

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

**COMMENTARY NUMBER 552**  
**GDP Revision, Systemic- and Consumer-Liquidity Updates**

**August 29, 2013**

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**GDP Revision Reflected Previously Discussed Trade-Flow Distortions**

**Well Removed from Real-World Activity, GDP Numbers Remain Nonsensical;  
There Never Was a Recovery and There Is None Pending**

**With Consumer Liquidity Issues Deepening,  
Broad U.S. Economic Activity Is in Renewed Contraction**

**Fed Pullback on QE3 Remains Unlikely,  
Amidst Suggestions of Intensifying Banking-System Stress**

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*PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, September 4th, covering the July trade deficit and construction spending. A subsequent Commentary on Friday, September 6th, will detail August employment and unemployment reporting.*

*Best wishes to all for an enjoyable Labor Day weekend! — John Williams*

## OPENING COMMENTS AND EXECUTIVE SUMMARY

**War Risks, Federal Debt Problems, Systemic-Solvency Issues and an Economic Downturn Are Not a Happy Mix.** The financial markets have seen a little roiling from expectations of U.S. military action against Syria. Depending on the nature of the action, and responses to same from the rest of the world, ensuing market turmoil could be significant. A major conflict would serve as a distraction for the public from domestic economic and financial difficulties and from political scandals (Bill Clinton once had the effect of briefly delaying impeachment activity by bombing Baghdad), but the Administration promises minimal action. Rumors are circulating that action has been put on hold, temporarily. Nonetheless, military actions usually have consequences, unintended or otherwise.

The risks here do not favor anything in terms of mitigating the fiscal crisis facing the U.S. government; effects would be to exacerbate the situation. From the standpoint of business activity, defense spending could receive some boost. Flight to financial safety usually benefits gold, the U.S. dollar and the Swiss franc, but the safe-haven character of the U.S. dollar appears to have been weakened in recent years. Still other factors can come into play. Commenting on the invasion of Iraq, then-Fed Chairman Greenspan noted that the President's Working Group on the Markets had intervened at the time, in the currency, gold and oil markets, among others, so as to keep circumstances orderly.

Separately, on the fiscal front, the Treasury Secretary Jacob J. Lew's latest advice is that "extraordinary measures" currently being taken by the U.S. Treasury to avoid hitting the debt ceiling "are projected to be exhausted in the middle of October [Bloomberg, August 26, 2013, *Lew Tells Congress Treasury to Hit Debt Limit in Mid-October*]." The budget-deficit crisis likely will come to the fore in the next month, as a result, with the risk of heavy selling pressure developing against the U.S. dollar. Chances of a meaningful resolution to the fiscal crisis remain nil. The global markets should respond negatively against the U.S. currency, in the event of no resolution or continued delay in addressing the issues.

Further complicating the dollar's circumstance, by mid-October, the Federal Reserve's monetization of net Treasury debt issuance for the year should be approaching 140% (it was 113% as of August 22nd). With political cover from a slowing, not an improving, economy, and with indications of increasing stress within the domestic banking, as discussed in the *Update on Systemic Liquidity* in the *Hyperinflation Watch* section, odds continue to favor the Fed not cutting back on QE3, at this time.

The fiscal and systemic-stress crises only are exacerbated by a deteriorating U.S. economy, even when the GDP gets an upside boost in revision. Where headline reporting of second-quarter GDP growth revised up to 2.5%, from initial reporting of 1.7%, the revision was due to a major, short-term distortion in the reporting of the trade deficit.

Beyond the otherwise statistically-insignificant, heavily-massaged and manipulated GDP data, evidence otherwise has continued to mount of a renewed downturn in broad U.S. economic activity, as discussed in [Commentary No. 550](#) and [Commentary No. 551](#). Related to this, the consumer's ability to fuel an expansion in personal consumption (70%-plus of GDP) remains structurally constrained by liquidity issues that include lack of income growth and lack of credit availability, and by confidence levels that continue to hold deep in recession territory.

**Upside GDP Revision Reflected Reporting Problems with the Trade Data.** In the first reporting since the comprehensive benchmark revision ([Commentary No. 546](#)), the second estimate of second-quarter 2013 GDP growth revised to 2.5%, from initial reporting of 1.7%, as generally was expected. That upside revision, however, primarily reflected a major distortion in flow-of-trade reporting, which falsely signaled a massive one-month improvement in the June 2013 trade deficit. As catch-up trade data are published, the second-quarter GDP will revise lower (though likely not until the July 2014 benchmark revision), or third- or fourth-quarter 2013 GDP will take an exaggerated hit to the downside. See the *Week Ahead* section in terms of the upcoming July trade data.

As explained in [Commentary No. 548](#) of August 6th: “... disruptions from the activation of a new computer system at one of the world’s largest container handlers have created major delays in the movement of goods through Port of New York and New Jersey. Where the issues here started in June, today’s [August 6th] trade reporting most likely was affected, primarily with imports, but also potentially on the export side, as well.”

“... By itself, the initial net-export account reduced the headline second-quarter GDP growth by 0.81%, leaving the initial aggregate headline GDP growth at 1.67%.

“As the numbers currently stand, the annualized, real merchandise trade deficit for the full reporting of second-quarter 2013 is \$569.3 billion, versus a revised \$575.2 billion in first-quarter 2013, an apparent slight narrowing, instead of deterioration, versus the first-quarter. That generates a significant upside potential for the “first revision” to second-quarter 2013 GDP growth, likely reversing the negative impact [the 0.81%] shown in the first estimate of the second-quarter GDP, again, irrespective of reporting problems with the June data, and irrespective of other revisions that may be forthcoming in the GDP.”

Indeed the contribution of net-exports to the annualized, quarterly second-quarter GDP growth rate went from a 0.81% contraction in the first estimate to 0.00% in the second estimate, accounting for nearly all of the 0.85% upside revision to the aggregate GDP growth, allowing for some minor offsetting revisions in other categories. The trade-flow distortions here likely included the delayed unloading of ships as well as re-routing and delays made in terms of arranging alternative transportation for the affected goods.

**GDP Annual Growth at Levels that Historically Have Preceded Recessions.** Despite the upside revision to second-quarter GDP, and despite the perpetual sunshine that the government would like to see radiating from its reports of broad economic activity, the year-to-year growth in quarterly GDP has fallen below levels have been seen historically only when the economy is headed into a recession (see the graphs of year-to-year growth in the *Reporting Detail* section). Similar patterns also have been evident in economic series such as industrial production and real retail sales. Again, the key pattern here is where annual growth slows to below key levels of economic activity and momentum.

