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

COMMENTARY NUMBER 646
Second-Quarter 2014 GDP, GDP Benchmark Revisions, Household Income

July 30, 2014

Second-Quarter GDP Surge Not Credible,
Significant Downside Revisions Remain in Offing

Actual Economic Activity Remains in Serious Trouble

Historical GDP Revised Lower Where Better Data Were Available and
Revised Higher Where Better Numbers Were Not

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, August 1st, covering July employment and unemployment data and June construction spending.*

Best wishes to all — John Williams

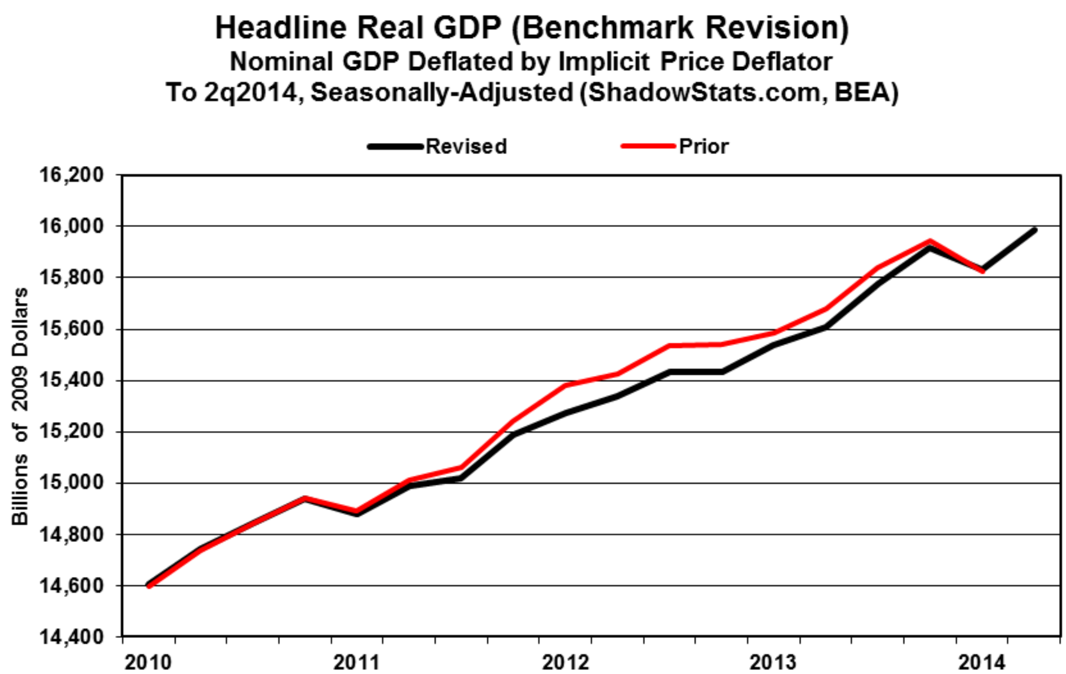
OPENING COMMENTS AND EXECUTIVE SUMMARY

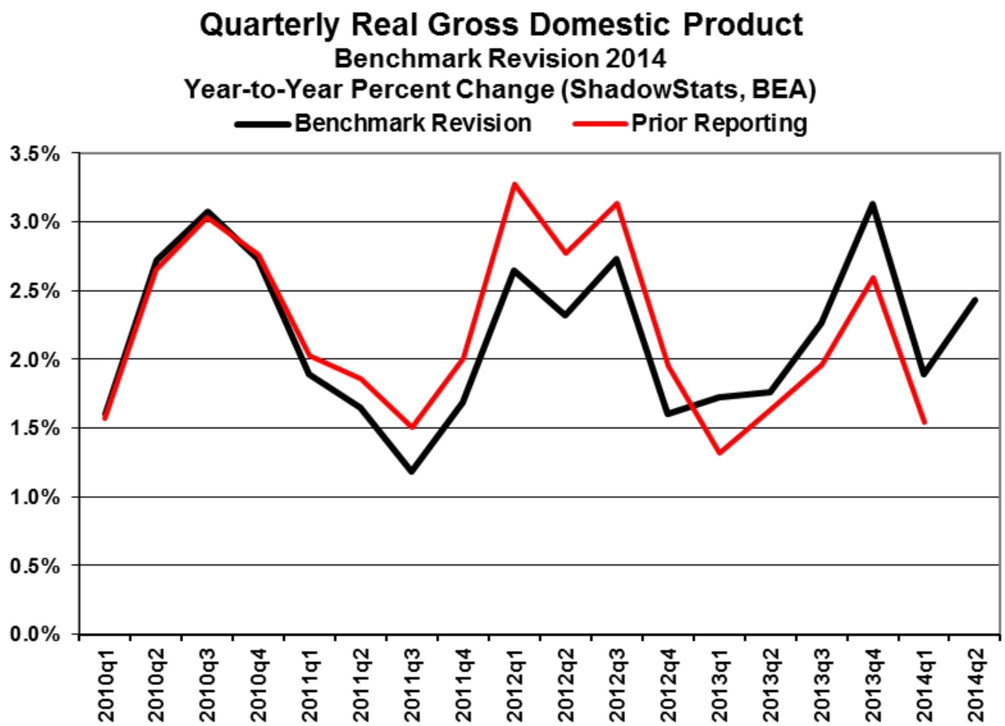
Booming Initial Estimate for Second-Quarter GDP Largely Was Fluff. I sure got the initial estimate of GDP growth wrong. Contrary to my thinking that the initial estimate for second-quarter 2014 GDP would come in well below market expectations, (see *Commentary No. 644*), it came in at 3.95%, at the high end of expectations, puffed largely by overly-optimistic guesses and assumptions on the part of the Bureau of Economic Analysis (BEA) as to inventory building, auto sales, construction spending, economic impact of the Affordable Care Act, near-term performance of the trade deficit and swings in consumer utility usage tied to unseasonable weather patterns. Each of those areas likely will see revisions in the next two months that will move headline second-quarter 2014 GDP much closer to flat-to-minus activity and, eventually, into a headline contraction.

With the government's estimates of GDP activity so far removed from reality, the issue here is not whether the U.S. economy is booming along or not. It is not; it never recovered from the collapse into 2008 and 2009. The issue with today's numbers is in the timing of a more-formal financial-market and political recognition of the issues and ongoing severe difficulties involved here for consumers. Follow-up reporting by the BEA on the first-quarter GDP contraction—which, by the way, survived today's benchmark revisions—could have had significant impact on the markets and the political environment. Sooner or later those issues will come to a head, irrespective of the happy economic fantasies out of Washington, D.C.

