John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 571
Third-Quarter GDP, Money Supply Velocity, September Household Income

November 7, 2013

Error Margin Around GDP Growth of 2.8% Includes Zero

GDP Gain Dominated by Involuntary Inventory Build-Up

Third-Quarter M3 Velocity Was Stable; M2 Velocity Declined

September Household Income Remained Near Cycle Low

PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Friday, November 8th, covering October employment and unemployment.*

Best wishes to all — John Williams

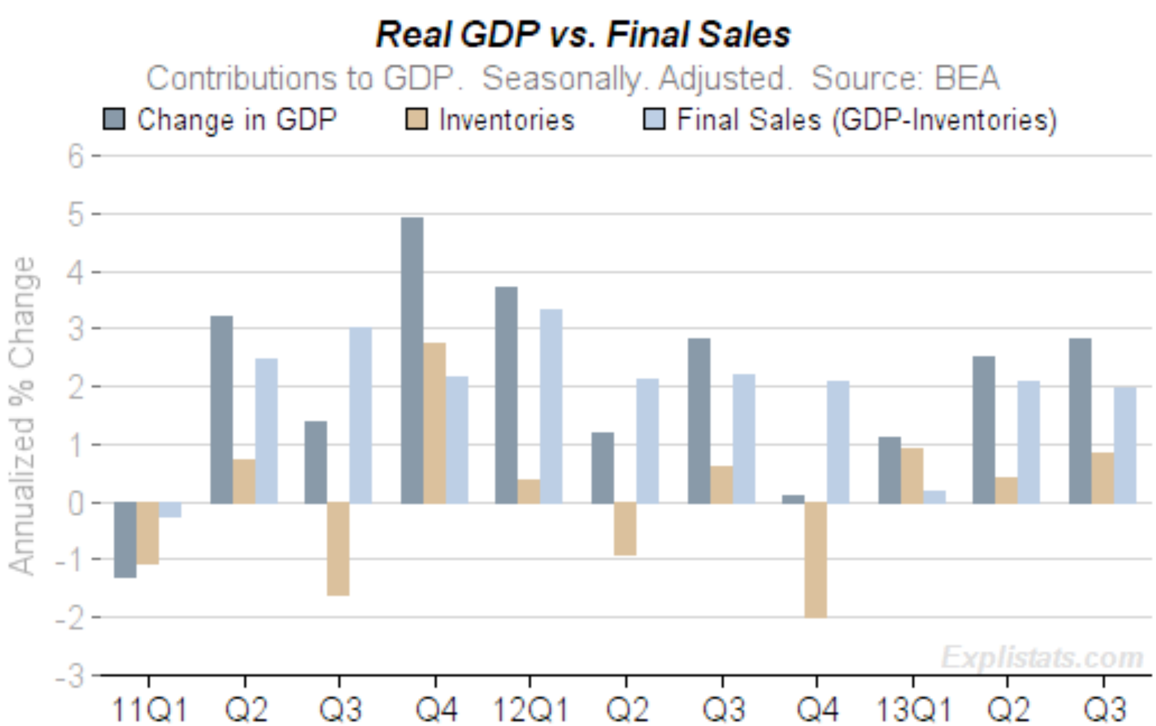
OPENING COMMENTS AND EXECUTIVE SUMMARY

Despite the nonsensical headline 2.8% third-quarter GDP growth—estimated today (November 7th) by the Bureau of Economic Analysis (BEA)—the economy still has not recovered and shows no prospects of any near-term recovery in business activity. If anything, the new data suggest that industry will have to cut back on production, in order to reduce rapidly rising, unwanted inventories that have not moved due to weak sales. GDP-related updates of money supply velocity are graphed in the *Hyperinflation Watch*.

Confirming one reason for weak consumption, www.SentierResearch.com released its estimate today for the September 2013 real median household income index. The index was little changed on the upside, where the gain was not statistically meaningful. Depressed levels of household income mean the consumer does not have the wherewithal to drive an economic rebound. Further details and related graphs are provided at the end of the *Opening Comments* section; other related comments follow.

Also likely to confirm a less-than-robust economic picture are tomorrow's employment data. The trend model—or mathematical baseline—that comes out of the regular concurrent seasonal-adjustment calculation process on the payroll series is suggesting an unusually-low 67,000 payroll increase for October, before any impact from the government's shutdown. Updated explanation and comments on the trend model and a possible upside revision to the pre-shutdown data are available on ExpliStats.com, click here. See also the related prior comments repeated in the *Week Ahead* section.

Third-Quarter Growth Estimate Was Dominated by a Build-Up in Unwanted Inventories. The statistically-insignificant headline 2.8% annualized gain in third-quarter real GDP reflected a substantial increase in unwanted inventories. Net of the inventory build-up, final sales (GDP less inventory change) was up by 2.0%. Net of a lesser build-up in second-quarter inventories, the headline 2.5% growth in second-quarter GDP translated into final sales growth of 2.1%, with the third-quarter number actually slightly softer than second-quarter activity. This detail can be seen in the accompanying graphs of official (not-corrected by ShadowStats) GDP activity, which are courtesy of our affiliate operation www.ExpliStats.com. See the discussion about ExpliStats in *Commentary No. 566*.



The normal business response to an undesired inventory build-up is to cut back on production, until production and inventories reach levels that are sustainable, based on underlying consumption. Some industries, like the auto industry, have been playing a variety of games both with inventories and promotions, where normal demand just has not been adequate to sustain the inventory levels that have been developed. Some meaningful production cutbacks are likely here in the near future, with accompanying cutbacks in headline GDP growth.

Even so, the year-to-year real growth in third-quarter GDP held at 1.6%, the same as in the second-quarter. Historically, growth rates have fallen below that level only when the economy was going into a recession (see the graphs in the *Reporting Detail* section). A similar pattern has been seen in the real retail sales series, with suggestions of same in industrial production. The key pattern here is where annual growth slows to below supportable levels of economic growth and momentum.

