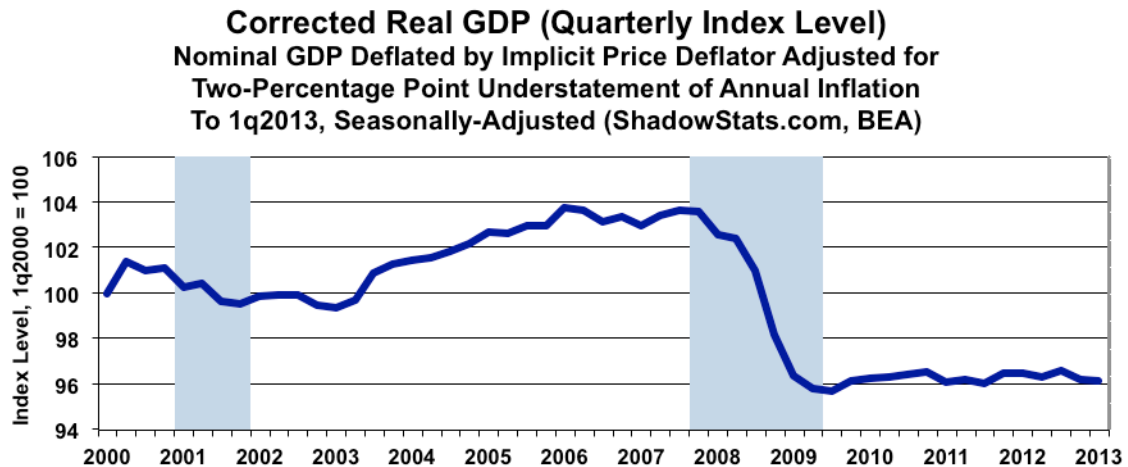
could not have taken place since 2009, and a recovery will not be forthcoming until the consumer's structural income and liquidity problems are resolved.

**Corrected GDP.** 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 estimate of first-quarter 2013 GDP. These graphs also update those in [No. 527: Special Commentary](#).

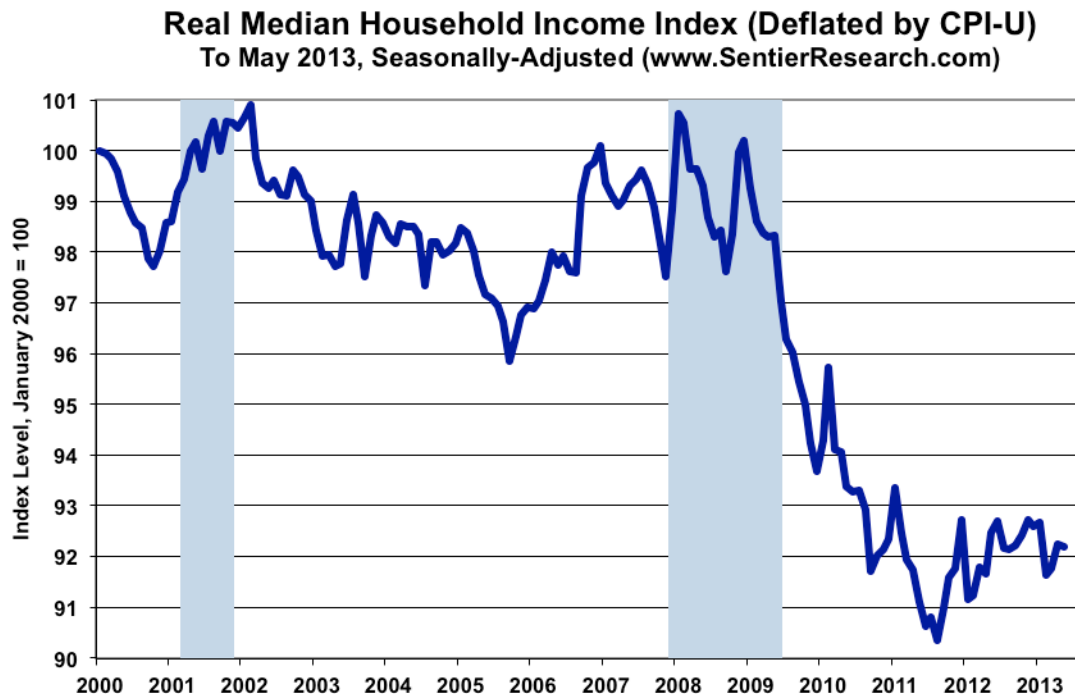
Shown in the first graph, official real GDP activity has been reported above pre-2007 recession levels—in full recovery—since fourth-quarter 2011, and has shown sustained growth since. Adjusted for official gains in GDP inflation, the level of first-quarter 2013 GDP is now at a revised 3.0% (previously 3.2%) above the pre-recession peak-GDP estimate of fourth-quarter 2007.

