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

COMMENTARY NUMBER 604
GDP Revision, GAAP-Based Federal Accounting

February 28, 2014

Third-Quarter GDP Downside Revision Was Consistent with Same Reports Signaling a First-Quarter 2014 Contraction

Renewed Economic Downturn Would Balloon the Budget Deficit

2013 GAAP-Financial Reporting for U.S. Government Published; Fiscal Conditions Remain a Disaster

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PLEASE NOTE: The next regular Commentary *is scheduled for Wednesday, March 5th, covering budget-deficit reality, based on analysis of the 2013 GAAP-based financial statements of the U.S. government that were released yesterday, February 27th. That will be followed by a* Commentary *on Friday, March 7th, covering February employment and unemployment, and the January trade balance and new construction spending.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

"Renewed" Recession Has Horrendous Implications for the Budget Deficit. This morning's GDP revision knocked down the headline growth guesstimate for fourth-quarter economic activity from 3.2% to 2.4%. Likely in the month ahead, regular economic reporting should continue to slow or decline, confirming the outlook for an outright contraction in headline first-quarter 2014 GDP reporting, at the end of April. When renewed recession takes hold of financial-market perceptions, forecasts of U.S. fiscal conditions should be hit hard. Fiscal deficits going forward are projected based on two-to-three percent growth in the GDP, not on a contracting economy. Accordingly, fiscal projections for ballooning budget deficits are likely in the not-too-distant future.

Fiscal Conditions Remain An Uncontrollable Nightmare. The headline, cash-based deficit in U.S. government financial operations was a headline $680 billion for the fiscal-year ended September 30, 2013, and some in Washington are looking for a smaller deficit in fiscal 2014. Those cash-based numbers are heavily gimmicked and have little relevance to the uncontainable fiscal imbalances and long-term sovereign-solvency issues facing the United States government. The general crisis is explored in *Hyperinflation 2014—The End Game Begins*.

Once per year, new light is shed on evolving fiscal reality, with the U.S. Treasury publishing the annual financial statements of the U.S. government, prepared using generally accepted accounting principles (GAAP), and audited by the Government Accountability Office (GAO), formerly the General Accounting Office. The statutory due-date for those statements is December 15th, 2-1/2 months following the close of the fiscal year. Yet, the 2012 as well as the 2013 statements were delayed by more than two months beyond the due-date. The 2013 statements initially were delayed to February 26th, and then to the 27th.

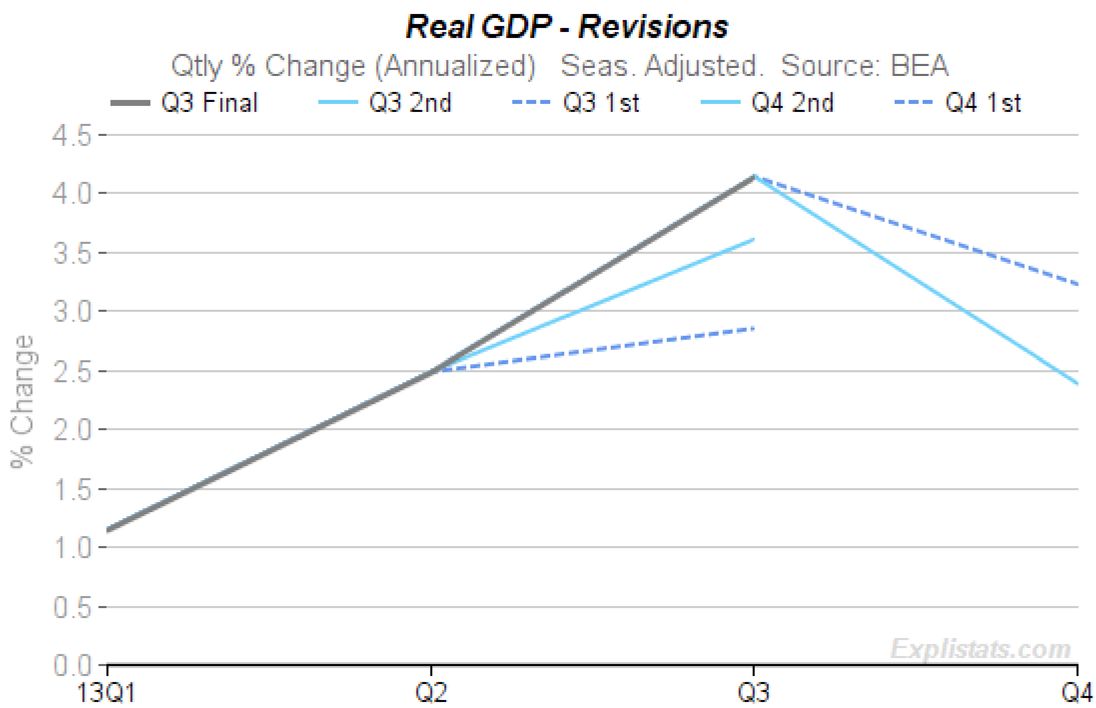
The *2013 Financial Report of the United States Government* was released about 3 p.m. Washington time, yesterday, February 27th, amidst a curious posting on the U.S. Treasury's Website. Initially, the posting indicated that only a summary statement was being released, and that the full financial reporting would be published on April 14th. The financial statements released—though labeled "summary"—were in fact the full report, and the Website posting subsequently was changed to reflect that.

