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

COMMENTARY NUMBER 662
Second-Quarter 2014 GDP -- Third Estimate

September 26, 2014

GDP Has Fully Reestablished Itself as the Most Worthless of Economic Series

Fluff and Guesstimates Dominated the Upside GDP Revision

Monthly Economic Reporting Should Turn Increasingly Negative

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, October 3rd, covering September employment and unemployment, the August trade deficit and August construction spending.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Some Political Shading of Language in the GDP Press Release. The second revision took second-quarter GDP growth to a near-consensus, headline 4.6%. That growth rate has little relationship to real-world activity, as most often is the case for the GDP numbers. The series has been subjected to long-range methodological manipulation, as discussed in the second installment of the hyperinflation report (linked below). Consistent overstatement of GDP growth has resulted directly from the consistent and deliberate understatement of inflation used in deflating the series.

Also, as noted in last month's *Commentary No. 653*, "On top of the gimmicked changes in reporting methodologies that have created regular downside biases in inflation numbers and upside biases in data affecting the broadly popular, underlying monthly economic series, the GDP also has been subject, traditionally, to special-purpose (usually election-related) political manipulations. Discussed previously, these manipulations have taken place over the last five decades and have involved both major political parties."

Some of those special-purpose political stresses may have been behind somewhat selective language in today's GDP press release from the Bureau of Economic Analysis (BEA). Irrespective of such, the chances that the heavy overstatement of second-quarter GDP growth resulted from normal GDP reporting, is of low probability, but the story of what happened has not surfaced yet, and it may not surface for some time, as often has been the case.

Today's Missive. In the context of yesterday's (September 25th) *Commentary No. 661*, which updated the general outlook on economic and financial conditions as well as the outlook for hyperinflation, the regular *Hyperinflation Watch* section is in the process of revision. A revised section will return with next week's *Commentary*.

As noted in the *Week Ahead* section, upcoming August trade data will influence the tone of initial reporting of third-quarter GDP, while September employment reporting also holds the potential of signaling much weaker, headline third-quarter economic activity. Weak September employment also would set a negative tone for a variety of economic reporting in the month ahead.

The balance of today's *Commentary* concentrates on the reporting of the third-estimate, second revision of second-quarter 2014 GDP.

Second-Quarter GDP, Second Revision—Despite the Happy Hype, Fluff and Guesstimates Boosted the GDP Growth Estimate. The Bureau of Economic Analysis (BEA) proclaimed in its September 26th GDP press release that, "The upward revision to the percent change in real GDP primarily reflected upward revisions to nonresidential fixed investment and to exports." Those were solid, politically-correct areas in which to show jobs-creating economic growth, and the comment was indicative of politically-massaged detail that would be touted widely in the popular media, financial and otherwise.

Consider, though, that the BEA failed to cite a less-politically-favorable area, such as the single dominant factor in the upside revision: a revised surge in expenditures for healthcare services. That one factor accounted for virtually all of the upside GDP revision, where business investment and exports did not.

Contrary to the conditions advertised to the popular press, of the 0.42% upside revision to annualized second-quarter GDP growth, only 0.27% came from the changes in "nonresidential fixed investment" (0.15%) and "exports" (0.12%). The exports, also had a 0.03% (-0.03%) offset from imports, while 0.04% of the fixed-investment contribution came from fluff and guesstimation in the recently added intellectual property category.

Not mentioned by the BEA was that of the 0.42% upside revision to the headline quarterly GDP growth, 0.40% also was attributable to an upwardly revised gain in the generally-nonproductive and more-politically-sensitive "healthcare services" category of "personal consumption expenditures." That is an area where the BEA has little, if any, meaningful detail. Offsetting the aggregated gains, "other services" in "personal consumption expenditures" made the largest negative contribution of 0.25% (-0.25%) to the revised growth. Distribution of the latest headline GDP detail, by major consumption grouping, follows later.

Most Worthless of Series. Likely here is that at the text in the GDP press release was massaged to help generate the happiest political story. Yet, well beyond any language games in BEA press releases, as shown later with the "corrected" GDP estimations, the GDP simply 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 recent quarters (see *2014 Hyperinflation Report—The End Game Begins – First Installment Revised*, and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*).

Shy of the "advance" estimate of third-quarter 2014 GDP, due for release on the Friday before Election-Tuesday on November 4th, today's unbelievably strong GDP report was the last one before the polls open. As to the initial third-quarter GDP estimate, discussed in last month's *Commentary No. 653*, "One should not underestimate the ability of the BEA to bring in an initial, positive-growth estimate for the third-quarter GDP, irrespective of the underlying detail and even though subsequent revisions well might take that number negative."