Today's missive concentrates on the GDP-related reporting and revisions. Median household income and consumer confidence numbers are updated at the end of this *Opening Comments* section. Severe structural problems with consumer liquidity continue to prevent normal economic activity and expansion, irrespective of the BEA's guesses. Money supply velocity is reviewed in the *Hyperinflation Watch* section. In the same section, the *Hyperinflation Summary Outlook* has not been updated for today's reporting, but it will be updated for the trade-deficit *Commentary No. 648* on August 6th.

Gross Domestic Product—GDP—2014 Benchmark Revisions. In conjunction with the "advance" estimate of second-quarter 2014 GDP, the Bureau of Economic Analysis (BEA) published today (July 30th) its annual benchmark revisions to the GNP. Although inflation-adjusted data were revised back to 1927, thanks to some series redefinitions, the noticeable GDP growth revisions were seen post-2010, reflecting "better quality" information from a variety of government surveys on hard economic activity.





With More Complete Detail, Economic History Usually Revises to the Downside. Where better-quality numbers were available, growth tended to revise lower. Where better information was not available, happy assumptions out of the BEA dominated the revisions, and growth was revised higher, as reflected in the two preceding graphs. The level of GDP activity generally was lower in 2011 through 2013 with downside revisions to annual growth evident in 2011 and 2012, when new, hard surveys of manufacturing, wholesale and retail trade activity were available.

Nominal, or current-dollar, GDP tended to be revised lower across the board, but generally that was not as much as downside changes in the real, or constant-dollar, numbers. Accordingly, the balancing implicit price deflator (IPD), or GDP-inflation measure, revised minimally higher, on average.

Revisions to Gross National Product (GNP) and Gross Domestic Income (GDI). The GNP tended to revise in line with the GDP. The GDI, which has tended to be weaker than GDP in regular reporting, was revised, irregularly, reflecting extreme shifts in the statistical discrepancy. The first estimates of second-quarter 2014 activity for these two series most likely will be published next month.

GNP is the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments). As a reporting gimmick aimed at boosting the headline reporting of economic growth for net-debtor nations such as Greece and the United States, international reporting standards were shifted some decades back to reporting headline GDP instead of GNP.

Statistical Discrepancy (GDP versus GDI) Is Running Wild. Theoretical equivalents, the GDP and GDI are made to equal each other, every quarter, with the addition of a “statistical discrepancy” to the GDI-side of the equation, but the discrepancy just as easily could be added to the GDP number. The statistical discrepancy widened sharply in the benchmark revisions, where one would expect the discrepancy to narrow with "better quality" information.

For example recent pre-benchmark statistical discrepancies, in billions of negative nominal dollars, were 2012 ($17.0), 2013 ($131.4), and first-quarter 2014 ($105.3). Post-benchmarking, they had revised to 2012 ($209.2), 2013 ($211.9), and first-quarter 2014 ($181.4).

Net of the statistical discrepancy, the benchmark-revised estimate of headline real GDI annualized quarterly change for first-quarter 2014 was a contraction of 0.68% (-0.68%), which previously had been a contraction of 2.61% (-2.61%). Fourth-quarter 2013 headline growth, however, revised to 1.82% (previously a gain of 2.60%). These numbers really are meaningless if one is trying to assess actual economic activity, but the financial markets rely on them.

Gross Domestic Product (GDP)—Second-Quarter 2014—No Change in Basic Economic Outlook. The "advance" estimate of second-quarter 2014 GDP showed a statistically-significant, real (inflation-adjusted), annualized, quarterly gain of 3.95%. That was in the context of and against a benchmark-revised 2.11% contraction (-2.11%), previously a 2.93% drop (-2.93%) in headline first-quarter 2014 GDP activity.

The graphs in the *Reporting Detail* section all are shown net of the benchmark revisions. The graph of annual average GDP change reflects a net downside revision in average annual growth of 0.25% (-0.25%) in 2011, a net downside revision of 0.46% (-0.46%) in 2012, and a net upside revision of 0.34% in 2012. As shown also in the second graph in the preceding *Benchmark* section, year-to-year growth on a quarterly basis, was estimated at 2.43% in second-quarter 2014 GDP, versus a benchmark-revised 1.89% (previously 1.54%) in the first-quarter.

Implicit Price Deflator (IPD). The "advance" estimate of second-quarter 2014 GDP inflation, or the implicit price deflator (IPD), was at an annualized quarterly pace of 1.99% in second-quarter 2014, versus a revised 1.33% (pre-benchmark 1.26%) in first-quarter 2014, and a revised 1.42% (pre-benchmark 1.58%) in fourth-quarter 2013. Year-to-year, second-quarter 2014 IPD inflation was 1.60%, versus a revised 1.37% (pre-benchmark 1.34%) in first-quarter 2014, and versus a revised 1.40% (1.45% pre-benchmark) in fourth-quarter 2013.

For comparison purposes, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation published by the Bureau of Labor Statistics (BLS), was up by 3.03%, the highest level since second-quarter 2011. That followed inflation of 1.91% in first-quarter 2014 and 1.14% in fourth-quarter 2013. Not-seasonally-adjusted, on a year-to-year basis, second-quarter 2014 CPI-U inflation was 2.05%, versus 0.86% in first-quarter 2014, and 1.23% in fourth-quarter 2013.

The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

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 estimate of the headline change in second-quarter 2014 GDP, in conjunction with the annual benchmark revision, was growth of 3.95 %, following a benchmark-revised quarterly contraction of 2.11 % (-2.11 %) for the first-quarter 2014, which last had been reported, pre-benchmark, as a contraction of 2.93% (-2.93%).

The annualized first-quarter growth rate is detailed in 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 1.69% + 2.57% - 0.61% + 0.30% = 3.95%. Again, the prior aggregate headline GDP change was estimated at a contraction of 2.11% (-2.11%), down 2.93% (-2.93%) pre-benchmark:

- ***Consumer Spending Contributed 1.69% to Second-Quarter Growth; Contributed 0.83 % (0.71% Pre-Benchmark) to First-Quarter Growth.*** Consumer-dependent personal consumption accounts for 68% of the GDP. Headline growth here reflected surging sales of durable goods (contributed 0.99%, of which 0.42% came from automobiles (these numbers rarely agree with other (auto industry, Census) surveys. Housing and utilities subtracted 0.41%, due to a reversal in difficult first-quarter weather conditions, but that should have been in excess of a 1.0% decline, with ongoing negative impact in the third-quarter 2014. Although only contributing 0.08% to growth, the Affordable Care Act should have been a further negative, and likely also gave a false boost to state-government spending.