The statements require extensive review and analysis, particularly in terms of changes made in reporting or in underlying assumptions that are not on a basis consistent with prior statements. The headline cash-based 2013 deficit of $680 billion appears likely to be in the $800-billion-plus range, with adjustment for some of the accounting gimmicks. Including accounting for unfunded liabilities, the numbers likely will be close in magnitude to the $6.6 trillion GAAP-based deficit in 2012, perhaps somewhat less. Full details will be published in a dedicated *Commentary* scheduled for March 5th.

Revised Fourth-Quarter 2013 Gross Domestic Product (GDP)—Slowing Activity Continued. Reflecting negative-reporting impact from recently published and revised trade, retail sales, production and housing data, the second estimate of headline real (inflation-adjusted) fourth-quarter GDP growth revised lower to 2.38%, from initial reporting of 3.23%. As with the first guess by the Bureau of Economic Analysis (BEA) on fourth-quarter activity, the second guess also was statistically-insignificant, but it was in line with market expectations. Not widely discussed, yet, that same reporting of underlying fundamental activity suggests likely initial reporting of a quarterly contraction in first-quarter 2014 GDP, due for release on April 26th.

As discussed in prior, GDP-related *Commentaries*, both the third- and fourth-quarter 2013 GDP estimates encompassed data that were impaired—distorted heavily—by the October government shutdown, in terms of surveying, numbers gathering and reporting. Where the third-quarter GDP will not be revised again until annual revisions (in the accompanying graph, note the continual upside revisions for the regular reporting of the shutdown-impaired third-quarter numbers), this morning's (February 28th) first revision to fourth-quarter GDP moved the relative economic performance of the fourth- versus third-quarter GDP to the downside. There is one more standard monthly revision here for the fourth-quarter GDP, next month. Nonetheless, with third-quarter reporting also heavily affected but not revisable, at the moment, the bulk of "shutdown" revisions likely will be seen with the July 30th annual revisions.

The graph, courtesy of ShadowStats affiliate www.ExpliStats.com, shows the three estimates published for third-quarter GDP, from the last second quarter level, and the two estimates, so far, for the fourth-quarter, from the last third-quarter level. The initial or first reporting is shown as the dashed blue line; the solid, thin blue line is the second estimate; and the thick gray line is the third or final reporting. The second estimate of fourth-quarter GDP has taken activity back to pre-second-quarter 2013 levels.



GDP Headline Detail. The second estimate, first revision of fourth-quarter 2013 GDP showed a downwardly-revised, statistically-insignificant, real headline gain of 2.38% (previously 3.23%). That was down from 4.13% growth estimated for the third-quarter, a 2.48% gain for the second-quarter, and against 1.15% growth for the first-quarter.

In terms of year-to-year growth, fourth-quarter 2013 GDP headline growth revised lower to 2.53% (previously 2.74%), versus 1.97% in the third-quarter, 1.63% in the second-quarter and 1.32% in the first-quarter 2013. The average annual real growth rate slowed to a revised 1.86% (previously 1.92%) in the calendar-year 2013, from 2.78% in 2012. Graphs and historical comparisons of these data are found in the *Reporting Detail* section.

Implicit Price Deflator (IPD). The second estimate of fourth-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized quarterly pace of 1.60% (previously 1.29%), versus 1.97% in the third-quarter, 0.58% in the second-quarter and against 1.67% in the first-quarter. Year-to-year, fourth-quarter 2013 IPD inflation was a revised 1.45% (previously 1.38%), versus 1.41% in the third-quarter, 1.44% in the second-quarter and 1.74% in the first-quarter. In terms of average annual inflation, the 2013 IPD was a revised 1.51% (previously 1.49%), versus 1.75% in 2012.

