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

COMMENTARY NUMBER 553
July Trade Deficit, Construction Spending

September 4, 2013

July Trade Data Remain in State of Flux

Reported Gain in July Construction Spending
Was Not Statistically Significant

Brief Update on New Liquidity Numbers

A Spurious Payroll-Data Blip for August?

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, September 6th, covering August employment and unemployment reporting.*

Best wishes to all — John Williams

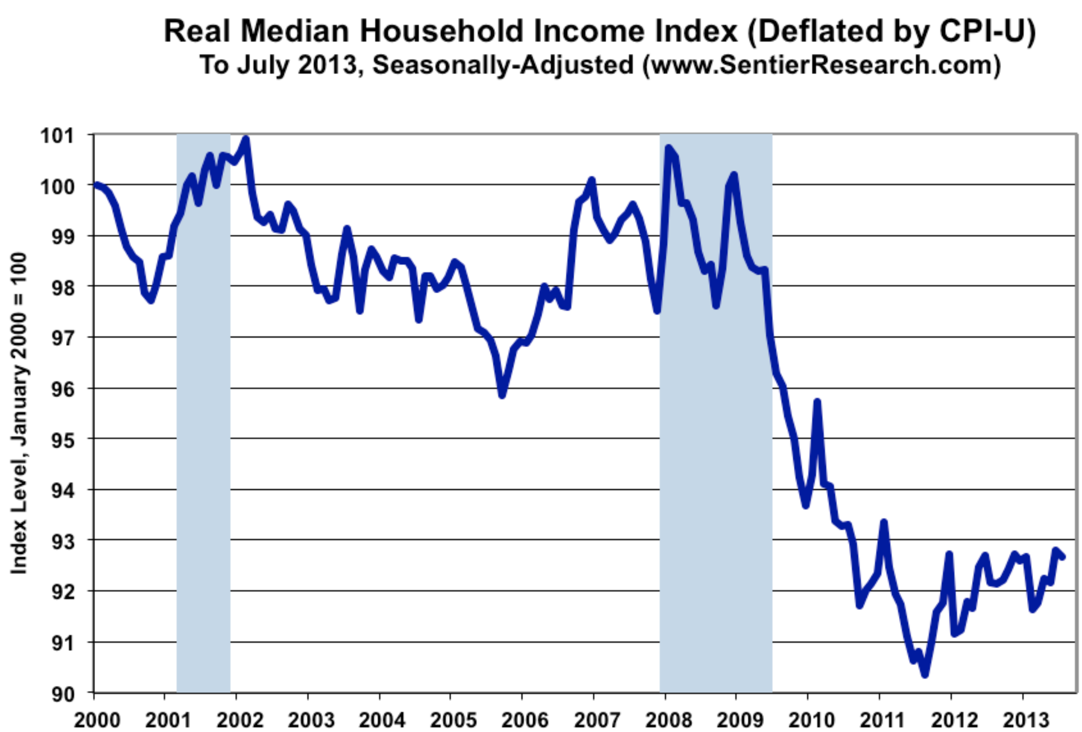
OPENING COMMENTS AND EXECUTIVE SUMMARY

Broad Outlook Is Unchanged. The general outlook on the economy, a brief review of continuing severe structural issues impairing consumer liquidity, and systemic-liquidity and War risks were covered in the prior *Commentary No. 552*. The economic outlook has not changed, other than the lack of meaningful correction to the June trade data in conjunction with July's reporting, suggests that corrective reporting in the under-estimated trade deficit, and in the corresponding overstatement of current GDP growth, will be worked out of third- and fourth-quarter GDP reporting, instead of through further second-quarter GDP revisions. As discussed in the *Latest Economic Reporting* in this section, and in *Reporting Detail*, there was nothing in the just-released trade or construction-spending numbers to suggest any form of economic recovery.

In the *Week Ahead* section, there is a *Special Alert* concerning a fair chance of an upside blip of 35,000 jobs in August teacher payrolls. That blip is no more than a modeling distortion in the government's estimation process, and the upside distortion—if it happens—should reverse out in coming months.

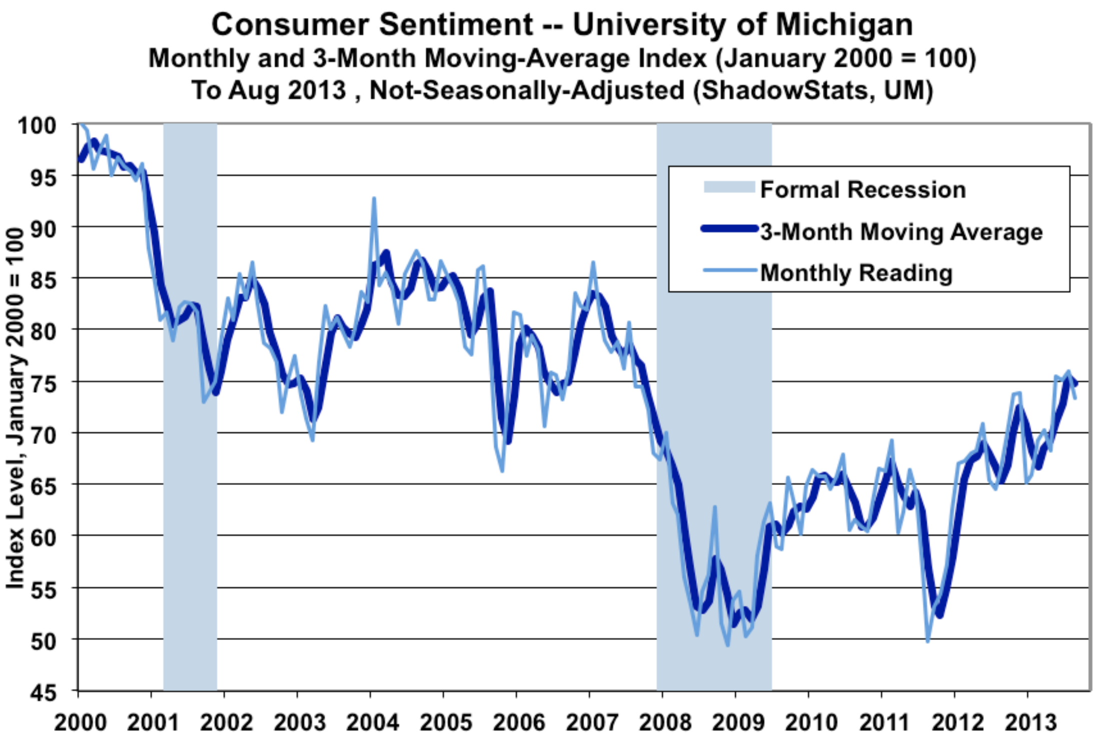
The latest graphs, updated for real median household income, and the University of Michigan's full reporting of August consumer sentiment, follow in this section, along with a brief note on the Federal Reserve's monetization of U.S. Treasury debt. The *Hyperinflation Summary* has not been revised.

