

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

COMMENTARY NUMBER 577
2013 Federal Deficit—Cash versus GAAP, Durable Goods Orders
November 27, 2013

**Irrespective of Gimmicked Narrowing of 2013 Cash-Based Federal Deficit,
GAAP-Based Deficit Remains Uncontrolled and Uncontained**

Commercial Aircraft Orders Led Decline in Durable Goods Orders

PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, December 4th covering the October trade deficit and, tentatively, September and October construction spending and new home sales. Subsequent Commentaries on December 5th and 6th, respectively, will cover the second estimate, first revision of third-quarter GDP, and the November employment and unemployment numbers.

Happy Thanksgiving! — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

GAAP-Based Accounting on 2013 Federal Deficit Delayed Until February 2014. The headline \$0.680 trillion cashed-based 2013 federal deficit reportedly narrowed by 38% versus the \$1.089 trillion deficit of 2012, but that is somewhat misleading. Assessing federal debt increases and allowing for accounting gimmicks, a more-reasonable headline decline for in the 2013 deficit would be around \$0.190 trillion instead of the reported \$0.409 trillion. Generally accepted accounting principles (GAAP)

accounting should show an actual 2013 deficit in the six- to seven-trillion dollar range, versus \$6.6 trillion in 2012. The years mentioned here are U.S. government fiscal years, ended September 30th.

The headline cash-based deficit, in theory but no longer in practice, reflects the net results of the federal government's cash receipts less cash outlays. In the wake of the 2008 panic, some outlays were treated as investments, and the otherwise gimmicked cash-based accounting became even more so.

While the current sequestrations did reduce outlays minimally, and while higher taxes—including a revocation of the Social Security Withholding Tax Holiday—did increase tax receipts, all is not as it appears with the headline reduction in the 2013 annual deficit.

For example, Fannie Mae and Freddie Mac, which were taken over by the federal government in the wake of the mortgage-market collapse, paid roughly \$100 billion into the U.S. Treasury in 2013. Used in reducing the cash deficit, those “dividends” purportedly reflected “profits” that were little more than bookkeeping gimmicks, not from a real recovery in housing. Most of that cash also was used by the Treasury to help skirt the debt ceiling, a process that stretched from May into October. Properly accounted for, Fannie Mae and Freddie Mac would be consolidated into the government financial statements, prepared using GAAP-based accounting, but they are not.

Separately, the annual cash deficit for the government should be reflective of the increase in gross federal debt for the same period, allowing for changes in cash balances. Per the U.S. Treasury, gross federal debt was \$16.066 trillion at fiscal-year-end 2012, and \$16.738 trillion at fiscal-year-end 2013, an increase of \$672 billion, apparently close to the deficit for the 2013-fiscal year, but that was not the case.

Consider that at fiscal-year-end 2013, the Treasury had been operating since May 2013 at a debt ceiling of \$16.7 trillion, using accounting gimmicks and borrowing from internal funds to operate. On October 17th, with the debt ceiling lifted, all those gimmicks were lifted and funded, with the gross federal debt jumping by more than \$300 billion in one day, to \$17.076 trillion. That suggested a reasonably realistic, effective gross federal debt increase of \$1.010 trillion for the 2013 fiscal year.

Combine that with a negative cash swing of \$40 billion, the dividend gimmick of \$100 billion, and allow for an offsetting \$92 billion deficit in October 2013 reporting, and the implied cash-based deficit for fiscal 2013 was about \$1.060 trillion. That is little changed from the \$1.089 trillion cash-based deficit in 2012, despite all the effects of spending cuts and new tax revenues. A similar analysis of 2012, however, would suggest a cash-based deficit of \$1.250 trillion for 2012. So, if the \$1.060 and \$1.250 trillion numbers were viewed as being on a consistent and comparable basis, that would suggest an annual cash-based deficit narrowing of about \$190 billion, instead of the headline \$409 billion.