For comparison purposes, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation changed with the annual revisions to seasonally-adjusted CPI-U, recently published by the Bureau of Labor Statistics (BLS). Annualized, quarterly headline CPI-U inflation was a revised 1.14% (previously 0.85%) in fourth-quarter 2013, versus a revised 2.16% (previously 2.63%) in the third-quarter, a revised 0.40% (previously a contraction of 0.03%) in the second-quarter, and a revised 1.19% (previously 1.44%) gain in the first-quarter (see *Commentary No. 592* and *Commentary No. 602*). On an unrevised year-to-year basis, fourth-quarter 2013 CPI-U (unadjusted) was 1.23%, versus 1.55% in the third-quarter, 1.39% in the second-quarter, and 1.68% in the first-quarter. The average-annual CPI-U inflation was 1.46% in 2013, versus 2.07% in 2012.

Gross National Product (GNP) and Gross Domestic Income (GDI). The initial estimates of the fourth-quarter 2013 and annual GNP and GDI will not be published for another month, given the unstable and unreliable nature of the available underlying detail. Data reliability also is a major issue with GDP reporting, but market pressures for "timely" reporting contribute to the general lack of GDP credibility. The BEA would do well to delay the GDP, as it does the other series, since the current reporting generally is without any statistical significance or relationship to underlying economic activity. The GNP here 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 GDI is the theoretical income-side equivalent of the consumption-side GDP estimate.

Distribution of Headline GDP Growth. Despite the severely-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 first revision of headline growth to a statistically-significant 2.38% (previously 3.23%) for fourth-quarter 2013 GDP is 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 1.73% + 0.72% + 0.99% - 1.05% = 2.39% (a rounding difference versus 2.38%). Previously, the "advance" estimate of fourth-quarter aggregate headline growth rate was 3.23%; third-quarter headline growth was 4.13%:

- ***Consumer Spending Contributed a Revised 1.75% to Fourth-Quarter Growth (Previously 2.26%, 1.36% in Third-Quarter).*** Consumer-dependent personal consumption accounts for 68% of the GDP. The downside revisions to the contributions of consumer spending were reflected in reduced levels of consumption of durable goods (particularly vehicles) and clothing, and of reduced spending at restaurants, hotels, etc.

- ***Business/Residential Investment Contributed a Revised 0.72% to Fourth-Quarter Growth (Previously 0.56%, 2.56% in Third-Quarter).*** The net upside revision to private investment was reflected in higher purchases of business equipment (not confirmed by durable goods orders) and the new intellectual-property gimmick, which recently was defined into the GDP. Offsetting that happy news was lower than previously-estimated inventory levels, which was a 0.28% subtraction from the aggregate GDP growth rate (included in the net 0.72% contribution of this category). That means that "final sales"—GDP net of inventory change—was a revised 2.52% (previously 2.81%), versus 2.47% in the third-quarter. The fourth-quarter downside revision to final sales encompassed all the other revisions as well.

