John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 561
Payroll Benchmark Revision, August Household Income, Revised Second-Quarter GDP

September 26, 2013

Bad Numbers? Just Change the Reporting Methodology!

Economic "Growth" Created by Statistical Redefinitions,
Not by Consumer or Business Demand

2013 Benchmark Payroll Employment Revision of Minus 124,000
Changed to Plus 345,000 with Redefinitions by BLS

GDP Revision Was No More Than Statistical Noise

Annual GDP Growth Has Slowed to Typical Pre-Recession Levels

Household Income Remained Stagnant, Near Cycle Lows

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, October 4th, covering September employment and unemployment, and August construction spending. Content may vary in the event of a government shutdown impacting data releases.*

Best wishes to all — John Williams

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OPENING COMMENTS AND EXECUTIVE SUMMARY

The quality of U.S. economic reporting continues to deteriorate rapidly. With the U.S. economy unable to generate normal growth, the Bureau of Labor Statistics (BLS) has joined the Bureau of Economic Analysis (BEA) (see *Commentary No. 546*) in creating the illusion of current economic growth by redefining key series, in this case, payroll employment. Economic activity, despite official GDP reporting, never recovered from the formal 2007 recession, and there is no recovery pending. Those areas are explored here, as usual, with the latest GDP revisions, which were no more than statistical noise. Nonetheless, year-to-year growth in real (inflation-adjusted) GDP has declined to a level that always has been followed by a formal recession. In a related real-word area, consumer structural liquidity issues continue, per the August 2013 measure of real median household income (www.SentierResearch.com), which held near its cycle lows.

Payroll Employment Benchmark Revision Estimate. Then there is the announcement this morning (September 26th) by the BLS of its estimate of the annual benchmark revision to payroll employment. As it has been configured, the payroll employment level in the benchmark month of March 2013 was found to have been overstated by 124,000 jobs, requiring a downside revision to the series in that month, with adjustments back to March 2012, and with adjustments forward in time through the reporting of January 2014 payrolls (to be released in February 2014). In the later months of the revision cycle, the downside revisions to monthly levels likely would have topped 200,000.

In a turnaround, the announced benchmark revision was restated so as to be to the upside by 345,000, thanks to the inclusion of 469,000 in employment that previously had not been counted as part of the nonfarm payroll survey. Aside from excluding agricultural employment, the payroll survey excluded those on household payrolls. Now 469,000 of the household payrolls have been moved into the payroll survey, into the education and healthcare industries, and there is no indication that the BLS plans to restate prior history so as to have a consistent historical series.

Further, this is an area that is not surveyed easily by the BLS on a monthly basis, so it becomes a new fudge-factor for re-jiggering the headline payroll numbers. As announced by the BLS:

"Each year, [payroll] employment estimates from the Current Employment Statistics (CES) survey are benchmarked to comprehensive counts of employment for the month of March. These counts are derived from State Unemployment Insurance (UI) tax records that nearly all employers are required to file. For National CES employment series, the annual benchmark revisions over the last 10 years have averaged plus or minus three-tenths of one percent of Total nonfarm employment. The preliminary estimate of the benchmark revision indicates an upward adjustment to March 2013 Total nonfarm employment of 345,000 (0.3 percent). This revision is impacted by a large non-economic code change [made by the BLS] in the Quarterly Census of Employment and Wages (QCEW) that moves approximately 469,000 in employment from Private households, which is out-of-scope for CES, to the Education and health care services industry, which is in scope. After accounting for this movement, the estimate of the revision to the over-the-year change in CES from March 2012 to March 2013 is a downward revision of 124,000."

More will follow on this, likely in the October 4th *Commentary* on September payrolls.

GDP Annual Growth Levels Suggest Looming, Formal Recession. Although the second revision to headline second-quarter GDP was little more than statistical noise, with growth holding at 2.5% for a second month, versus an initial estimate of 1.7%, the mechanics of the "unchanged" growth rate reflected a 0.2-percentage point drop in annualized, nominal (not-adjusted-for-inflation) second-quarter GDP, which was offset by a decline in GDP inflation and a 0.06-percentage point decline in the unchanged real (inflation-adjusted) GDP. These numbers continue in the wake of the comprehensive (as in redefined) benchmark revision to the GDP of July 31st (*Commentary No. 546*).