Forthcoming GAAP-based accounting for fiscal-year 2013, from the GAO, will resolve most of those issues. With an uncontained and uncontrolled GAAP deficit at \$6.6 trillion in 2012 (see [No. 500: Special Commentary](#)), an expectation in the six- to seven-trillion dollar range is reasonable for 2013. Although the annual GAAP accounting is supposed to be published on or about the 15th of December following the close of the fiscal year, the accounting for 2013 has been delayed until February 26, 2014.

A Most Difficult Time Ahead: *Hyperinflation 2014—The End Game*. The still-evolving and fully-updated version of [Hyperinflation 2012](#) should be published around mid-December. The broad outlook

remains intact as described in the *Hyperinflation Watch* section. This missive will be massive, going beyond revising previous versions, with a comprehensive assessment of the historical factors leading into the pending crisis, relationships with earlier crises, and approaches—at both the personal and government levels—that could help to mitigate what will be very difficult times in the year ahead. Many thanks to those who submitted questions and suggestions; they will be addressed as best as a possible.

New Orders for Durable Goods (October 2013)—Aircraft Orders Lead Durable Goods Decline. As often happens, irregular commercial aircraft orders heavily influenced the reporting of new orders for durable goods, with the aggregate October orders falling by 1.98%.

Net of the volatility in airplane orders, new orders broadly have been stagnant on a monthly basis for the last five months and were down by 0.75% in October. Even with the headline monthly decline in total orders of a rounded 2.0%, however, the October contraction was not meaningful, remaining well within the normal variability of the series. As a result, the ongoing long-term pattern of stagnation remains in place—particularly when viewed as adjusted for inflation—despite any short-term blips, and the growth patterns in this series remain of a nature that usually precedes or coincides with a recession or deepening business downturn.

Official, Nominal (Not-Adjusted-for-Inflation) October 2013 Reporting. The seasonally-adjusted, nominal level of October 2013 new orders for durable goods fell by 1.98%, month-to-month, following a revised 4.08% monthly gain in September. The upside revision to September's aggregate orders included an upside revision to commercial aircraft orders. Before prior-period revisions, October aggregate new orders declined by 1.35%.

Contractions and surges in commercial aircraft orders are seen in an irregularly-repeating process throughout the year. Although these extremely volatile orders tend to dominate total durable goods orders, the aircraft orders are booked well into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

Nondefense (or commercial) aircraft orders dropped by 15.86% in October, following a revised 59.20% surge in September. Net of prior-period revisions, October commercial aircraft orders fell by 14.99%. Net of these orders, total new orders declined by 0.75% in October, following a revised 0.99% gain in September.

What these numbers show over the last five months is no growth (actually down by 2.09%)—effectively stagnation—in new orders for durable goods, net of commercial aircraft order activity and before any consideration for the effects of inflation.