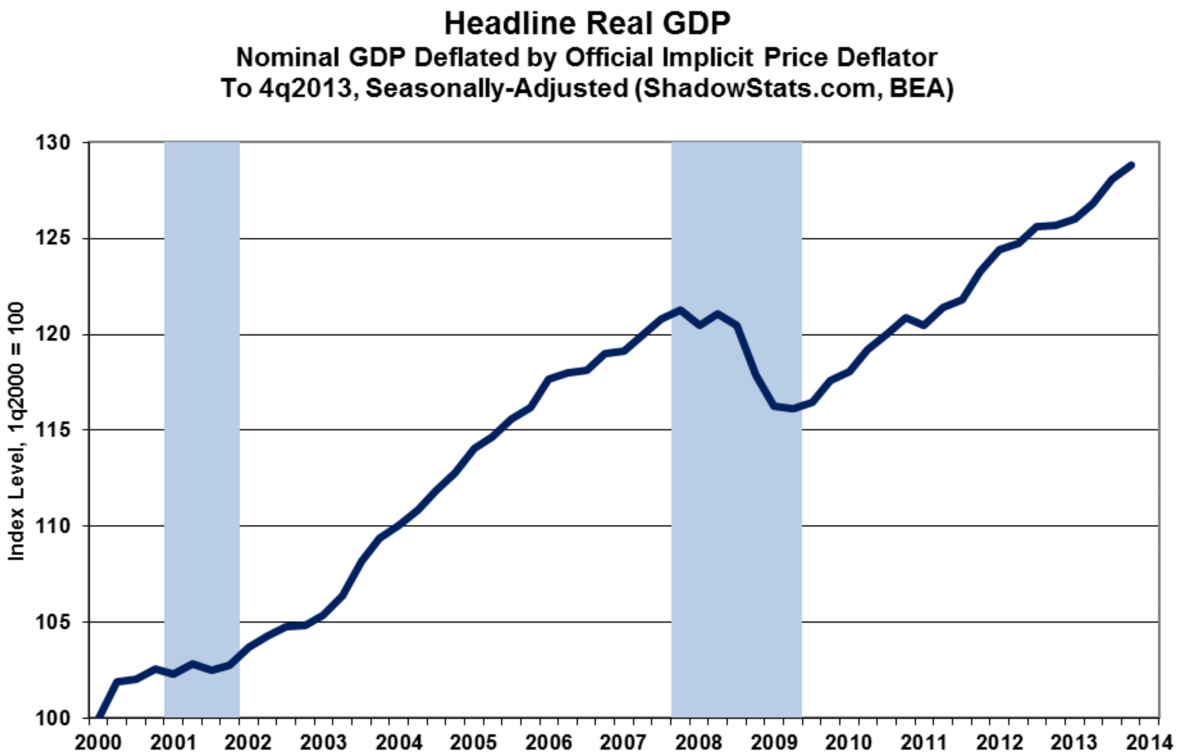
- ***Net Exports Contributed a Revised 0.99% to Fourth-Quarter Growth (Previously 1.33%, 0.14% in Third-Quarter).*** In a direction consistent with recent, headline monthly trade data, the trade deficit and the deficit in the related net-export account, widened in revision, a net negative for the GDP. The December (and quarterly) trade deficit is subject to further revision on March 7th (see the *Week Ahead* section).
- ***Government Spending Subtracted a Revised 1.05% from Fourth-Quarter Growth (Previously Subtracted 0.93%, Contributed 0.08% in Third-Quarter).*** The increased negative impact from the pullback in government spending was estimated largely at the state and local government levels. National defense spending, however, still accounted for two-thirds of the aggregate. negative economic contribution from the government sector.

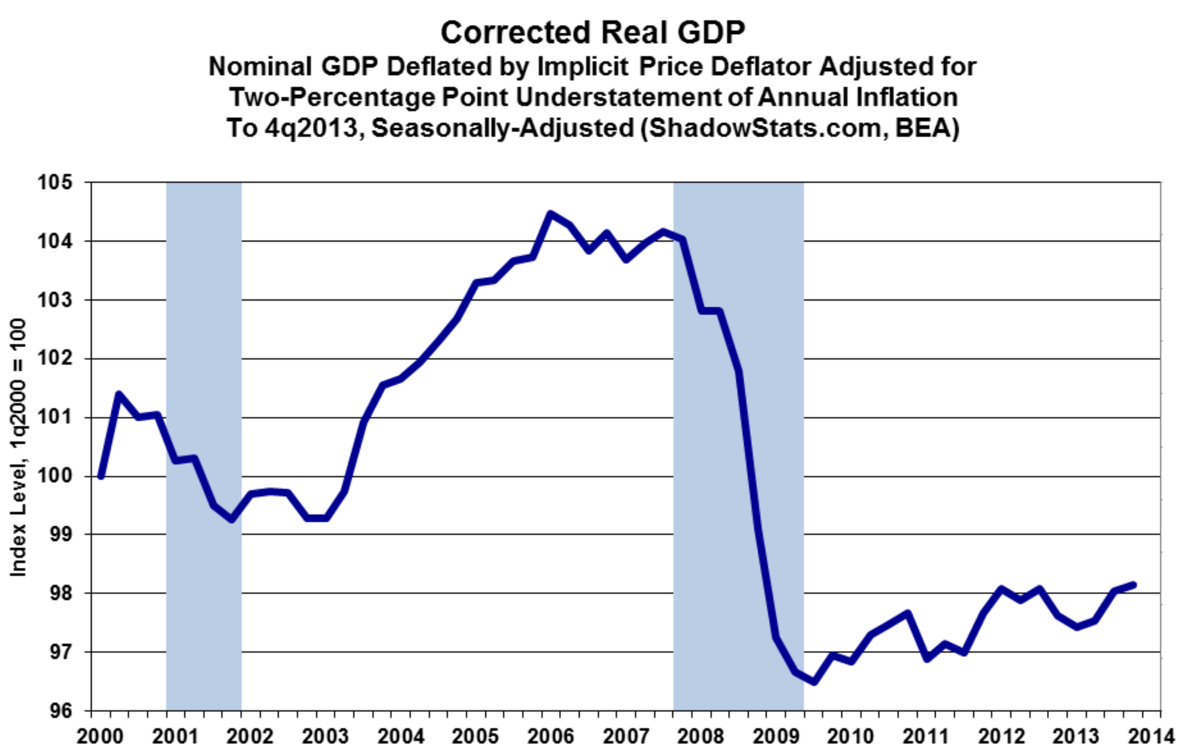
Economic Reality. With the downside revision to the second estimate of fourth-quarter 2013 GDP growth still at the level of statistical-noise, the general outlook is unchanged. Recent underlying economic fundamentals not only suggested the pending revisions, but also suggest a looming quarterly contraction in headline first-quarter 2014 GDP reporting. 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 of, and first revision to, aggregate fourth-quarter 2013 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)*, *Hyperinflation 2012* and pending detail in the *Second Installment* of *Hyperinflation 2014—The End Game Begins*). Irrespective of the reporting gimmicks introduced in the July 2013 GDP benchmark revision, the consistent, fundamental pattern of historical activity 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. 603*. 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 following two graphs tell that story, updated for the second estimate of fourth-quarter 2013 GDP.