The economy already appears to be in renewed contraction, as discussed in [Commentary No. 550](#) and [Commentary No. 551](#). Where consumer liquidity issues have been the primary constraints in preventing an economic recovery, they also are key to the unfolding renewed downturn, as discussed at the last part of the *Opening Comments* section.

**Gross Domestic Product (GDP) Reporting.** The second estimate, first revision of second-quarter 2013 GDP showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 2.52% (previously 1.67%) +/- 3.5% (95% confidence interval). That was against a 1.15% headline gain in first-quarter 2013. Second-quarter year-to-year growth revised to 1.64% (previously 1.43%), up from 1.32% in first-quarter 2013 GDP.

**Implicit Price Deflator (IPD).** Second-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was reported at an unrevised annualized pace of 0.71%, versus 1.67% in the first-quarter. Year-to-year, second-quarter IPD inflation remained 1.47%, versus 1.74% in the first-quarter. The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

**Gross Domestic Income (GDI).** The GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The first estimate of headline second-quarter 2013 GDI real growth was 2.46%, versus a revised 2.44% in first quarter 2013. Second-quarter year-to-year growth was 2.65%, versus a revised 1.87% in the first-quarter.

**Gross National Product (GNP).** GNP is the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments). The initial estimate of headline second-quarter 2013 GNP real growth was 2.96%, versus 0.63% in first-quarter 2013. Second-quarter year-to-year growth was 1.59%, versus 1.21% in the first-quarter.

**Distribution of Headline GDP Growth.** Despite the limited significance of the following detail, it is included for those interested in the reported internal patterns of GDP growth, as guessed at by the BEA. The statistically-insignificant, second estimate of 2.52% (initial reporting of 1.67%) headline growth for second-quarter GDP reflected the following aggregation of contributed growth. Please note that the annualized growth number in each sub-category is the additive contribution to the aggregate, headline change in GDP, where  $1.21\% + 1.48\% + 0.00\% - 0.18\% = 2.51\%$  (rounding difference versus 2.52%), versus an aggregate first-quarter growth rate of 1.15%:

- **Consumer Spending Contributed 1.21% (Previously 1.22%) to Second-Quarter Growth (1.54% in First-Quarter).** Recreational goods/vehicles, clothing, healthcare, and financial services still were among the larger contributing elements to second-quarter growth in personal consumption.
- **Business/Residential Investment Contributed 1.48% (Previously 1.34%) to Second-Quarter Growth (0.71% in First-Quarter).** Growth in the business investment sector reflected a relative increase in inventories, plus gains in residential and nonresidential construction.
- **Net Exports Contributed 0.00% to (Previously Subtracted 0.81% from) Second-Quarter Growth (0.28% Subtraction from First-Quarter).** The elimination of the initial, negative trade contribution to the “advance” second-quarter GDP estimate was the primary factor behind the upside revision to the second estimate (see earlier comments on trade data).
- **Government Spending Subtracted 0.18% (Previously 0.08%) from Second-Quarter Growth (0.82% Subtraction from First Quarter).** Following sharp declines in first-quarter defense spending, government outlays were less negative in second-quarter reporting.

**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 [Commentary No. 550](#), [Special Commentary \(No. 485\)](#) and [Hyperinflation 2012](#)). Most-recent reporting of underlying fundamentals suggests ongoing quarterly contractions, irrespective of the reporting gimmicks in the recently revamped GDP. The consistent fundamental pattern is shown in the accompanying “corrected” GDP graph.

Please note that the pattern of activity shown for the “corrected” GDP series is much closer to the patterns shown in the graphs of real median household income and of the consumer confidence and sentiment measures shown in the *Consumer Liquidity* section at the end of these *Opening Comments*, than is the accompanying plot of indexed headline real GDP growth.

As suggested by the latest detail on consumer liquidity (see also [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.

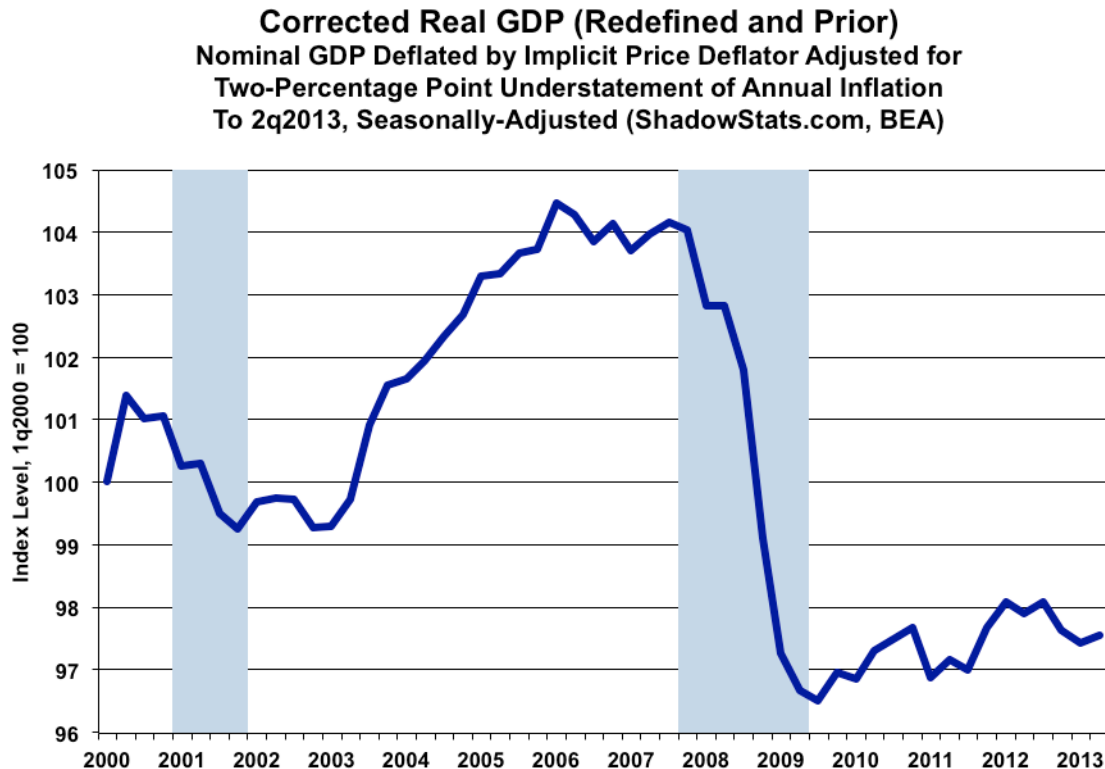
**Corrected GDP.** As usually discussed in the *Commentaries* covering the monthly GDP reporting and revisions, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. The following two graphs tell that story, updated for the second estimate of second-quarter 2013 GDP. These graphs 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 second-quarter 2011 (it had been fourth-quarter 2011 before the recent benchmarking), and the headline GDP has shown sustained growth since. Adjusted for official GDP inflation (the implicit price deflator), the level of second-quarter 2013 GDP is 4.6% 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 uncorrected real retail sales—a coincident indicator of GDP activity—recently moved minimally past that full-recovery point, such happened seven quarters after the GDP reached that point. 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 still attempt to survey real-world activity. Flaws in the GDP inflation methodologies and simplifying reporting assumptions 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 here are indexed to first-quarter 2000 = 100.