Gross Domestic Product (GDP). The third estimate, second revision of second-quarter 2013 GDP showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 2.48% (previously 2.52%, initially 1.67%) +/- 3.5% (95% confidence interval). That was against a 1.15% headline gain in first-quarter 2013. The second revision here was no more than statistical noise.

GDP Annual Growth at Levels that Historically Have Preceded Recessions. Year-to-year growth in quarterly GDP has fallen below levels have been seen historically only when the economy is headed into a recession. Similar patterns also have been evident in economic series such as industrial production and real retail sales. The key pattern here is where annual growth slows to below key levels of economic activity and momentum.

For second-quarter 2013 GDP, the third estimate of year-to-year growth revised to 1.63% (previously 1.64%, initially 1.43%), up from 1.32% pace of annual growth in first-quarter 2013 GDP. Annual real GDP growth of 1.6% or less always has been followed by a recession, in the 66-year history of the quarterly GDP series (see graphs in the *Reporting Detail*).

Implicit Price Deflator (IPD). Offsetting a downside revision in annualized second-quarter nominal growth (before inflation adjustment) from 3.25% in the prior reporting, to 3.08% in the latest revision, second-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was revised lower to an annualized pace of 0.58% from prior and initial reporting of 0.71%, versus 1.67% in the first-quarter. Year-to-year, second-quarter 2013 IPD inflation eased to 1.44%, from prior and initial reporting of 1.47%, versus 1.74% in the first-quarter.

Gross Domestic Income (GDI). The GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDI and GDP 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 a revised, excess $162.5 (previously $154.5 billion), or 0.98% of nominal GDP, despite the recent comprehensive revision to the series.

The second estimate of headline, annualized second-quarter 2013 GDI growth was 2.62% (previously 2.46%), versus an unrevised 2.44% (previously 2.16%) in first quarter 2013. Second-quarter year-to-year growth was a revised 2.69% (previously 2.65%), versus an unrevised 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). In its second estimate, the headline, annualized quarterly real growth for second-quarter 2013 GNP revised lower to 2.67% (previously 2.96%), versus 0.63% in first quarter 2013. Second-quarter year-to-year growth revised to 1.52% (previously 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, third estimate of 2.48% (previously 2.52%, initially 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 1.24% + 1.38% - 0.07% - 0.07% = 2.48%, versus an aggregate first-quarter growth rate of 1.15%:

- ***Consumer Spending Contributed 1.24% (Previously 1.21%, Initially 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 1.38% (Previously 1.48%, Initially 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 the otherwise slowing residential and nonresidential construction.
- ***Net Exports Subtracted 0.07% (Previously 0.00%, Initially 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. The third estimate reflected minor correction to same.
- ***Government Spending Subtracted 0.07% (Previously 0.18%, Initially 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. The second revision to the second-quarter reflected a revised upswing, from a downswing, in investment by state and local governments.