Headline Real GDP
Nominal GDP Deflated by Official Implicit Price Deflator
To 4q2013, Seasonally-Adjusted (ShadowStats.com, BEA)
Index Level, 1q2000 = 100
130
125
120
115
110
105
100
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Corrected Real GDP
Nominal GDP Deflated by Implicit Price Deflator Adjusted for
Two-Percentage Point Understatement of Annual Inflation
To 4q2013, Seasonally-Adjusted (ShadowStats.com, BEA)
Index Level, 1q2000 = 100
105
104
103
102
101
100
99
98
97
96
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

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 fourth-quarter 2013 GDP now stands at a revised 6.3% (previously 6.5%) above the pre-recession, peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, shows fourth-quarter activity at an unrevised 5.9% below the pre-recession peak of first-quarter 2006.

No other major economic series has shown a parallel pattern of official full economic recovery and meaningful expansion beyond. Although uncorrected real retail sales—a leading indicator of GDP activity—recently moved minimally past that full-recovery point, such happened seven quarters after the GDP reached that point. In like manner, uncorrected industrial production—a coincident indicator of GDP activity—first moved beyond its pre-recession high in November 2013 reporting. Both the retail and production series have started to back-off those "post-recession" highs.

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*, and as will be reviewed in the *Second Installment* of the hyperinflation report. Both graphs here are indexed to first-quarter 2000 = 100.

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

HYPERINFLATION WATCH

Hyperinflation Outlook. With the *First Installment* of *Hyperinflation 2014—The End Game Begins* published on January 7th, a new *Hyperinflation Summary* for this section will be added in conjunction with the publication of the *Second Installment*. The second and final installment will cover historical and prospective economic activity, as well as possible protective and preventative actions and reactions at both a personal and federal level, versus the unfolding circumstance. It will be published shortly, including the analysis of the much-delayed and just-released 2013 GAAP-based financial statements of the United States government, discussed in the *Opening Comments*. The new material in the *Second Installment* will supplement and update the basic material already available to ShadowStats readers in Chapters 4, 5 and 9 of *Hyperinflation 2012*.

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Fourth-Quarter 2013, Second Estimate, First Revision)

A Modest, Corrective Revision. Reflecting the negative-reporting impact of recently published and revised trade, retail sales, production and housing data, the second estimate of headline real (inflation-adjusted) fourth-quarter GDP growth revised lower to 2.38%, from initial reporting of 3.23%. As with the first guess by the Bureau of Economic Analysis (BEA), the second one also was statistically-insignificant, but it was in line with market expectations.

Not widely discussed, yet, that same reporting of underlying fundamental activity is indicating likely reporting of a quarterly contraction in first-quarter 2014 GDP, due for release on April 26th.