Updated Liquidity Issues. Subsequent to the review of consumer liquidity conditions in the prior *Commentary No. 552*, two of the graphs related to consumer liquidity have been updated and are included here. The fist graph shows real (inflation-adjusted) median household income (data courtesy of www.SentierResearch.com), updated through July 2013.



Real median household income remains relatively stagnant, close to its near-term cycle low. Contrary to the GDP's reported pattern of activity of plunge through June 2009, followed by full economic recovery, household income showed continued plunge and then stagnation, a pattern seen commonly among economic series that usually are not tied to issues involving the government's understated inflation reporting. A similar pattern is evidenced in the second graph, following, of consumer sentiment.

The University of Michigan's estimate of consumer-sentiment has been updated to reflect reporting for the full month of August (the prior estimate was for early-August). Despite recent upticks and subsequent declines or flattening in both the Michigan and Conference Board series, the mood of consumers remains at levels commonly seen in post-World War II recessions, not in expanding recoveries as hyped by current GDP reporting.



How Can the Fed Monetize More than 100% of Net Treasury Issuance? With the Federal Reserve having monetized 116.9% of the U.S. Treasury's net issuance of gross federal debt since the expansion of QE3 at the beginning of the 2013 calendar year, through August 28th, a common question from subscribers has been, "How can the Fed monetize more than 100% of the Treasury's net issuance?"

The Fed usually buys its Treasury securities in the open market through banks, not directly upon issuance by and from the Treasury. In the open market is all the currently available marketable Treasury debt that has been issued over the years.

So far this year, the net amount bought up by the Fed is more than the net issuance of new Treasury securities. The result is that the total supply of marketable securities, outside of direct Fed ownership, has declined since the beginning of the year, while the Treasury has had effectively one buying customer who has absorbed the amount of all the new debt issuance, plus some debt issued in earlier years.

Latest Economic Reporting. July 2013 trade deficit reporting reflected no correction and minimal catch-up to June's reporting. Accordingly, correction in the trade understatement and GDP overstatement likely will be in relatively higher trade deficits, and in weaker third- and fourth-quarter GDP growth, than in an imminent revision to second-quarter 2013 GDP. The July 2013 construction-spending estimate showed continued stagnation on a month-to-month basis, with no recovery in broad construction activity.

Trade Data Remain Unstable. Discussed in *Commentary No. 548*, computer-system problems triggered major delays in the flow of goods through the Port of New York and New Jersey. Where the issues started in June and continued in July, the effects likely have included trade-flow and related paperwork delays tied to the unloading and re-routing of goods, among other issues. Accordingly, there should be some catch-up reporting in the months ahead of what are temporary disruptions to the normal flow of merchandise trade, but the widening of the monthly trade shortfall in July versus June was not a meaningful catch-up.

Beyond the lack of significant capturing or reflection of the underreported June trade deficit, July reporting included incomplete revisions to earlier data. The monthly trade deficit estimates were revised somewhat lower for the January-to-June 2013 period, reflecting a widening of merchandise trade deficits being more than offset by increases in the gimmicked estimates of service-sector surpluses. Those widened, merchandise trade-deficit revisions, however, did not surface in the inflation-adjusted estimates used in estimating the GDP.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The headline monthly trade deficit in goods and services for July 2013, on a balance-of-payments basis, widened to $39.1 billion from a revised $34.5 (previously $34.2 billion) in June. The monthly trade deterioration reflected declining exports and rising imports, including imports reflecting higher oil-import volume and prices. Year-to-year, the July 2013 deficit also narrowed against the $43.5 billion deficit of July 2012.

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil-price swings and other inflation (2009 chain-weighted dollars), but not reflecting the revisions to the nominal merchandise trade data revised with the July 2013 reporting, the July 2013 merchandise trade deficit widened to $47.7 billion. That was against a revised $43.8 in June 2013, and it narrowed from a $48.9 billion deficit in July 2012.

The extreme distortions in June's reporting led to a narrowing of the negative level of net exports in second-quarter GDP reporting. In turn, that boosted headline second-quarter GDP growth by 0.8%, from 1.7% to 2.5%, in the first revision to that number (see *Commentary No. 552*).

As the inflation-adjusted numbers currently stand, the annualized, real merchandise trade deficit for full reporting of second-quarter 2013 just revised to $571.8 (previously $569.3) billion, versus an annualized $572.3 billion for July, the first month of third-quarter 2013. In the unlikely event that the level of July reporting continued for the full quarter, then the net-export component of third-quarter GDP would be relatively neutral in its impact on the first estimate of third-quarter GDP growth, at the end of October.

Again, the June and July trade deficits appear to have suffered major distortions from trade-flow reporting problems. Meaningful, corrective revisions to second-quarter GDP are unlikely, now, with the result that a catch-up in reporting probably will be reflected in relatively weaker third- and fourth-quarter 2013 GDP estimates and in relatively wider third- and fourth-quarter trade deficits than would have been seen otherwise.