Gross Domestic Product (GDP)—Headline Reporting. The third estimate of, second revision to second-quarter 2014 GDP showed a statistically-significant, real (inflation-adjusted), annualized, quarterly gain of 4.59%, which was near market expectations. The previous estimate had been for 4.17% growth; initial reporting had been for 3.95%. That was against a 2.11% contraction (-2.11%) in headline first-quarter 2014 GDP activity. Year-to-year growth in real second-quarter 2014 GDP revised to 2.59%, versus annual growth of 1.89% in first-quarter 2014. The latest reporting continued in the context of the annual GDP benchmark revisions on of July 30th (see *Commentary No. 646*).

Implicit Price Deflator (IPD). The third estimate of second-quarter 2014 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized quarterly pace of 2.15% (previously 2.16%, initially 1.99%), at the highest level since third-quarter 2011. That followed IPD annualized inflation of 1.33% in first-quarter 2014. Year-to-year, second-quarter 2014 IPD inflation held at 1.64% (initially 1.60%), versus 1.37% in first-quarter 2014. The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

For comparison, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation was up by 3.03% in second-quarter 2014, at the highest level since second-quarter 2011. That followed annualized inflation of 1.91% in first-quarter 2014. Not-seasonally-adjusted, on a year-to-year basis, second-quarter 2014 CPI-U inflation was 2.05%, up from 0.86% in first-quarter 2014.

Gross National Product (GNP). 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.

With only minor relative shifts in second-quarter versus first-quarter factor-income activity, the headline annualized quarterly-growth rate in real second-quarter 2014 GNP revised higher in its second estimate to 4.57% (previously 4.34%), in tandem with the third-estimate of GDP, up from a 2.81% (-2.81%) contraction in first-quarter 2014.

Gross Domestic Income (GDI). GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. 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 headline annualized quarterly-growth rate in real second-quarter 2014 GDI jumped to 4.90% in its second estimate, first revision (previously 4.34%), a relatively greater upside change than was seen in the third estimate of GDP. The second-quarter GDI gain was against a 0.44% contraction (-0.44%) in first-quarter 2014. Year-to-year change was 1.90% in second-quarter 2014, versus 1.49% in first-quarter 2014.

Suggestive of the ongoing deterioration the quality of the GDP-related statistics, irrespective of the recent benchmark revisions, the statistical discrepancy continued to deteriorate, in nominal terms (all negative) of a revised $207.7 (previously $202.5) billion as of second-quarter 2014, versus $177.5 billion as of the first-quarter 2014, which had been $105.3 billion before the July 30th benchmark revision.

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 third estimate of the headline change in second-quarter 2014 GDP, was revised growth of 4.59% (previously 4.17%, initially 3.95%), following a benchmarked quarterly contraction in first-quarter 2014 GDP of 2.11% (-2.11%).

The annualized second-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 1.75% + 2.87% - 0.34% + 0.31% = 4.59%.

- ***Consumer Spending Contributed a Revised 1.75% (Previously and Initially 1.69%) to Second-Quarter Growth; Contributed 0.83% to First-Quarter.*** As noted earlier, the bulk of the 0.42% incremental upside revision to the aggregate growth rate was accounted for by a 0.40% added growth contribution from healthcare services. There was an offset of a negative-growth contribution of 0.25% (0.25%) in "other" services.

- ***Business/Residential Investment Contributed a Revised 2.87% (Previously 2.64%, Initially 2.57%) to Second-Quarter Growth; Subtracted 1.13% (-1.13%) from First-Quarter.*** Against the previous growth-contribution estimate, nonresidential fixed investment added 0.15%, as discussed earlier. Inventories contributed an extra 0.03% in revised growth, fully accounting for 1.42% of the headline 4.59% GDP growth rate. Net of inventories, final sales rose by a revised 3.17%, (previously 2.78%, initially 2.29%) in second-quarter 2014, versus a 0.95% (-0.95%) contraction in first-quarter 2014.

- ***Net Exports Subtracted a Revised 0.34% (-0.34%) [Previously 0.43% (-0.43%), Initially 0.61% (-0.61%)] from Second-Quarter Growth; Subtracted 1.66% (-1.66%) from First-Quarter.*** The difference was reflected in a greater upside revision to exports than to imports. Consistently assessed, this area should have subtracted more than 1.0% from aggregate second-quarter growth.

- ***Government Spending Contributed a Revised 0.31% (Previously 0.27%, Initially 0.30%) to Second-Quarter Growth; Subtracted 0.15% (-0.15%) from First-Quarter.*** With minimal revisions, federal government spending remained a drag on government spending, but a continuing increase in local government spending and investment pushed the aggregate category into greater positive territory.