No other major economic series has shown a parallel pattern of full economic recovery and beyond (although current uncorrected real retail sales have just moved past that full-recovery point, five quarters later, as discussed in [Commentary No. 534](#)). 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. It is the same graph as shown at the end of the prior section, but plotted to scale that is fully consistent with the graph of the uncorrected, headline series. 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 here are indexed to first-quarter 2000 = 100, again, with the plots to consistent scales.





**Median Household Income (May 2013).** As shown in the preceding graph, May 2013 real median household income, as deflated by the CPI-U, and as estimated by [www.SentierResearch.com](http://www.SentierResearch.com), notched lower, month-to-month, continuing a pattern of low-level stagnation. Allowing for normal volatility of the series, the current level basically is at the low of the cycle. Without income growth, consumers cannot support sustained growth in the personal consumption component of the GDP. See [Commentary No. 534](#) for additional comments on consumer liquidity.

The household income patterns tracked here tend to reflect that patterns of the “corrected,” not the “headline,” GDP series.

*[For further detail on the second revision to first-quarter 2013 GDP, see the Reporting Detail section.]*

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## HYPERINFLATION WATCH

**Hyperinflation Outlook—Revised Summary.** *[The summary has been revised for this Commentary. Changes from the prior version as first published in Commentary No. 531 are underlined. Otherwise, the text has not been changed.]* The comments here are intended as background material for new subscribers and for those looking for a brief summary of the broad outlook of the economic, systemic and inflation crises that face the United States in the year or so ahead.

**Background Material.** [No. 527: Special Commentary](#) (May 2013) supplemented [No. 485: Special Commentary](#) (November 2012), reviewing shifting market sentiment on a variety of issues affecting the U.S. dollar and prices of precious metals. [No. 485](#), in turn, updated [Hyperinflation 2012](#) (January 2012)—the base document for the hyperinflation story—and the broad outlook for the economy and inflation, as well as for systemic-stability and the U.S. dollar. Of some use, here, also is the [Public Comment on Inflation](#).

These are the primary articles outlining current conditions and the background to the hyperinflation forecast, and they are suggested reading for subscribers who have not seen them and/or for those who otherwise are trying to understand the basics of the hyperinflation outlook. The fundamentals have not changed in recent years, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, the next, fully-updated hyperinflation report is planned for the near future.

**Beginning to Approach the End Game.** Nothing is normal: not the economy, not the financial system, not the financial markets and not the political system. The financial system still remains in the throes and

aftershocks of the 2008 panic and near-systemic collapse, and from the ongoing responses to same by the Federal Reserve and federal government. Further panic is possible and hyperinflation remains inevitable.

Typical of an approaching, major turning point in the domestic- and global-market perceptions, bouts of extreme volatility and instability have been seen with increasing frequency in the financial markets, including equities, currencies and the monetary precious metals (gold and silver). Consensus market expectations on the economy and Federal Reserve policy also have been in increasing flux. The FOMC and Federal Reserve Chairman Ben Bernanke have put forth a plan for reducing and eventually ending quantitative easing in the form of QE3. The tapering or cessation of QE3 is contingent upon the U.S. economy performing in line with overly-optimistic economic projections provided by the Fed. Initially, market reaction pummeled stocks, bonds and gold.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment should shift quickly towards no imminent end to QE3, and then to expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and, eventually, they will have to recognize same. Business activity remains in continued and deepening trouble, and the Federal Reserve—despite currency-market platitudes to the contrary—is locked into quantitative easing by persistent problems now well beyond its control. Specifically, banking-system solvency and liquidity remain the primary concerns for the Fed, driving the quantitative easing. Economic issues are secondary concerns for the Fed; they are used as political cover for QE3. That cover will continue for as long as the Fed needs it.