As discussed in prior, GDP-related *Commentaries*, both the third- and fourth-quarter 2013 GDP estimates encompassed data that were impaired—distorted heavily—by the government shutdown, in terms of surveying, data gathering and reporting. Where the third-quarter GDP will not be revised again until the July 2014 annual revisions, the first revision to fourth-quarter GDP moved the relative economic performance of the fourth- versus third-quarter GDP, was to the downside, with one more standard monthly revision in at the end of March. Nonetheless, with third-quarter reporting heavily affected but no longer subject to near-term revisions, the bulk of "shutdown" catch-up likely will be seen with the July 30th annual revisions.

Aside from near-term distorted reporting, 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 fourth-quarter GDP, real GDP was a revised 6.3% (previously 6.5%), versus 5.6% in the third-quarter, above the pre-recession peak-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. Understated inflation has resulted in overstated real growth (see the updated discussion and graph of the ShadowStats estimate of "corrected" GDP in the *Opening Comments*).

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*, *Commentary No. 575* and *Hyperinflation 2012*).

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. Again, temporarily, some data of the last two quarters appear to have been skewed by the effects of the government shutdown.

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, February 28th, by the Bureau of Economic Analysis (BEA), the second estimate, first revision of fourth-quarter 2013 GDP showed a downwardly-revised, statistically-insignificant, real (inflation-adjusted), annualized, quarterly gain of 2.38% (previously 3.23%) +/- 3.5% (95% confidence interval). That was against a 4.13% headline gain in third-quarter 2013, a 2.48% increase in second-quarter 2013 and a 1.15% gain in the first-quarter.

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

Shown in the following three graphs are the year-to-year or annual real rates of change for the GDP series. For the first two graphs, fourth-quarter 2013 GDP annual growth was a revised 2.53% (previously 2.74%) year-to-year, versus 1.97% in the third-quarter, 1.63% in the second-quarter and 1.32% in the first-quarter 2013.

The first graph shows near-term historical detail since 2000. The second graph shows the full history of the series. The latest quarterly year-to-year growth remained below 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 third graph shows the average annual real growth rate, which slowed to a revised 1.86% (previously 1.92%) in the calendar-year 2013, from 2.78% in 2012. The 2.80% annual contraction in 2009 real GDP was the largest contraction seen in the series since the post-World War II production shutdown in 1946, when GDP fell by 11.59%. Otherwise, the 2009 contraction was the steepest decline since the Great Depression, actually rivaling the second-half of that economic disaster of the 1930s.


Quarterly Real Gross Domestic Product
Year-to-Year Change 2000-to-Date (ShadowStats, BEA)
6%
5%
4%
3%
2%
1%
0%
-1%
-2%
-3%
-4%
-5%
2000q1
2001q1
2002q1
2003q1
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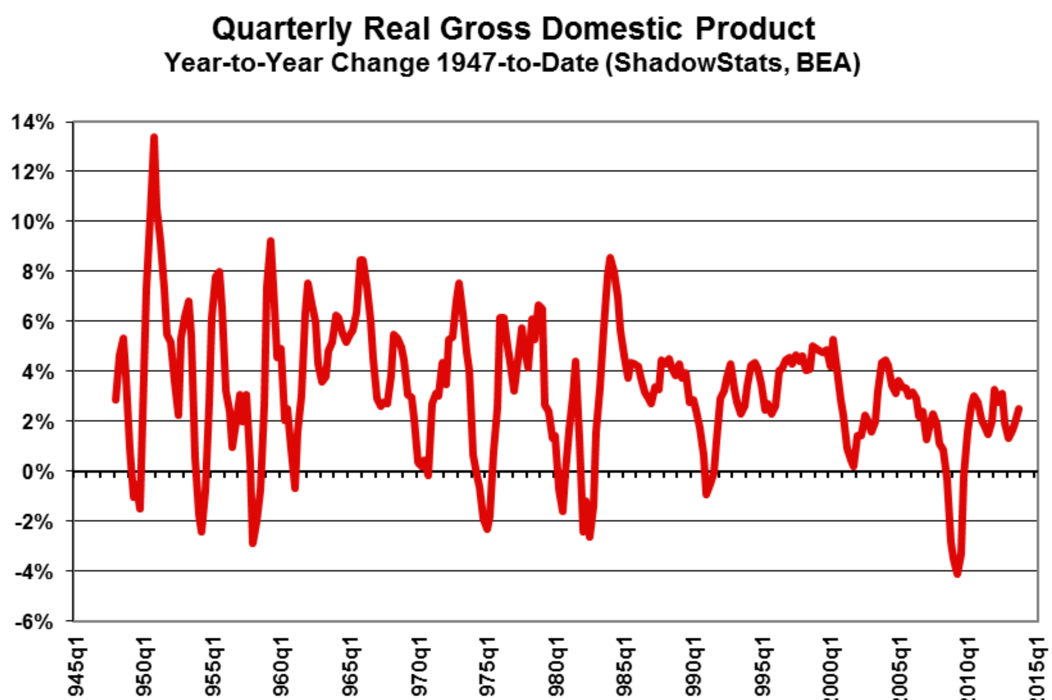
2012q1
2013q1
2014q1


