

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

COMMENTARY NUMBER 579
First Revision to Third-Quarter 2013 GDP

December 5, 2013

“Booming” GDP Growth Not Reflected in Any Other Major Economic Indicator

**Involuntary Inventory Build-Up Spiked GDP Revision;
Final Sales (GDP Less Inventory Change) Growth Revised to 1.9% from 2.0%**

**Revised Headline Growth in Third-Quarter GDP Was Reported at 3.6%; GNP Was 3.9%;
But GDI (the Theoretical GDP Equivalent) Was 1.4%**

Another Set of GDP Revisions in Two Weeks

PLEASE NOTE: The next regular Commentary is scheduled for tomorrow, Friday, December 6th covering the November employment and unemployment numbers.

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Third-Quarter GDP “Boom” Did Not Happen. An unusually-large upside change, reflecting an upwardly revised surge in estimated private inventories—an involuntary build-up—spiked today’s (December 5th) second estimate of headline, third-quarter GDP growth to 3.61%, from initial reporting of 2.85% (rounds to 2.8%). That is above-average growth, nearing “economic boom” territory.

The 3.61% third-quarter growth was against 2.48% growth in the second-quarter. The third-quarter inventory build-up, however, was not supported by the consumption numbers or industrial production reporting, and it appears to have been reversed in today's separate reporting of October manufacturer's inventories. Based on the official GDP inventory gyrations, growth in third-quarter final sales, which is GDP less the change in inventories, revised to 1.93% (previously 2.02%), versus second-quarter final sales of 2.07%. The problem with excessive inventory build-up is that companies most often cut back on production to bring inventories into line, and that usually results in an economic contraction.

A further indication of GDP reporting instabilities was seen in related reporting. The revised headline GDP growth of 3.61% was against growth of 3.94% in initial gross national product (GNP) reporting (GDP is a GNP component), suggestive of an unusual decline in financial flows from the United States. The problem for the GDP reporting, though, is with the theoretically-equivalent gross domestic income (GDI), where initial headline growth came in at 1.39% versus the GDP's 3.61%. Keep in mind that these growth rates are annualized quarterly numbers, so any errors are amplified, raised to the fourth power.

New Downside GDP Revisions in Two Weeks. Likely reflecting some reporting distortions in components used in constructing the GDP—distortions resulting from the shutdown of the federal government in October—the first revision to third-quarter GDP was highly questionable. The third-quarter GDP, however, remains subject to another potentially large revision (this time to the downside) in about two weeks. The Bureau of Economic Analysis (BEA) will publish the second revision of third-quarter GDP on December 20th.

Discussed as a possibility in prior the [Commentary No. 578](#) and seen in today's reporting, the first GDP revision incorporated much of an implied earlier trade-deficit revision. Due to the publishing-schedule disruptions forced by the government shutdown, however, further implied downside revisions to second-quarter GDP—tied to trade and construction-spending reporting of the last day or so—were not incorporated.

Additionally, based on inventories that also were reported today in the Commerce Department's October 2013 manufacturer's shipments, inventories and orders report (ShadowStats normally covers the advance reporting of new orders for durable goods)—a source document for the BEA—third-quarter inventories should be subject to a meaningful downside revision. Along with this inventory revision, the construction and further trade revisions await that December 20th third-quarter GDP revision.

Further official detail on the latest manufacturing inventories and GDP reporting will be found with our affiliate www.ExpliStats.com.

Annual Growth Still at Pre-Recession Levels. The year-to-year growth in third-quarter 2013 GDP revised higher to 1.83%, from initial reporting of 1.65%. Historical growth rates have fallen below the 2.0% level only when the economy was going into a recession (see the graphs in *Reporting Detail* section). A similar pattern has been seen in the real retail sales series, with suggestions of same in industrial production. The key movement here is where annual growth slows to below supportable levels of economic growth and momentum.

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.

Gross Domestic Product (GDP)—Official Numbers. The second estimate, first revision of third-quarter 2013 GDP showed a statistically-significant, real (inflation-adjusted), annualized quarterly gain of 3.61% (previously 2.85% [rounds to 2.8%]). That was against a 2.48% headline gain in second-quarter 2013 and 1.15% increase in the first-quarter.