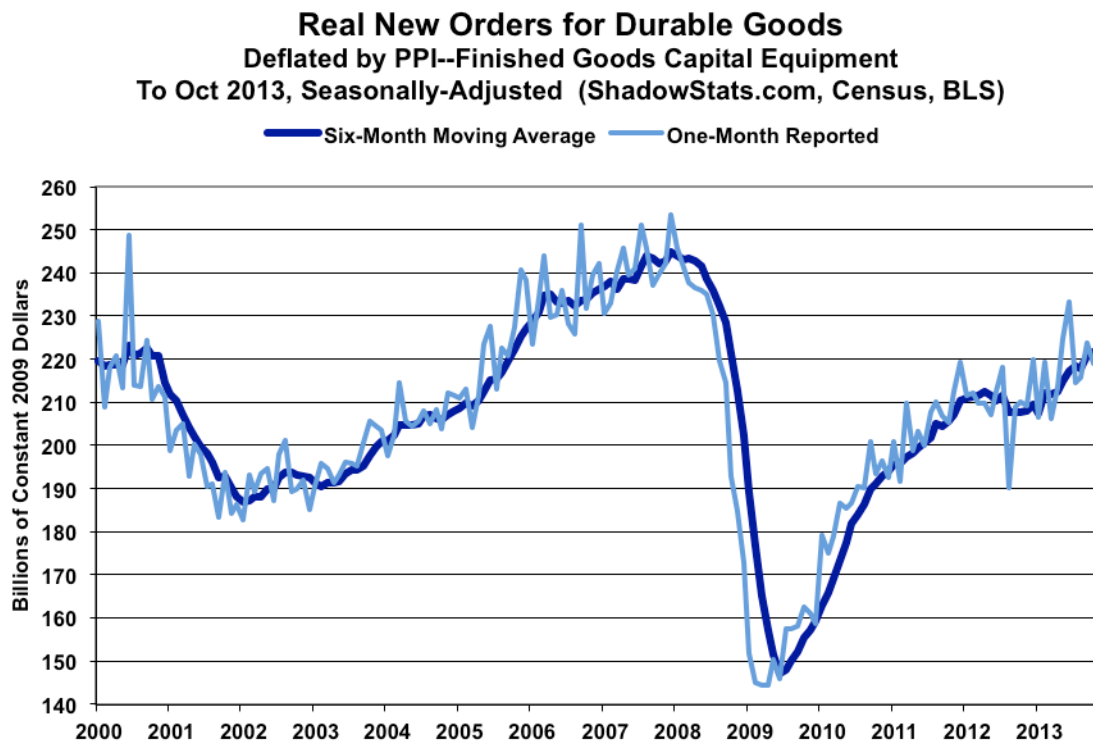
Aircraft-order volatility also has impacted year-to-year change in seasonally-adjusted, total new orders. Total orders in October 2013 were up by 5.27% (up 5.53% ex-commercial aircraft) versus a revised 8.12% (up 7.28% ex-commercial aircraft) in September.

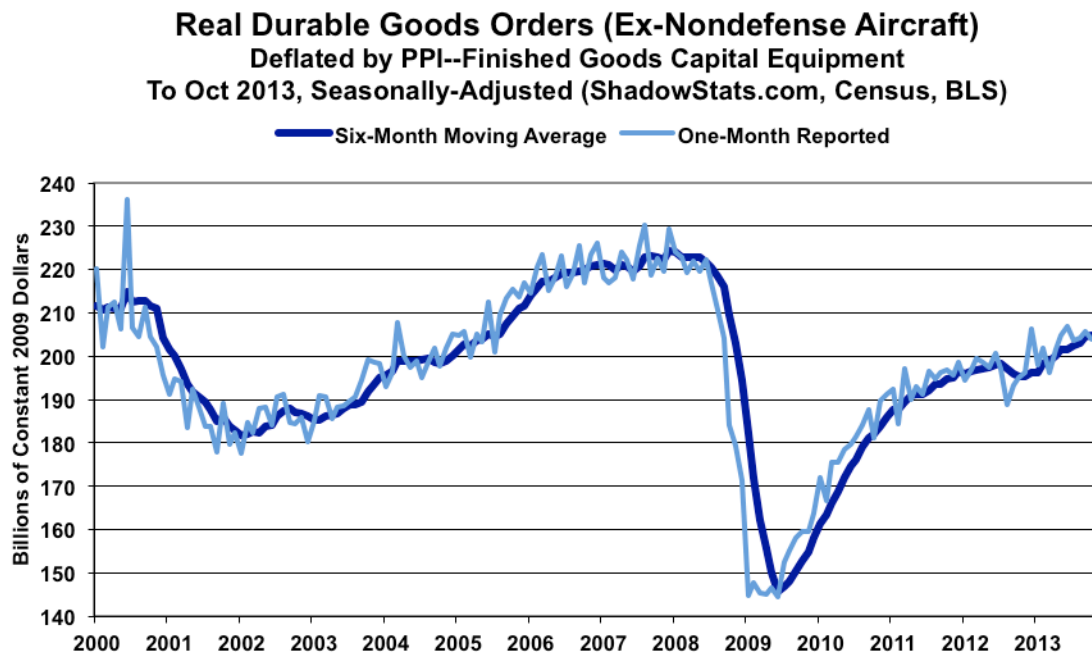
Further affected by aircraft-order activity were seasonally-adjusted new orders for nondefense capital goods, which fell by 3.90% in October (down by 0.21% ex-commercial aircraft), versus a revised gain of 6.82% (down by 3.00% ex-commercial aircraft) in September. Again, all of the preceding is before adjustment for inflation.