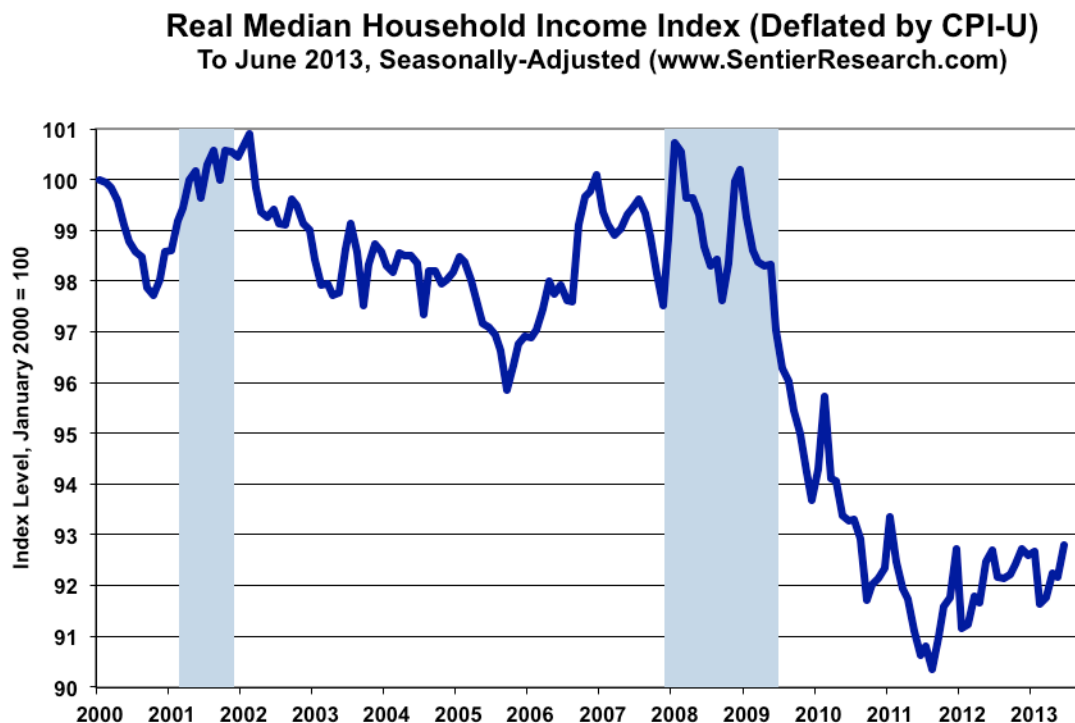


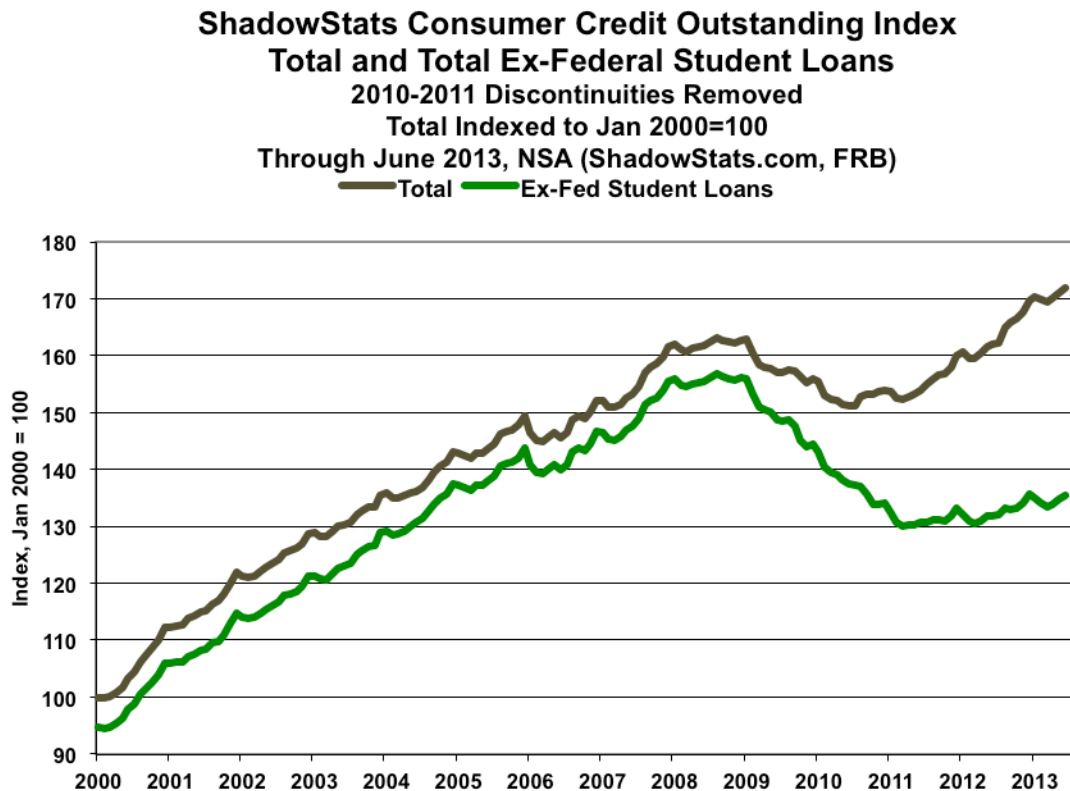
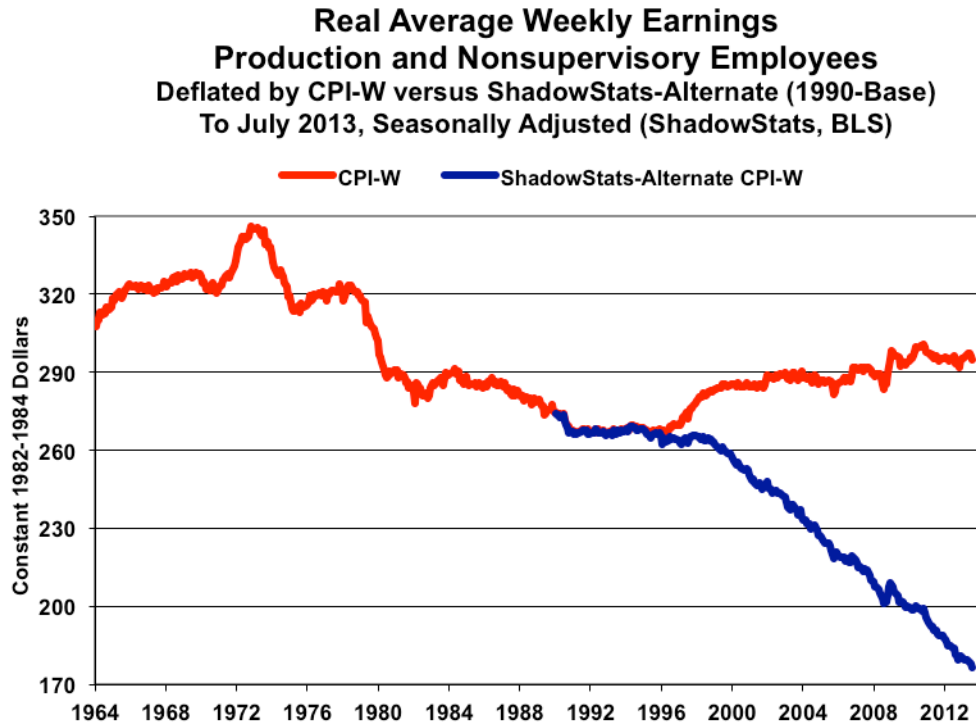