Construction-Spending Increase Was Insignificant, Once Again. Total construction spending in July 2013 continued a pattern of monthly, low-level stagnation. Although the general trend has been minimally to the upside since 2011, monthly changes rarely have been significant. The broad pattern of activity has been one of plunge (starting in 2006) and stagnation (starting in 2011), not the hyped-GDP pattern of plunge (starting at the end of 2007) and ever-after recovery (starting in mid-2009).

July 2013 Detail. The total value of construction put in place in the United States during July 2013 was $900.8 billion, on a seasonally-adjusted—but not inflation-adjusted—annual-rate basis. That estimate was up month-to-month by a statistically-insignificant 0.6%, versus a revised $895.7 (previously $883.9) billion in June. Before prior-period revisions, July reporting would have reflected a still statistically-insignificant monthly gain of 1.9%.

On an annual-growth basis, July 2013 construction spending was up year-to-year by a statistically-significant 5.2%, versus a revised June annual gain of 4.7% (previously up by 3.3%).

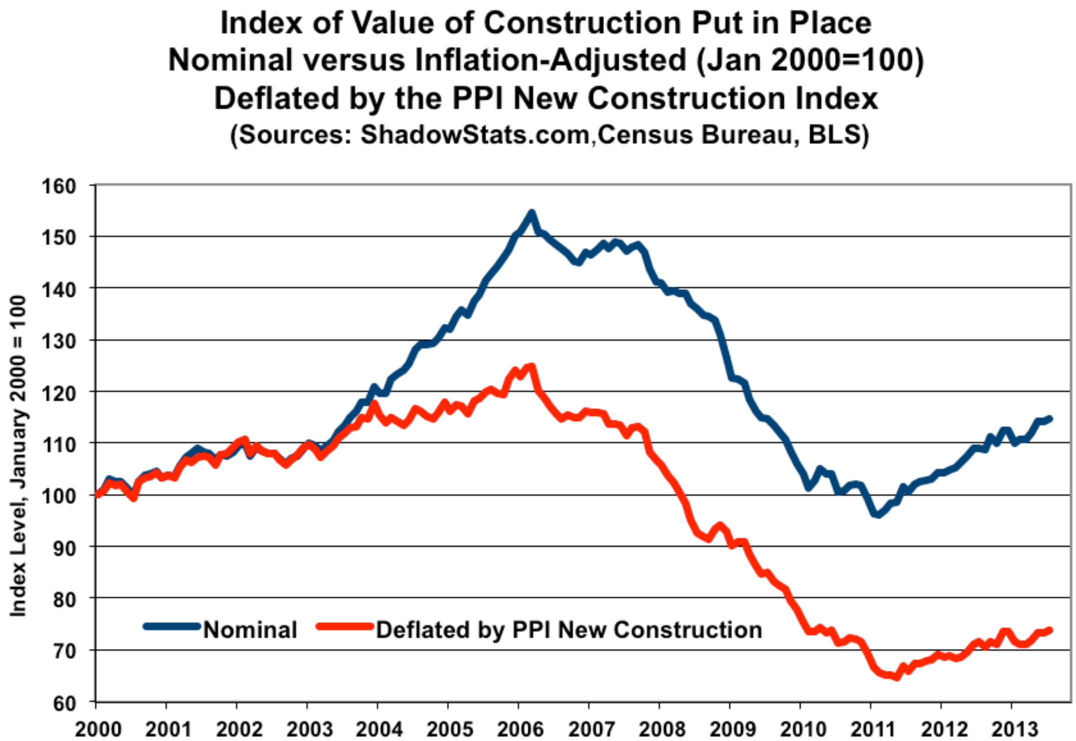
The statistically-insignificant 0.6% gain in monthly July 2013 construction spending included a 0.3% monthly contraction in public construction spending, versus a revised 0.3% month-to-month gain (previously a 1.1% contraction) in June. July private construction was up by 0.9%, following a revised 0.2% (previously 0.4%) contraction in June.

Please note that corrections to the private residential construction series, for estimates of spending on residential improvements, were published in June 2013 by the Commerce Department. Those are reflected in related graphs of private residential spending and the various total spending series in the *Reporting Detail*, and in the following graph on the inflation-adjusted aggregate series.

Adjusted for PPI new construction inflation, aggregate real spending in July 2013 was up by 0.6% month-to-month, versus an unchanged monthly level in June, while year-to-year growth in spending was 3.1% in July 2013, versus 3.1% in June. More-realistic private surveying suggests annual costs to be up by enough to come close to turning those annual construction-spending growth rates into annual contractions.

Given the usual lack of statistical significance in the monthly change in spending, and the impact of inflation, activity in the construction-spending series generally has continued at a low level of stagnation since early 2011. Such can be seen in the accompanying inflation-adjusted graph.

More-comprehensive graphs, in the *Reporting Detail* section, show detail by type of construction since 2000.



[For further detail on the July trade and construction data, see the* Reporting Detail *section.]

HYPERINFLATION WATCH

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

U.S. TRADE BALANCE (July 2013)

Unusual Distortions and Incomplete Revisions Leave the Monthly Trade Data in a State of Flux. As discussed in *Commentary No. 548*, computer-system problems, at one of the world's largest handlers of cargo containers, triggered major delays in the flow of goods through the Port of New York and New Jersey. Where the issues started in June and continued in July, the effects likely have included trade-flow and related paperwork delays tied to the unloading and re-routing of goods, among other issues. Accordingly, there should be some catch-up reporting in the months ahead of what are temporary disruptions to the normal flow of merchandise trade, but the widening of the monthly trade shortfall in July versus June fell far short of reflecting any meaningful catch-up.

There was no reporting with the July data that would suggest any significant, further related revisions to the headline estimate of second-quarter GDP growth. In terms of the trade-flow reporting problems in June and July, corrective revisions to the second-quarter GDP are unlikely now. Instead, corrective reporting probably will be seen in relatively weaker third- and fourth-quarter 2013 GDP estimates. Those growth estimates also could be recast later, in the 2014 benchmark revisions to the GDP series.