As will be discussed shortly, however, the purported formal post-2009 economic recovery in headline GDP is a canard. The GDP continues to be the most meaningless of the major economic series published by the U.S. government.

First Estimate, Third-Quarter 2013 Gross Domestic Product (GDP). The first estimate of third-quarter 2013 GDP showed a statistically-insignificant, real (inflation-adjusted), annualized quarterly gain of 2.85% (rounds to 2.8%) +/- 3.5% (95% confidence interval). That was against a 2.48% headline gain in second-quarter 2013 and 1.15% increase in the first-quarter.

In terms of year-to-year growth, the initial third-quarter 2013 estimate was 1.65% (rounds to 1.6%), versus 1.63% in the second-quarter and 1.32% in the first-quarter. Again, detail is graphed in the *Reporting Detail* section.

Implicit Price Deflator (IPD). The advance estimate of third-quarter GDP inflation, or the implicit price deflator (IPD), was at an annualized pace of 1.90%, versus 0.58% in the second-quarter and against 1.67% in the first-quarter. Year-to-year, third-quarter 2013 IPD inflation eased to 1.40%, from 1.44% in the second-quarter and from 1.74% in the first-quarter.

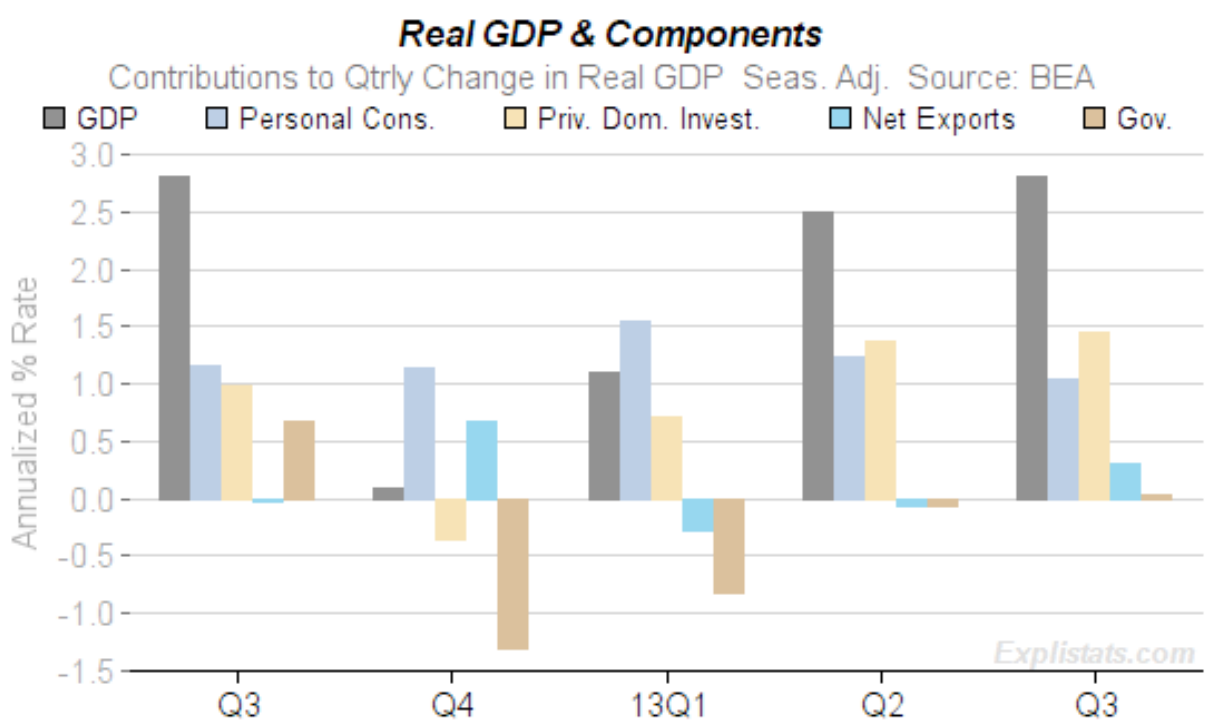
Gross Domestic Income (GDI) and Gross National Product (GNP). Due to inadequate data availability the BEA does not publish an initial estimate of the GDI and GNP, along with the initial estimate of the GDP.

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, first estimate of 2.85% headline growth for third-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 1.04% + 1.45% + 0.31% + 0.04% = 2.84% (rounding difference versus 2.85%), versus an aggregate second-quarter growth rate of 2.48%:

- ***Consumer Spending Contributed 1.04% to Third-Quarter Growth (1.24% in Second-Quarter).*** With personal consumption accounting for 68% of the recently redefined GDP—it used to be 71% of GDP (see benchmark revision detail in Commentary No. 546)—the reported slowing pace of annualized real growth was in line with headline real retail sales for the quarter, but some of the detail highlighted improbable changes or other questionable reporting. Of major contributing factors, quarterly growth largely collapsed in healthcare and in financial services and insurance, areas that should be reasonably stable quarter-to-quarter. Then there was a sharp drop in utilities, which ran contrary to the boost in utility usage that supported third-quarter industrial production.

- ***Business/Residential Investment Contributed 1.45% to Third-Quarter Growth (1.38% in Second-Quarter).*** Growth in the business investment sector was dominated by a relative increase in inventories, which contributed 0.83% to the aggregate growth number, leaving third-quarter "final sales" (GDP less inventory change) growth at 2.02%, versus an inventory contribution of 0.41% in the second-quarter, which left final sales there at 2.07%. Net of inventory growth, business investment activity also slowed in the third-quarter. As with the "net export" accounting, inventories are guessed at in the initial reporting.
- ***Net Exports Contributed 0.31% to Third-Quarter Growth (a 0.07% Subtraction in Second-Quarter).*** Although the two months of trade data published so far for the third-quarter are suggestive of a small narrowing in the deficit (a plus for the GDP), the number used here still is a guess.
- ***Government Spending Contributed 0.04% to Third-Quarter Growth (a 0.07% Subtraction in Second-Quarter).*** The small gain in government spending reflected a small increase in state and local spending more than offsetting the decline in federal spending.