- ***Business/Residential Investment and Contributed 2.57 % to Second-Quarter Growth; Subtracted 1.13% (-1.13%) [Pre-Benchmark 1.97% (-1.97%)] from First-Quarter Growth.*** Both residential and nonresidential construction should have been net negatives (not a plus 0.38% growth contribution) based on the most-recent housing and construction numbers. The biggest plus here was 1.66% from higher inventories, but that should have been a contraction with an outright inventory liquidation. This area is a regular BEA tool for spiking or offsetting headline growth. Net of inventories, final sales rose by 2.29% in second-quarter 2014, versus a revised contraction of 0.95% (-0.95%), previously a 1.23% drop (-1.23%) in first-quarter 2014.

- ***Net Exports Subtracted 0.61% (0.-61%) from Second-Quarter; Subtracted 1.66% (-1.66 %) [Pre-Benchmark Subtracted 1.53% (-1.53%)] from First-Quarter Growth.*** Although in the correct direction, the widening trade deficit should have subtracted more than 1.0% from aggregate growth.

- ***Government Spending Contributed 0.30% to Second-Quarter; Subtracted 0.15% (-0.15%) [Pre-Benchmark Subtracted 0.14% (-0.14%)] from First-Quarter Growth.*** Federal government spending remained a drag on government spending, but a surge in local government spending and investment pushed the aggregate category into positive territory.

Economic Reality. Even with the initial second-quarter 2014 GDP headline growth of 3.95%, following a contraction of 2.11% (-2.11%) in first-quarter 2014, the general outlook has not been altered. The broad economy still is turning down anew, and a wide variety of economic detail should confirm that in the next month or two. Accordingly, 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 "advance" reporting of aggregate second-quarter 2014 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 *2014 Hyperinflation Report—The End Game Begins – First Installment Revised*, and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*). Irrespective of the reporting gimmicks introduced in the July 2013 GDP (prior) benchmark revision, a consistent, fundamental pattern of historical activity is shown in the accompanying sets of "corrected" GDP graphs.

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 and other liquidity measures (see graphs at the end of this *Opening Comments* section) and of economic series not otherwise reliant on understated inflation for their reported growth (see the second installment of the *Hyperinflation Report*). 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 sets of graphs tell that story, updated for the first estimate of second-quarter 2014 GDP and the 2014 GDP benchmark revisions.

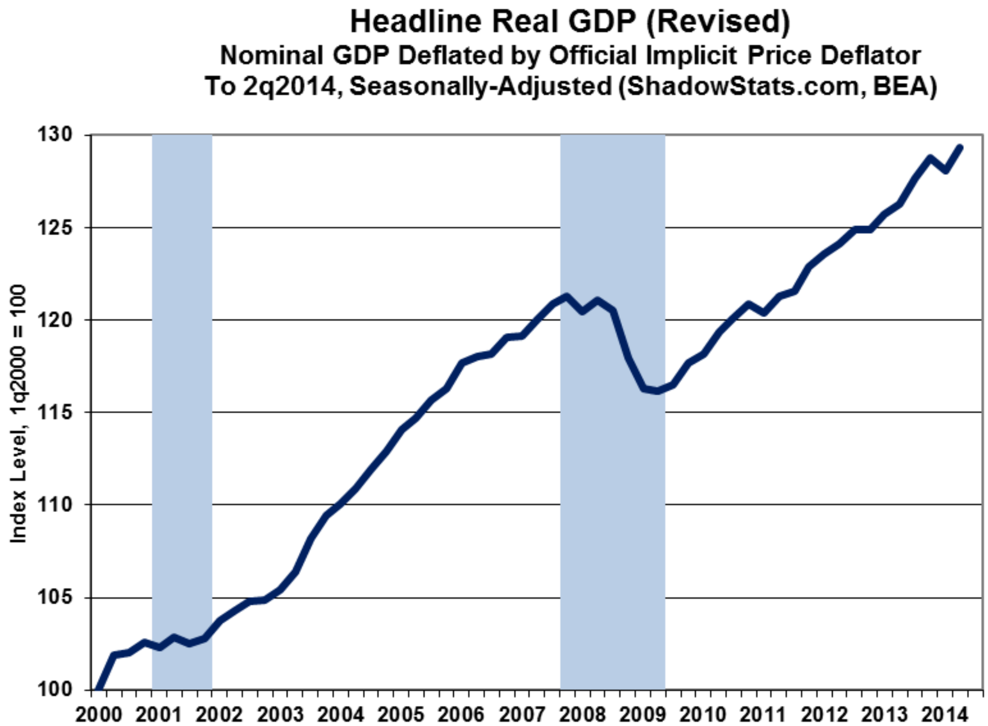
The first set of graphs (2000-to-date) is the one traditionally incorporated in the GDP *Commentaries*. The second set updates the longer-term graphs (1970-to-date), published in *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*.