Economic Reality. Even with the third estimate of second-quarter 2014 GDP headline growth of 4.59%, following a contraction of 2.11% (-2.11%) in first-quarter 2014, the general outlook as to economic reality has not been altered. The broad economy still is turning down anew, and a wide variety of monthly economic detail should confirm that in reporting of 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 third reporting of aggregate second-quarter 2014 economic activity.

As discussed earlier, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity shows 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 recent quarters. Irrespective of the reporting gimmicks introduced in the July 2013 and July 2014 GDP benchmark revisions, 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, other liquidity measures and recent indications of annual consumer expenditures (see graphs in and discussions in *Commentary No. 656*, *Commentary No. 658* and *Commentary No. 659*), and of economic series not otherwise reliant on understated inflation for their reported growth (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*). 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.

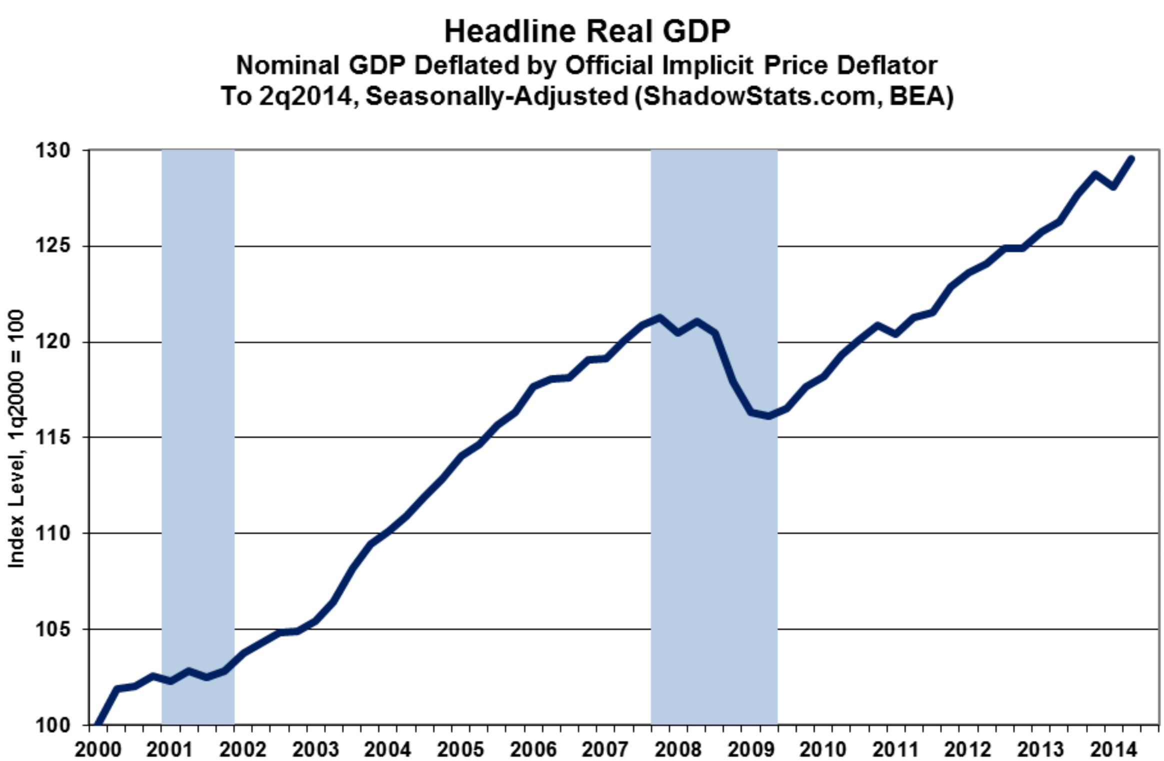
Official and Corrected GDP. As usually discussed in the *Commentaries* covering the quarterly GDP reporting and monthly revisions, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. The accompanying two sets of graphs tell that story, updated for the third estimate of second-quarter 2014 GDP.