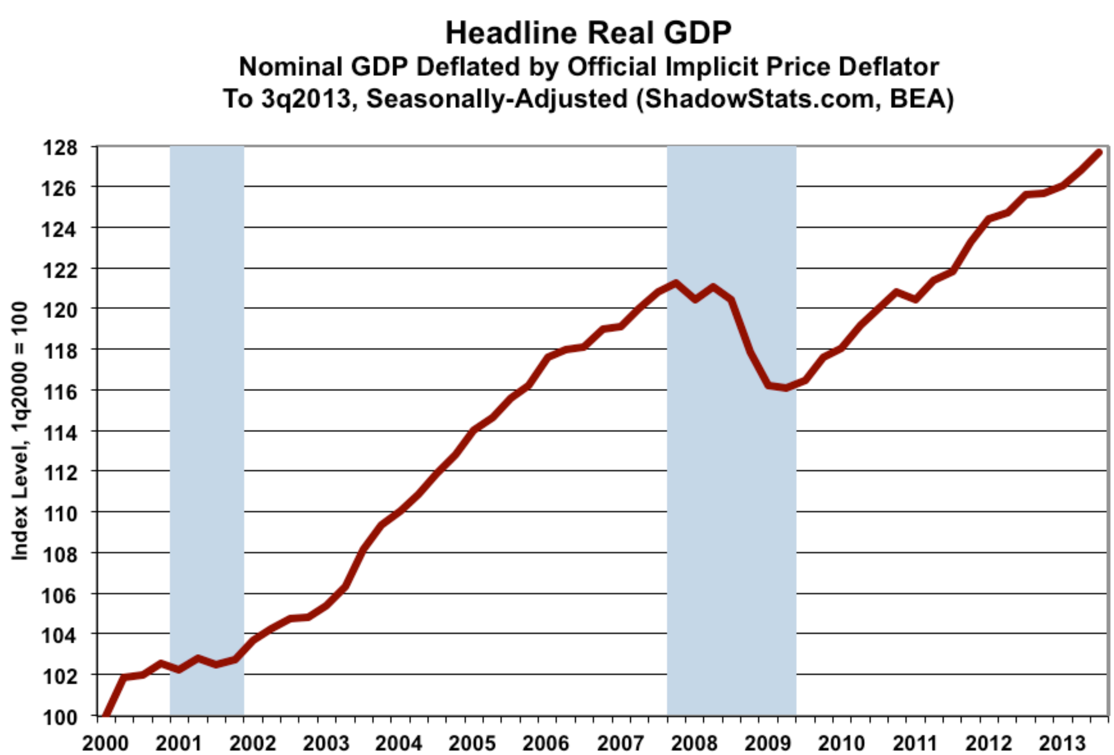
The preceding detail is reflected in the following graph, courtesy of www.ExpliStats.com.



Economic Reality. Given that the first estimate of third-quarter 2013 GDP growth was no more than statistical noise, as usual, and the general outlook is unchanged, the gist of much of the following text is along the lines of other recent GDP commentaries, but the details and numbers have been updated for today's initial reporting on the aggregate third-quarter economic activity.

The GDP remains the most-worthless and the most-heavily modeled, massaged and politically-manipulated 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.

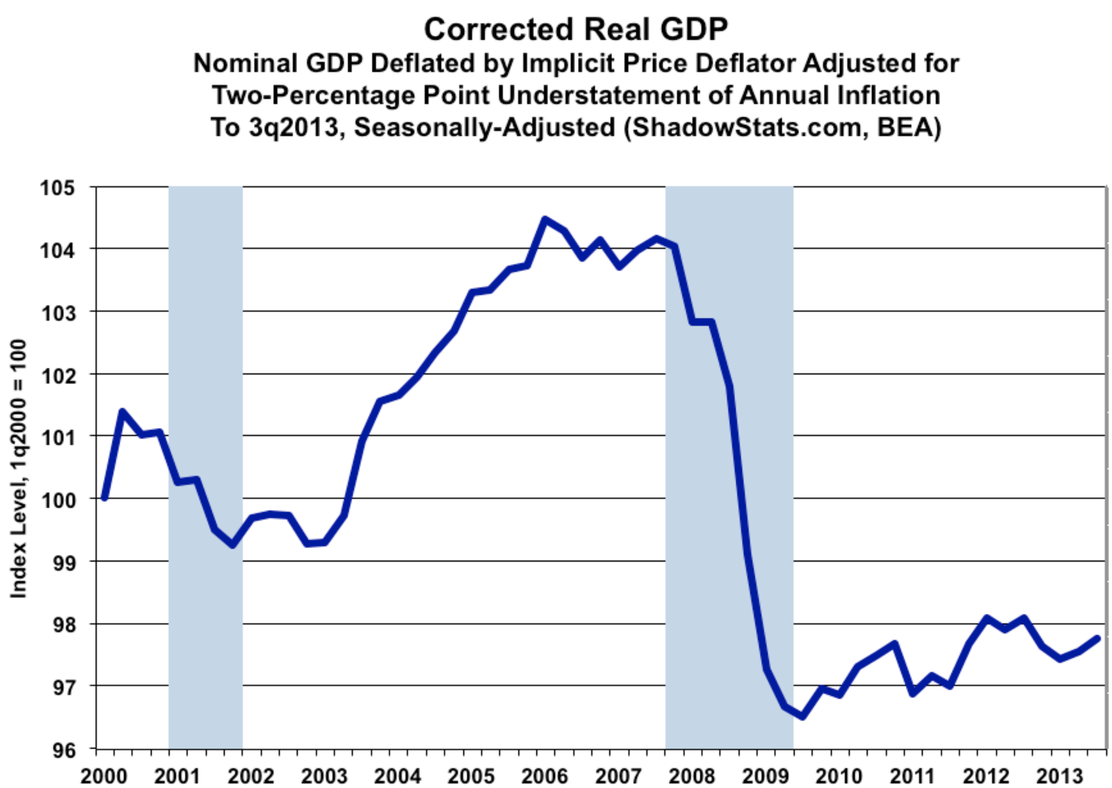
Please note that the pattern of activity shown for the "corrected" GDP series is much closer to the patterns shown in the graph of monthly real median household income at the end of these *Opening Comments,* than is the accompanying plot of indexed headline real GDP growth, shown first. This also holds true with patterns of consumer confidence and housing as seen in recent *Commentaries* such as *Commentary No. 569* (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.