At the same time, rapidly deteriorating expectations for domestic political stability reflect widening government scandals, in addition to the dominant global-financial-market concern of there being no viable prospect of those controlling the U.S. government addressing the long-range sovereign-solvency issues of the United States government. All these factors, in combination, show the end game to be nearing.

The most visible and vulnerable financial element to suffer early in this crisis likely will be the U.S. dollar in the currency markets (all dollar references here are to the U.S. dollar, unless otherwise stated). Heavy dollar selling should evolve into massive dumping of the dollar and dollar-denominated paper assets. Dollar-based commodity prices, such as oil, should soar, accelerating the pace of domestic inflation. In turn, that circumstance likely will trigger some removal of the U.S. dollar from its present global-reserve-currency status, which would further exacerbate the currency and inflation problems tied to the dollar.

This still-forming great financial tempest has cleared the horizon; its impact on the United States and those living in a dollar-based world will dominate and overtake the continuing economic and systemic-solvency crises of the last eight years. The issues that never were resolved in the 2008 panic and its aftermath are about to be exacerbated. Based on the precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises. Attempts to save the system all have inflationary implications. A domestic hyperinflationary environment should evolve from something akin to these crises before the end of next year (2014). The shifting underlying fundamentals are discussed in [No. 527: Special Commentary](#); some of potential breaking crises will be expanded upon in the next revision to the hyperinflation report.

***Still Living with the 2008 Crisis.*** 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 (see new detail in [Commentary](#)



[No. 530](#)). The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series (see [No. 527: Special Commentary](#), [Commentary No. 528](#) and [Public Comment on Inflation](#)). 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.

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 ongoing panicked actions by the Federal Reserve, where it still proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise.

Before and since the mid-April rout in gold prices, there had and has been mounting hype about the Fed potentially pulling back on its “easing” and a coincident Wall Street push to talk-down gold prices. As discussed in [No. 527: Special Commentary](#), those factors appeared to be little more than platitudes to the Fed’s critics and intensified jawboning to support the U.S. dollar and to soften gold, in advance of the still-festering crises in the federal-budget and debt-ceiling negotiations. Despite orchestrated public calls for “prudence” by the Fed, and Mr. Bernanke’s press conference following the June 19th FOMC meeting, the underlying and deteriorating financial-system and economic instabilities have self-trapped the Fed into an expanding-liquidity or easing role that likely will not be escaped until the ultimate demise of the U.S. dollar.

Further complicating the circumstance for the U.S. currency is the increasing tendency of major U.S. trading partners to move away from using the dollar in international trade, such as seen most recently in the developing relationship between France and China (see [No. 527: Special Commentary](#)).

The Fed’s recent and ongoing liquidity actions themselves suggest a signal of deepening problems in the financial system. Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Accordingly, the Fed’s continuing easing moves appear to have been primarily an effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury, under the political cover of a “weakening economy.” Mounting signs of intensifying domestic banking-system stress are seen in softening annual growth in the broad money supply, despite a soaring pace of annual growth in the monetary base, and in global banking-system stress that followed the crisis in Cyprus and continuing, related aftershocks.

***Still Living with the U.S. Government’s Fiscal Crisis.*** Again, as covered in [No. 527: Special Commentary](#), the U.S. Treasury is in the process of going through extraordinary accounting gimmicks, at present, in order to avoid exceeding the federal-debt ceiling. Early-September appears to be the deadline for resolving the issues tied to the debt ceiling, including—in theory—significant budget-deficit cuts.

Both Houses of Congress recently put forth outlines of ten-year budget proposals that still 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 unrealistically 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. There still appears to be no chance of a forthcoming, substantive agreement on balancing the federal deficit.

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, including briefly postponing conflict over the Treasury's debt ceiling, bought the politicians in Washington minimal time in the global financial markets, but the time 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](#).

***U.S. Dollar Remains Proximal Hyperinflation Trigger.*** 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 has given way to mounting instabilities, and severe market turmoil likely looms, despite the tactics of delay by the politicians and ongoing obfuscation by the Federal Reserve.

This should become increasingly evident as the disgruntled global markets begin to move sustainably against the U.S. dollar. As discussed earlier, a dollar-selling panic is likely this year—still of reasonably high risk in the next month or so—with its effects and aftershocks setting hyperinflation into action in 2014. Gold remains the primary and long-range hedge against the upcoming debasement of the U.S. dollar, irrespective of any near-term price gyrations in the gold market.