**Consumer Liquidity Remains Structurally Impaired.** The most-recent details on consumer income, credit and confidence continue to highlight the structural liquidity impairments constraining the consumer's ability to generate sustainable growth in consumption and broad economic activity. Without sustainable growth in real (inflation-adjusted) income, growth in real consumption cannot be sustained, although short-term growth conceivably could be borrowed from the future, through debt expansion.

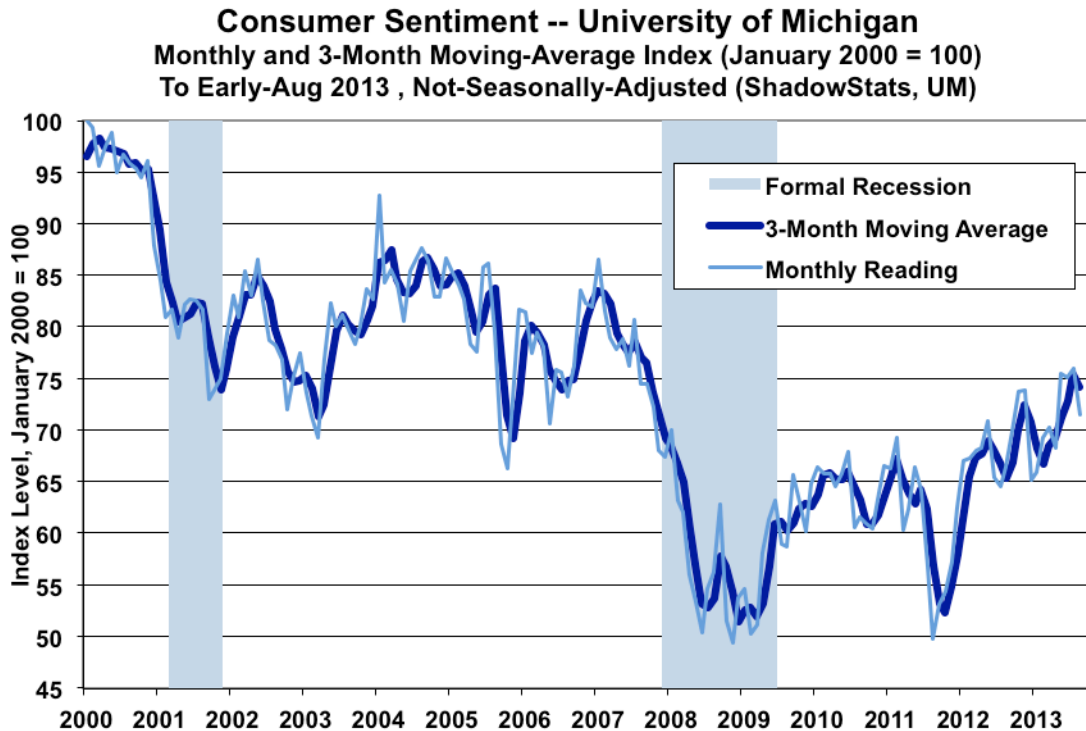
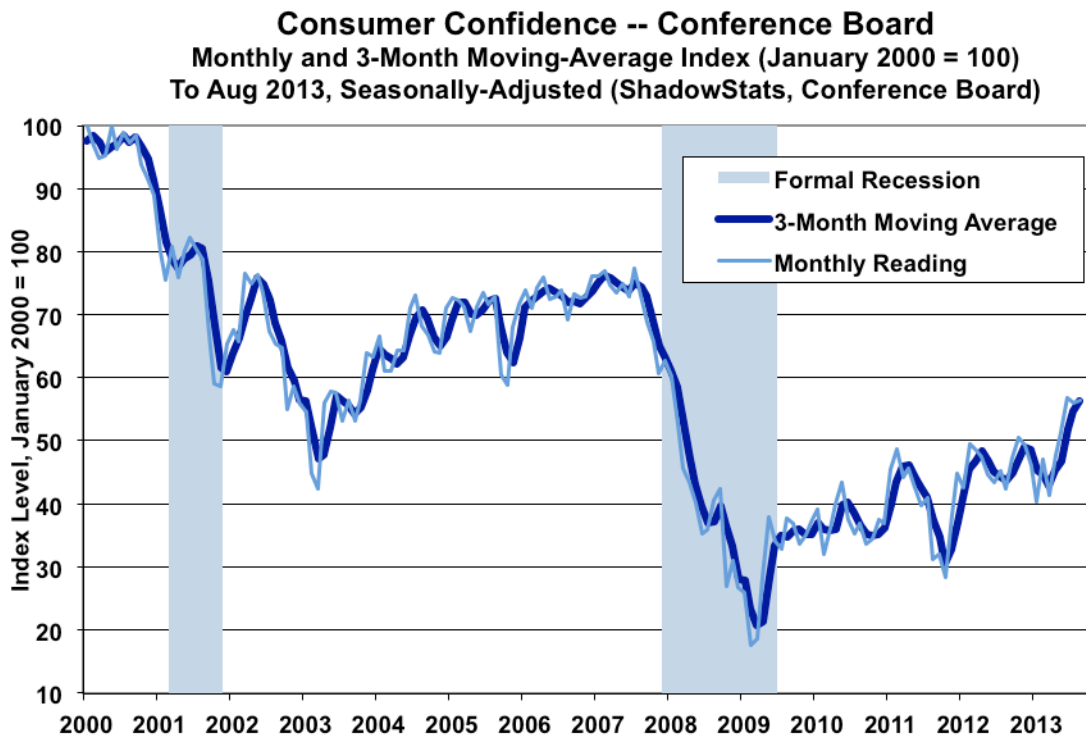
As shown in the first graph of June 2013 real median household income (data courtesy of [www.SentierResearch.com](http://www.SentierResearch.com) and republished from [Commentary No. 546](#)), median household income remains stagnant, near its cycle low. Graphs of real earnings and consumer credit (republished from [Commentary No. 549](#)) also are repeated as the second and third graphs. Real earnings remain stagnant, based on official inflation reporting, and are declining using the ShadowStats (1990-Based) alternate consumer inflation number. In terms of credit, all the post-2008-crisis growth in consumer credit outstanding has been in government-owned student loans, not in consumer lending that would fuel broad consumption.