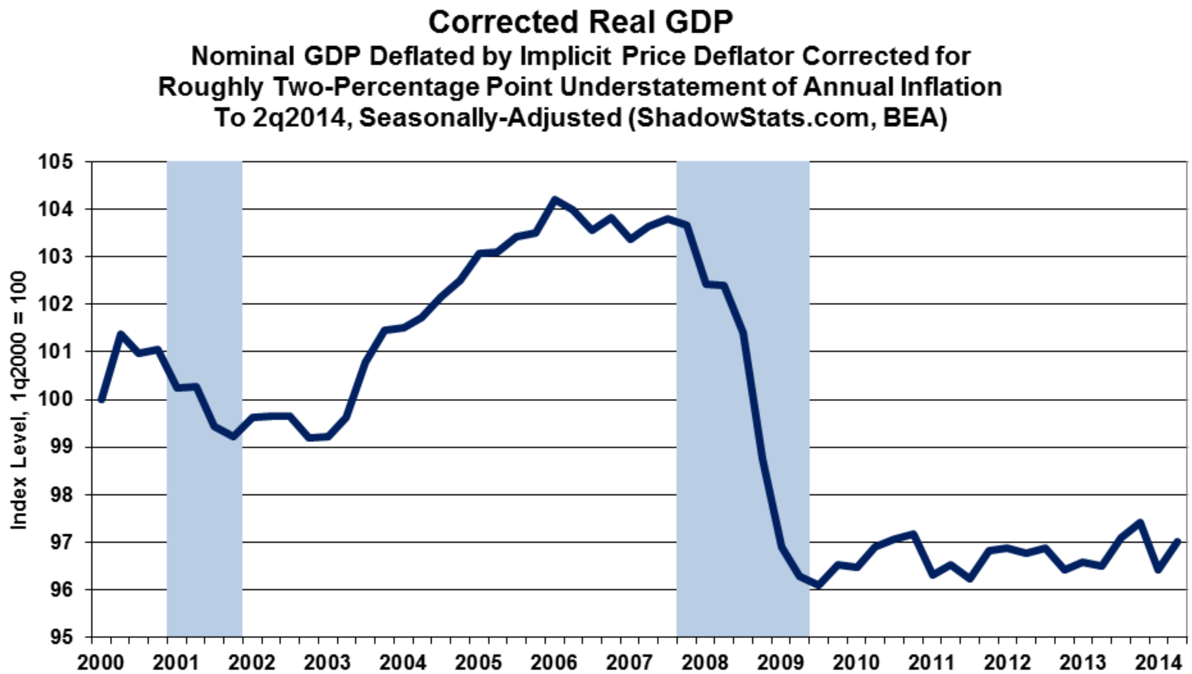
The first set of graphs (2000-to-date) is the one traditionally that has been incorporated in the GDP *Commentaries*, and is expressed on an index base where first-quarter 2000 = 100.0. The second set updates the longer-term graphs (1970-to-date), expressed in billions of 2009 dollars, as found in the second installment of the *Hyperinflation Report*.

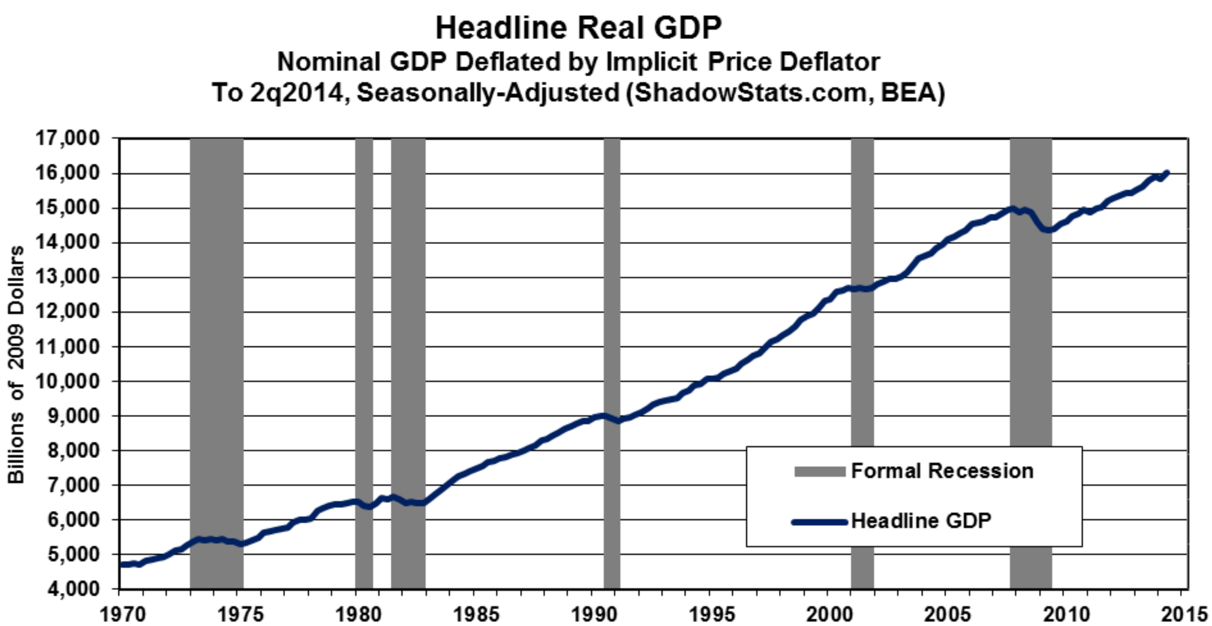
Shown in the first graph of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (with a growth interruption in first-quarter 2014). Adjusted for official GDP inflation (the implicit price deflator), the level of first-quarter 2014 GDP currently stands at 7.0% 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 6.9% below the pre-recession peak of first-quarter 2006.