The rise in the price of gold in recent years was fundamental. The intermittent panicked selling of gold has not been. With the underlying fundamentals of ongoing dollar-debasement in place, the upside potential for gold, in dollar terms, is limited only by its inverse relationship to the purchasing power of the U.S. dollar (eventually headed effectively to zero). Again, physical gold—held for the longer term—remains as a store of wealth, the primary hedge against the loss of U.S. dollar purchasing power.

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## REPORTING DETAIL

### GROSS DOMESTIC PRODUCT—GDP (First-Quarter 2013, Third Estimate, Second Revision)

**Unusually Large Second-Revision May Be Suggestive of Benchmark Changes.** Most commonly, second revisions to quarterly GDP data are minimal. Although still statistical noise, the downside revision in headline first-quarter 2013 GDP growth from 2.4% in the prior reporting, to 1.8% in today's (June 26th) headline growth rate, was unusually large. While the change is not particularly meaningful in the context of usually statistically-insignificant headline quarterly numbers, it may be somewhat indicative of what lies ahead in the July 31st comprehensive revisions to the GDP series.

The current GDP estimate is the final one before the benchmarking. Statistical agencies tend to report the last pre-benchmark growth rate at close to what will be estimated along with the benchmark revision. As a result, significant prior-period revisions are not quite as visible to the casual observer. Hence, there is a suggestion here of possible downside revisions ahead for recent GDP reporting.

Otherwise, the shifts in the headline-growth distribution from today's revisions, by major sub-category, are covered in the *Opening Comments*.

Further, 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. Based on official reporting, first-quarter 2013 GDP was a revised 3.0% (previously 3.2%) above the pre-recession GDP peak estimate of fourth-quarter 2007. With common experience and the vast bulk of other economic data showing no recovery, the headline upswing in GDP 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](#)). The “comprehensive” GDP revision, due to be published on July 31st, should alter historical GDP reporting to be more in line with those described patterns of activity. The ShadowStats estimated of “corrected” GDP, as usual, is plotted in the *Opening Comments*.

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### **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  $1.01 \times 1.01 \times 1.01 \times 1.01 = 1.0406$  or 4.1%, instead of  $4 \times 1\% = 4\%$ .

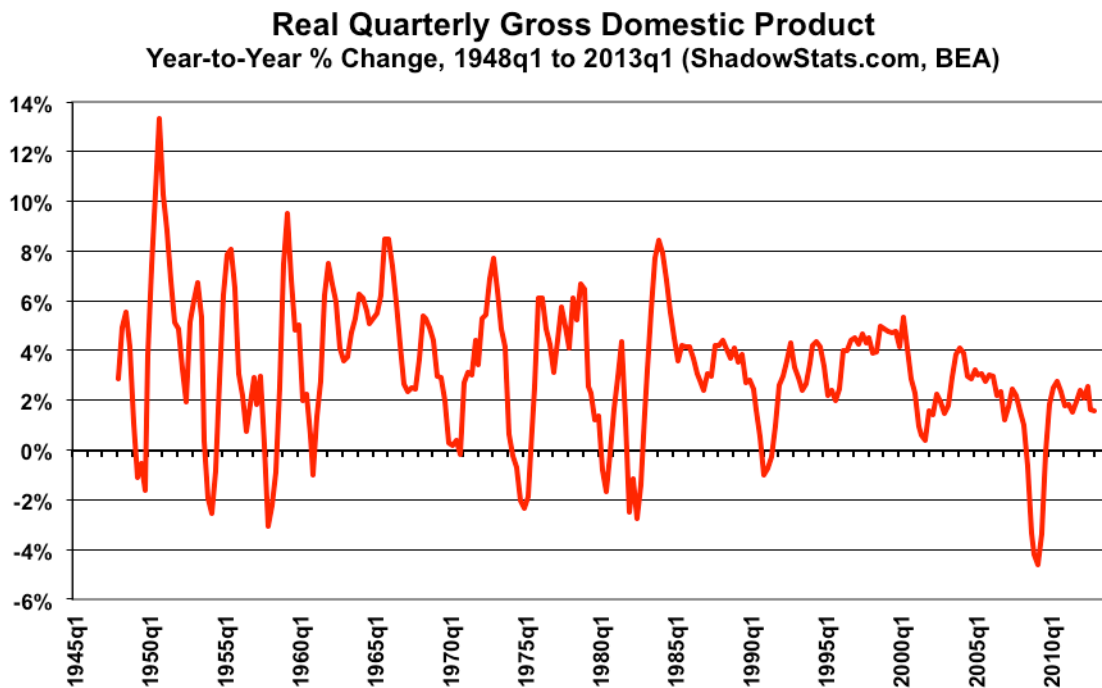
**Annual** growth refers to the year-to-year change of the referenced period versus the same period the year before.