The real median household income and real earnings graphs should be updated in the week ahead for July and August, respectively. Updated July consumer credit outstanding will available in the week following.









Separately, the prior two graphs show, respectively, the updated Conference Board's August consumer-confidence and the University of Michigan's early-August consumer-sentiment measures. Despite recent upticks in the series and subsequent declines or flattening, the mood of consumers remains at levels commonly seen in post-World War II recessions, not in expanding recoveries.

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

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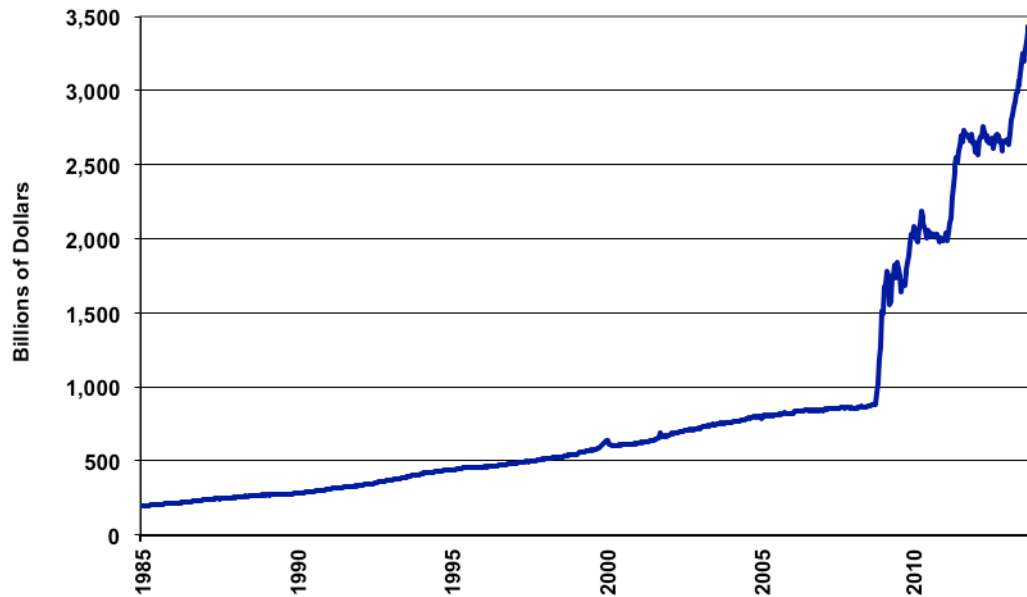
## HYPERINFLATION WATCH

**Update on Systemic Liquidity.** Along with the Federal Reserve's year-to-date net monetization of U.S. Treasury securities currently (August 22nd) at 113.2% of net issuance, the monetary base has continued to soar, both in terms of level and year-to-year growth, as reflected in the accompanying graphs. At the same time, though, annual growth has flattened out for the broad money supply (M3), and it appears to be in a tentative sharp slowing for what should be the August reporting of the ShadowStats Ongoing-M3 Estimate. There is a relationship between growth in the monetary base and the growth in M3. When the patterns diverge, they can signal mounting liquidity stresses in the banking system. The divergence, based on estimated growth rates for August, has started to increase.

The variance between the behavior of M3 and the monetary base likely is a result of the lack of normal bank lending, and the nature of the increasing variance is suggestive of mounting banking-system 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 still is nothing here to suggest an imminent end to QE3.

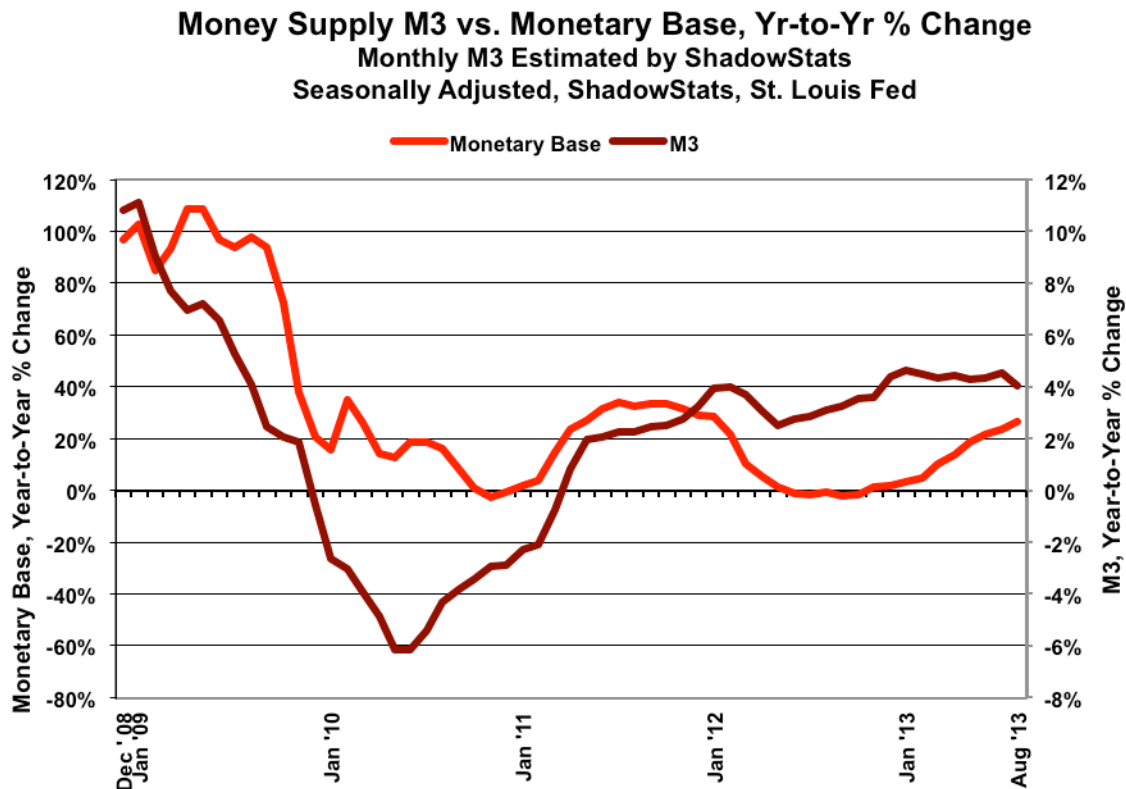
The monetary base is currency in circulation (part of M1 money supply) plus bank reserves (not part of the money supply) (see a more-complete definition in the [Money Supply Special Report](#)). Traditionally, the Federal Reserve has used the monetary base to increase or decrease growth in the money 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 Aug 21, 2013, SA, ShadowStats, St. Louis Fed