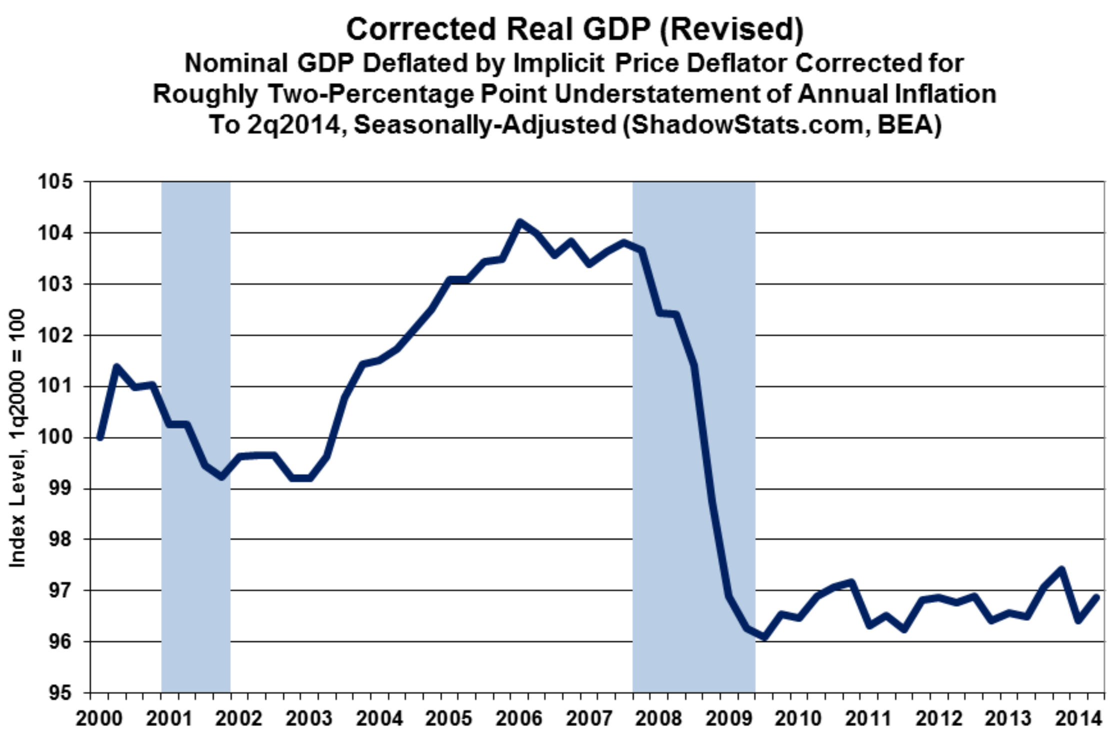
Shown in the first graph of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (with a growth interruption in first-quarter 2014). Adjusted for official GDP inflation (the implicit price deflator), the level of first-quarter 2014 GDP currently stands at 6.6% above the pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, shows second-quarter 2014 GDP activity at 7.0% below the pre-recession peak of first-quarter 2006.

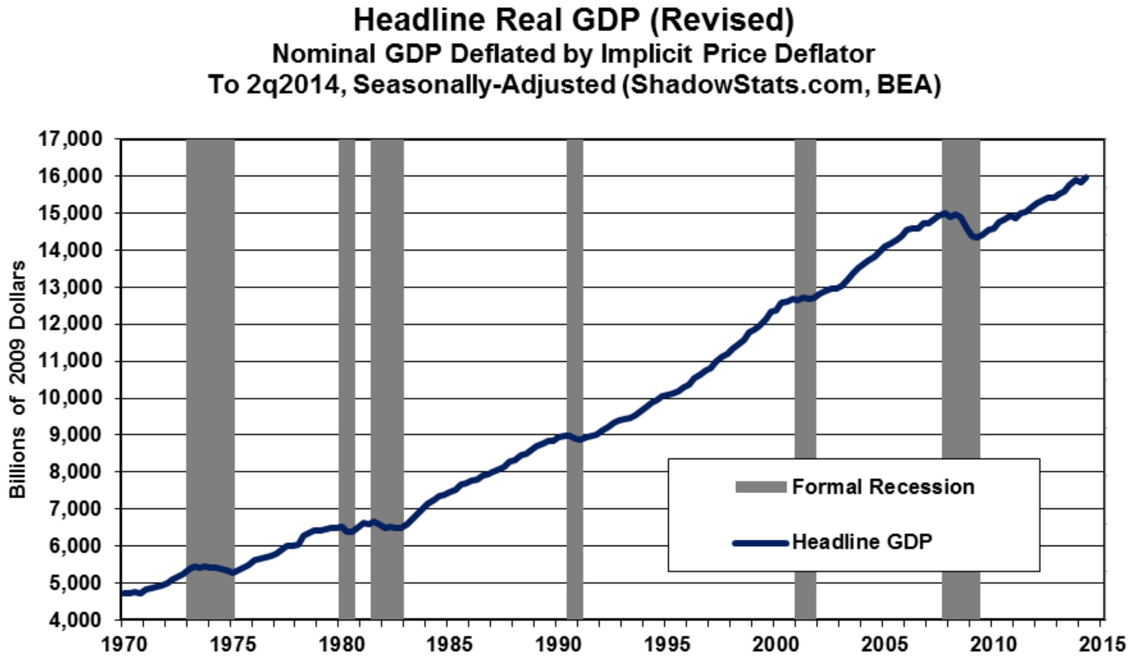
Also, as discussed in the second installment of the *Hyperinflation Report*, no other major economic series has shown a parallel pattern of official full economic recovery and meaningful expansion beyond, consistent with the GDP reporting. Either the GDP reporting is wrong, or all other major economic 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."

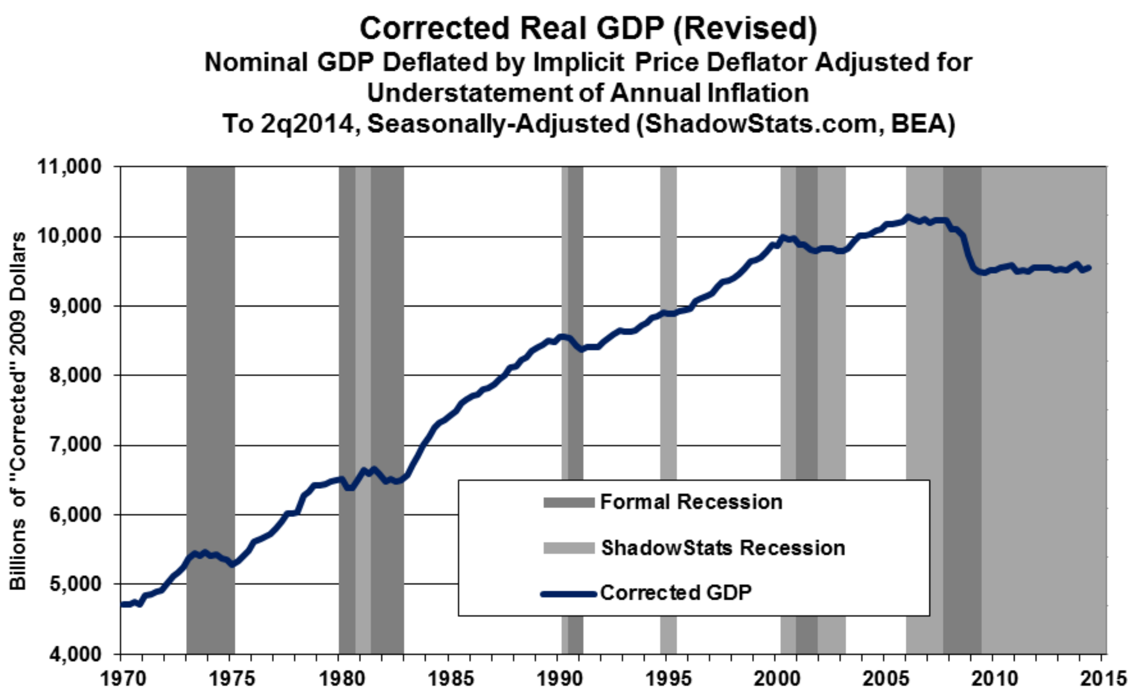
The second graph in each series plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates (see *Public Commentary on Inflation Measurement*), with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in the

Hyperinflation Reports. Both graphs in the first set are indexed to first-quarter 2000 = 100, and show official periods of recession as shaded areas.