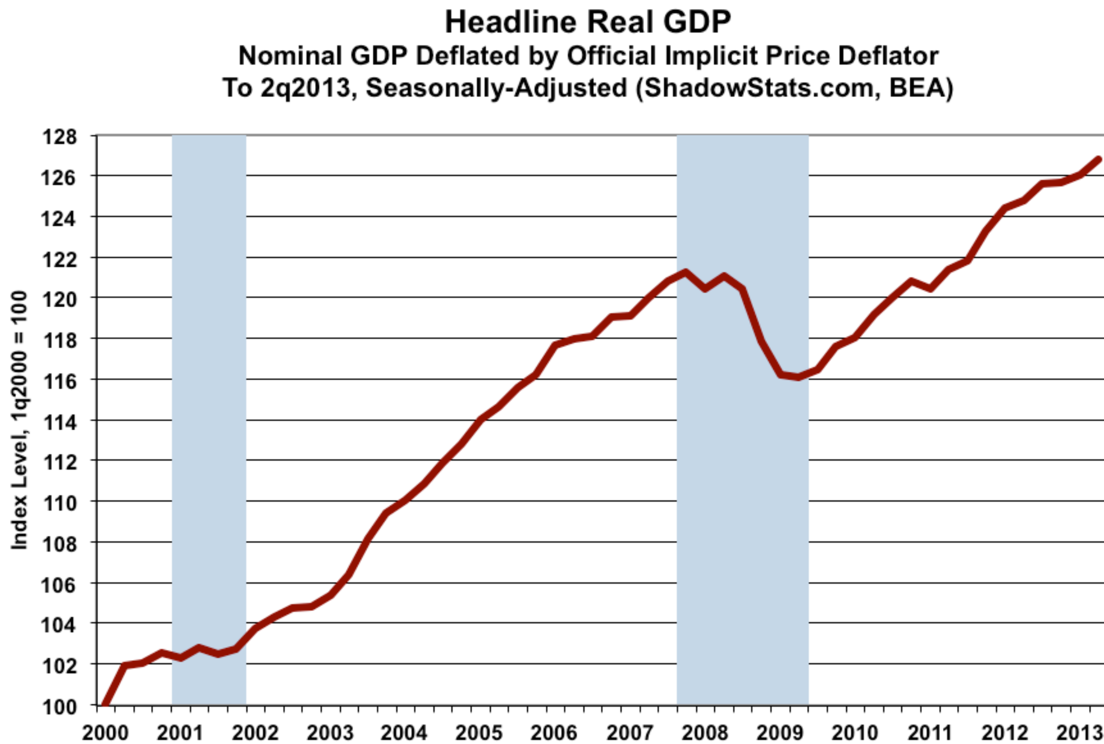
Economic Reality. Given that the second revision to second-quarter 2013 GDP was no more than statistical noise, much of the following text here, and in the *Reporting Detail* section, exclusive of the revisions to the implicit price deflator, gross national product and gross domestic income, is unchanged from the GDP commentary in *Commentary No. 552*, of August 29th, which covered the first revision.

The GDP remains the most-worthless and most-heavily-politicized of government economic series. It does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity suggests that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in second- and third-quarter 2012 (see *Special Commentary (No. 485)* and *Hyperinflation 2012*). Most-recent reporting 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 graph of monthly real median household income at the end of these *Opening Comments,* than is the accompanying plot of indexed headline real GDP growth. This also holds true with patterns of consumer confidence and housing as seen in recent *Commentaries* such as *Commentary No. 560* (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 third 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 remained 4.6% above the pre-recession peak-GDP estimate of fourth-quarter 2007, as of the second revision.

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

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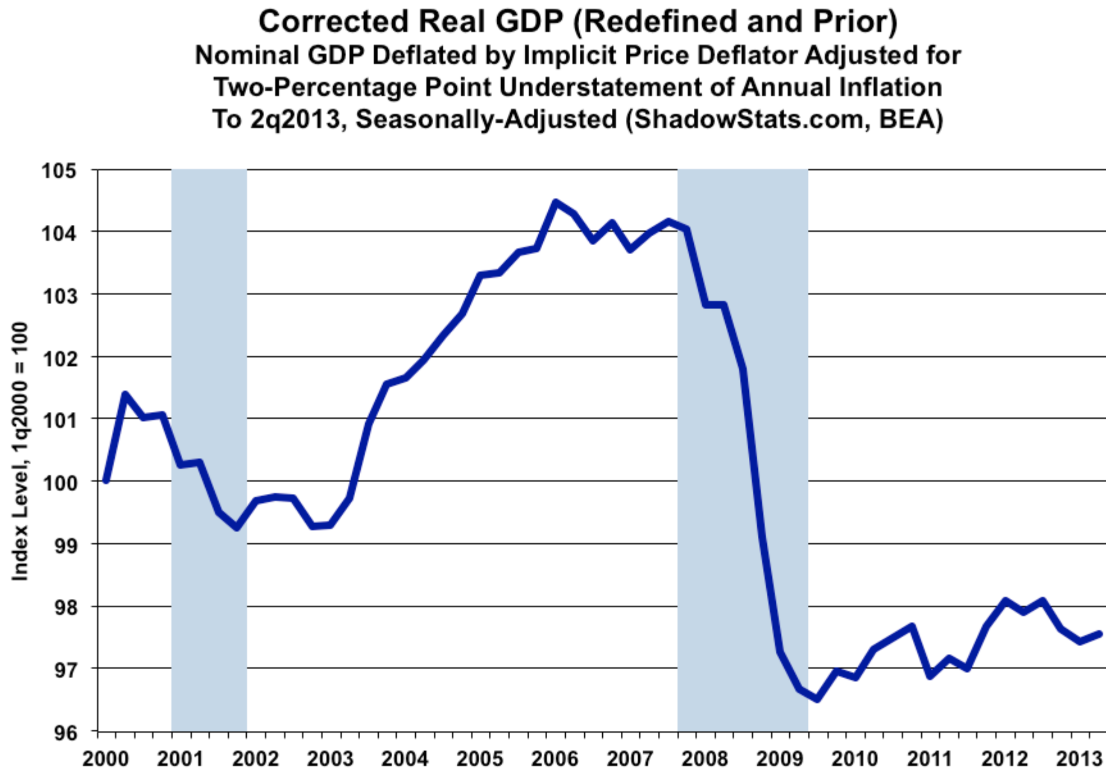
major economic series and private surveys, which still attempt to survey real-world activity. Flaws in the GDP inflation methodologies and simplifying reporting assumptions have created the "recovery."