This above-average growth rate was due to an unusually large and unsustainable upside revision to inventories. As discussed above, the second revision to third-quarter GDP should see downside growth revisions tied to lower inventories, weaker construction and further deterioration in the trade deficit.

For third-quarter 2013 GDP, the second estimate of year-to-year growth was revised to 1.83% (previously 1.65%), versus 1.63% in the second-quarter and 1.32% in the first-quarter 2013 (see graphs in the *Reporting Detail* section).

Implicit Price Deflator (IPD). The second estimate of third-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized pace of 1.96% (previously 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 1.41% in revision (previously 1.40%), from 1.44% in the second-quarter and from 1.74% in the first-quarter. The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

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](#)).

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

The headline third-quarter GNP real growth rate was 3.94%, up from 2.67% in the second-quarter. Year-to-year GNP growth was 1.89% in the third-quarter 2013, versus 1.52% in the second-quarter. The relatively stronger headline GNP growth reflected a recent string of quarterly declines in U.S. payments of factor income to the rest of the world, a trend in place since the beginning of 2013. It may be reflective partially of the Federal Reserve's monetizing Treasury debt under QE3, with a coincident reduction in foreign holdings of Treasury debt and continued low domestic interest rates.

Gross Domestic Income (GDI), Statistical Discrepancy and Residuals. The first-estimate of third-quarter 2013 GDI also was published today, where the GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. Any difference between the GDP and GDI is accounted for by adding a "statistical discrepancy" into the GDI account.

The headline third-quarter GDI real growth rate was 1.39%, down from 3.21% in the second-quarter. Year-to-year GDI growth was 2.97% in third-quarter 2013, versus 2.84% in the second-quarter. The difference between the headline third-quarter 3.61% GDP growth and the headline 1.39% GDI growth provides some indication of the scope of problems involved in putting together meaningful numbers on the broad economy, where much of the data construction is theoretical and on a bookkeeping basis, with limited linkage real-world activity, and with books that never balance.

In the third-quarter, the statistical discrepancy narrowed to a negative \$97.5 billion, from a negative \$186.8 in the second-quarter (these numbers are nominal, before adjustment for inflation). Separately, as an aside, in the real GDP accounting, there is a “residual” line item that is added in the with GDP components, so that the components will add to the headline total GDP. Due to the manner of the chain-weighted deflation of the GDP numbers, the components will not otherwise total the GDP. At the level broken out in Table 3 of the [GDP press release](#), the residual was a negative \$41.2 billion (revised from a negative \$42.1 billion) in the third-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-significant, second estimate of 3.61% headline growth (previously 2.85%) 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 $0.96\% + 2.49\% + 0.07\% + 0.09\% = 3.61\%$ (previous third-quarter aggregate was 2.85%), versus aggregate second-quarter growth rate of 2.48%:

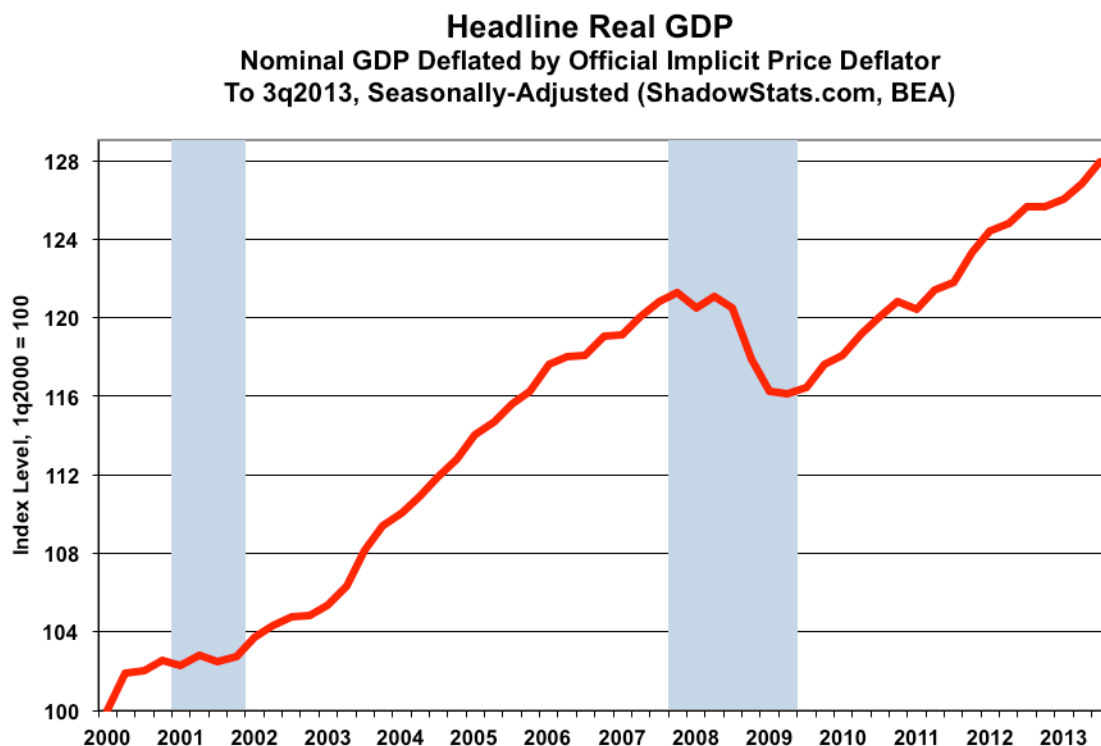
- **Consumer Spending Contributed 0.96% (previously 1.04%) to Third-Quarter Growth (1.24% in Second-Quarter).** With personal consumption accounting for 68% of the recently redefined GDP—it used to be 71% of GDP (see benchmark revision detail in [Commentary No. 546](#))—the reported slowing pace of annualized real growth remained somewhat in line with headline real retail sales for the quarter, with a downside revision in the pace of growth in car sales and recreational goods and vehicles. Other revisions were minimal.
- **Business/Residential Investment Contributed 2.49% (previously 1.45%) to Third-Quarter Growth (1.38% in Second-Quarter).** The revised growth in the business investment sector was dominated by an upside revision to the relative increase in inventories, which contributed a revised 1.68% to the 3.61% aggregate GDP growth, versus an initial 0.83% to the initial aggregate growth rate of 2.85%. The balance of the upside revision to this category was in nonresidential equipment, which revised to flat from a 0.21% contraction.
- **Net Exports Contributed 0.07% (previously 0.31%) to Third-Quarter Growth (a 0.07% Subtraction in Second-Quarter).** Much of the suggested deterioration in the third-quarter trade deficit, as indicated in initial reporting of September, was reflected in this revision. As discussed earlier, more downside revision to the contribution is pending.
- **Government Spending Contributed 0.09% (previously 0.04%) to Third-Quarter Growth (a 0.07% Subtraction in Second-Quarter).** On a quarterly basis, the small gain in government spending still reflected a small increase in state and local spending more than offsetting the decline in federal spending. The numbers otherwise were little changed from the first estimate of the third-quarter GDP.

Economic Reality. Although the second estimate of third-quarter 2013 GDP growth moved slightly above statistical-noise status, 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 second 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 graphs of monthly real median household income, other liquidity measures and economic series not otherwise reliant on understated inflation for their reported growth, as shown in [Commentary No. 575](#). 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.