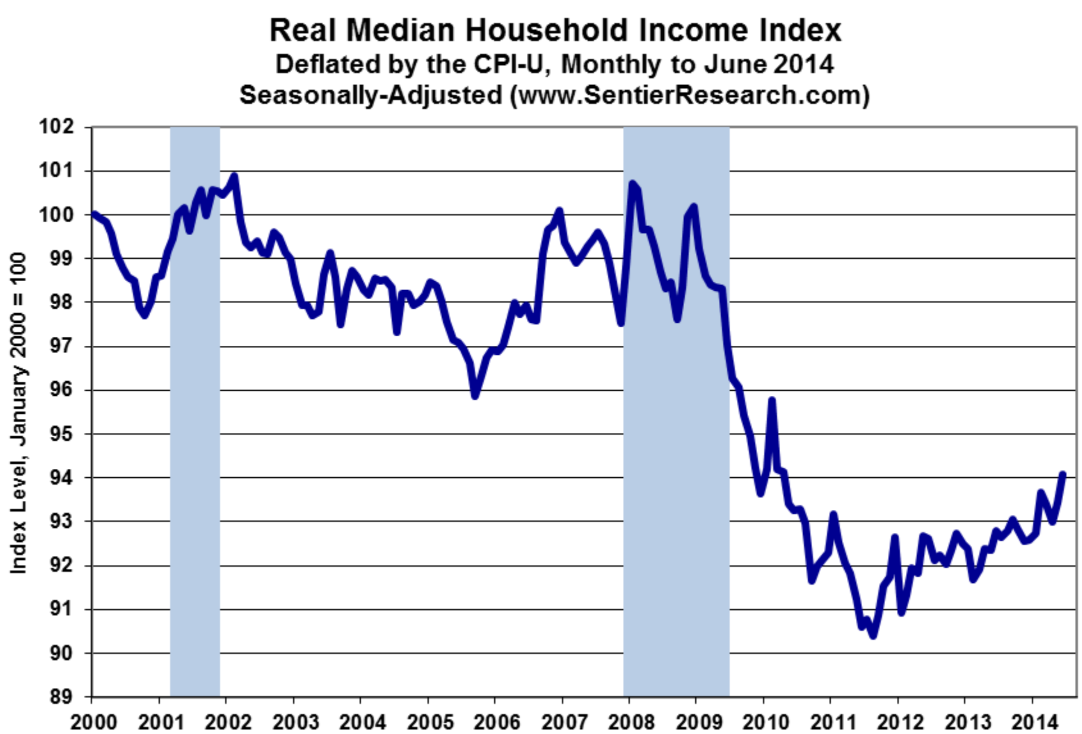
The shaded areas in the “corrected” graph in this second set reflect official as well as ShadowStats-defined recessions, as discussed in detail in the second installment of the *Hyperinflation Report.*

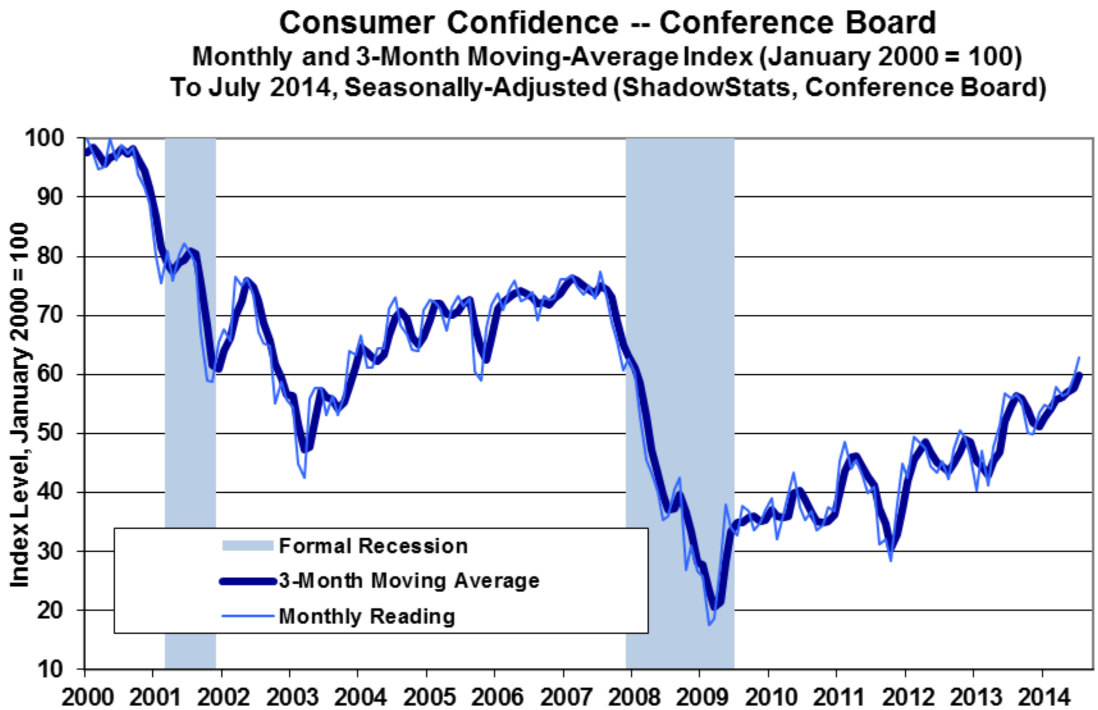
June Real Median Household Income Showed Insignificant Monthly Gain—Still Holding Near, but Above, Cycle Low. Serious, structural liquidity problems continue to impair consumer activity, as discussed frequently in these *Commentaries* (see *Commentary No. 643*) and as updated with the accompanying graph of real median household income, with the headline data courtesy of www.SentierResearch.com. The latest headline detail was released on July 28th, with June showing a second month of gain, but with both the May and June changes statistically-insignificant.