Beyond the lack of significant catch-up in the likely severe underreporting of the June trade deficit, the July 2013 trade reporting included incomplete revisions to earlier data. The monthly nominal (not-adjusted-for-inflation) trade deficit estimates were revised somewhat lower for the January-to-June 2013 period, reflecting wider merchandise trade deficits being more than offset by increases in the gimmicked estimates of service-sector surpluses. Those widened, merchandise trade-deficit revisions, however, are yet to surface in the real (inflation-adjusted) estimates used in estimating the GDP.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The BEA and the Census Bureau reported this morning, September 4th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for July 2013, on a balance-of-payments basis, widened to $39.1 billion from a revised $34.5 (previously $34.2 billion) in June. The monthly trade deterioration reflected declining exports and rising imports. Part of the monthly gain in imports was due to oil-related factors. Of some note, the July import increase also included a large carryover for a third month, $1.8 billion in July, versus $1.4 billion in June and $1.7 billion in May. Carryover reflects the current month's reporting of imports or exports that had not been reported previously in the proper month. Year-to-year, the July 2013 deficit also narrowed against the $43.5 billion deficit of July 2012.

Crude Oil and Energy-Related Petroleum Products. Higher prices and physical imports of oil helped to boost aggregate imports. For the month of July 2013, the not-seasonally-adjusted average price of imported oil notched higher to $97.07 per barrel, up from $96.93 June and up from an average of $93.71 in July 2012. Further, not-seasonally-adjusted, physical oil import volume in July 2013 averaged 8.523 million barrels per day, up from 7.811 million in June, but it was down from 8.950 million barrels per day in July 2012.

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

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil-price swings and other inflation (2009 chain-weighted dollars, used for GDP deflation), but not reflecting the revisions to the nominal merchandise trade data revised with the July 2013 reporting, the July 2013 merchandise trade deficit (no services) widened to $47.7 billion. That was against a revised $43.8 (previously $43.1 billion) in June 2013, and it narrowed from a $48.9 billion deficit in July 2012.

The extreme distortions in June's reporting (see *Commentary No. 548*) led to a narrowing of the negative level of net exports in second-quarter GDP reporting. In turn, that boosted headline second-quarter GDP growth by 0.8%, from 1.7% to 2.5%, in the first revision of that series (see *Commentary No. 552*).

As the inflation-adjusted numbers currently stand, the annualized, real merchandise trade deficit for full reporting of second-quarter 2013 just revised to $571.8 (previously $569.3) billion, versus an annualized $572.3 billion for July, the first month of third-quarter 2013. In the unlikely event that the level of July reporting continued for the full quarter, then the net-export component of third-quarter GDP would be relatively neutral in the first estimate of third-quarter GDP growth at the end of October.

The monthly trade data in June and July appear to have suffered major distortions from trade-flow problems. Meaningful, corrective revisions to the second-quarter GDP are unlikely now, with the result that a catch-up in reporting probably will be reflected in relatively weaker third- and fourth-quarter 2013 GDP estimates.

CONSTRUCTION SPENDING (July 2013)

July Construction-Spending Increase Was Insignificant, Even Allowing for Upside Revisions to June. Total construction spending in July 2013 continued a monthly pattern of low-level stagnation. Although the general trend has been minimally to the upside since 2011, monthly changes rarely have been statistically significant. The general pattern of activity has been one of plunge and stagnation, not the hyped GDP pattern of plunge and ever-after recovery, with recovery starting in mid-2009.

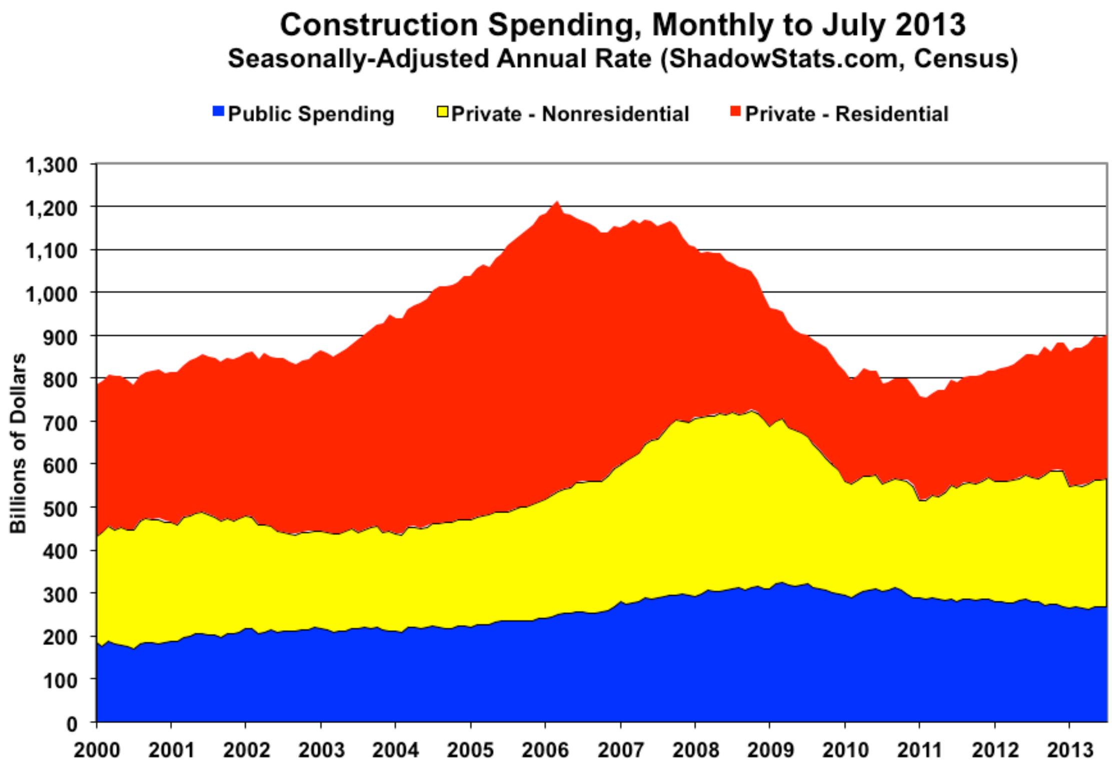
Official Reporting. The Census Bureau reported, yesterday, September 3rd, that the total value of construction put in place in the United States during July 2013 was $900.8 billion, on a seasonally-adjusted—but not inflation-adjusted—annual-rate basis. That estimate was up month-to-month by a statistically-insignificant 0.6% +/- 2.3% (all confidence intervals are at a 95% level), versus a revised $895.7 (previously $883.9) billion in June. Before prior-period revisions, July reporting would have reflected a monthly gain of 1.9%.