Further, 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."

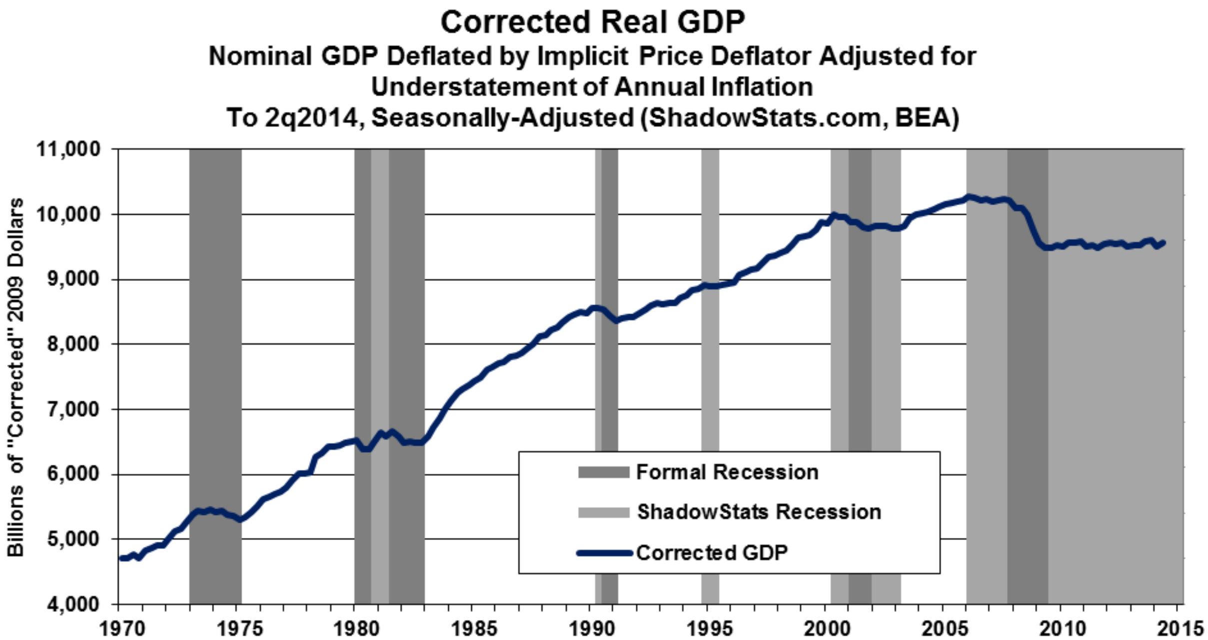
The second graph in each series plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates (see *Public Commentary on Inflation Measurement*), with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points 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 that follows reflect official as well as ShadowStats-defined recessions, as discussed in detail in the second installment of the *Hyperinflation Report.*



[For further details on the third estimate, second revision of second-quarter 2014 GDP, see the* Reporting Detail *section.]

[Drill-down detail and customized graphic options for the headline GDP data are to subscribers at ShadowStats affiliate www.ExpliStats.com.]

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Second-Quarter 2014, Third Estimate, Second Revision)

Most-Worthless of Economic Series. Broadly discussed in the *Opening Comments*, the GDP remains the most-worthless and the most-heavily modeled, massaged and politically-manipulated of government economic series. Beyond historical changes in reporting methodology, a special-purpose political manipulation appears increasingly likely as a factor in the current circumstance. It likely will take some time, though, for the full story to surface.