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**Gross Domestic Product (GDP).** Published this morning, June 26th, by the Bureau of Economic Analysis (BEA), the third estimate (second revision) of first-quarter 2013 GDP showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 1.78% (previously 2.39%, initially 2.50%) +/- 3.5% (95% confidence interval). That was against a 0.38% headline gain in fourth-quarter 2012. Those numbers and all related data released today will be fully revamped with the July 31st “comprehensive revision” and redefinition of the GDP series, with all data re-estimated back to 1929.

For eight of the nine quarters since first-quarter 2011 (fourth-quarter 2011 excepted), officially-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, positive territory.

Shown in the accompanying graph is the revised, year-to-year real change in first-quarter 2013 GDP of 1.62% (previously 1.78%, initially 1.80%). That was revised to a level lower than the 1.67% in fourth-quarter 2012. 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.



***Implicit Price Deflator (IPD).*** First-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was reported at a revised annualized pace of 1.26% (previously 1.17%, initially 1.20%), versus 0.97% in the fourth-quarter. Year-to-year IPD inflation was a revised 1.62% (previously and initially at 1.60%) in the first-quarter, versus 1.84% in the fourth-quarter. Again, these numbers will be recast come July 31st.

For comparison purposes, the annualized seasonally-adjusted quarterly inflation for the CPI-U in first-quarter 2013 was 1.44%, versus 2.19% in fourth-quarter 2012, with year-to-year first-quarter CPI-U (unadjusted) at 1.68%, versus annual inflation of 1.89% in the fourth-quarter.

The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

***Pending GDP “Comprehensive Revision” and Redefinitions.*** As discussed in the prior *Commentaries* covering the GDP, the July 31st GDP overhaul will reflect much more than the 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. Better-quality underlying data for the current GDP series should result in downside revisions to reported economic activity of recent years, showing the economic downturn since 2006 to have been deeper and more-protracted than previously estimated. There is a fair chance of those revisions showing that the economy started to turn down anew, officially, in 2012, and the possibility of a quarterly contraction in the coincident release of the “advance” estimate of second-quarter 2013 GDP.



Beyond the standard data revisions, 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 nominal GDP level, per the BEA.

Where the impact of the definitional changes on estimated quarterly growth rates most likely will be positive, that effects of better-quality data revisions still should dominate the revamped historical reporting of recent years, showing weaker than previously estimated economic growth. The redefinition issues also were discussed in [Commentary No. 518](#), where, for example it was noted that the resulting:

“...higher level of nominal (not-adjusted-for-inflation) GDP will reduce slightly the federal debt-to-GDP ratio. It also will increase estimates of the velocity of money (GDP/money supply), or how many times the money supply turns over in the economy in a given year. Separately, the changes will boost the reported size of the U.S. economy on a comparative basis versus the rest of the world, although the underlying economic reality will not have changed at all.

“These methodological shifts also should result in the reporting of a somewhat less-severe Great Depression, as a result of ‘Pollyanna Creep’ that is discussed in the [GDP Primer Series](#).”

The BEA description of the pending changes can be found here: [GDP Comprehensive Revision](#).

Prior to the benchmark release, ShadowStats will publish an assessment of the pattern of likely shifts in quarterly GDP growth resulting from these revisions.

**ShadowStats-Alternate GDP.** The ShadowStats-Alternate GDP estimate for first-quarter 2013 remains a 2.0% year-to-year contraction, versus the revised headline gain of 1.6%. The alternate first-quarter estimate is a narrower contraction than the 2.2% estimated for fourth-quarter 2012, versus the official estimate then of 1.7% 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 first-quarter 2013, as it has been for eight of the last nine quarters, a period of protracted business bottom-bouncing in the real world.

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 reversing additional methodological distortions of recent decades.