Official and Corrected GDP. As usually discussed in the *Commentaries* covering the quarterly GDP reporting and monthly 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 accompanying two graphs tell that story, updated for the first estimate of third-quarter 2013 GDP.

Shown in the first graph, preceding, of official *Headline 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 most-recent benchmarking), and headline GDP has shown sustained growth since. Adjusted for official GDP inflation (the implicit price deflator), the level of third-quarter 2013 GDP stood at 5.3% above the pre-recession peak-GDP estimate of fourth-quarter 2007.

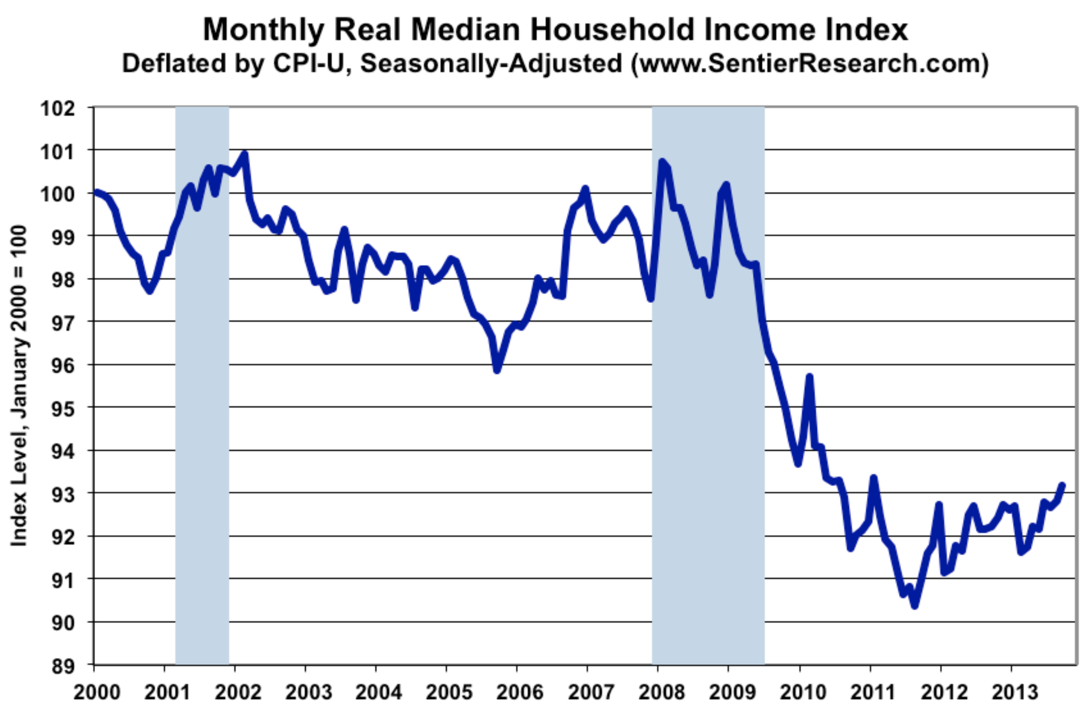
No other major economic series has shown a parallel pattern of full economic recovery and beyond. Although uncorrected real retail sales—a coincident indicator of GDP activity—recently moved minimally past that full-recovery point, such happened seven quarters after the GDP reached that point. Either 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."