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. Updated for August 2013 detail, real median household income was little changed in August, per www.SentierResearch.com, holding near its cycle low. The annual graph based on Census Bureau reporting is included for comparison purposes, as discussed in *Commentary No. 558*.

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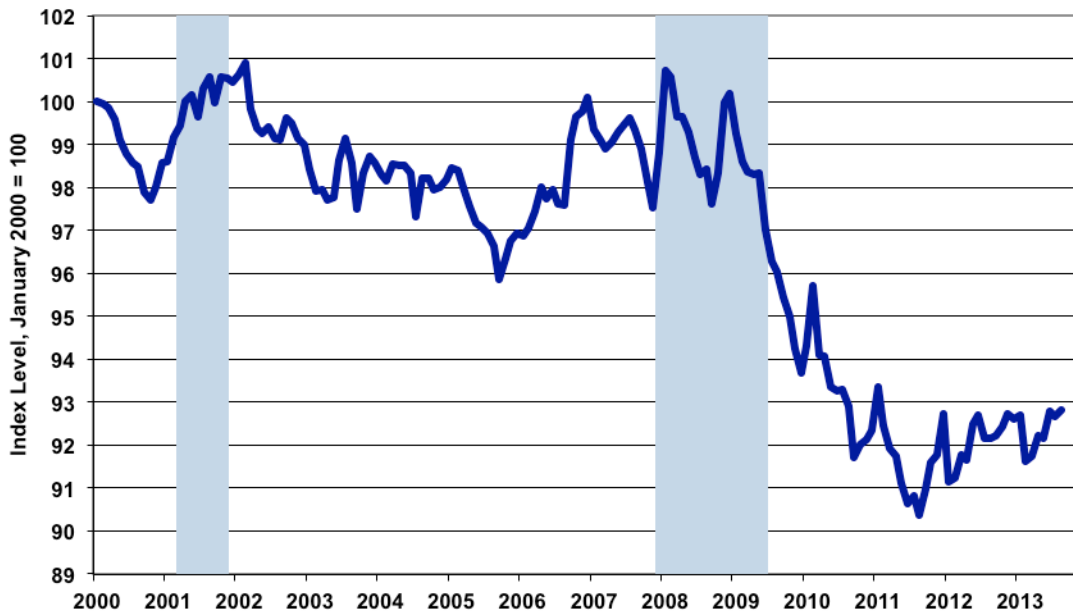