Real (Inflation-Adjusted) Durable Goods Orders—October 2013. Headline monthly inflation in the October PPI finished goods, capital equipment measure was a seasonally-adjusted 0.12%, month-to-month, versus a 0.30% monthly gain in September. On an annual basis, October inflation was 0.98%, versus 0.86% in September. Please note that this inflation series will be revised after the publication of the revamped producer price index series, due for release in February 2014 (see [Commentary No. 575](#)).

Adjusted for the PPI inflation, and reflected in the accompanying graphs, real month-to-month orders dropped by 2.09% in October, versus a revised gain of 3.76% in September (aggregate), and they declined by 0.87% in October, versus a revised 0.68% gain in September (ex-commercial aircraft). Real year-to-year orders gained 4.25% in October, versus a revised 7.20% in September (aggregate), and they gained 4.51% in October, versus a revised 6.37% in September (ex-commercial aircraft).

Graphs of Inflation-Adjusted and Smoothed Durable Goods Orders. As usually shown and discussed in the *Commentaries* covering new orders for durable goods, the following two graphs plot the new orders, adjusted for inflation. These graphs show monthly as well as a six-month moving average of the activity level. The first graph shows the aggregate new orders series. The second series is net of the unstable commercial-aircraft order sector, and, accordingly, it is somewhat smoother than the first graph. As reflected in these graphs of still-irregular activity, the moving-average levels in both series have been holding in a pattern of near-stagnation, with mixed trends the most-recent months, as the monthly numbers turn lower.





In terms of inflation-adjusted activity, both of these series have shown a slowing uptrend and flattening-out in the last two-to-three years—most recently with a dip and upside bouncing, a general pattern of stagnation or bottom-bouncing—clearly not the recovery that is seen in official GDP reporting. The real (inflation-adjusted) level of orders in October 2013 remained at or below both the pre-2001 and pre-2007 recession highs. The pattern of recent stagnation in the inflation-adjusted series also is one that commonly precedes or is coincident with a recession.

If the deflation measure here were corrected meaningfully for the hedonic-adjusted understatement of the respective PPI inflation measure, the post-2009 uptrend in real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity, with a pattern of renewed downturn now well entrenched.

[For further detail on November new orders for durable goods, see Reporting Detail Section.]

HYPERINFLATION WATCH

Summary Hyperinflation Outlook—Unchanged. 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 and expanded version of [Hyperinflation 2012](#), is discussed in the *Opening Comments*.

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 uncontrollable 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-fester 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

NEW ORDERS FOR DURABLE GOODS (October 2013)

October 2013 Decline in Durable Goods Orders Largely Was Due to Volatile Commercial Aircraft Sector. Irregular commercial aircraft orders heavily influenced reporting of new orders for durable goods in October, with aggregate orders falling by 1.98%.

Net of the volatility in airplane orders, new orders for durable goods broadly have been stagnant on a monthly basis for the last five months, down 0.75% in October. Even with the aggregate monthly decline of a rounded headline 2.0%, the October contraction was not meaningful, remaining well within the normal variability of the series. As a result, the ongoing long-term pattern of stagnation remains in place—particularly when viewed net of inflation—despite any short-term blips. The growth patterns in this series remain of a nature that usually precedes or coincides with a recession or deepening business downturn.