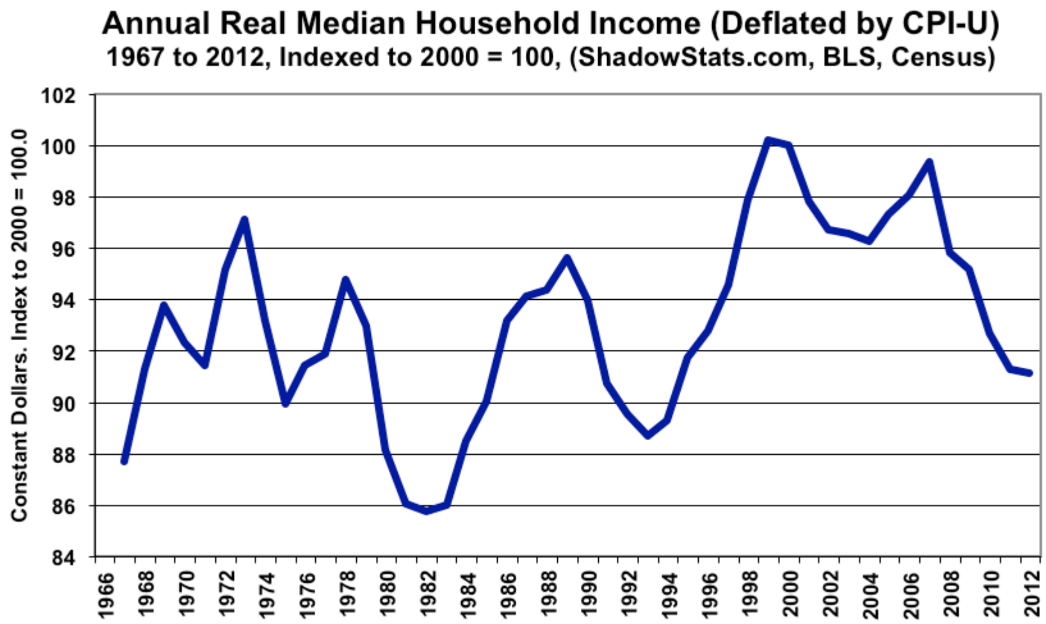


The second graph, preceding, plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates, with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation. The inflation understatement 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 September 2013 detail, real (inflation-adjusted) median household income was slightly higher in September, versus August, but as with the prior month's small increase, the monthly change was statistically insignificant per www.SentierResearch.com. The series continues to hold near its cycle low, as shown in the first graph following. The second accompanying graph is on an annual basis through 2012, based on Census Bureau reporting, and it is included for comparison purposes. As discussed in *Commentary No. 558*, current levels of real median household income, on an annual basis, are below the levels seen the late-1960s and early-1970s. The same should be true for the recent monthly estimates versus the historical annual estimates.

Without growth in real income, without the ability or the will to expand debt meaningfully, the consumer has not been able to support the purported, full-fledged economic recovery, and no recovery is pending in the immediate future. Credit- and confidence-related consumer liquidity measures should be updated in tomorrow's (November 8th) *Commentary No. 572*.





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

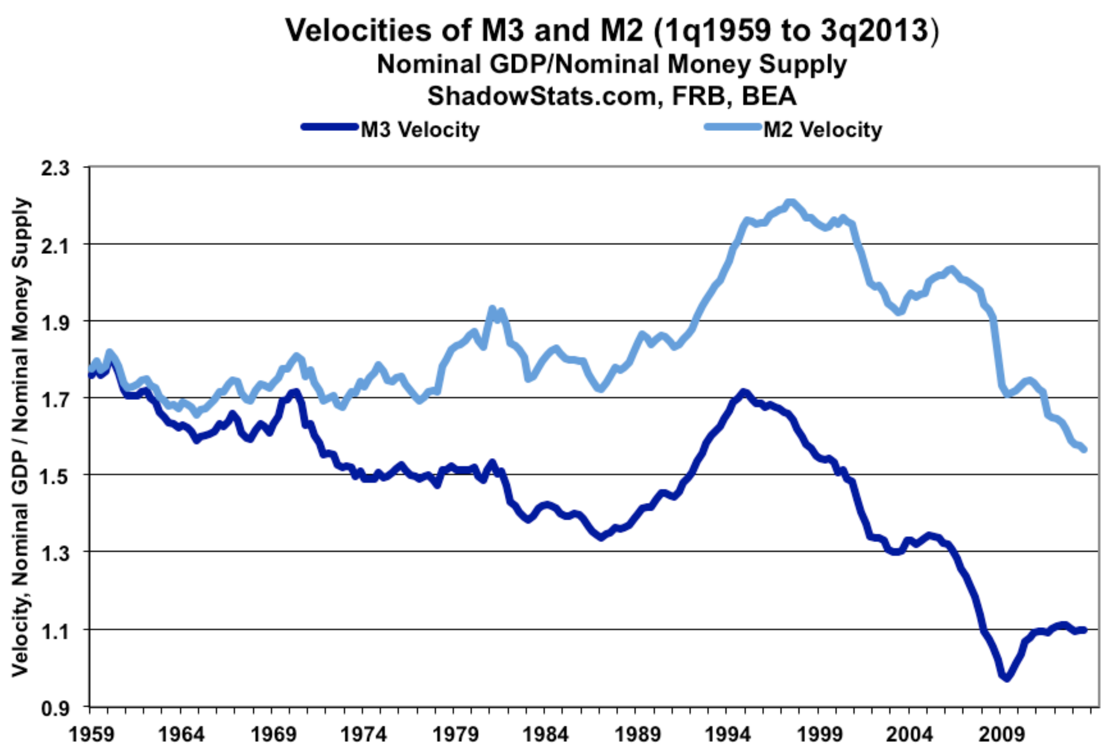
HYPERINFLATION WATCH

Money Supply Velocity. Incorporating today's nominal data on third-quarter 2013 GDP, as well as recent Federal Reserve benchmark revisions to money supply-related data, updated estimates of money velocity for money supply M2 and M3 are graphed below. The decline seen in second-quarter 2013 velocity continued in third-quarter 2013 for M2, but third-quarter velocity held even for M3 (using the ShadowStats Ongoing-M3 Measure), as shown in the accompanying graph.

Subscribers often ask for specifics on the velocity of the money supply, with the result that this section has become a standard feature for *Commentaries* covering the first GDP reporting of a given quarter. The nature of velocity is discussed in some detail in the 2008 *Money Supply Special Report*. Velocity simply is the number of times the money supply turns over in the economy in a given year, or the ratio in nominal terms (not adjusted for inflation) of GDP to the money supply. It is a residual number, not otherwise open to calculation.

Velocity has theoretical significance, where, in combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is a ratio of two numbers that are not particularly well or realistically measured, its actual estimate is of limited value. As an inflation predictor, it has to be viewed in the context of accompanying money-supply growth.

M3 and M2 had been showing opposite patterns in 2011 and 2012, because growth in M3 had been much weaker than growth in M2. The reason behind that difference was that much of the relatively stronger M2 growth reflected cash moving out of M3 categories—such as large time deposits and institutional money funds—into M2 or M1 accounts. Early-October 2013 reporting has shown an intensifying M3 to M2 shift in funds. M3 contains M2, and M2 contains M1. The effect of the funds shift had no impact on M3, but it spiked M2 growth. The clarity of what happened there is why ShadowStats still tracks what had been the broadest money measure (M3) available. Again, full definitions can be found in the *Money Supply Special Report*. The ShadowStats estimate for October M3 growth and other money supply detail will be published with tomorrow's (November 8th) *Commentary No. 572*.



