

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

COMMENTARY NUMBER 644
Pending GDP Reporting and Revisions

July 23, 2014

Unhappy Surprises in Pending GDP Numbers

**Look for Downside Revisions to GDP Growth of Recent Years,
Including First-Quarter 2014**

**Initial Estimate of Second-Quarter GDP Growth
Should Surprise Market Expectations Sharply on the Downside**

Headline Second-Quarter Contraction Likely by September 26th Revision

PLEASE NOTE: The next regular Commentary is scheduled for Friday, July 25th, covering June new orders for durable goods and new home sales.

The Hyperinflation Outlook Summary is updated in the Hyperinflation Watch section. Due to the general nature of today's comments and lack of new headline reporting, there is no Reporting Detail section.

Best wishes to all — John Williams

ECONOMIC COMMENT

Headline Second-Quarter GDP Should Offer Negative Shocks to, and Could Roil the Markets. The Bureau of Economic Analysis (BEA) will publish its advance estimate of second-quarter 2014 Gross Domestic Product (GDP), next Wednesday, July 30th, in conjunction with annual benchmark revisions to the series. The GDP commonly is viewed as the broadest indicator of domestic U.S. economic activity,

but Gross National Product (GNP)—also subject to revision—actually is a broader measure. GDP is GNP less trade in factor income, or dividend and interest payments. As a result, GDP is the more-positive economic measure for net-debtor nations such as the United States and most third-world countries. Nonetheless, the U.S. GDP is the most heavily-politicized, manipulated, guessed-at and worthless of the popularly-followed economic series. It also is the most widely-followed domestic economic report, and heavily influences global financial and currency markets.

That said, benchmark revisions likely will show that GDP growth of recent years has been softer than previously estimated, and they could be suggestive of weaker growth leading into the troubled first- and second-quarter 2014 GDP activity. The initial second-quarter GDP growth estimate likely will be on the plus-side, but well below market expectations, and it should revise into contraction territory in the ensuing two monthly revisions. ShadowStats will cover the details in *Commentary No. 646* of July 30th.

GDP Annual Benchmark Revision. In the annual revisions, the BEA will restate economic activity from first-quarter 2011 through first-quarter 2014, based on the availability of better information than has been guessed at, otherwise. The new information includes recent annual surveys of the wholesale and retail trades. Traditionally, those surveys result in downside GDP revisions, where the GDP estimates most frequently have been based on overly-optimistic assumptions. Benchmark revisions to other economic series, including payrolls, construction spending, retail sales, industrial production, new orders for durable goods and international trade balances, generally have shown downside revisions to prior reporting, with implications for similar revisions to the GDP.

Going back to first-quarter 1999, the BEA also will redefine such areas as international transaction accounts and defined-benefits plans. The changes in those areas will end up in a restatement of the levels of real (inflation-adjusted) GDP activity going back to 1929.

Second-Quarter 2014 GDP Advance Estimate. The July 30th initial headline estimate of real second-quarter GDP annualized quarterly growth most likely will be a meaningfully-negative surprise (in the positive 1.0% to 2.0% range), against market expectations of about 3.0% growth, with the headline second-quarter GDP then revising to a contraction of roughly 1% (-1%), or worse, within two months. In what appears to be wishful thinking, the consensus 3.0% growth rate happens to be what would be needed for second-quarter 2014 GDP to recover to the level of pre-benchmark fourth-quarter 2013 economic activity. That will not happen, shy of some extraordinary manipulations by the BEA.

The underlying fundamentals suggest reporting of a second, consecutive quarter-to-quarter GDP contraction, likely with the August 28th or September 26th revision to second-quarter 2014 GDP. Pre-benchmark, first-quarter 2014 GDP showed an annualized quarterly contraction of 2.9% (-2.9%), while second-quarter 2014 GDP, again, appears set for an eventual contraction of about 1% (-1%), subsequent to the initial July 30th headline estimate. In its first guesstimate—the “advance” estimate—the BEA likely will hold second-quarter GDP growth in positive territory.

The headline pace of contraction in first-quarter 2014 faces some downside revision risk—a deepening of the decline—reflecting negative revisions in construction activity published after the last GDP estimate.

A widening trade deficit; a large downturn (more than reversing the weather-induced first-quarter surge) in consumer utility usage; further slowing growth or an outright contraction in inventories; and continued negative turmoil in guesstimated healthcare consumption; should more than offset positive elements in

second-quarter GDP growth, again, with an outright annualized quarterly GDP contraction in excess of 1% (-1%) settling into the BEA headline estimates by the September 26th revision.