Official, Nominal (Not-Adjusted-for-Inflation) October 2013 Reporting. The Census Bureau reported today, November 27th, that the regularly-volatile, seasonally-adjusted nominal (not-adjusted-for-inflation) level of October 2013 new orders for durable goods fell by 1.98%, following a revised 4.08% (previously

3.66%) monthly gain in September. The upside revision to September's aggregate orders included an upside revision to commercial aircraft orders. Before prior-period revisions, October total new orders declined by 1.35%.

The reporting of contractions and surges in commercial aircraft orders is seen in an irregularly-repeating process throughout the year. These extremely volatile orders, which usually dominate the aggregate durable goods growth numbers, are booked well into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

Nondefense (or commercial) aircraft orders dropped by 15.86% in October, following a revised 59.20% (previously 57.48%) surge in September. Net of prior-period revisions, October commercial aircraft orders fell by 14.99%. Net of these orders, total new orders declined by 0.75% in October, following a revised 0.99% (previously 0.64%) gain in September.

What these numbers show over the last five months is no growth (actually down by 2.09%)—effectively stagnation—in new orders for durable goods, net of commercial aircraft order activity and before any consideration for the effects of inflation.

Aircraft order volatility also has impacted year-to-year change in seasonally-adjusted, total new orders. Total orders in October 2013 were up by 5.27% (up 5.53% ex-commercial aircraft), versus a revised 8.12% (up 7.28% ex-commercial aircraft) in September.

Further affected by aircraft-order activity were the seasonally-adjusted new orders for nondefense capital goods, which fell by 3.90% in October (down by 0.21% ex-commercial aircraft), versus a revised gain of 6.82% (down by 3.00% ex-commercial aircraft) in September. All of the preceding is before adjustment for inflation.

Caution: Current durable goods reporting remains subject to many of the same sampling and concurrent-seasonal-adjustment problems that are seen with retail sales, payroll and unemployment reporting. Unusual seasonal-factor volatility raises issues as to the significance of reported seasonally-adjusted monthly and annual changes. While those issues are brought into balance, temporarily, with an annual benchmark revision to durable goods orders (usually in May), subsequent reporting makes all historical reporting prior to August 2013 inconsistent with the current headline numbers.

Real (Inflation-Adjusted) Durable Goods Orders—October 2013. Headline monthly inflation in the October PPI finished goods, capital equipment measure was a seasonally-adjusted 0.12%, month-to-month, versus a 0.30% monthly gain in September. On an annual basis, October inflation was 0.98%, versus 0.86% in September.

Adjusted for that inflation, and reflected in *Opening Comments* graphs, real month-to-month orders dropped by 2.09% in October, versus a revised gain of 3.76% in September (aggregate), and they declined by 0.87% in October, versus a revised 0.68% gain in September (ex-commercial aircraft). Real year-to-year orders gained 4.25% in October, versus a revised 7.20% in September (aggregate), and they gained 4.51% in October, versus a revised 6.37% in September (ex-commercial aircraft).

Graphs of Inflation-Adjusted and Smoothed Durable Goods Orders. The usual two inflation-adjusted graphs are found in the *Opening Comments* section. Those graphs show the monthly as well as a six-month moving average activity for both the aggregate new orders series and the series net of the unstable

commercial-aircraft order sector. The moving-average levels in both series have been holding in a pattern of near-stagnation, with mixed trends in the most-recent months, as the monthly numbers turn lower.

In terms of inflation-adjusted activity, both of these series have shown a slowing uptrend and flattening-out in the last two-to-three years, with the real levels of the October 2013 orders remaining at or below both the pre-2001 and pre-2007 recession highs. The pattern of recent stagnation in the inflation-adjusted series also is one that commonly precedes or is coincident with a recession.

If the deflation measure here were corrected meaningfully for the hedonic-adjusted understatement of the respective PPI inflation measure, the post-2009 uptrend in real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity, with a pattern of renewed downturn now well entrenched. Please note that the inflation series here will be revised after the publication of the revamped producer price index series, due for publication in February 2014 (see [Commentary No. 575](#)).