Adjusted for PPI new construction inflation, aggregate real spending in July 2013 was up by 0.6% month-to-month, versus an unchanged monthly level in June.

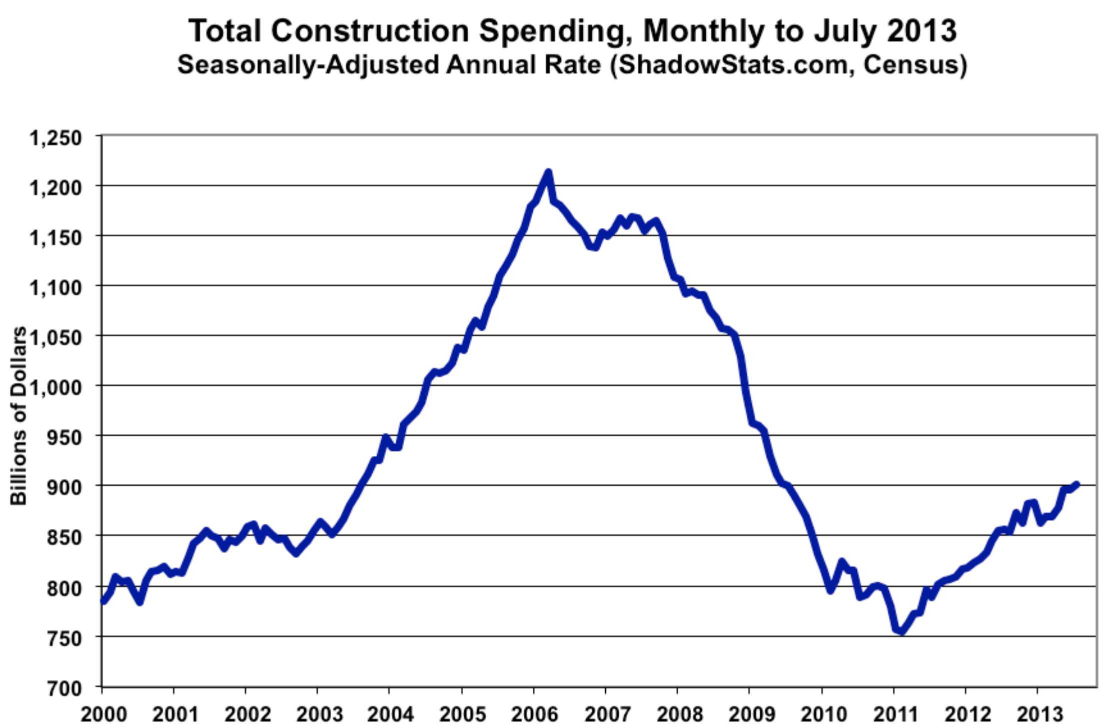
On an annual-growth basis, July 2013 construction spending was up year-to-year by a statistically-significant 5.2% +/- 2.5%, versus a revised June annual gain of 4.7% (previously up by 3.3%). Net of construction costs indicated by the PPI current construction index, year-to-year growth in spending was 3.1% in July 2013, versus 3.1% in June. More-realistic private surveying suggests annual costs to be up by enough to come close to turning those annual construction-spending growth rates into annual contractions.

The statistically-insignificant 0.6% gain in monthly July 2013 construction spending included a 0.3% monthly contraction in public construction spending, versus a revised 0.3% month-to-month gain (previously a 1.1% contraction) in June. July private construction was up by 0.9%, following a revised 0.2% (previously 0.4%) contraction in June. The accompanying graphs, including the first graph following, show the 0.6% monthly gain in July total construction, with private residential construction up by 0.6%, private nonresidential construction up by 1.3% and public construction down by 0.3% for the month.