In the context of the annual benchmark revisions to the series, the BEA has unusual flexibility in setting up the reporting of initial headline growth in second-quarter GDP, particularly where consensus forecasts seem to be holding around 3.0% for the advance estimate, well above economic reality. As discussed in [Commentary No. 623](#), following the initial release of headline first-quarter GDP:

“The Bureau of Economic Analysis (BEA) has tremendous leeway in the level of growth that it reports in its first or ‘advance’ estimate of headline GDP growth in a given quarter. Usually, the BEA attempts to target the initial headline growth estimate to consensus expectations, moving the internal BEA estimate towards the consensus number. Where the consensus appears to have been about 1.0% coming into this morning’s (April 30th) report, and where the BEA gave a 0.1% headline growth estimate—the lowest positive growth rate possible—the message was negative as to what the BEA was seeing in reality. The internal BEA estimate probably was for a quarterly contraction, and the message from the BEA to consensus forecasters likely was that the numbers were worse than they appeared, and that downside revisions are pending.”

By the second revision to the first-quarter GDP, the initial headline 0.1% growth had turned into a headline 2.9% contraction (-2.9%). A somewhat similar reporting pattern for the second-quarter is a good bet, again, with an initial headline reporting perhaps in the positive 1% to 2% range—well below consensus—ending in a headline contraction of at least 1% (-1%) by the September 26th second revision.

The primary elements used most commonly and recently by the BEA to prop up otherwise bad numbers have been overly-optimistic assumptions on inventories and healthcare numbers. The trade data also can be played with, where the June trade deficit (third month of the second-quarter detail) will not be available until the first full week of August, after the initial-GDP estimate.

Official New Recession versus Ongoing Great Economic Downturn. Consecutive contractions in first- and second-quarter 2014 GDP almost certainly would gain rapid recognition as a new recession, although underlying reality remains that the current negative activity is just a renewed down-leg in the great economic downturn that began in 2006. Officially, recent economic travails have been recognized as a formal recession only from December 2007 through June 2009. Instead of the formal reporting of the economy crashing through 2008 into mid-2009 and then recovering and expanding to date, the more realistic economic pattern has been one of plunge into 2009 and stagnation, and now renewed downturn. This has been discussed regularly in the GDP-related *Commentaries* (see for example [Commentary No. 637](#)), and in the [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#).

Nonetheless, despite the pending GDP benchmark revisions, which likely will indicate a weaker historical economy and weaker “recovery”—moving the official data more in line with the ShadowStats story—the developing official version of economic activity should remain the story of plunge-and-recovery, and now a new recession. The “recovery” discussed in the preceding links has been no more than a statistical illusion, where understated inflation used in deflating the popular headline economic numbers has resulted in overstated real (inflation-adjusted) growth estimates.

HYPERINFLATION WATCH

Hyperinflation Outlook Summary. The long-standing hyperinflation and economic outlooks were updated with the publication of [2014 Hyperinflation Report—The End Game Begins – First Installment Revised](#), on April 2nd, and publication of [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#), on April 8th, along with ongoing updates in the regular *Commentaries*. The pending crises also were reviewed in [Commentary No. 639](#). In the following summary, nothing of substance has changed from prior writings.

Primary Summary. The primary and basic summary of the broad outlook and the story of how and why this crisis has unfolded and developed over the years—particularly the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked above). The following section summarizes the underlying current circumstance.

Consistent with the above *Special Commentaries*, the unfolding economic circumstance discussed in the opening *Economic Comment*, in confluence with other fundamental issues, should place mounting and massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic. Physical gold and silver, and holding assets outside the U.S. dollar, remain the primary hedges against the pending the total loss of U.S. dollar purchasing power.

Current Economic Issues versus Underlying U.S. Dollar Fundamentals. U.S. economic activity has turned down anew, with headline first-quarter 2014 GDP having contracted at an annualized real pace of 2.9% (-2.9%), following 2.6% fourth-quarter growth, and the second-quarter GDP is set for headline contraction minimally of 1% (-1%), by the September 26th revision to the series. With market expectations for initial second-quarter growth of about 3.0%, the Bureau of Economic Analysis likely will bring in its initial estimate at perhaps 1% to 2% positive growth. As discussed in the *Economic Comments*, without the expected quarterly economic recovery to fourth-quarter 2013 levels of economic activity, that could be enough below consensus expectations to shock the popular outlook towards a “new recession,” with attendant adjustments hitting the markets.

In turn, as financial-market expectations increasingly shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, should place mounting and massive selling pressures on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic.