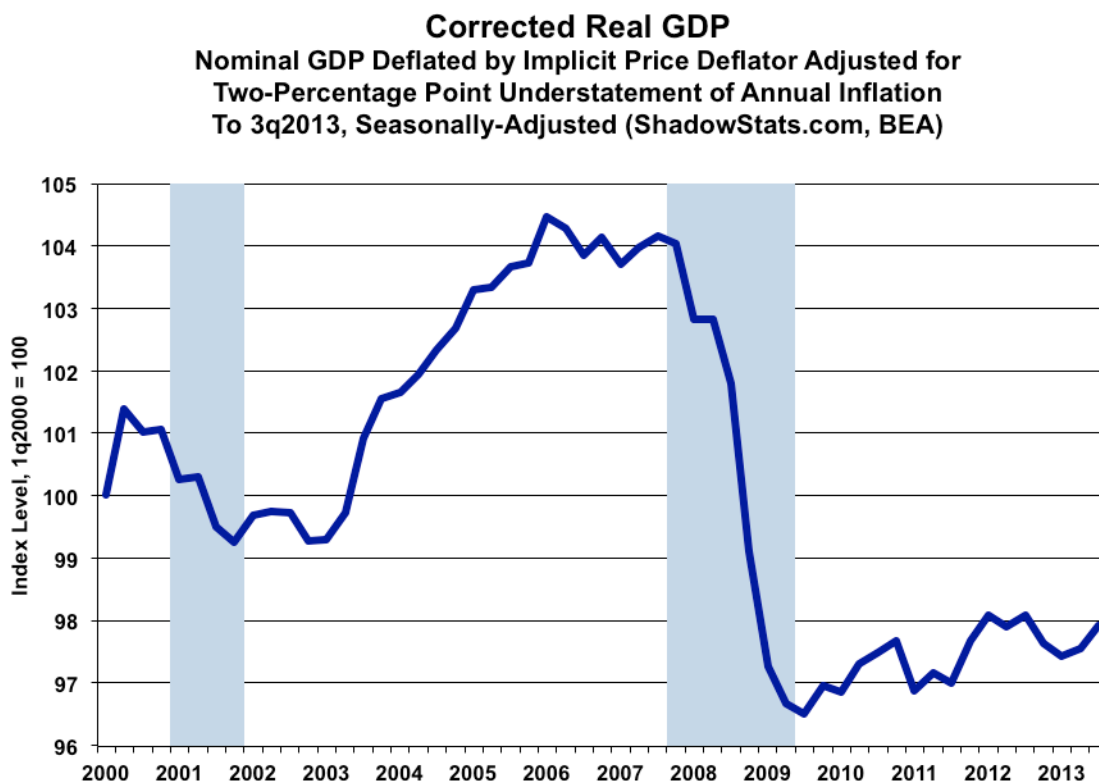


Official and Corrected GDP. As usually discussed in the *Commentaries* covering the quarterly GDP reporting and monthly revisions, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (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 of official *Headline Real GDP*, 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 now stands at 5.5% (previously 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 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.



[For further detail on the GDP revision and reporting, see the 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](#), was discussed in the *Opening Comments* of [Commentary No. 577](#).

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-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, Second Estimate, First Revision)

Revised “Booming” Third-Quarter GDP Growth Was Nonsense. In an unusually-large upside revision, which may have reflected data issues tied to the recent government shutdown, a surge in private inventories—an involuntary build-up—spiked revised headline third-quarter growth from an annualized 2.85% to 3.61%. That is above-average growth and nearing “economic boom” territory.

The headline 3.61% growth was against second-quarter growth of 2.48%. The continuing third-quarter inventory build-up was not supported by the GDP consumption numbers or industrial production reporting. Separately, today's (December 5th) reporting of October manufacturer's inventories showed a downside revision for the third-quarter. As a result of the official GDP inventory gyrations, third-quarter final sales, which is GDP less the change in inventories, revised lower to headline growth of 1.93%, versus initial reporting of 2.02%, versus second-quarter final sales of 2.07%.

The problem with excessive inventory build-up is that companies usually cut back on production to bring inventories into line, and that often results in an economic contraction.

Annual Growth Still at Pre-Recession Levels. The year-to-year growth in third-quarter GDP revised higher to 1.83%, from initial reporting of 1.65%, up from 1.63% in the second-quarter. Historical growth rates have fallen below the 2.0% 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 movement 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 second estimate of the level of third-quarter GDP, real GDP is a revised 5.5% (previously 5.3%) above the pre-recession peak in GDP activity of 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 (see [Commentary No. 575](#)).

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 $1.01 \times 1.01 \times 1.01 \times 1.01 = 1.0406$ or 4.1%, instead of $4 \times 1\% = 4\%$.

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

Gross Domestic Product (GDP). Published this morning, December 5th, by the Bureau of Economic Analysis (BEA), the second estimate, first revision of third-quarter 2013 GDP showed a statistically-significant, real (inflation-adjusted), annualized, revised quarterly gain of 3.61% (previously 2.85% [rounds to 2.8%]) +/- 3.5% (95% confidence interval). That was against a 2.48% headline gain in second-quarter 2013 and a 1.15% increase in the first-quarter.