Without real, inflation-adjusted, growth in income, and without the ability or willingness to take on meaningful new debt, the consumer simply cannot sustain real growth in retail sales or in the personal-consumption activity that dominates the headline growth in GDP (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*). These liquidity issues remain primary constraints on any broad economic recovery or expansion.

As the GDP purportedly was starting a solid recovery in mid-2009, household income plunged to new lows. Deflated by headline CPI-U, the annual series published by the Census Bureau showed further that annual real median household income in 2012 was at levels seen in the late-1960s and early-1970s (again, see the *Hyperinflation Report – Second Installment*).

Also, the Conference Board released its estimate of July Consumer Confidence yesterday, July 29th, showing a strong monthly gain and as reflected in the updated second graph. While such spikes most often reflect economic hype in the press, the level of "confidence" seen in July remained deep in traditional recession territory, never having regained its pre-recession high, going into either the 2001 recession or the 2007 recession.





[For further details on Second-Quarter 2014 GDP, see* Reporting Detail and www.ExpliStats.com.*]

HYPERINFLATION WATCH

Money Supply Velocity. Incorporating the new nominal data on second-quarter 2014 GDP, the benchmark revision to historical nominal data back to 1999, as well as recent Federal Reserve benchmark revisions to money supply-related data, updated estimates of money velocity for money supply M2 and M3 are graphed below.

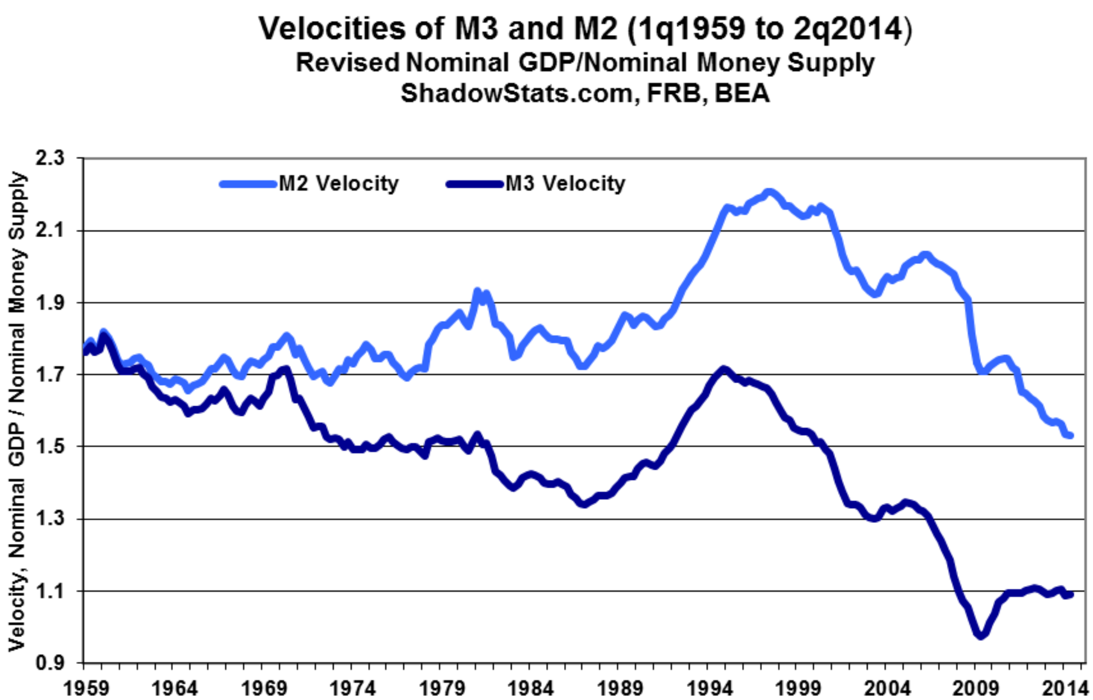
Velocity held steady in second-quarter 2014 for both money-supply M2 and M3 (ShadowStats Ongoing-M3 Measure), as shown in the accompanying graph.

Where velocity simply is the ratio of the nominal GDP to the money supply number, the unchanged ratios, here, reflected somewhat stronger money growth and GDP growth, with recent slowing in M2 velocity perhaps starting to bottom out, and the recent flattening of M3 holding in place.

Most recently, M3 and M2 had been showing opposite patterns since 2011, because growth in M3 has been weaker than growth in M2. The reason behind that difference was that much of the relatively stronger M2 growth reflected cash moving out of M3 categories—such as large time deposits and institutional money funds—into M2 or M1 accounts. The clarity of what happened there is why ShadowStats still tracks what had been the broadest money measure (M3) available.

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

Velocity has theoretical significance, where, in combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is a ratio of two numbers that are not particularly well or realistically measured, its actual estimate is of very limited value. As an inflation predictor, it has to be viewed in the context of accompanying money-supply growth, and vice versa, generally as a coincident indicator, with limited predictive value. Again, full definitions can be found in the *Money Supply Special Report*.



Hyperinflation Outlook Summary. ***[PLEASE NOTE: The main text here is as published in Commentary No. 644.]*** 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. It will be updated with next week's trade report *Commentary* to reflect today's (July 30th) stronger GDP reporting and the August 1st detail on July labor conditions.

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 (*Commentary No. 644*), 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* of *Commentary No. 644*, 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.

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REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Second-Quarter 2014, First or “Advance” Estimate)

The Better the Quality of New Data, the More Likely GDP Will Be Revised to the Downside. Despite headline second-quarter 2014 GDP coming in well above the ShadowStats estimate, the broad outlook is not changed. Boosted by overly-optimistic guesses and assumptions on the part of the Bureau of Economic Analysis (BEA) as to inventory building, auto sales, construction spending, economic impact of the Affordable Care Act, near-term performance of the trade deficit and swings in consumer utility usage tied to unseasonable weather patterns. Those areas likely will see revisions in the next two months that will move headline second-quarter 2014 GDP much closer to flat-to-minus activity and, and eventually likely move into a headline contraction. See the distribution of the headline quarterly GDP growth rate by major components, in the *Opening Comments*.

Separately, the pattern of benchmark revisions, also released today and discussed and graphed in the *Opening Comments*, tended to be to the downside when new information as available from higher-quality sources, such as comprehensive industry surveys, and to the upside when the primary revisions were guesstimates tied to BEA modeling activity.