Otherwise, the headline GDP 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 recent quarters (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.*

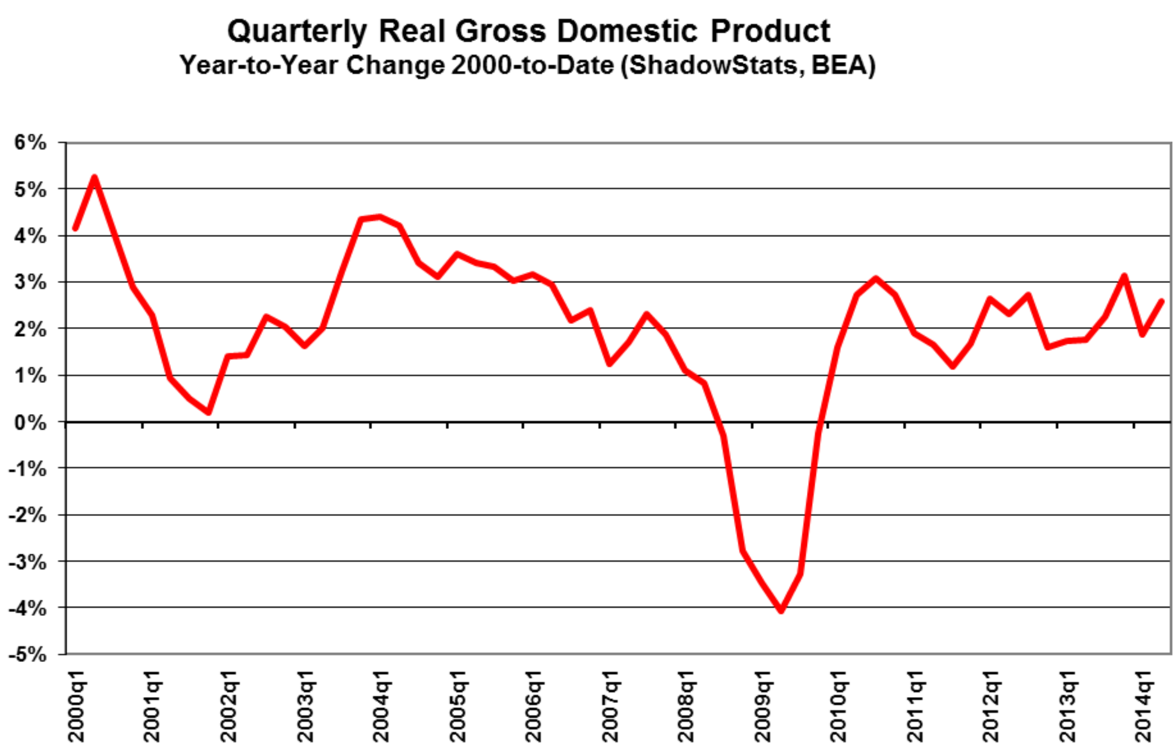
Quarterly *growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by multiplying 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%.*

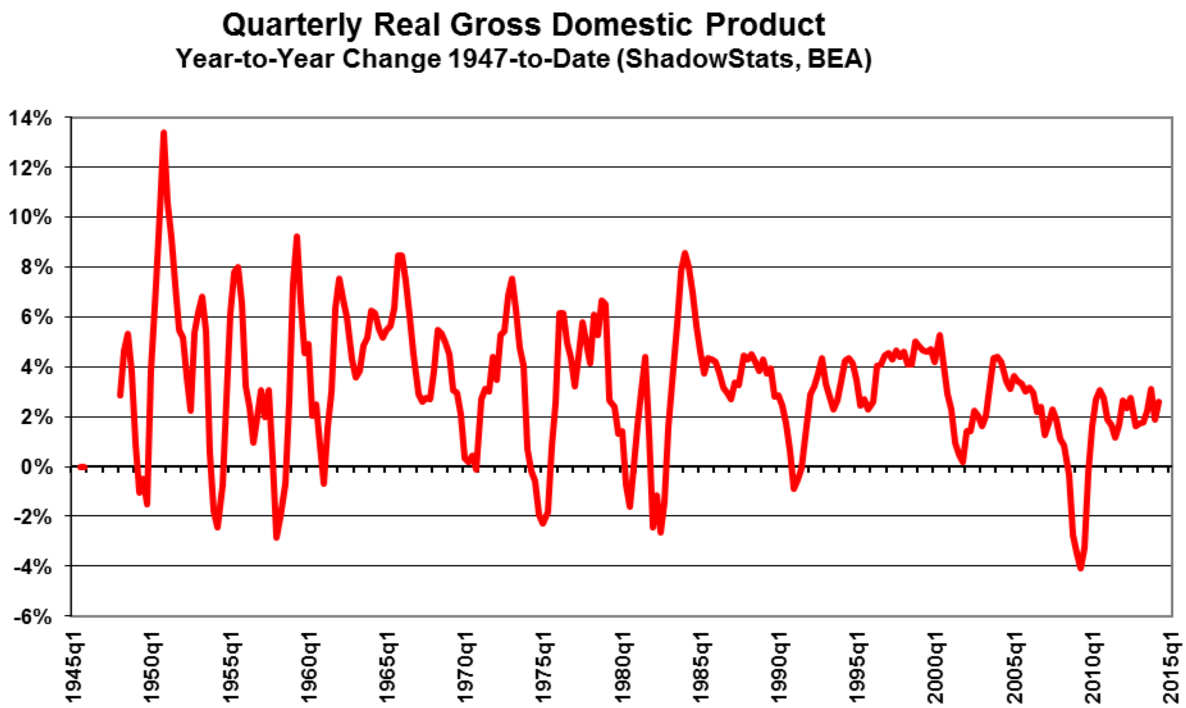
Annual *growth refers to the year-to-year change of the referenced period versus the same period the year before.*