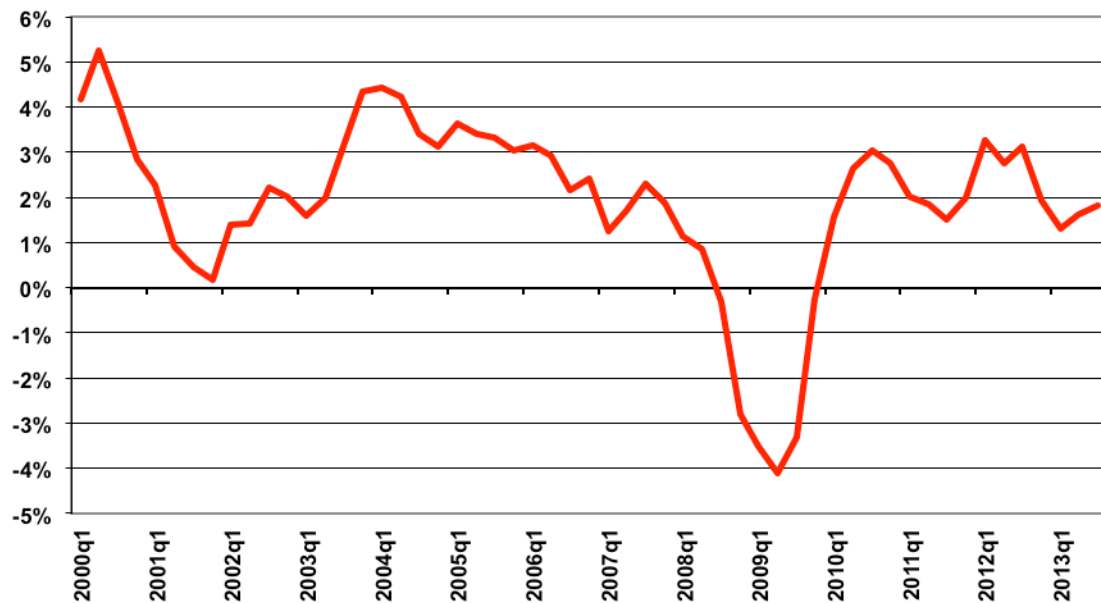
Distribution of the headline quarterly GDP growth rate, by major GDP component, is detailed in the *Opening Comments* section.

This above-average aggregate GDP growth rate was due to an unusually large and unsustainable upside revision to inventories. Due to the unusual publishing schedules forced by the government shutdown in October, the second revision appeared to incorporate an earlier trade deficit revision, but further implied downside revisions to second-quarter GDP tied to trade and construction-spending reporting of the last day or so await the third-estimate of third-quarter GDP on December 20th (see discussion in *Opening Comments* and in [Commentary No. 578](#)). A downside revision to today’s inventories also looms, given today’s report on October manufacturing inventories from the Commerce Department.