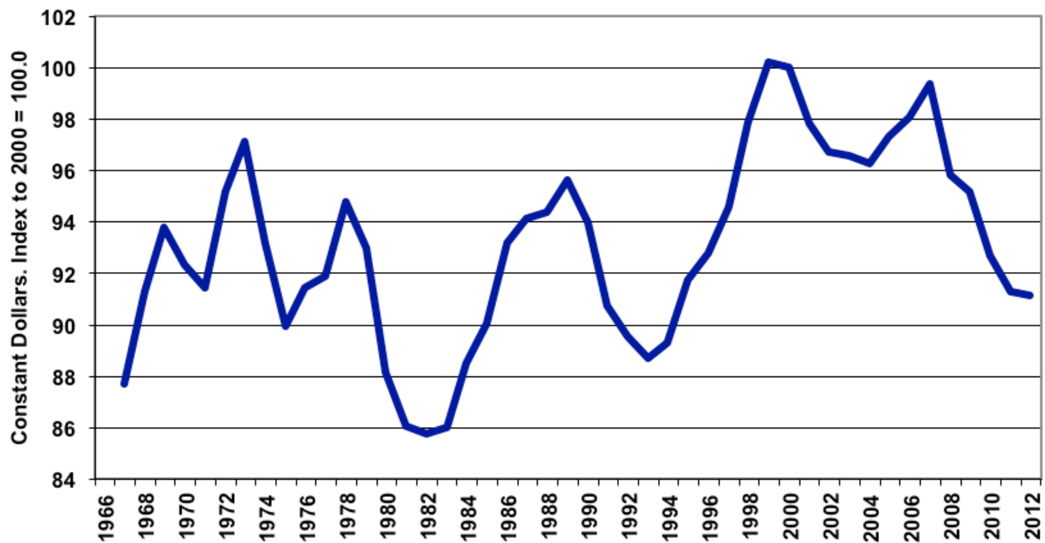

[For further detail on the second-quarter 2013 GDP revision, see the **Reporting Detail** *section.]*

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HYPERINFLATION WATCH

Hyperinflation Outlook—Summary. This *Hyperinflation Outlook* summary was just updated in *Commentary No. 559* of September 19th, and it is repeated here. The summary is intended as background material for new subscribers and for those looking for a brief version of the broad outlook on 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 month ahead.

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 early talk of tapering QE3 was 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.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment even could shift from what now is no imminent end to QE3, to an expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and,

increasingly, they are beginning to to recognize same. Business activity remains in continued and deepening trouble, and the Federal Reserve 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 government scandals and conflicting policy actions, 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. Indeed, 2012 household income data from the Census Bureau show no recovery whatsoever.

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. 552*). 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* and *Public Comment on Inflation*). Nonetheless, given the nature of official reporting, the renewed downturn

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still should gain eventual recognition as the second-dip in a double- or multiple-dip recession, with current reporting in basic economic series, such as housing, retail sales and production (not the GDP), 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 2013, the Fed had monetized in excess of 100% 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 were 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. Late-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

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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, Third Estimate, Second Revision)

GDP Annual Growth Holds at Pre-Recession Levels. 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 held at 4.6% (initially 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.

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.*

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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 x 1.01 x 1.01 x 1.01 = 1.0406 or 4.1%, instead of 4 x 1% = 4%.*