**St. Louis Fed Adjusted Monetary Base, Yr/Yr %**  
Bi-Weekly through Aug 21, 2013, SA, ShadowStats, St. Louis Fed





In the post-2008 period of extreme accommodation by the Fed, there has been some correlation between annual growth in the St. Louis Fed's monetary base and annual growth in M3, as measured by the ShadowStats-Ongoing M3 Estimate. The correlations between the growth rates are 58.1% for M3, 39.9% for M2 and 36.7% for M1, on a coincident basis, with annual M3 growth plotted versus annual growth in the monetary base shown in the preceding graph

While there has been no significant flow-through to the broad money supply from the expanded monetary base—banks still are not lending normally into the regular flow of commerce—there appears to have been some minor effect. The ShadowStats contention, again, has been that the Fed's easing activity has been aimed primarily at supporting banking-system solvency and liquidity, not at propping the economy or containing inflation. When the Fed boosts its easing, but money growth does not pick up, or it contracts, as seen at present, there is a potential indication of mounting financial stress within the banking system.

**Hyperinflation Outlook—Unchanged.** This summary of the *Hyperinflation Outlook* has been not been changed from *Commentary No. 550* of August 16th. 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, a fully-updated hyperinflation report is planned in 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. Yet, the talk of ending (or extending/expanding) QE3 still appears to be little more than jawboning, aimed either at placating a growing chorus of Fed critics or at manipulating variously the gold, currency and domestic-stock markets. Indeed, as part of the ongoing mind-games with the public, various Fed officials regularly offer contradictory stories, when the stock market needs a boost or distraction from other concerns, such as pending discord over U.S. fiscal policy.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment should shift increasingly 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, 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. These factors, in combination, show the end game to be nearing, and while they may have been in recent summer-holiday hibernation, post-Labor Day political turmoil is imminent.

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, at any time, with little or no warning. 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 precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises, hoping to push the problems even further into the future. Such attempts to save the system, however, all have exceptional inflationary implications.

The global financial markets appear ready to move beyond the forced patience with U.S. policies that had been induced by the financial terror of the 2008 panic. Accordingly, the U.S. dollar faces likely extreme and negative turmoil in the months ahead. A domestic hyperinflationary environment still 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.*** Despite the happy news from the redefined GDP series that the recession was shallower, and the recovery more rapid, than previously estimated, there still never has been an actual recovery following the economic downturn that began in 2006, and collapsed into 2008 and 2009. No other major economic series has confirmed the pattern of activity now being reported in the GDP.

Instead, what followed was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012 (see the corrected GDP graph in the *Opening Comments* section of [Commentary No. 546](#)). 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 still should gain eventual recognition as the second-dip in a double- or multiple-dip recession, with current reporting in basic economic series coming into synchronization with a renewed downturn in broad economic activity starting in second- and third-quarter 2013.

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. As of August 15, 2013, the Fed had monetized 110% of the net issuance of U.S. Treasury debt, since the beginning of the calendar year.

The Fed's unconscionable market manipulations and games playing in fueling speculation over the future of quantitative easing clearly have been used to move the U.S. dollar (the purpose of initial quantitative



easing was U.S. dollar debasement). QE3 and continuing efforts at dollar-debasement are not about to go away. 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. The loss of some reserve status for the U.S. dollar is likely, as the crises break, and that would intensify both the dollar-selling and domestic U.S. inflationary pressures.

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 soft 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 still 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 have put forth outlines of ten-year budget proposals that remain 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](#)). Recent reductions reported in the year-to-date cash-based 2013 deficit reflect gimmicks such as the U.S. government declaring itself dividends out of government-backed and controlled Fannie Mae and Freddie Mac. Those dividends also have helped the Treasury operate around the limits of the current debt ceiling. If the government consolidated those entities into its financial statements, as would happen in the corporate world, the deficit position would be much bleaker, as it is otherwise with generally accepted accounting principles or GAAP-based accounting.

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 global markets previously had expressed their extreme discomfort with the unresolved longer-range sovereign solvency issues of the United States, by dumping dollars at the time of the failed July/August 2011 fiscal negotiations. The continuing unwillingness and political inability of the current government to address those issues, only

pushes along the regular unfolding of events that eventually will trigger a massive flight from the U.S. dollar and 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 extreme 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 near-term—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 (Second-Quarter 2013, Second Estimate, First Revision)

**GDP Annual Growth at Pre-Recession Levels.** In the first GDP reporting since the July 31st comprehensive benchmark revision (see [Commentary No. 546](#)), the second estimate of second-quarter 2013 growth revised to 2.5%, from initial reporting of 1.7%. That revision largely reflected a major distortion in flow-of-trade reporting, which falsely signaled a massive one-month improvement in the June 2013 trade deficit, discussed in [Commentary No. 548](#) and in the *Opening Comments*. As catch-up trade data are published, the second-quarter GDP will revise lower (though likely not until the July 2014 benchmark revision), or third- or fourth-quarter 2013 GDP will take an exaggerated hit to the downside.

Despite the upside revision to second-quarter GDP, the year-to-year growth in quarterly GDP has fallen below levels that historically only have been seen when the economy was going into a recession (see the second graph following). Similar patterns also have been evident in the industrial production and real

retail sales series. Again, the key pattern here is where annual growth slows to below key levels of economic growth and momentum.