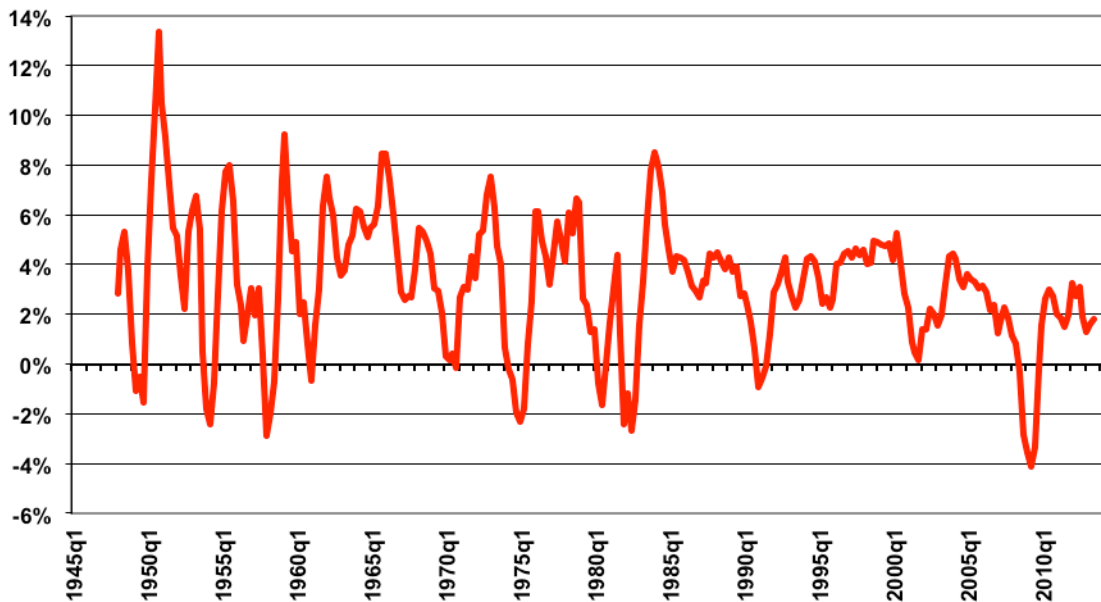
For nearly all of the seventeen quarters of the post-second-quarter 2009 official recovery period, headline growth rates have been little more than statistical noise around the unchanged level, and these heavily guessed-at numbers possibly were massaged to keep the quarterly growth rates in politically-desirable, 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 second estimate was a revised 1.83% (previously 1.65%), 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.

Real Quarterly Gross Domestic Product (GDP)
Year-to-Year % Change, 2000q1 to 2013q3 (ShadowStats, BEA)



Real Quarterly Gross Domestic Product
Year-to-Year % Change, 1948q1 to 2013q3 (ShadowStats.com, BEA)



The first graph preceding 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 below 2.0%, a recession always has followed. Again, today’s headline annual growth rate was 1.83%.

Implicit Price Deflator (IPD). The second estimate of third-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized pace of 1.96% (previously 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 1.41% in revision (previously 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 revised headline year-to-year gain of 1.8%. 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 National Product (GNP). The first-estimate of third-quarter 2013 GNP was published today, where GNP is the broadest measure of U.S. economic activity, and GDP is GNP net of trade flows in factor income (interest and dividend payments).

The headline third-quarter GNP real growth rate was 3.94%, up from 2.67% in the second-quarter. Year-to-year GNP growth was 1.89% in the third-quarter 2013, versus 1.52% in the second-quarter. The relatively stronger headline GNP growth reflected a recent string of quarterly declines in U.S. payments of factor income to the rest of the world, which has been in place since the beginning of 2013. It may be reflective of the Federal Reserve monetizing Treasury debt under QE3, with a coincident reduction in foreign holdings of Treasury debt and continued low interest rates

Gross Domestic Income (GDI). The first-estimate of third-quarter 2013 GDI also was published today, where the GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. Any difference between the GDP and GDI is accounted for by adding a “statistical discrepancy” into the GDI account.

The headline third-quarter GDI real growth rate was 1.39%, down from 3.21% in the second-quarter. Year-to-year GDI growth was 2.97% in third-quarter 2013, versus 2.84% in the second-quarter. The difference between the headline third-quarter 3.61% GDP growth and the headline 1.39% GDI growth provides some indication of the scope problems involved in putting together meaningful numbers on the broad economy, where much of the data construction is theoretical and on a bookkeeping basis, with limited linkage to the real world, and with books that never balance.

In the third-quarter, the statistical discrepancy narrowed to a negative \$97.5 billion, from a negative \$186.8 in the second-quarter (these numbers are nominal, before adjustment for inflation).

Separately, and as an aside, in the real GDP accounting, there is a “residual” line item that is added in the with GDP components, so that the components will add to the headline total GDP. Due to the manner of the chain-weighted deflation (inflation adjustment) of the GDP numbers, the components will not otherwise total the GDP. At the level broken out in Table 3 of the [GDP press release](#), the residual was a negative \$41.2 billion (revised from a negative \$42.1 billion) in the third-quarter.

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 deletion of the pending reporting released today, the 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:

Employment/Unemployment (November 2013). The release of November 2013 employment and unemployment by the Bureau of Labor Statistics (BLS) is scheduled 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 government 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.