Summary Hyperinflation Outlook. The *Hyperinflation Outlook* of *Commentary No. 567* is repeated here without change. Detail on the pending publication of *Hyperinflation 2014—The End Game*, which will be a fully-updated version of *Hyperinflation 2012,* also was discussed in *Commentary No. 567*.

This summary is intended as guidance for both new and existing subscribers, who are 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.

Recommended Background Material. *Commentary No. 559* (September 2013) and *No. 527: Special Commentary* (May 2013) supplemented *No. 485: Special Commentary* (November 2012), which reviewed 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 use here also are *No. 500: Special Commentary* on GAAP-based federal deficit reality and 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 or recent months, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, a fully-updated *Hyperinflation 2014—The End Game* is planned by the end of November, again, as discussed in *Commentary No. 567*.

Hyperinflation Timing, Set for 2019 Back in 2004, Advanced to 2014 in Aftermath of 2008 Panic. While the U.S. government has lived excessively beyond its means for decades, it was not until the December 2003 (federal government's 2004 fiscal year) enactment of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 that the United States was set solidly on a course for eventual hyperinflation. Back in 2004, ShadowStats began forecasting a hyperinflation by 2019; that forecast was advanced to 2014 as a result of the nature of, and the official handling of the 2008 panic and near-collapse of the domestic financial system. The hyperinflation forecast for 2014 remains in place, with 90% odds estimated in favor of its occurrence.

The initial unfunded liabilities for the Medicare overhaul, alone, added nearly $8 trillion in net-present-value unfunded liabilities to the fiscal-2004 federal deficit, based on generally accepted accounting principles (GAAP accounting), exceeding the total $7.4 trillion gross federal debt of the time. When approached by ShadowStats as to how this circumstance likely would lead to an eventual domestic hyperinflation, the response from a member of the Bush Administration was "that is too far into the future to worry about."

That future has come too quickly. Adjusted for one-time events, GAAP-based federal deficits have averaged $5 trillion per year for the last seven years, with government spending and financial commitments exploding out of control. As of fiscal-2012 the GAAP-based annual federal deficit was an uncontainable and uncontrollable $6.6 trillion, with gross federal debt at $16.2 trillion and total federal obligations (net present value) in excess of $85 trillion, more than five-times the level of annual GDP and deteriorating at an annual pace in excess of $6 trillion per year. Details can be found in *No. 500: Special Commentary*.

On a GAAP-basis, the United States faces long-range insolvency. The global financial markets know it, and so do the miscreants currently controlling the U.S. government. Yet, as just demonstrated in the crisis negotiations surrounding the federal-government shutdown and debt ceiling, there is no controlling, political will in Washington to address the long-term solvency issues. The still-festering budget crisis and recent negotiations reflect no more than the formal, continued posturing and political delay of the same issues and crisis that nearly collapsed the U.S. dollar in August and September of 2011, that then were pushed beyond the 2012 election, and then pushed again to the just-postponed negotiations of October 2013.

The chances of the United States actually not paying its obligations or interest are nil. Instead, typically a country which issues its debt in the currency it prints, simply prints the cash it needs, when it can no longer can raise adequate funds through what usually become confiscatory tax rates, and when it can no longer sucker the financial markets and its trading partners into funding its spending. That results in inflation, eventual full debasement of the currency, otherwise known as hyperinflation. The purchasing power of the current U.S. dollar will drop effectively to zero.

Therein lies the root of a brewing crisis for the U.S. dollar (all "dollar" references here are to the U.S. dollar unless otherwise specified). Global financial markets have wearied in the extreme of the political nonsense going on in Washington. No one really wants to hold dollars to or hold investments in dollar-denominated assets, such as U.S. Treasury securities.

Due to ongoing solvency issues within the U.S. banking system, that Federal Reserve is locked into a liquidity trap of flooding the system with liquidity, with no resulting surge in the money supply. Yet, the Fed's quantitative easings have damaged the dollar, which in turn has triggered sporadic inflation from the related boosting of oil prices. The overhang of dollars in the global markets—outside the formal U.S. money supply estimates—is well in excess of $10 trillion. As those funds are dumped in the global markets, the weakening dollar will trigger dumping of U.S. Treasury securities and general flight from the U.S. currency. As the Fed moves to stabilize the domestic financial system, the early stages of a currency-driven inflation will be overwhelmed by general flight from the dollar, and a resulting surge the domestic money supply. Intensifying the crisis, and likely coincident with heavy flight from the dollar, odds also are high of the loss of the dollar's global-reserve-currency status.

These circumstances can unfold at anytime, with little or no warning. Irrespective of short-lived gyrations, the dollar should face net, heavy selling pressure in the months ahead from a variety of factors, including, but certainly not limited to: (1) a lack of Fed reversal on QE3; (2) a lack of economic recovery and renewed downturn; (3) concerns of increased quantitative easing by the Fed; (4) inability/refusal of those controlling the government to address the long-range sovereign-solvency issues of the United States; (5) declining confidence in, and mounting scandals involving the U.S. government.

It is the global flight from the dollar—which increasingly should become a domestic flight from the dollar—that should set the early stages of the domestic hyperinflation.

Approaching the End Game. As previously summarized, 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, but that appears to have been more of an intellectual exercise aimed at placating Fed critics, than it was an actual intent to "taper" QE3. The tapering or cessation of QE3 was contingent upon the U.S. economy performing in line with deliberately, overly-optimistic economic projections provided by the Fed.

Manipulated market reactions and verbal and physical interventions have been used to prop stocks and the dollar, and to pummel gold.

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 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.

The same systemic problems will face incoming Fed Chairman Janet Yellin. She will face the same quandaries and issues addressed by current Chairman Ben Bernanke. Where she also has been involved actively in formulating current Fed policies, no significant shifts in Fed policy are likely. QE3 should continue for the foreseeable future.

