

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

**COMMENTARY NUMBER 663**

**September Labor and Monetary Conditions, August Trade Deficit and Construction Spending**

**October 3, 2014**

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**No Recovery in Actual Business Activity**

**Pre-Election Nonsense in Labor Numbers**

**Congress Addresses Data Falsification in Unemployment Survey**

**September Unemployment Rates: 5.9% (U.3), 11.8% (U.6), 23.1% (ShadowStats)**

**Fed's Monetary Policy Propped Stocks**

**Annual Money Supply M3 Growth Fell to 4.3% in September**

**Trade Data Were Positive, Construction Spending Was Neutral for Third-Quarter GDP**

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*PLEASE NOTE: The next regular Commentary is planned for Friday, October 10th, reviewing topical economic and financial-market issues, including a fully-updated Hyperinflation Summary Outlook. No major economic releases are scheduled for the week ahead.*

*ACCORDINGLY, this Commentary excludes the regular Week Ahead section. A review of monetary issues dominates the Hyperinflation Watch section. For the most-recent Hyperinflation Outlook Summary, see the Opening Comments and Summary sections of [Commentary No. 661](#).*

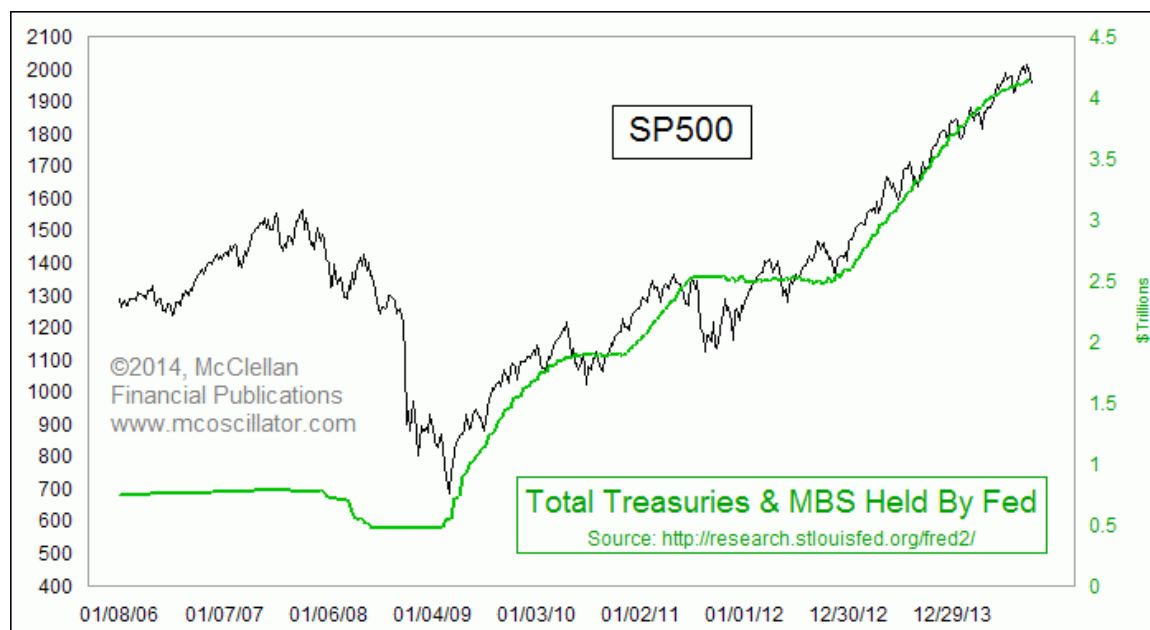
*Best wishes to all — John Williams*

## OPENING COMMENTS AND EXECUTIVE SUMMARY

**Economic Activity Is Not Recovering.** Top managers of major corporations dealing with broadly-based consumer and business products and services, generally have not seen and are not seeing strong consumption or a broad rebound in domestic business activity. Among those with whom I have talked recently, the consensus indication was that the broad economy had grown perhaps by two-percent in the last year, but that included gains from inflation. Take out roughly two-percent for the government's understated inflation rate, and annual growth has been flat. In contrast, real GDP—already adjusted for inflation—has averaged 2.5% year-to-year growth for the four-quarters through second-quarter 2014. Year-to-year growth for real second-quarter 2014 GDP, by itself, was 2.6%.

Until consumer liquidity conditions improve meaningfully, personal consumption generally will remain stagnant. This means that rapid growth reported for some popular economic series most likely is unrealistic, not sustainable and should settle down to more-stable and credible levels of activity, in the near future, perhaps post-election?