Gross Domestic Product (GDP). Published this morning, September 26th, by the Bureau of Economic Analysis (BEA), the third estimate of, second revision to second-quarter 2014 GDP showed a statistically-significant, real (inflation-adjusted), annualized, quarterly gain of 4.59% +/- 3.5% (95% confidence interval). The previous estimate had been for 4.17% growth; initial reporting had been for 3.95%. That was against a benchmarked 2.11% contraction (-2.11%) [a pre-benchmark 2.93% drop (-2.93%)] in headline first-quarter 2014 GDP activity. The latest reporting remains in the context of the annual GDP benchmark revisions on of July 30th (see *Commentary No. 646*). The distribution of the headline quarterly GDP growth rate by major components is detailed in the *Opening Comments*.

As shown in the two following graphs, year-to-year growth in real second-quarter 2014 GDP revised to 2.59% in the third estimate, up from a 2.48% second estimate and a 2.43% initial estimate, versus benchmarked growth of 1.89% (1.54% pre-benchmark) in the first-quarter. The first graph shows current detail, from 2000-to-date, where the second graph shows the series in terms of its full quarterly history.

The latest quarterly year-to-year growth remained below the near-term peak of 3.13% seen in fourth-quarter 2013. The current-cycle trough in annual change was in second-quarter 2009, at a 4.09% pace of decline (-4.09%). That was the deepest year-to-year contraction for any quarterly GDP in the history of the series, which began with first-quarter 1947.





Implicit Price Deflator (IPD). The third estimate of second-quarter 2014 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized quarterly pace of 2.15% (previously 2.16%, initially 1.99%), at the highest level since third-quarter 2011. That followed benchmarked IPD inflation of 1.33% in first-quarter 2014. Year-to-year, second-quarter 2014 IPD inflation held at 1.64% (initially 1.60%), versus a benchmarked 1.37% in first-quarter 2014.

For comparison, 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% in second-quarter 2014, at the highest level since second-quarter 2011. That followed inflation of 1.91% in first-quarter 2014. Not-seasonally-adjusted, on a year-to-year basis, second-quarter 2014 CPI-U inflation was 2.05%, up from 0.86% in first-quarter 2014.

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

Gross National Product (GNP). The second estimate of second-quarter 2014 real GNP growth was published today (September 26th), along with the third estimate of second-quarter GDP growth. The second-quarter detail also was reported in the context of the annual benchmark revisions of a July 30th, as discussed in *Commentary No. 646*.

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.

With only minor relative shifts in second-quarter versus first-quarter factor-income activity, the headline annualized quarterly-growth rate in real second-quarter 2014 GNP revised higher, in tandem with the GDP, to 4.57% (previously 4.34%), up from a benchmarked 2.81% contraction (-2.81%) in first-quarter 2014. Pre-benchmark, headline first-quarter growth had been a 3.61% (-3.61%) contraction. Year-to-year change revised to 2.53% (previously 2.47%) in second-quarter 2014, versus a benchmarked 1.86% in first-quarter 2014.

Gross Domestic Income (GDI). The second estimate of second-quarter 2014 real GDI growth also was published today (September 26th), along with the third estimate of second-quarter GDP growth. The second-quarter detail, again, was reported in the context of the annual benchmark revisions of July 30th, as discussed in *Commentary No. 646*.

GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. 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 headline annualized quarterly-growth rate in real second-quarter 2014 GDI jumped to 4.90% in revision (previously 4.34%) a relatively greater upside change than was seen in the GDP. The second-quarter GDI gain was against a benchmarked 0.44% contraction (-0.44%) in first-quarter 2014. Pre-benchmark, headline first-quarter growth had been a 2.61% contraction (-2.61%). Year-to-year change was 1.90% in second-quarter 2014, versus a benchmarked 1.49% in first-quarter 2014.