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

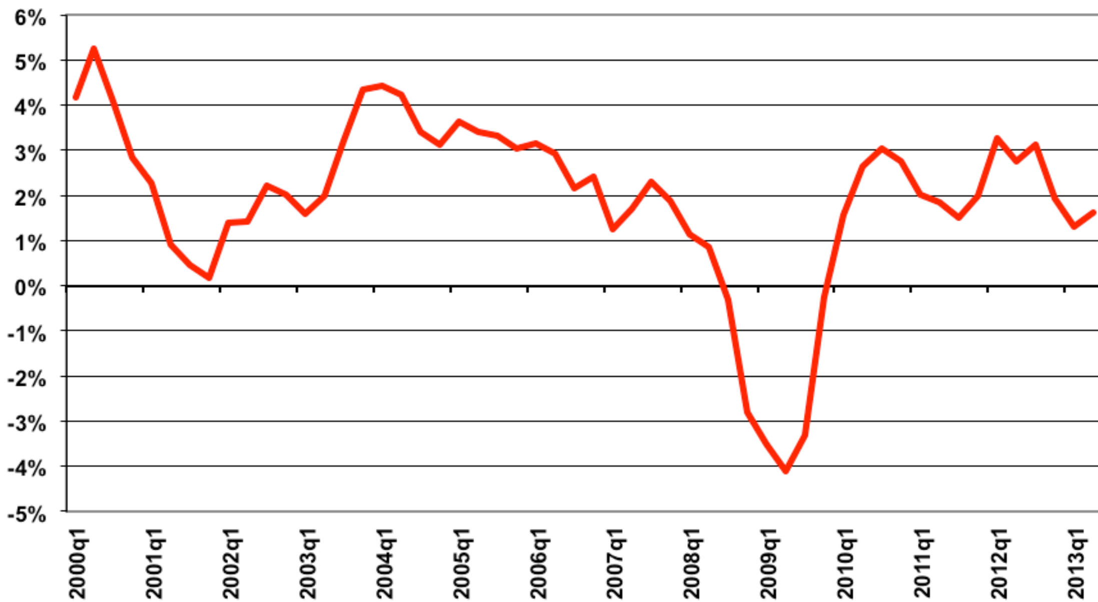
Gross Domestic Product (GDP). Published this morning, September 26th, by the Bureau of Economic Analysis (BEA), the third estimate, second revision of second-quarter 2013 GDP showed statistically-insignificant, real (inflation-adjusted), annualized quarterly growth of 2.48% (previously 2.52%, initially 1.67%) +/- 3.5% (95% confidence interval). That was against a 1.15% (pre-benchmark 1.78%) headline gain in first-quarter 2013. The second revision here was no more than statistical noise.

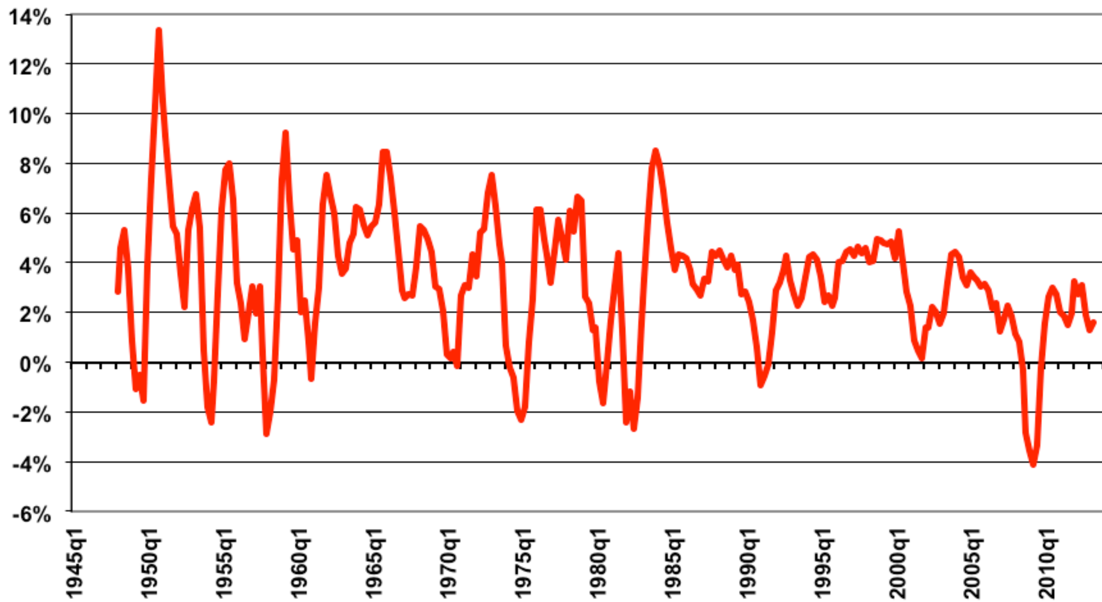
For nearly all of the sixteen quarters of the post-second-quarter 2009 official recovery period, headline growth rates have been little more than statistical noise around the unchanged level, and these heavily guessed-at numbers possibly were massaged to keep the quarterly growth rates in politically-desirable, 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 third estimate of year-to-year growth revised to 1.63% (previously 1.64%, initially 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 sixty-six years—whenever year-to-year change has fallen to current levels (1.6%) or below, a recession always has followed.