Unexpected economic weakness intensifies the stresses on an already-impaired banking system, hence a perceived need for expanded, not reduced, quantitative easing. The highly touted “tapering” by the FOMC is pre-conditioned by continued “happy” economic news. Banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs likely still will be provided as needed by the Fed, under the ongoing political cover of a weakening economy.

Unexpected economic weakness also savages projections of headline, cash-based, federal-budget deficits (particularly the 10-year versions) as well as projected funding needs for the U.S. Treasury. Current fiscal “good news” is based on cash-based, not GAAP-based accounting, and comparative year-ago cash numbers are against Treasury and government activity operating *sub rosa* in order to avoid the limits of a constraining debt ceiling.

All these crises will combine against the U.S. dollar, likely in the very-near future.

In summary, the fundamental issues threatening the dollar could not be worse. They include, but are not limited to:

- A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew, including a sharply widening trade deficit.
- The U.S. government will not address its long-term solvency issues. Current fiscal “good news” is based on cash-based, not GAAP-based accounting. The GAAP-based version continues to run in the \$6-trillion-plus range.
- Monetary malfeasance by the Federal Reserve is seen in its process of seeking to provide liquidity to a troubled banking system, and also to the U.S. Treasury, with a current pace of monetization at 94.1% of effective net issuance of the federal debt to be held by the public, so far, in calendar-year 2014 (through July 16th), 75.3% since the January 2013 expansion of QE3.
- Mounting domestic and global crises of confidence in a dysfunctional U.S. government, where the relative positive rating by the public of the U.S. President tends to have a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar.
- Mounting global political pressures contrary to U.S. interests, political and military, as well as financial and economic.
- Mounting global efforts to dislodge the U.S. dollar from its primary reserve-currency status.

Intensifying weakness in the U.S. dollar will place upside pressure on oil prices and other commodities, boosting domestic inflation and inflation fears. Domestic willingness to hold U.S. dollars will tend to move in parallel with global willingness to do the same. Both the dollar weakness and resulting higher inflation should boost the prices of gold and silver, where physical holding of those key precious metals remains the ultimate hedge against the pending inflation and financial crises.

WEEK AHEAD

Much-Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead.

Although shifting to the downside, amidst fluctuations, market expectations generally still are overly optimistic as to the economic outlook. Expectations should continue to be hammered, though, by ongoing downside corrective revisions and an accelerating pace of downturn in headline economic activity. The initial stages of that process have been seen in the recent headline reporting of many major economic series (see [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)), including the sharp pace of economic decline seen in real first-quarter 2014 GDP, which is the first contemporary reporting of a quarterly GDP contraction since the formal end of the 2007 recession, in mid-2009.

Weakening, underlying economic fundamentals indicate still further deterioration in business activity. Accordingly, weaker-than-consensus economic reporting should become the general trend until such time as the unfolding “new” recession receives general recognition, which likely would follow the reporting of a headline contraction in second-quarter 2014 GDP real growth.

Stronger inflation reporting also remains likely, as has been seen in recent reporting. Upside pressure on oil-related prices should reflect intensifying impact from global political instabilities and a weakening U.S. dollar in the currency markets. Food inflation has been picking up as well. The dollar faces pummeling from the weakening economy, continuing QE3, the ongoing U.S. fiscal-crisis debacle, and deteriorating U.S. and global political conditions (see [Hyperinflation 2014—The End Game Begins \(Updated\) – First Installment](#)). 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 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, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data). These issues have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

PENDING RELEASES:

New-Home Sales (June 2014). The Census Bureau will provide the government's estimate of new-home sales for June, on Thursday, July 24th. See [Commentary No. 643](#) for details of the National Association of Realtors survey of June existing-home sales.

Despite recent upticks in both these series, a pattern of stagnation or intensifying downturn still appears to be in play for both the existing- and new-home sales. Market consensus even appears to favor an outright contraction in June new-home sales. Monthly changes in home-sales activity usually are not statistically-significant, and still-unstable reporting and revisions (both are likely to the downside) remain a fair bet for the new-home sales series.

New Orders for Durable Goods (June 2014). The reporting of June 2014 new orders for durable goods is scheduled for Friday, July 25th, by the Census Bureau. Recently, new orders generally have been stagnant, plus or minus, particularly net of inflation. Sharp and irregular volatility in commercial aircraft orders should dominate the numbers anew in the next several months. Commercial aircraft orders usually are booked years in advance with relatively minimal impact on near-term production activity. Net of the unstable aircraft reporting, some intensification in downside activity is likely, coincident with slowing activity seen recently in the broad economy. Market expectations appear to be for flat-to-plus activity in orders, with headline reporting generally a fair bet to disappoint expectations on the downside.