**Fed's Activity Has Propped Stocks; Fed Likely Will Move Again to Systemic Liquefaction.** Many thanks to Tom McClellan, publisher of the McClellan Oscillator at [www.mcoscillator.com](http://www.mcoscillator.com), who kindly gave us permission to use the following graph. The plot shows the S&P 500 versus the total Treasuries and Mortgage Back Securities (MBS) held on the Fed's balance sheet. While the graph largely speaks for itself, Tom's thoughts—when he published an earlier version of the graph in June—are found at this link: [McClellan Financial Publications](http://www.mcclellanfinancial.com). Although growth in the Fed's assets has slowed with the "tapering" in QE3, those assets still held at an all-time high of \$4.19 trillion on October 1st, for the third week, as announced by the Fed last night (October 2nd), one week subsequent to the last green point on the chart.



Impact of the continued tapering, and other current Federal Reserve monetary activities—including detail on a record monetary base, a slowing pace of Fed monetization, and slower broad money supply M3 growth—are discussed in the *Hyperinflation Watch* section.

The economy is not recovering. Happy headline numbers, including the increasing nonsense and unreliability in the unemployment and employment data should reverse in the months ahead, with other series turning increasingly negative. In response, the pressures for continued or increased Federal Reserve accommodation should mount anew. Whether in an attempt to prop a falling stock market, or more likely to liquefy a faltering banking system, the Federal Reserve should continue to use the political cover of declining economic activity for any such renewed actions.

**Today's Missive.** The balance of today's (October 3rd) *Commentary*, concentrates on the September report on labor conditions, the August trade deficit and August construction spending, both in these *Opening Comments* and in the *Reporting Detail* section. The employment and unemployment data were unrealistically positive and are subject to some potentially-unusual reporting issues, with increasing weakness likely in the months ahead.

The August trade number indicated a narrowing of the third-quarter real trade deficit, which would be a positive for the "advance" third-quarter GDP estimate. August construction spending turned lower along with a downside revision to July; those numbers should be relatively neutral for the "advance" GDP.

A brief update on consumer-related data follows at the end of these *Opening Comments*.

**Household Survey Data "Falsified," While Other Flaws Mount in Employment and Unemployment Reporting.** Reporting-quality issues continue to intensify for the popularly-followed employment and unemployment series. The House Committee on Oversight and Government Reform and the U.S. Congress Joint Economic Committee have been investigating "data falsification" in the monthly Current Population Survey (CPS, a.k.a. the Household Survey), which is conducted by the U.S. Census Bureau on behalf of the Bureau of Labor Statistics.

The investigation was triggered by the November 18, 2013 *New York Post* story by John Crudele, "Census 'faked' 2012 election jobs report." A Congressional *Staff Report* published on September 18, 2014, indicated data falsification had taken place at the Philadelphia Regional Office of the Census Bureau, in order to meet survey-participation requirements for the CPS. In reading the report, there are indications of all offices being involved, including direction from headquarters in Washington. While there has been no finding of the data being altered for specific political purposes, that had been alleged, and the behavior of the Obama Administration, through its Commerce Department and subsidiary Census Bureau during the investigation, could be described as "obstructive." The *Staff Report* can be found here: [U.S. Census Bureau: Addressing Data Collection Vulnerabilities](#). The body of the report includes interesting detail.

Separate from the report, there are major concerns—irrespective of whether there was politically-motivated falsification—specifically including the accuracy of the household survey reporting of at least the last four years. There appears to have been enough falsification of data to affect the significance of

reported numbers, such as the unemployment rate. Separately, the Census Bureau purportedly already has started to alter its surveying and household sampling techniques, with the effect of now having new data that are not comparable with the old data. To my knowledge, all this has developed without any cautions on data quality being published by the Census Bureau or the BLS. There is reason to suspect that today's headline household survey data may have been impacted by the new surveying or sampling policies.

**“Trend Model” Estimate Suggests Slowing Payroll Growth in October.** An unusual number from the latest analysis by ShadowStats affiliate [www.ExpliStats.com](http://www.ExpliStats.com) of the BLS's concurrent-seasonal-adjustment program for payroll employment is that the trend for the post-election October payroll report is for a gain of 180,000, which is a declining trend, despite the stronger-than-expected September gain. That gain usually would boost the trend level for the next month. More on this will follow, too, in the weeks ahead.