Quarterly Real Gross Domestic Product
Year-to-Year Change 1947-to-Date (ShadowStats, BEA)
14%
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
1945q1
1950q1
1955q1
1960q1
1965q1
1970q1
1975q1
1980q1
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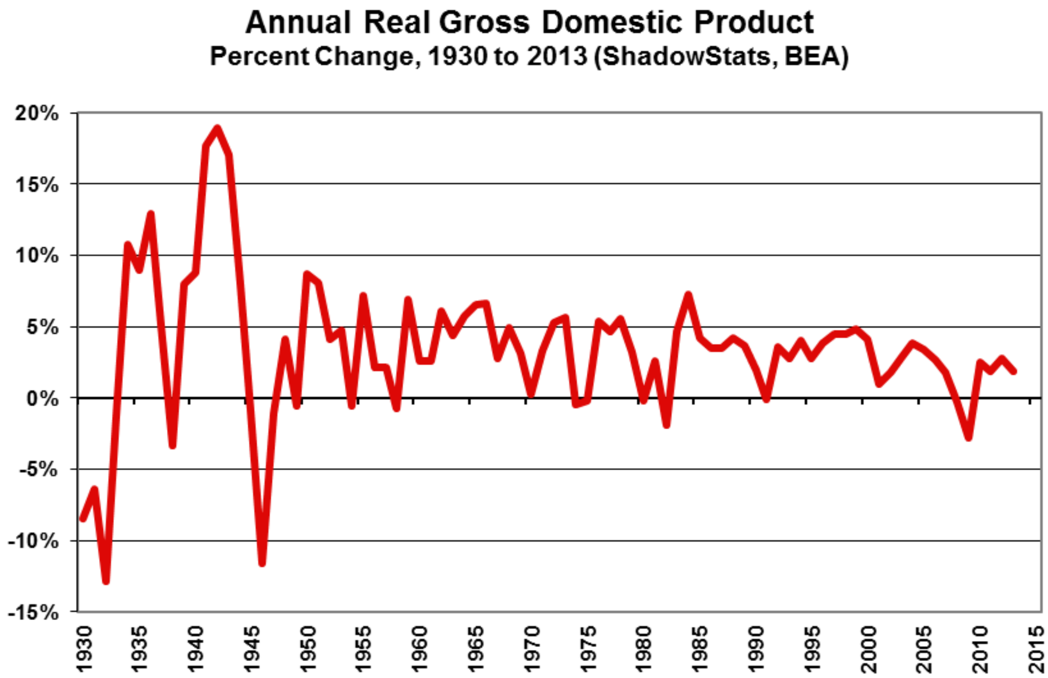
1995q1
2000q1
2005q1
2010q1
2015q1



Implicit Price Deflator (IPD). The second estimate of fourth-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized quarterly pace of 1.60% (previously 1.29%), versus 1.97% in the third-quarter, 0.58% in the second-quarter and against 1.67% in the first-quarter. Year-to-year, fourth-quarter 2013 IPD inflation was a revised 1.45% (previously 1.38%), versus 1.41% in the third-quarter, 1.44% in the second-quarter and 1.74% in the first-quarter. In terms of average annual inflation, the 2013 IPD was a revised 1.51% (previously 1.49%), versus 1.75% in 2012.

For comparison purposes, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation changed with the annual revisions to seasonally-adjusted CPI-U, recently published by the Bureau of Labor Statistics (BLS). Annualized, quarterly headline CPI-U inflation was a revised 1.14% (previously 0.85%) in fourth-quarter 2013, versus a revised 2.16% (previously 2.63%) in the third-quarter, a revised 0.40% (previously a contraction of 0.03%) in the second-quarter, and a revised 1.19% (previously 1.44%) gain in the first-quarter (see *Commentary No. 592* and *Commentary No. 602*). On an unrevised year-to-year basis, fourth-quarter 2013 CPI-U (unadjusted) was 1.23%, versus 1.55% in the third-quarter, 1.39% in the second-quarter, and 1.68% in the first-quarter. The average-annual CPI-U inflation was 1.46% in 2013, versus 2.07% in 2012.