Nonetheless, as reported, the GDP remains the only major economic series to show a full economic recovery and meaningful new expansion, since the onset of official recession in December 2007. Based on the revised reporting, second-quarter 2013 GDP was at 4.6% (previously 4.4%) above the pre-recession GDP peak in activity, designated as fourth-quarter 2007. With common experience and the vast bulk of other economic data showing no recovery, though, the headline upswing in GDP activity, since mid-2009, has been no more than a statistical illusion created by the use of bad-quality inflation data.

Underlying real-world economic activity still indicates 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 [No. 527: Special Commentary](#), [No. 485: Special Commentary](#) and [Hyperinflation 2012](#)). The updated ShadowStats estimate of “corrected” GDP is plotted in the *Opening Comments*.

The GDP continues to be the most worthless, and the most-heavily modeled, massaged and politically-manipulated of the major economic series published by the U.S. government.

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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.

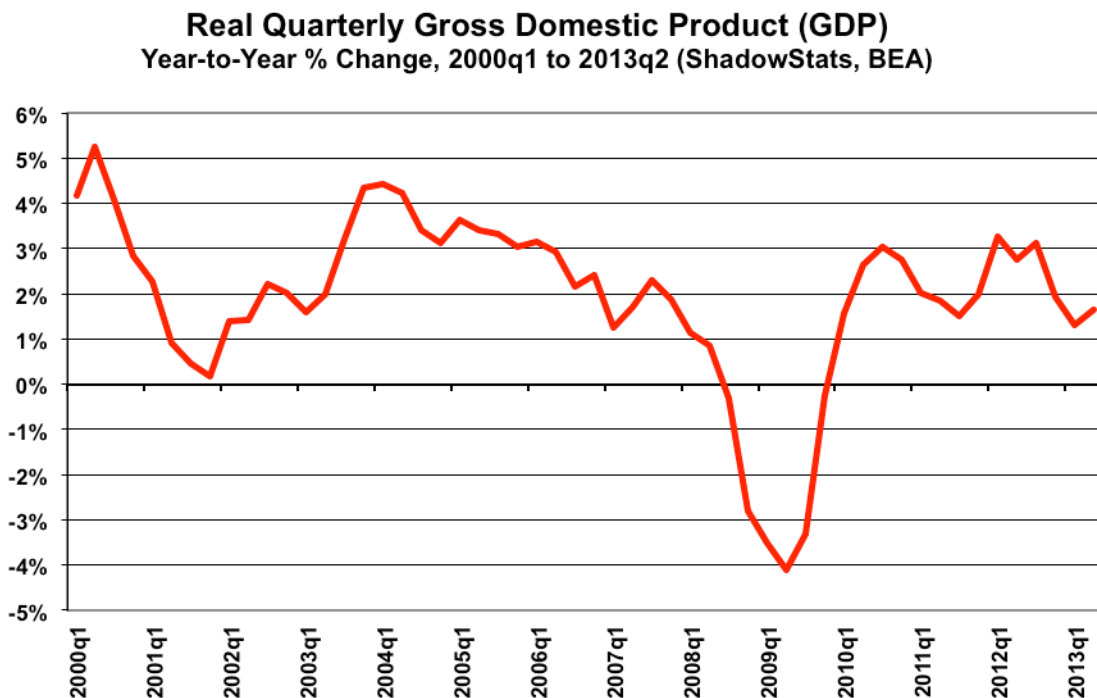
**GDP Implicit Price Deflator (IPD)** is the inflation measure used to convert GDP data from nominal to real. The adjusted numbers are based on “Chained 2009 Dollars,” as introduced with the 2013 comprehensive revisions, where 2009 is the base year for inflation. “Chained” refers to the substitution methodology which gimmicks the reported numbers so much that the aggregate of the deflated GDP sub-series missed adding to the theoretically-equivalent deflated total GDP series by \$41.8 billion in “residual,” as of the initial estimate of second-quarter 2013.

**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.

**Gross Domestic Product (GDP).** Published this morning, August 29th, by the Bureau of Economic Analysis (BEA), the second estimate, first revision of second-quarter 2013 GDP showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 2.52% (previously 1.67%) +/- 3.5% (95% confidence interval). That was against a 1.15% (pre-benchmark 1.78%) headline gain in first-quarter 2013.

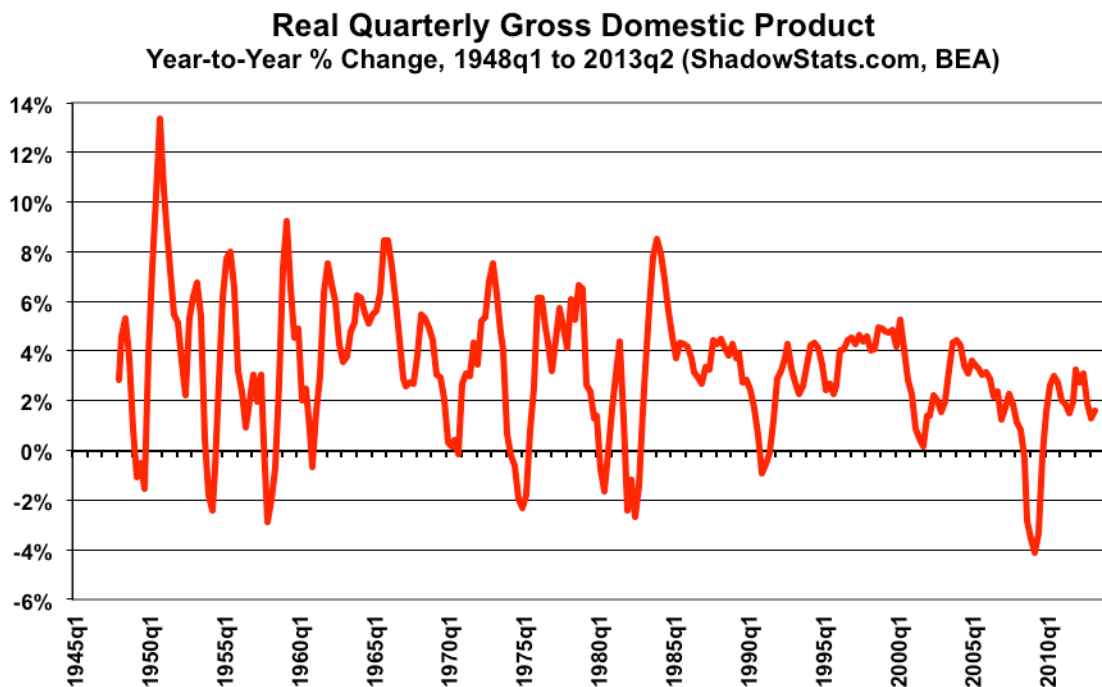
For nearly all of the sixteen quarters of the post-second-quarter 2009 official recovery period, headline growth rates have been little more than statistical noise around the unchanged level, and these heavily guessed-at numbers possibly were massaged to keep the quarterly growth rates in politically-desirable, positive territory as much as possible. Even so, as a result of the recent benchmark revisions, second-quarter 2011 GDP now shows a headline 1.3% contraction, and fourth-quarter 2012 shows annualized headline growth of just 0.1%. Those quarterly changes, though, also remain in the realm of being statistically-insignificant.