Otherwise, the concurrent-seasonal-factor adjustments leave the seasonally-adjusted headline payroll employment and unemployment-related data non-comparable on a month-to-month basis (headline payroll data changes in September are not comparable with anything before August; headline household data simply are not comparable month-to-month). Given the non-reporting of consistent historical data, jobs from earlier periods, also can be moved into headline months, by stealth. The non-comparability and stealth issues are not so much a problem with the seasonal-adjustment process, as they are with the lack of willingness on the part of the BLS to publish the revised historical numbers, which are comparable month-to-month.

Beyond the concurrent-seasonal-factor issues, there remains the upside-bias factor built into the monthly payroll employment numbers, with effective overstatement of monthly payroll gains in excess of 200,000 jobs. These issues, again, are addressed further in the *Reporting Detail* section.

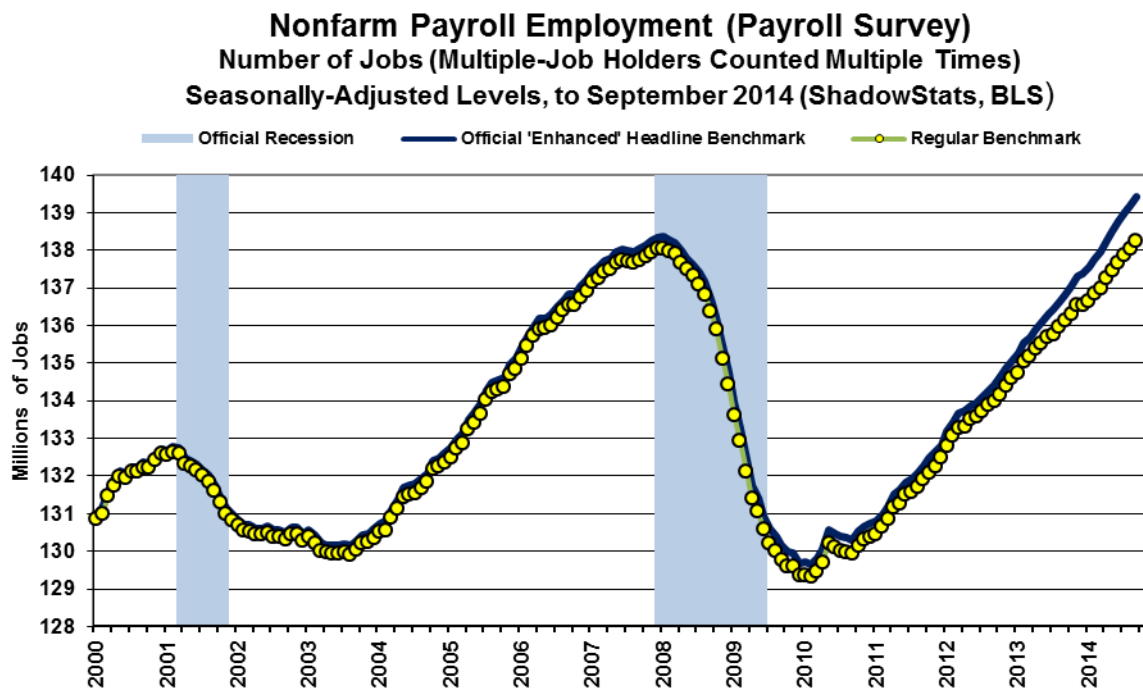
**Bottom Line:** More in line with common experience, the 248,000 headline payroll jobs growth in September would have been unchanged, plus or minus, while the 5.9% headline unemployment rate would have topped 23%, again, taking all the short- and long-term discouraged workers into account.

**Headline Payroll Data—September 2014.** The seasonally-adjusted, month-to-month headline payroll-employment gain for September 2014 was 248,000, technically, a statistically-significant gain, topping both trend and market expectations. The September gain followed an upwardly revised August gain of 180,000, and an upwardly revised July gain of 243,000. The reported July gain, however, was an outright fraud by the BLS, as discussed in the *Reporting Detail* section. Full ExpliStats analysis on the concurrent seasonal adjustment process showed that the headline July change from June actually was a gain of 225,000, based on consistent and comparable reporting, instead of the purported 243,000 increase.

**Annual Change in Payrolls—New Post-Recession Growth Peak.** Not-seasonally-adjusted, year-to-year change in payroll employment is untouched by the concurrent-seasonal-adjustment issues, so the monthly comparisons of year-to-year change are reported on a consistent basis, although the redefinition of the series—not the standard benchmarking process—recently boosted reported annual growth in the last year, as discussed and graphed in the benchmark detail of [Commentary No. 598](#).