**Gross Domestic Income (GDI).** The BEA’s second estimate of first-quarter 2013 GDI, which is the income-side reporting equivalent of the consumption-side GDP, came in at a revised headline real growth rate of 2.48% (previously 2.50%), versus a 5.47% gain in fourth-quarter 2012. This reporting reflected wild gyrations in income numbers that BEA is not otherwise offsetting. One can hope for more stable reporting out of the July 31st benchmark revision. First-quarter 2013 year-to-year growth held at 2.17%, versus 2.50% in fourth-quarter 2012.



**Gross National Product (GNP).** The GNP once was the benchmark economic statistic used as the broadest measure of economic activity in the United States. GNP still is the broadest measure in the national income accounts, where GDP is GNP net of trade in factor-income (interest and dividend payments). Global political problems with the GNP concept arose initially with third-world economies, where net-debtor nations usually showed much weaker GNP growth, than GDP growth, due to the net outflow of interest and dividend payments to the net-lender nations. Accordingly, the GDP became the international reporting standard. As the United States became a net-debtor nation, it shifted its headline reporting from GNP to GDP.

The headline revision to first-quarter 2013 GNP showed annualized quarterly real growth of 1.23% (previously 1.46%), versus the revised headline GDP growth of 1.78%. While the difference there is in the net relative outflow of interest and dividend payments, the series has been heavily distorted and particularly volatile in the period following the 2008 financial panic. At such time as the financial system stabilizes, the GNP should settle into a more regular pattern of weaker growth relative to the GDP.

The revised 1.23% first-quarter GNP growth was against 0.93% headline growth in the fourth-quarter. On a year-to-year basis, first-quarter annual growth was a revised 1.78% (previously 1.84%), versus 1.62% in the fourth-quarter.

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## WEEK AHEAD

**Weaker Economic and Stronger Inflation Data Are Likely for June and Beyond.** In the context of mixed, but generally weak May economic reporting, the data into June and beyond likely will disappoint a still overly-optimistic consensus view of the broad economy. Separately, with energy-inflation related seasonal-adjustment factors swinging to the plus-side in June, higher inflation reporting is likely in the months ahead. *[Except for the new series details on construction spending, trade, and employment and unemployment, the remaining text in the Week Ahead section is unchanged from the prior Commentary.]*

Going forward, reflecting the still-likely negative impact on the U.S. dollar in the currency markets from continuing QE3 and the still-festerling fiscal crisis/debt-ceiling debacle, reporting in the ensuing months and year ahead 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 the 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 likely is pending for construction spending (July 1st). The big event, though, will be the July 31st comprehensive overhaul, benchmark revision and redefinition of the GDP back to 1929. A ShadowStats estimate of the likely net shift in GDP reporting patterns (generally slower growth in recent years) 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\*](#).

**Construction Spending (May 2013, Annual Benchmark Revisions).** Due for release on Monday, July 1st, by the Commerce Department, May 2013 construction spending will be reported in the context of an annual benchmark revision, back to January 2011. The benchmarking likely will be to the downside.

Although expectations appear to favor a monthly gain in May month-to-month spending, the monthly change likely will not be statistically significant, and the series should continue its recent trend of month-to-month stagnation, particularly after adjustment for inflation.

**U.S. Trade Balance (May 2013).** The May trade deficit is scheduled for release on Wednesday, July 3rd, by the Census Bureau and the Bureau of Economic Analysis (BEA). Where the inflation-adjusted merchandise trade deficit in April basically was flat against reported first-quarter activity, the May report will set the tone for the net-export contribution to the initial estimate of second-quarter 2013 GDP (July 31st). Significant trade deterioration in May would be a net negative for the GDP, while significant

narrowing of the deficit would boost GDP growth. Underlying fundamentals and long-term trends favor trade deterioration.

**Employment and Unemployment (June 2013).** The June labor data are due for release on Friday, July 5th, 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 June 2013 payroll trend number is for a 148,000 jobs gain, versus May reporting of 175,000 (see [Commentary No. 531](#)). The developing early consensus appears to be somewhat above the trend, but weaker than the May reporting. Separately, the markets appear to be looking for the June unemployment rate to notch lower from the 7.6% headline U.3 level reported in May.

Reflecting underlying fundamental economic activity that is 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—at least in its broader measures that include discouraged workers—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.

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