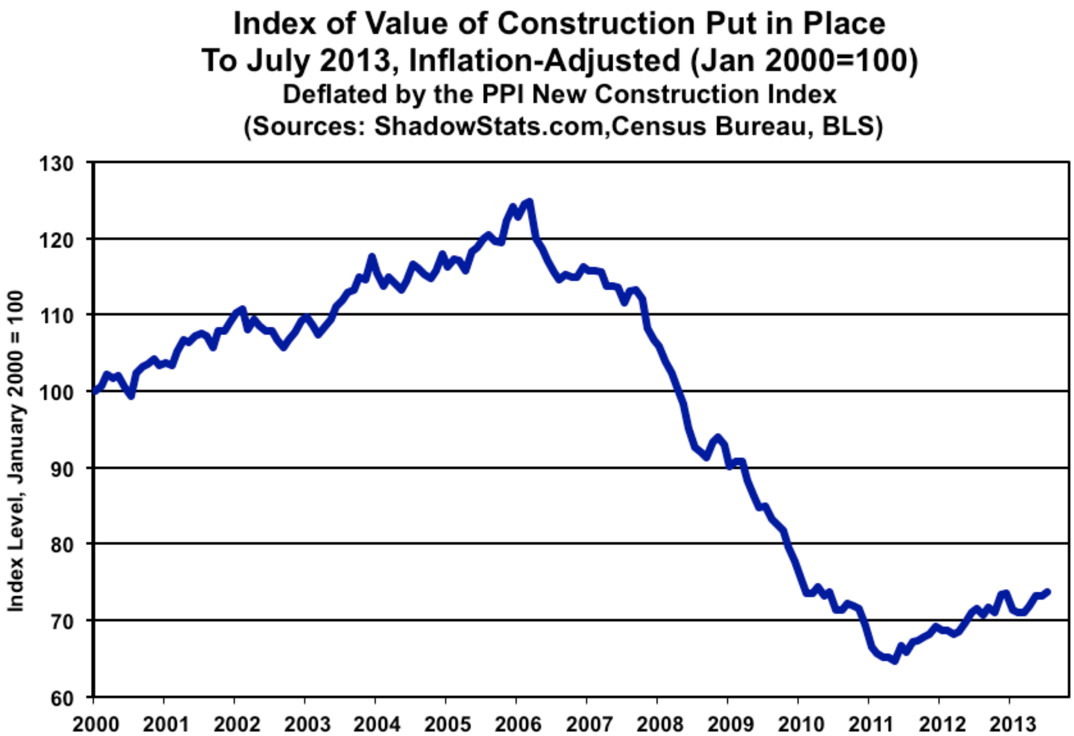
Please note that corrections to the private residential construction series, for estimates of spending on residential improvements, were published in June 2013 by the Commerce Department. Those are reflected in related graphs of private residential spending and the various total spending series.



Construction Spending, Monthly to July 2013
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Public Spending
Private - Nonresidential
Private - Residential
Billions of Dollars
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
100
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013

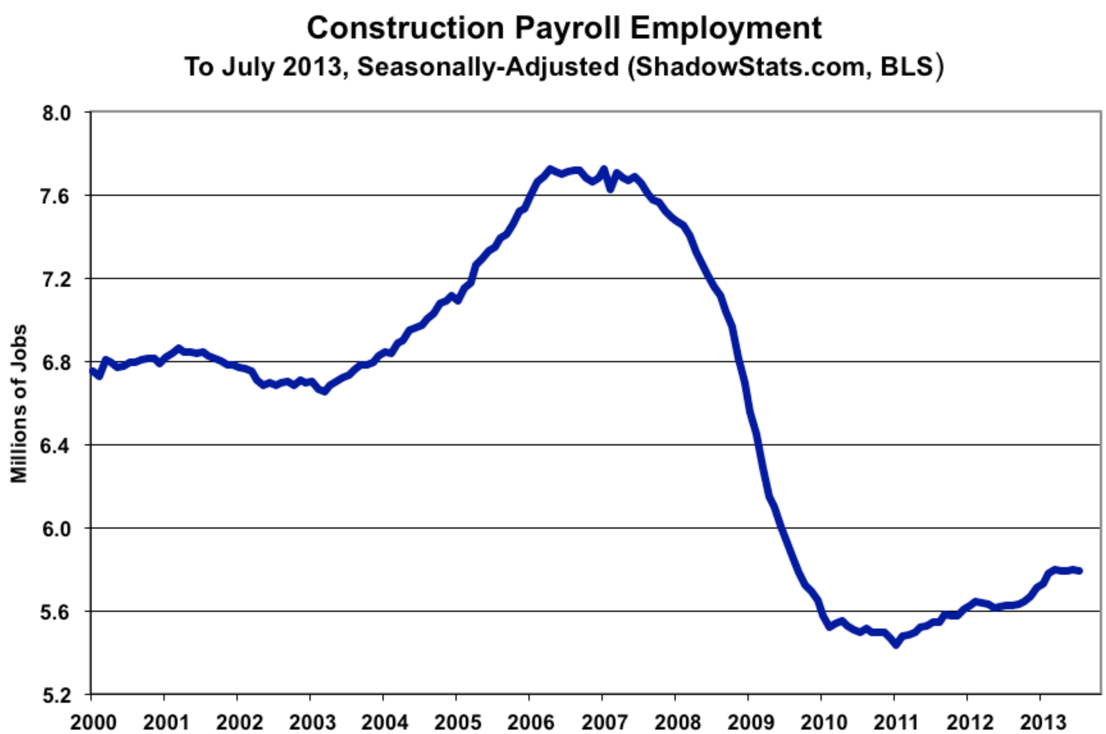


Total Construction Spending, Monthly to July 2013
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Billions of Dollars
1,250
1,200
1,150
1,100
1,050
1,000
950
900
850
800
750
700
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013