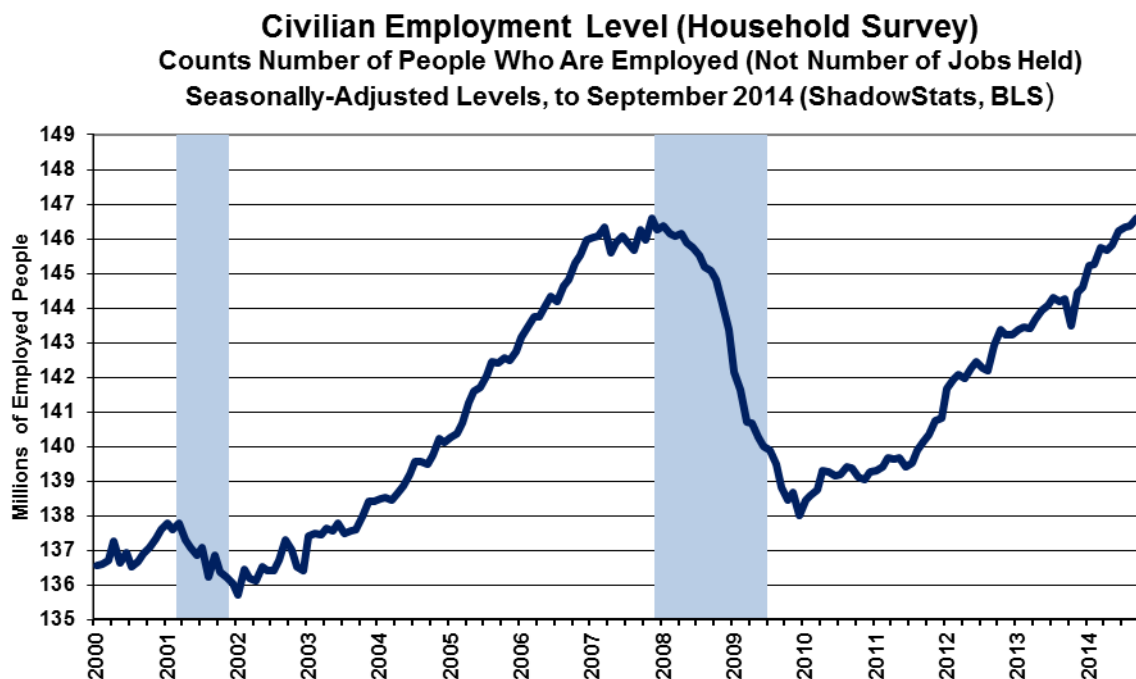
For September 2014, year-to-year or annual nonfarm payroll growth was 1.96%, which was a new post-recession high, versus revised annual growth of 1.89% in August and 1.93% in July 2014. Had the 2013 benchmark revision been standard, not a gimmicked redefinition, year-to-year jobs growth as of

September 2014 would have been about 1.5%, consistent with near-term peak annual growth of about 1.9% in February 2012.



**Record Jobs and Now the Employment Level.** Headline payroll employment recovered its pre-recession high, in May 2014, and has continued to rise. This pattern, however, was accelerated by the payroll levels all being redefined favorably with the January 2014 benchmarking, despite the actual benchmark having been negative. This is seen where the yellow points in that graph reflect the ShadowStats assessment of what payroll employment would be showing, with just a regular benchmarking, rather than the gimmicked redefinition of the series, which added a new upside bias. Even with what should have been a standard benchmarking, however, the pre-recession level was hit this month, as expected. Graphs of year-to-year headline payroll change and a longer-term perspective on headline payroll levels are shown in the *Reporting Detail* section.

As seen in the next graph, the number of employed individuals had yet to recover its pre-recession high, as recently as August 2014, but the headline September number—the last reporting before the election—fortuitously moved to top the pre-recession high by 5,000 employed. That is in contrast to soaring headline payroll employment discussed earlier. The difference is that the payroll survey count reflects the number of jobs, irrespective of how many jobs an individual holds. The household survey count of employment reflects the number of people who are employed, not the number of jobs.



***Counting All Discouraged Workers, September 2014 Unemployment Stood at 23.1%.*** The headline household survey reporting (unemployment-related) is virtually worthless. As previously discussed, aside from sampling-quality issues, the numbers are highly volatile and unstable, inadequately defined—not reflecting common experience—and simply are not comparable on a month-to-month basis. The month-to-month comparability issue again is tied to the concurrent seasonal adjustment process, discussed in the *Reporting Detail* section.