Suggestive of the ongoing deterioration the quality of the GDP-related statistics, irrespective of the recent benchmark revisions, the statistical discrepancy continued to deteriorate, in nominal terms (all negative) of a revised $207.7 (previously $202.5) billion as of second-quarter 2014, versus $177.5 billion as of a revised first-quarter 2014, which had been $105.3 billion pre-benchmark.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for second-quarter 2014 GDP remains a 1.7% year-to-year contraction (-1.7%) versus the headline revised annual gain of 2.6% (previously 2.5%, initially 2.4%). Those second-quarter estimates were against a ShadowStats 1.9% year-to-year contraction (-1.9%)—unaltered by the July 2014 benchmarking games—and the benchmarked 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 4.6% quarter-to-quarter gain for second-quarter 2014 likely was much weaker, flat-to-minus, 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 2007 recession.

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) are 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

Against Overly-Optimistic Expectations, Pending Economic Releases Should Be Much Weaker; Inflation Releases Should Be Increasingly Stronger. Although shifting to the downside, again, amidst wide fluctuations, market expectations for business activity generally remain overly optimistic, well above any potential, underlying economic reality. Market outlooks should be hammered, though, by ongoing, downside corrective revisions and by an accelerating pace of downturn in headline economic activity.

Longer-Range Reporting Trends. The initial stages of the process shifting economic-growth expectations to the downside already have been seen in the recent headline reporting of 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 largely survived the GDP benchmark revisions. The strong bounce-back estimated by the Bureau of Economic Analysis (BEA) for headline second-quarter GDP still faces revision, and a third-quarter GDP contraction is likely, come post-election revisions.

Indeed, weakening, underlying economic fundamentals indicate still further deterioration in business activity. Accordingly, weaker-than-consensus economic reporting should remain the general trend until the unfolding "new" recession receives broad recognition, which likely would follow the next reporting of a headline contraction in real GDP growth.

A generally stronger inflation trend remains likely to continue, as seen in recent months (August 2014 excepted). Beyond the spread of earlier oil-based inflation pressures into the broad economy, upside pressure on oil-related prices should continue and be rekindled from the intensifying impact of global political instabilities and a likely near-term weakening of the U.S. dollar in the currency markets. Again, near-term food inflation has been picking up, partially due to supply issues. 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 U.S. inflation across the board.

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 (August 2014). The Commerce Department has scheduled release of August 2014 construction spending for Wednesday, October 1st. The headline monthly changes, as usual, should not be statistically significant, while previous data will be subject to large and unstable revisions. Most frequently, revisions are to the downside, irrespective of almost perpetually-positive market expectations for this series.

U.S. Trade Balance (August 2014). The Commerce Department and Bureau of Economic Analysis (BEA) will release their estimate of the August 2014 trade-balance on Friday, October 3rd. The August trade deficit estimate and any revisions to July will set the tone for the growth contribution of the net-export account in the initial estimate of third-quarter 2014 GDP on October 30th.

Irrespective of wherever the consensus outlook settles, the August deficit likely will widen versus July, with the first-two months of the third-quarter deficit likely suggesting a third-quarter widening versus the second-quarter trade shortfall. Trade deficit deterioration should continue to be the norm, going forward, along with the related, increasingly-negative effects of a deteriorating net-export account balance on aggregate GDP activity.

Employment/Unemployment (September 2014). The Bureau of Labor Statistics (BLS) will release its September 2014 labor data also on Friday, October 3rd. Given continuing indications of weakening broad economic activity, and the heavy, regular distortions in the headline reporting of monthly nonfarm payroll gains, almost anything is possible with the headline September reporting. Nonetheless, the system is due for continuing, negative surprises against overly-optimistic market expectations.

Another round of below-consensus reporting in the September payroll numbers, not only would help to set an increasingly-negative tone for third-quarter GDP activity, but also would set a negative tone for a variety of economic indicators due for release in the month ahead.

As published previously by ShadowStats-affiliate www.ExpliStats.com, in its extended analysis of the trends and biases built into the concurrent seasonal factor modeling of August 2014 payroll employment, the implied built-in bias trend as of August, for September 2014, suggests a headline September jobs gain of 225,000, versus the 142,000 headline payroll employment gain reported in August. Where consensus forecasts tend to settle in around the trend number, market expectations currently seem to be running slightly lower, but within 10,000 jobs of the indicated trend level. Again, underlying economic reality would suggest another downside surprise to the market expectations.

Separately, expectations appear to be for the September U.3 unemployment rate to hold at 6.1% for a second month. 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. Further, as discussed regularly in the employment/unemployment-related *Commentaries*, month-to-month comparisons of U.3 and related numbers 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 headline 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.