Shown in the accompanying graphs are the year-to-year real change for the GDP series. For second-quarter 2013 GDP, the second estimate of year-to-year growth revised to 1.64% (previously 1.43%), up from 1.32% (pre-benchmark 1.62%) pace of annual growth in first-quarter 2013 GDP. The latest year-to-year growth still is well off the near-term peak of 3.13% growth in third-quarter 2012. The current-cycle trough was in second-quarter 2009 at a 4.09% 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 first accompanying graph shows near-term historical detail.

The second graph shows the full history of the series. Please note in the history of the series—going back seventy years—whenever year-to-year change has fallen to current levels (1.6%) or below, a recession always has followed.



**Implicit Price Deflator (IPD).** Second-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was reported at an unrevised annualized pace of 0.71%, versus 1.67% (pre-benchmark 1.26%) in the first-quarter. Year-to-year, second-quarter 2013 IPD inflation remained 1.47%, versus 1.74% (1.62% pre-benchmark) in the first-quarter.

For comparison purposes, the annualized seasonally-adjusted quarterly inflation for the CPI-U in second-quarter 2013 was a 0.03% contraction, versus 1.44% positive inflation in first-quarter 2013, with year-to-year second-quarter 2013 CPI-U (unadjusted) at 1.39%, versus 1.68% in the first-quarter.

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

**ShadowStats-Alternate GDP.** The ShadowStats-Alternate GDP estimate for second-quarter 2013 is a 1.8% annual contraction, versus a headline year-to-year gain of 1.6%. The alternate first-quarter estimate remains a 2.0% year-to-year contraction, versus the headline gain of 1.3%, which was 1.6%, pre-benchmark (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 second-quarter 2013, as it has been for most quarters since the official second-quarter 2009 end to the recession.

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 (“Pollyanna Creep”) of recent decades.

**Gross Domestic Income (GDI).** The first estimate of second-quarter 2013 GDI also was published today (August 29th). The GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The series are forced to be equal with a “statistical discrepancy” category included in the GDI accounting. The level of nominal GDI currently shows a statistical discrepancy versus GDP of an excess \$154.5 billion (0.92%), despite the recent comprehensive revision to the series.

The headline, annualized quarterly real growth for second-quarter 2013 GDI was 2.46%, versus a revised 2.44% (previously 2.16%, pre-benchmark 2.48%) in first quarter 2013. Second-quarter year-to-year growth was 2.65%, versus a revised 1.87% (previously 1.80%, pre-benchmark 2.17%) in the first-quarter.

**Gross National Product (GNP).** The first estimate of second-quarter 2013 GNP also was published today (August 29th). GNP is the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments).

The headline, annualized quarterly real growth for second-quarter 2013 GNP was 2.96%, versus 0.63% (pre-benchmark 1.23%) in first quarter 2013. Second-quarter year-to-year growth was 1.59%, versus 1.21% (pre-benchmark 1.78%) in the first-quarter.

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## WEEK AHEAD

**Weaker-Economic and Stronger-Inflation Reporting Remain Likely in the Month and Months Ahead.** Although there appears to have been some downside adjustment to consensus expectations on the economy, the markets still are overly optimistic. That circumstance and underlying fundamentals that are



suggestive of deteriorating business activity, mean that weaker-than-consensus economic reporting should remain the ongoing trend.

Separately, given that energy-inflation-related seasonal-adjustment factors are on the plus-side for a couple of months, combined with stable or higher oil and gasoline prices—exacerbated at the moment by political tensions in the Middle East—stronger-than-expected headline CPI and PPI also are likely for at least the next month or two.

Reflecting the still-likely negative impact on the U.S. dollar in the currency markets, pending from continuing QE3, and the still-festering fiscal crisis/debt-ceiling debacle (see *Hyperinflation Outlook* section), reporting in the ensuing months and year ahead generally should reflect much higher-than-expected inflation (see [No. 527: Special Commentary](#)).

Where market expectations for economic data in the months and year ahead should continue to soften, still-weaker-than-expected economic results remain likely, given the intensifying structural liquidity constraints on the consumer, as discussed in the *Opening Comments*.

*[Except for the detail on the pending economic releases, the balance of this Week Ahead section is unchanged from the prior Commentary.]*

**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 (July 2013).** The Commerce Department will release its estimate of July 2013 construction spending on Tuesday, September 3rd. Although expectations appear to favor a small

monthly gain in spending, the monthly change, as usual, should not be statistically significant. The series likely will continue its recent trend of month-to-month stagnation.

**U.S. Trade Balance (July 2013).** The July trade deficit is scheduled for release on Wednesday, September 4th, by the Census Bureau and the Bureau of Economic Analysis (BEA). While the markets are expecting some rebound in the monthly deficit, following June's sharp narrowing of the monthly trade shortfall, that trade "improvement" was not real, reflecting instead major distortions in trade and paperwork flows, as discussed in the *Opening Comments* and in [Commentary No. 548](#).

The issue here will be if the new data will reflect any correction, either in June reporting, which would mean a pending downside revision to the just upwardly revised second-quarter 2013 GDP growth, or, more likely, exaggerated trade deterioration and false GDP-growth suppression in either third- or fourth-quarter reporting. The trade-flow and reporting problems continued into July, so the developing consensus of a bounce-back deterioration in the deficit might not surface quite as expected. Underlying trade-related fundamentals and long-term trends continue to favor significant and ongoing trade-deficit deterioration.

**Employment and Unemployment (August 2013).** The August labor data are due for release on Friday, September 6th, from the Bureau of Labor Statistics (BLS). Most commonly, the consensus jobs estimate settles around the trend estimate from the BLS seasonal-adjustment models. While the August 2013 payroll trend number is for a 212,000 jobs gain, versus July reporting of 162,000 (see [Commentary No. 547](#)), the early market consensus for August appears to be around July's relatively soft gain. Separately, the markets appear to be looking for the August headline U.3 unemployment rate to hold at July's 7.4% level.

The consensus outlook on the economy appears to have been rattled to the downside, a little, in the last month. Nonetheless, still 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 (particularly for the broader U.6 and ShadowStats measures).

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.