What removes headline-unemployment reporting from broad underlying economic reality and common experience, though, simply is definitional. To be counted among the headline unemployed (U.3), an individual has to have looked for work actively within the four weeks prior to the unemployment survey. If the active search for work was in the last year, but not in the last four weeks, the individual is considered a “discouraged worker” by the BLS. ShadowStats defines that group as “short-term discouraged workers,” as opposed to those who become “long-term discouraged workers” after one year.

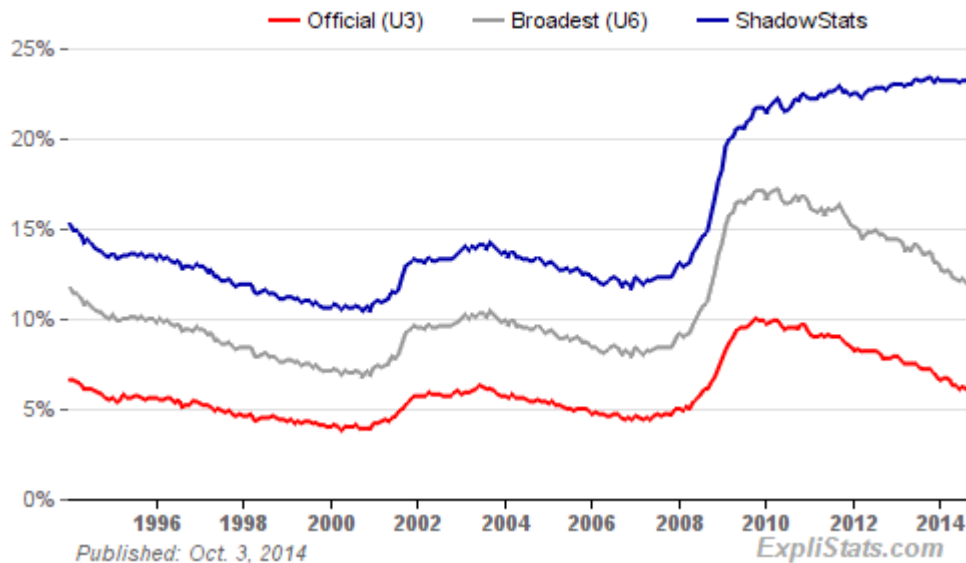
Moving on top of U.3, the broader U.6 unemployment measure includes only the short-term discouraged workers. The still-broader ShadowStats-Alternate Unemployment Measure includes an estimate of all discouraged workers, including those discouraged for one year or more, as the BLS used to measure the series pre-1994, and as Statistics Canada still does.

When the headline unemployed become discouraged, they roll over from U.3 to U.6. As the headline, short-term discouraged workers roll over into long-term discouraged status, they move into the ShadowStats measure, where they remain. Aside from attrition, they are not defined out of existence for political convenience, hence the longer-term divergence between the various unemployment rates. Further detail is discussed in the *Reporting Detail* section. The resulting difference here is between a headline September 2014 unemployment rate of 5.9% (U.3) and 23.1% (ShadowStats).



### Unemployment Rate - Official (U-3 & U-6) vs ShadowStats Alternate

Monthly SA. Through Sep. 2014 (ShadowStats, BLS)