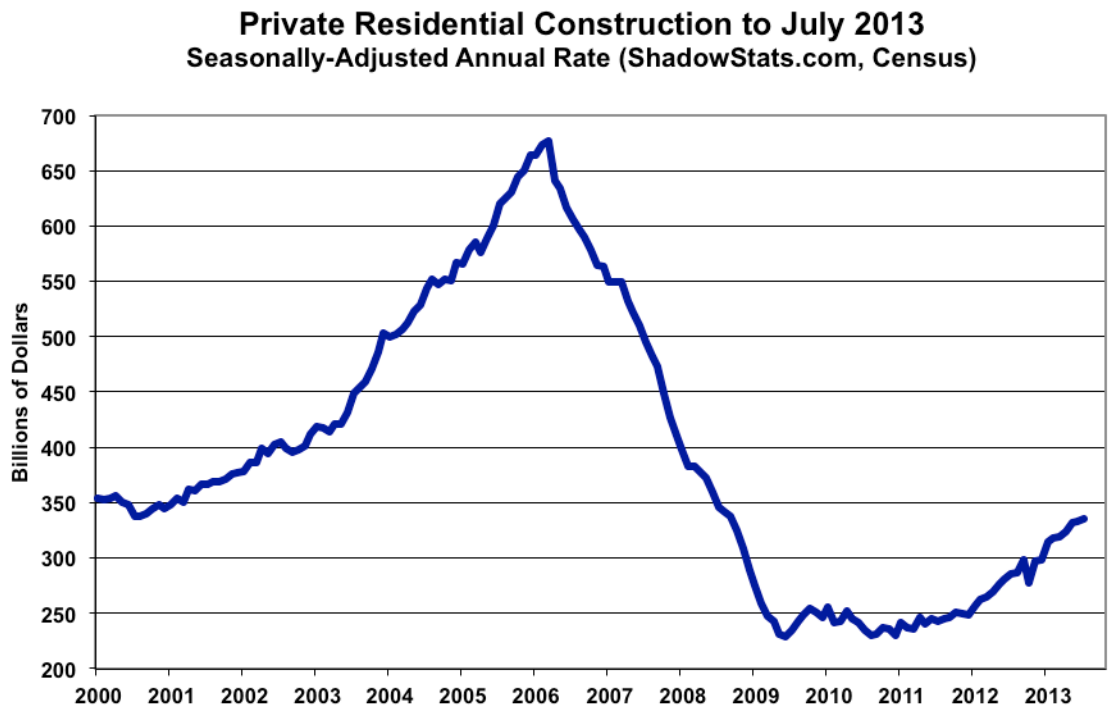


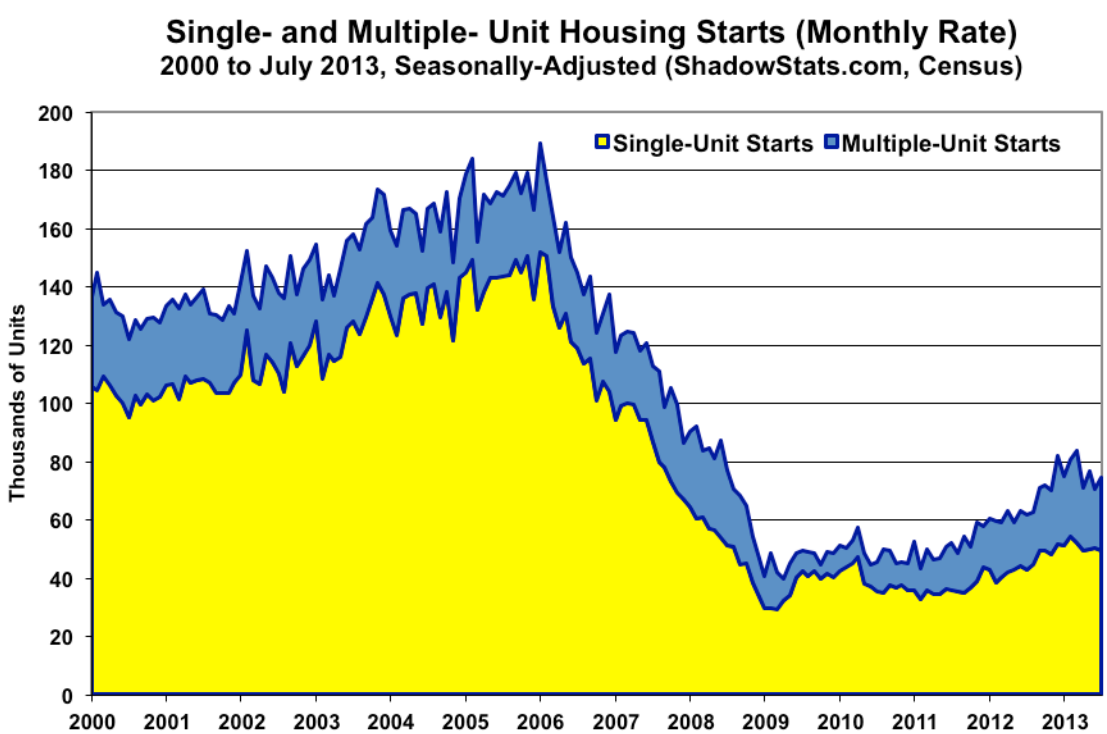
The preceding two graphs reflect total construction spending through July 2013, the first is before inflation adjustment; the second is an aggregate index reflecting inflation-adjusted data. The second graph (see also *Opening Comments)* shows the July 2013 ShadowStats estimation of an inflation-adjusted construction spending series. There is no perfect inflation measure for deflating construction, but the PPI new construction index is the closest found in publicly available series. Adjusted for the PPI measure, construction spending shows the economy slowing in 2006, plunging into 2011 and then turning minimally higher in an environment of low-level stagnation, through the most-recent reporting. The pattern of inflation-adjusted activity here does not confirm the economic recovery shown in the headline GDP series (see *Commentary No. 552*). To the contrary, the latest construction reporting, both before and after inflation adjustment, shows a pattern of ongoing stagnation.