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Likely in the Months Ahead. The markets generally remain overly optimistic as to the economic outlook, although expectations have softened during the last year. That circumstance, and underlying fundamentals that remain highly 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. Data distortions resulting from the October government shutdown increase the risk for unusual reporting and revisions in most federal-government and related series. *[Other than for the entries in the Pending Releases section, this Week Ahead is unchanged from the prior Commentary.]*

In terms of monthly inflation reporting, energy-inflation-related seasonal-adjustment factors will be turning negative by year end, and were not positive enough in October to offset declines in unadjusted energy prices in the CPI or the PPI. That said, 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 the *Summary 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:

Construction Spending (September and October 2013). The Commerce Department will release its estimates for September and October 2013 construction spending on Monday, December 2nd. Although expectations appear to favor modest monthly gains in spending, the monthly changes, as usual, should not be statistically significant. The series likely will continue its recent trend of month-to-month stagnation, particularly after consideration of inflation impact.

New-Home Sales (September and October 2013). Catch-up reporting for September and October new-home sales is due for release from the Census Bureau on Wednesday, December 4th. As is the usual circumstance with this highly volatile and unstable series, an entrenched pattern of stagnation has continued, with the pending reports of monthly change in new-home sales activity not likely to be statistically-significant, in either direction. This report comes against a backdrop of declining existing-home sales in September and October (see [Commentary No. 574](#)) and incomplete reporting on residential construction (see [Commentary No. 576](#)).

U.S. Trade Balance (October 2013). The October trade deficit is scheduled for release on Wednesday, December 4th, by the Census Bureau and the Bureau of Economic Analysis (BEA). While the markets appear to expect a small narrowing in the monthly deficit, heavy reporting distortions to trade-flow data and paperwork disruptions likely linger in the background, both from private-industry computer problems and from possible paperwork flow distortions during the October government shutdown. Accordingly, there could be unusual volatility in the monthly reporting. Underlying trade-related fundamentals and long-term trends continue to favor significant and ongoing trade-deficit deterioration.

Any significant revision to the September data would impact the first or second revision to third-quarter GDP (see next entry). A wider-than-expected deficit in the October trade numbers would have negative implications for market expectations of headline GDP growth in fourth-quarter 2013 GDP, and vice versa.

Gross Domestic Product—GDP (Third-Quarter 2013, Second-Estimate, First Revision). The Bureau of Economic Analysis has scheduled release of the second estimate of third-quarter 2013 GDP for Thursday, December 5th (the third estimate is scheduled for December 20th). Market expectations appear to be for an upside revision to the initial 2.8% headline growth estimate, but the September trade report

favors a downside revision, perhaps to 2.5% (see [Commentary No. 573](#)). Given the surveying problems the statistical agencies have had as a result of the October shutdown of the federal government, the first-estimate of the GDP included a great deal more in the way of guessing of data than was usual. Accordingly, this and the next revision could be unusually large; underlying economic reality favors adjustments to the downside.

Employment/Unemployment (November 2013). The release of November 2013 employment and unemployment by the Bureau of Labor Statistics (BLS) is schedule for Friday, December 6th. With November recovering from the effects of the October government shutdown, the numbers are going to be haphazard, at best. The extraordinary misreporting of October's labor data was covered in [Commentary No. 572](#).

The unemployment rate should decline, as the limited numbers of furloughed governments workers, who properly were counted as unemployed, should be employed again. Further, there is no reason to expect that the rapid loss of long-term unemployed from the headline labor force has subsided, so the expected decline in headline U.3 unemployment to the pre-shutdown 7.2% level, easily could drop to 7.1%. The broader U.6 and ShadowStats unemployment measures would tend to hold at higher respective levels.

From the payroll employment perspective, the BLS trend model suggests a 168,000 jobs gain in November. The consensus tends to reflect the trend model but seems to be setting somewhat above it. Underlying economic reality would suggest a downside surprise with the payrolls, with an outright contraction possible. Nonetheless, all these numbers are unsettled and could come in well outside general expectations.