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 fourth-quarter 2013 is a 1.4% year-to-year contraction, versus a downwardly-revised headline year-to-year gain of 2.5%. The alternate third-quarter estimate was a 1.7% year-to-year contraction, versus a headline gain of 2.0% (see the Alternate Data tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, a quarter-to-quarter contraction remains a possibility for actual headline growth in the fourth-quarter, but that would not be evident until after the annual revisions to the GDP are published in July 2014. An actual quarterly contraction appears to have been a realistic possibility for the real GDP in most quarters since the official second-quarter 2009 end to the recession.

Adjusted for gimmicked inflation and other methodological changes (such as the inclusion of intellectual property, including software), 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) and Gross Domestic Income (GDI). The initial estimates of the fourth-quarter 2013 and annual GNP and GDI will not be published for another month, given the unreliable nature of the available detail. The BEA would do well to delay the GDP, as well, since the current reporting generally is without any statistical significance or relationship to underlying economic activity.

The GNP here 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 GDI is the theoretical income-side equivalent of the consumption-side GDP estimate.

WEEK AHEAD

Much Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead. Although shifting to the downside, market expectations generally still appear to be overly optimistic as to the economic outlook, based on data that likely were puffed-up in the process of going through the data-gathering and reporting distortions of the October shutdown to the federal government, in addition to the regular seasonal-adjustment issues. Expectations should continue to soften, though, with an increasing number of corrective revisions and disappointing headline economic activity. The initial stages of that process have been seen in the recent reporting of December and January payroll, retail sales, housing and industrial production data, and in the December trade-balance detail.

That corrective circumstance and underlying weak economic fundamentals remain highly suggestive of deteriorating business activity. Accordingly, weaker-than-consensus economic reporting should become the general trend until such time as an unfolding "new" recession receives general recognition.

Stronger inflation reporting remains likely. 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, the ongoing U.S. fiscal-crisis debacle, a weakening U.S. economy and deteriorating U.S. political conditions (see *Hyperinflation 2014—The End Game Begins*). Particularly in tandem with a weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected inflation.

A Note on Reporting-Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-evolving economic turmoil of the last seven-to-eight 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 (January 2014). The Commerce Department is scheduled to release its estimate of January 2014 construction spending on Monday, March 3rd. The headline monthly changes, as usual, should not be statistically significant, while previous data could be subject to unusually large revisions, while the shutdown-distorted data continue to stabilize.

U.S. Trade Deficit (January 2014). The Commerce Department and Bureau of Economic Analysis (BEA) will release the January 2014 trade-balance data on Friday, March 7th. Continued deterioration the monthly trade deficit remains likely. Any widening (or narrowing) of the December deficit, in revision, would have negative (or positive) impact on the second revision to fourth-quarter GDP. The initial reporting for January will help set the outlook for initial first-quarter 2014 reporting.

Employment/Unemployment (February 2014). The Bureau of Labor Statistics (BLS) will release its February 2014 labor data on Friday, March 7th. Following January's 113,000 consensus-shocking low gain in payroll employment (the second straight month of negative surprises), a further downside surprise to expectations is a fair bet. The BLS trend model suggests a 183,000 jobs gain for January. While the consensus tends to close in around the trend, expectations seem to be running about 40,000 jobs below trend. Again, underlying economic reality would suggest a downside surprise versus both the trend and market expectations.

Expectations appear to be for the headline January U.3 unemployment rate to hold near January's 6.6% reading. Underlying fundamentals would suggest an upturn in U.3, but the BLS's continuing purge of discouraged workers from the unemployment rolls would argue in favor of a lower rate. As discussed regularly in the employment/unemployment-related *Commentaries*, month-to-month comparisons of U.3 are of no meaning, because of the standard, inconsistent reporting calculations that leave the monthly data not comparable.

If U.3 drops, there likely would be some further labor-force loss associated with that. The broader U.6 and ShadowStats unemployment measures would tend to hold, or increase anew, at their broader and higher respective levels.

Again, all these numbers are unsettled and could come in well outside general expectations.