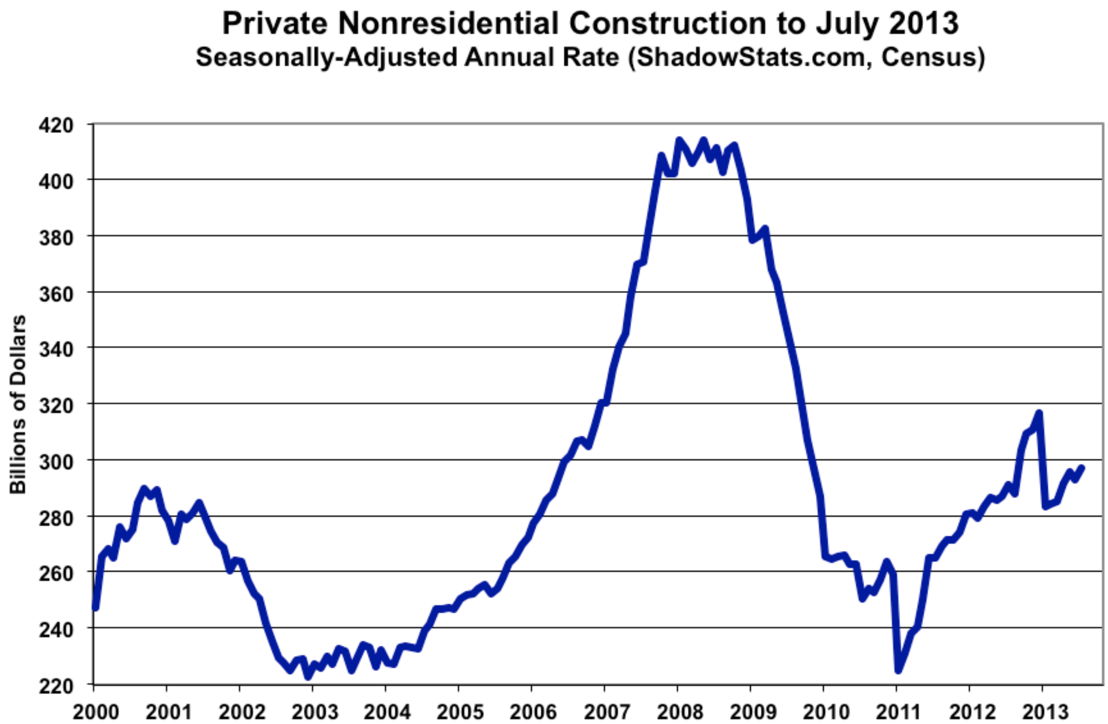
The next graph reflects the reporting of July 2013 construction employment, released on August 2nd. The graph will be updated in Friday's (September 6th) *Commentary*, reflecting the latest labor conditions, as reported by the Bureau of Labor Statistics (BLS) for August 2013.

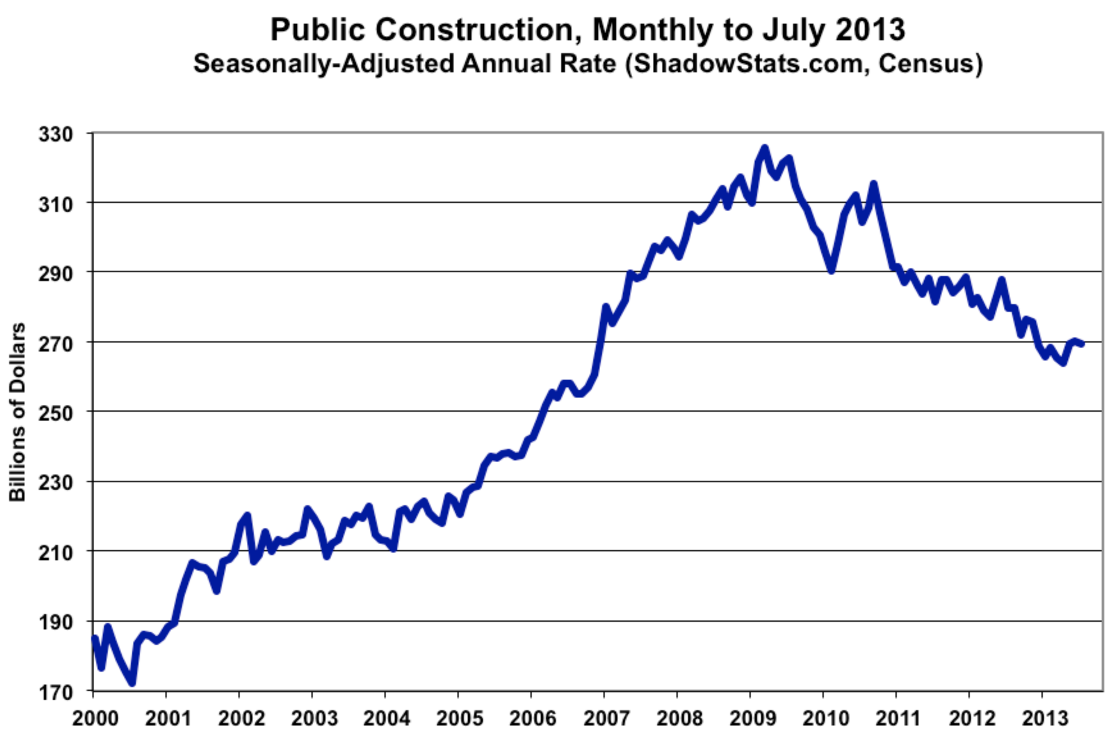


The next two graphs cover private residential construction, including housing starts, as reported for July 2013 (see *Commentary No. 550* for detail). The difference in the graphs is the smoother pace of actual spending (not-adjusted-for-inflation), instead of the more-irregular monthly variation in the count of physical monthly starts.


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


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


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


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

The last two graphs of the preceding series show the patterns of the monthly level of activity in private nonresidential construction spending and in public construction spending. The spending in public construction spending, which is 98% nonresidential, has been in a broad downtrend following a short-lived upside bounce in 2010.

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WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Remain Likely in the Month and Months Ahead. *[Other than for a revamped section on the pending payroll/unemployment data for August, the balance of this* Week Ahead *section is unchanged from the prior* Commentary.*]* 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*.

***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*.

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 still-early market consensus for August appears to be around ten to twenty thousand above July's relatively soft gain. Separately, the markets still appear to be looking for the August headline U.3 unemployment rate to hold at July's 7.4% level.

Special Alert on Distorted Employment Count for Teachers. The ShadowStats analysis of the seasonal-adjustment and trend models suggests that there are high odds of an artificial 35,000 jobs spike for teachers in August, a distortion that will reverse out in the months ahead. At the time of year when teachers return to work, the data should show minimal changes, if seasonally adjusted, properly.

Otherwise Risks Would Favor Weaker Than Consensus Reporting. 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 headline unemployment rate should be higher—at least in the 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 simply are not legitimate. The headline change in the unemployment rate is of no meaning, other than in misguided-media and market reactions. Where the problems were created deliberately by the BLS, they are easily fixed, but BLS will not do so.

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, will not make available, the revised number from the month before, which would be the consistent unemployment rate with the new number.

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