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 at hand.

This still-forming great financial tempest has cleared the horizon; its early ill winds are being felt with increasing force; and 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 to have begun to move beyond the forced patience with U.S. policies that had been induced by the financial terror of the 2008 panic. Again, the dollar faces likely extreme and negative turmoil in the months ahead. A domestic hyperinflationary environment should evolve from something akin to these crises before the end of 2014.

Still Living with the 2008 Crisis. Despite the happy news from headline GDP reporting that the recession ended in 2009 and the economy is full recovery, there never has been an actual recovery following the economic crash 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 showed no recovery whatsoever.

What followed the economic crash 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 still should gain eventual recognition as the second-dip in a double- or multiple-dip recession.

What continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 turmoil. All the extraordinary actions and interventions bought a little time, but they did not resolve the various crises. That the crises continue can be seen in deteriorating economic activity and in the ongoing panicked actions by the Federal Reserve, where it still proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise. As of the government shutdown, the Fed had monetized in excess of 100% of the net issuance of U.S. Treasury debt, since the beginning of calendar-year 2013.

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 mounting global banking-system stress.

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 move sustainably against the U.S. dollar, a movement that may have begun. As discussed earlier, a dollar-selling panic is likely in the next several months, 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.

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Third-Quarter 2013, First or Advance Estimate)

GDP Annual Growth Continues Holding at Pre-Recession Levels. The year-to-year growth in third-quarter GDP held at 1.6%, the same as in the second-quarter. Historical growth rates have fallen below that level only when the economy was going into a recession (see the graphs in this section). A similar pattern has been seen in the real retail sales series, with suggestions of same in industrial production. The key pattern here is where annual growth slows to below supportable 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 initial third-quarter estimate, real GDP is 5.3% (second-quarter was 4.6%) 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.*

***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.*

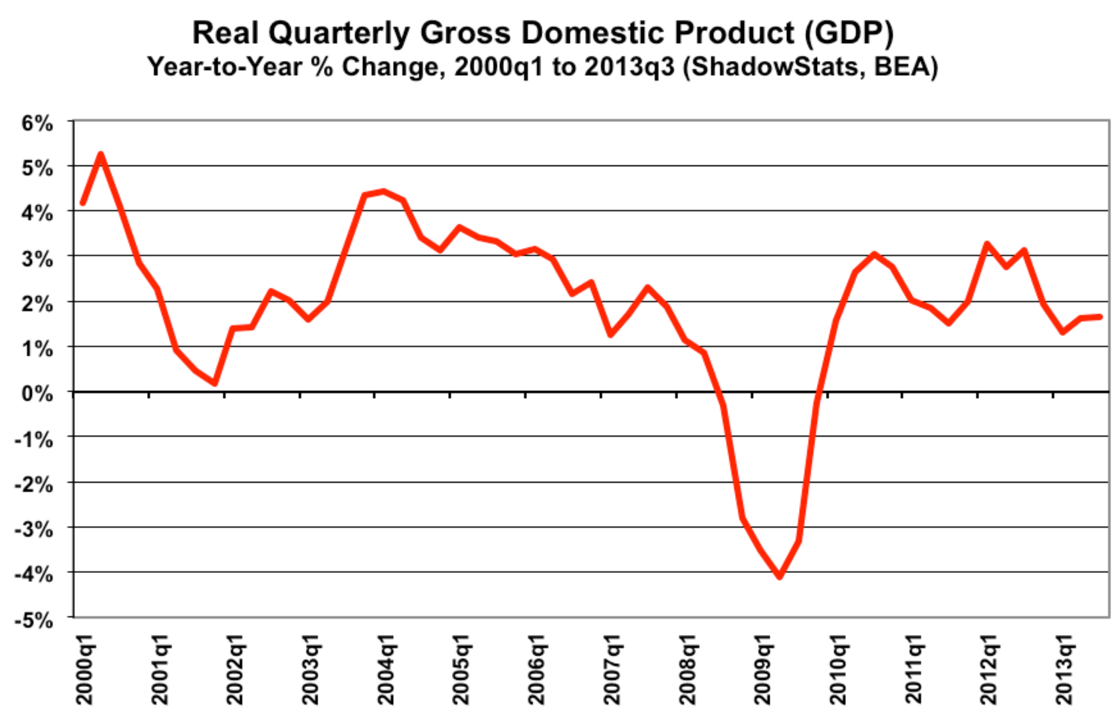
Gross Domestic Product (GDP). Published this morning, November 7th, by the Bureau of Economic Analysis (BEA), the first or "advance" estimate of third-quarter 2013 GDP showed a statistically-insignificant, real (inflation-adjusted), annualized quarterly gain of 2.85% (rounds to 2.8%) +/- 3.5% (95% confidence interval). That was against a 2.48% headline gain in second-quarter 2013 and 1.15% increase in the first-quarter.