Otherwise, 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 *2014 Hyperinflation Report—The End Game Begins – First Installment Revised*, and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*).

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.*

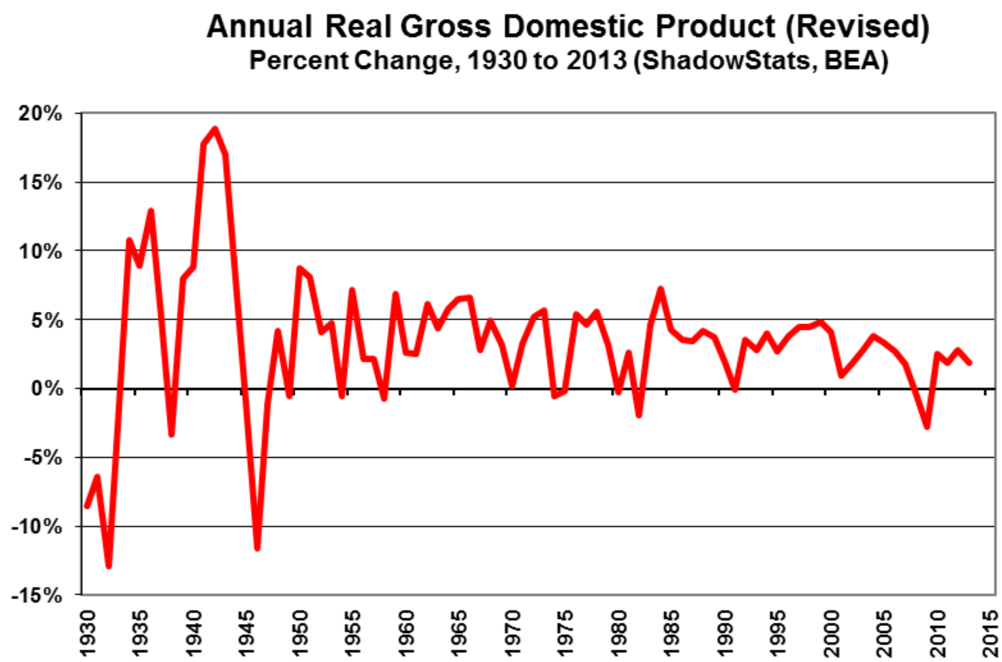
Gross Domestic Product (GDP). Published this morning, July 30th, by the Bureau of Economic Analysis (BEA), the first or "advance" estimate of second-quarter 2014 GDP showed a statistically-significant, real (inflation-adjusted), annualized, quarterly gain of 3.95% +/- 3.5% (95% confidence interval). That was against a benchmark-revised 2.11% contraction (-2.11%), previously a 2.93% drop (-2.93%) in headline first-quarter 2014 GDP activity. The distribution of the headline quarterly GDP growth rate, by major components, is detailed in the *Opening Comments*.

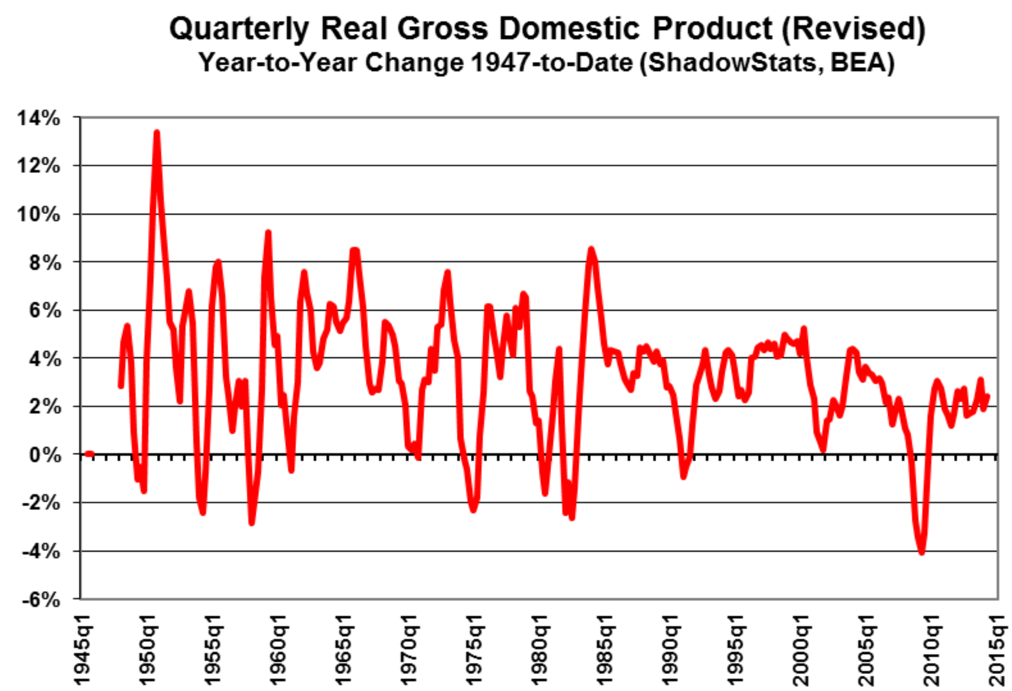
This reporting was in the context of annual benchmark revisions to the GDP series, released along with the initial second-quarter GDP estimate, also as discussed in the *Opening Comments*.

Shown in the following three graphs are the latest and revised year-to-year or annual rates of change for the real GDP series, both for annual and quarterly numbers. The first graph of annual average GDP change reflects a net downside revision in average annual growth of 0.25% (-0.25%) in 2011, a net downside revision of 0.46% (-0.46%) in 2012, and a net upside revision of 0.34% in 2012. Again, as discussed in the *Opening Comments*, where new and better-quality numbers were available, growth revised lower. Where the data faced nothing new but continued happy assumptions and massaging from the BEA, growth revised higher.

Year-to-year growth on a quarterly basis (reflected in the second and third graphs following), was estimated at 2.43% in second-quarter 2014 GDP, versus a benchmark-revised 1.89% (previously 1.54%) in the first-quarter. The second graph shows the series in terms of its full quarterly history. The third graph shows more-current detail, from 2000-to-date. The 2014 benchmark revisions in recent years for year-to-year change are plotted in the *Opening Comments*.