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Implicit Price Deflator (IPD). Offsetting the downside revision in annualized second-quarter nominal growth (before inflation adjustment) from 3.25% in the prior reporting, to 3.08% in the latest revision, second-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was revised lower to an annualized pace of 0.58% from prior and initial reporting of 0.71%, versus 1.67% (pre-benchmark 1.26%) in the first-quarter. Year-to-year, second-quarter 2013 IPD inflation eased to 1.44%, from prior and initial reporting of 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 remains 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 second estimate of second-quarter 2013 GDI also was published today (September 26th). The GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDI and GDP 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 a revised excess $162.5 (previously $154.5 billion) or 0.98% of nominal GDP, despite the recent comprehensive revision to the series.

The headline, annualized quarterly real growth for second-quarter 2013 GDI was 2.62% (previously 2.46%), versus an unrevised 2.44% (previously 2.16%, pre-benchmark 2.48%) in first quarter 2013. Second-quarter year-to-year growth was a revised 2.69% (previously 2.65%), versus an unrevised 1.87% (previously 1.80%, pre-benchmark 2.17%) in the first-quarter.

Gross National Product (GNP). The second estimate of second-quarter 2013 GDP also was published today (September 26th). 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 revised lower to 2.67% (previously 2.96%), versus 0.63% (pre-benchmark 1.23%) in first quarter 2013. Second-quarter year-to-year growth revised to 1.52% (previously 1.59%), versus 1.21% (pre-benchmark 1.78%) in the first-quarter.

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Likely in the Months Ahead. *[Other than for the new detail of next week's pending economic releases, the* Week Ahead *section is unchanged from the prior* Commentary.*]* Despite continuing downside adjustments to consensus expectations on the domestic 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 general trend. Inflation likely will be higher than market expectations.

In terms of monthly inflation reporting, energy-inflation-related seasonal-adjustment factors are on the plus-side through the end of the year. That, combined with likely stable or higher oil and gasoline prices, means stronger-than-expected headline CPI and PPI are a good bet for at least the next four months, and beyond. Upside pressure on oil-related prices should reflect intensifying impact from a weakening U.S. dollar in the currency markets, and from ongoing political instabilities in the Middle East. The dollar faces pummeling from continuing QE3, and the soon-to-resurface fiscal-crisis/debt-ceiling debacle (see opening comments and the *Hyperinflation Outlook* section). Particularly in tandem with the likely weakened dollar, inflation reporting in the year ahead generally should reflect much higher-than-expected inflation (see also *No. 527: Special Commentary*).

A Note on 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.

Construction Spending (August 2013). The Commerce Department will release its estimate of August 2013 construction spending on Tuesday, October 1st. Although expectations appear to favor a modest

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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.

Employment and Unemployment (September 2013). The September labor data are due for release on Friday, October 4th, from the Bureau of Labor Statistics (BLS).

Most commonly, the consensus jobs estimate settles around the trend estimate from the BLS seasonal-adjustment models. The September 2013 payroll trend number is for a 181,000 jobs gain, versus August's headline gain of 169,000 (see *Commentary No. 554*), and the early market consensus for September appears to be around the trend estimate. Separately, the markets appear to be looking for the September headline U.3 unemployment rate to hold at August's 7.3% level.

The consensus outlook on the economy appears again to have been rattled to the downside, 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 (at least as viewed in the broader U.6 and ShadowStats measures).

Indeed, the unemployment rate should move higher, at least in its broader measures that include discouraged workers. Nonetheless, there is a persistent reporting problem that has been discussed frequently with this series (see *Commentary No. 451* and *Commentary No. 487*, for example). Month-to-month comparisons of the headline unemployment data cannot be made legitimately. The headline change in the unemployment rate is of no meaning, other than in misguided-media and market reactions. Specifically, all the recent historical unemployment rates are re-calculated each month as part of the concurrent-seasonal-adjustment process, but where the BLS publishes the new headline unemployment rate, it does not publish, and it does not make available, the revised number from the month before, which would be consistent with the new number.

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