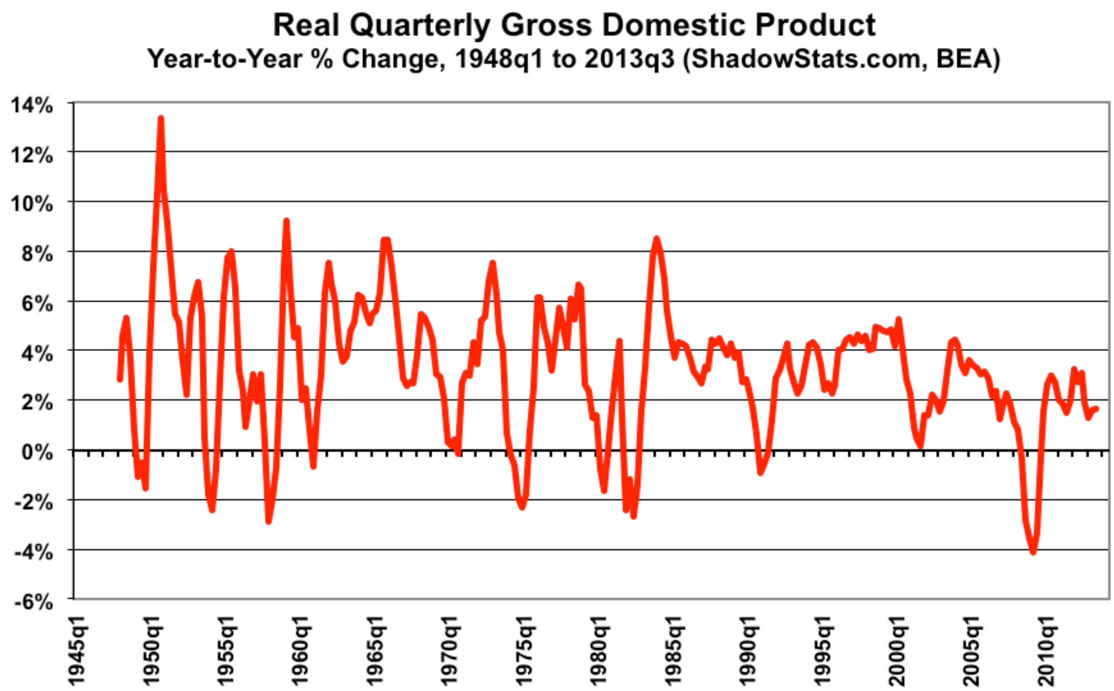
For nearly all of the seventeen quarters of the post-second-quarter 2009 official recovery period, headline growth rates have been little more than statistical noise around the unchanged level, and these heavily guessed-at numbers possibly were massaged to keep the quarterly growth rates in politically-desirable, positive territory as much as possible. Even so, as a result of the recent July 31st benchmark revisions, second-quarter 2011 GDP 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 rates of change for the GDP series. For third-quarter 2013 GDP, the initial estimate was 1.65% (rounds to 1.6%), versus 1.63% in the second-quarter and 1.32% in the first-quarter 2013. The latest year-to-year growth remains well off the near-term peak of 3.13% growth reported for 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.





Implicit Price Deflator (IPD). The advance estimate of third-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at an annualized pace of 1.90%, versus 0.58% in the second-quarter and against 1.67% in the first-quarter. Year-to-year, third-quarter 2013 IPD inflation eased to 1.40%, from 1.44% in the second-quarter and from 1.74% in the first-quarter.

For comparison purposes, the annualized seasonally-adjusted quarterly inflation for the CPI-U in third-quarter 2013 was 2.63%, versus a second-quarter contraction of 0.03%, and a 1.44% quarterly gain in the first-quarter. On a year-to-year basis, third-quarter 2013 CPI-U (unadjusted) was 1.55%, versus 1.39% in the second-quarter, and 1.68% in the first-quarter (see *Commentary No. 570*).

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 third-quarter 2013 is a 1.7% year-to-year contraction, versus a headline year-to-year gain of 1.6%. The alternate second-quarter estimate was a 1.8% year-to-year contraction, versus a headline gain of 1.6% (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) and Gross National Product (GNP). Due to inadequate data availability the BEA does not publish an initial estimate of the GDI and GNP along with the initial estimate of the GDP. The BEA would do the markets a favor also by delaying the GDP release, for similar reasons. The GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. 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).

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Likely in the Months Ahead. See the schedule for the latest detail on the rescheduling of the delayed September and October economic reporting in the post-government shutdown period. *[Other than for a brief reference to the* Opening Comments *section, in the employment outlook posting in* Pending Releases*, the* Week Ahead *section is unchanged from the prior* Commentary No. 570 *of October 30th.]*

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.

PENDING RELEASES:

Employment/Unemployment (October 2013). The release of October 2013 employment and unemployment by the Bureau of Labor Statistics (BLS) has been rescheduled for tomorrow, Friday, November 8th, as a result of the now-ended suspension of government operations. Reflecting impact from slowing trends and partial effects of government furloughs and related private-sector impact, payroll employment likely will be flat; it could be negative. The unemployment should rate jump about 0.3% above what it would have been otherwise. Beyond the supplemental trend model discussion in the *Opening Comments* section, the detail and forecasts for the special outlook for October labor conditions also were covered in *Commentary No. 567*, as generally repeated here:

Yes, You Can Be Unemployed and Employed at the Same Time! ShadowStats had indicated that the October shutdown of the federal government likely would spike the October unemployment rate and shrink nonfarm payrolls (see *Commentary No. 564* and *Commentary No. 566*). The reopened Bureau of Labor Statistics (BLS) has offered some guidance as to how the once-furloughed federal employees will be handled in the labor statistics.

The furloughed workers, who were out of work for the full reference week ended October 12th, would be counted as unemployed, on temporary lay-off, as part of the household survey. That should add about 0.3-percentage point to whatever the headline (U.3) October unemployment rate would have been otherwise.

Anyone who was employed at any time during the payroll period that included October 12th is counted as employed in the payroll survey. Some two-week payrolls and certainly monthly payrolls would cover some of the furloughed employees. Separately, though, since the government (after the fact) determined that the furloughed employees would be paid, the BLS has decided to include the furloughed among the employed.

None of this applies to government contract workers, or to those who lost their jobs as a secondary effect, such as private restaurant employees at a National Park. Accordingly, the payroll impact is not as clear-cut as the household survey. Nonetheless, with the BLS trend model geared to generate only a 67,000 jobs gain in October—exclusive of any government shutdown considerations—the headline jobs number still has a solid chance of reflecting a net monthly jobs loss. If there is a headline contraction, the popular media likely still will blame the furloughs, irrespective of what has been happening in a rapidly-slowing real-world economy.

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