The latest quarterly year-to-year growth still remained below the near-term peak of 3.13% growth, but where that peak pre-benchmark had been reported for third-quarter 2012 (revised to 2.73%, that now has shifted to fourth-quarter 2013 (formerly growth of 2.59%. The current-cycle trough, however, still held 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.


Annual Real Gross Domestic Product (Revised)
Percent Change, 1930 to 2013 (ShadowStats, BEA)
20%
15%
10%
5%
0%
-5%
-10%
-15%
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015


Quarterly Real Gross Domestic Product (Revised)
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
1985q1
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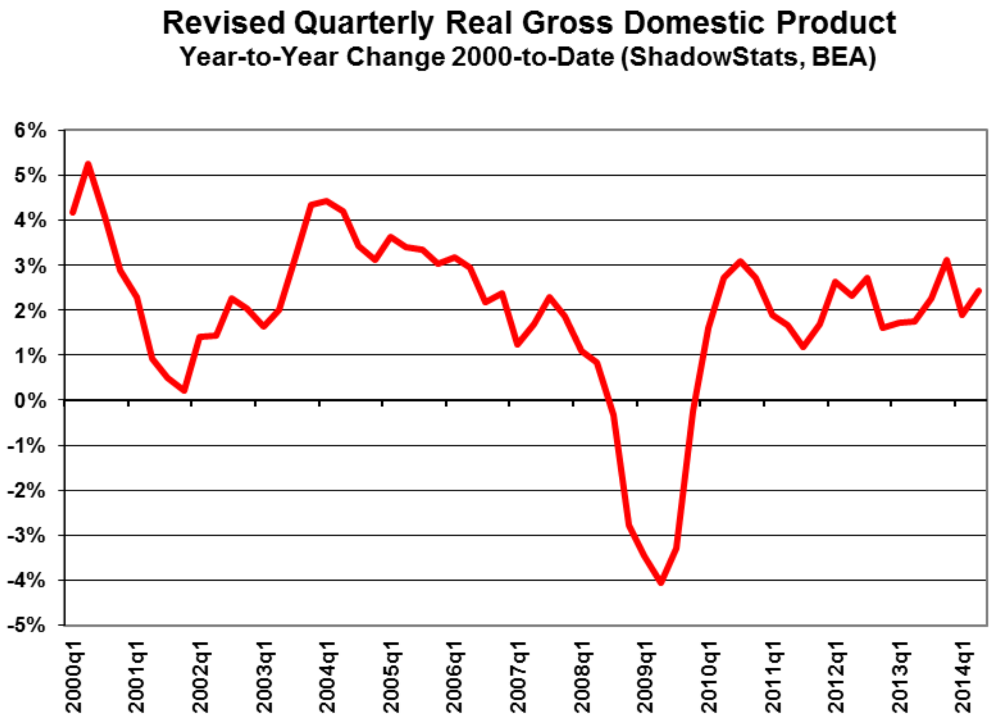
1995q1
2000q1
2005q1
2010q1
2015q1



Implicit Price Deflator (IPD). The "advance" estimate of second-quarter 2014 GDP inflation, or the implicit price deflator (IPD), was at an annualized quarterly pace of 1.99% in second-quarter 2014, versus a revised 1.33% (pre-benchmark 1.26%) in first-quarter 2014, and a revised 1.42% (pre-benchmark 1.58%) in fourth-quarter 2013. Year-to-year, second-quarter 2014 IPD inflation was 1.60%, versus a revised 1.37% (pre-benchmark 1.34%) in first-quarter 2014, and versus a revised 1.40% (1.45% pre-benchmark) in fourth-quarter 2013.

For comparison purposes, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation published by the Bureau of Labor Statistics (BLS), was up by 3.03%, the highest level since second-quarter 2011. That followed inflation of 1.91% in first-quarter 2014 and 1.14% in fourth-quarter 2013. Not-seasonally-adjusted, on a year-to-year basis, second-quarter 2014 CPI-U inflation was 2.05%, versus 0.86% in first-quarter 2014, and 1.23% in fourth-quarter 2013.

The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

Gross National Product (GNP) and Gross Domestic Income (GDI). Although revamped in today's benchmark revisions through first-quarter 2014 (see the *GDP Revision* section), neither the GDP nor the GDI will be estimated for second-quarter 2014 until at least the first revision to the second-quarter GDP on August 28th.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for second-quarter 2014 GDP is a 1.7% year-to-year contraction (-1.7%) versus a headline annual gain of 2.4%, that was against an unrevised ShadowStats 1.9% year-to-year contraction (-1.9%), and a revised headline GDP gain of 1.9% (pre-benchmark 1.5%) in first-quarter 2014 (see the Alternate Data tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, the headline quarter-to-quarter contraction for the first-quarter likely was even deeper, net of all the regular reporting gimmicks. 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, including today's headline data.

Adjusted for understated 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, and the longer-term "corrected" graph updated from *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* (see the *Opening Comments* section) 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.

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:

Construction Spending (June 2014). The Commerce Department has scheduled release of June 2014 construction spending for Friday, August 1st. The headline monthly changes, as usual, should not be statistically significant, while previous data will be subject to large and unstable revisions.

Employment/Unemployment (July 2014). The Bureau of Labor Statistics (BLS) also will release its July 2014 labor data on Friday, August 1st. Given general indications of a weakening economy and the heavy, regular distortions in the headline reporting of monthly nonfarm payroll gains, almost anything is possible in the headline reporting. Nonetheless, the system is due for some negative surprises against the usual, overly-optimistic market expectations.

Based on the headline payroll employment reporting in June, the BLS trend model indicates a 232,000 headline jobs gain for July 2014, as discussed by ShadowStats affiliate www.ExpliStats.com. The consensus outlook tends to settle in around the trend number, and late expectations indeed appear to be settling close to that (a Bloomberg reading on July 28th was at 233,000), versus what had been a headline jobs gain of 288,000 in June. Again, underlying economic reality would indicate a pending downside surprise to those expectations.

Separately, expectations appear to be for the July U.3 unemployment rate to hold at the highly-troubled 6.1% level seen in June. Underlying economic reality and the fundamental drivers of economic activity would suggest a general increase in the U.3 rate, but the BLS's continuing purge of discouraged workers from the unemployment rolls and headline labor force could argue in favor of a lower rate. Separately, 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 anew, there likely would be additional labor-force loss associated with those relative, but still-not-comparable numbers. The broader U.6 and ShadowStats unemployment measures would tend to hold, or increase anew, at their broader and higher respective levels. All the Labor Department numbers remain unsettled and could come in well outside general expectations.