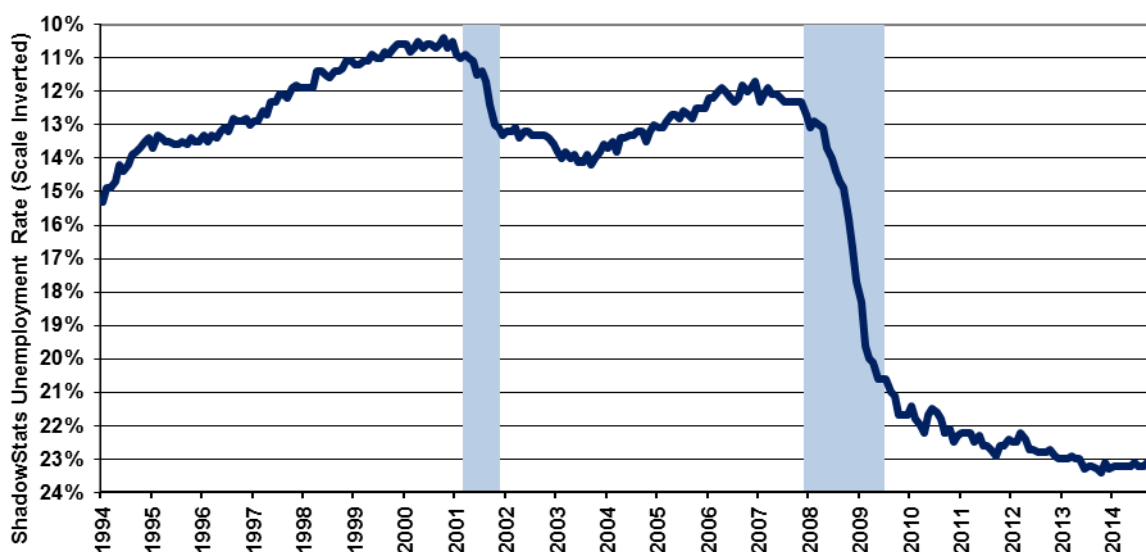
The graph immediately preceding reflects headline September 2014 U.3 unemployment at 5.9%, down from 6.1% in August; headline September U.6 unemployment declining to 11.8%, from 12.0% in August; and the headline September ShadowStats unemployment measure dropping a notch to 23.1%, from 23.2% in August. The October 2013 ShadowStats reading of 23.4% was the series high (since 1994).

The two graphs that follow reflect longer-term unemployment and discouraged-worker conditions.

### ShadowStats-Alternate Unemployment Rate (Inverted Scale)

Long-Term Discouraged Workers Included (BLS Excluded Since 1994)

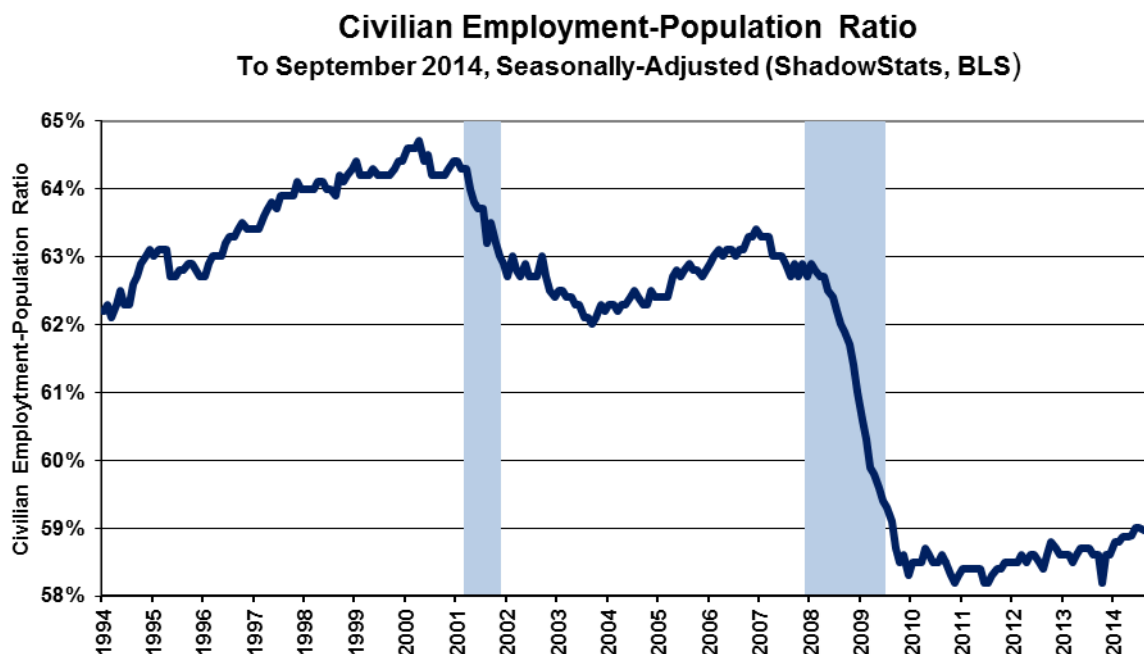
To September 2014, Seasonally-Adjusted (ShadowStats, BLS)



The first graph (preceding) is of the ShadowStats unemployment measure, with an inverted scale. The higher the unemployment rate, the weaker will be the economy, so the inverted plot tends to move in tandem with plots of most economic statistics, where a lower number means a weaker economy.

The inverted-scale ShadowStats unemployment measure also tends to move with the employment-to-population ratio, which is plotted in the second graph, which follows. Discouraged workers are not counted in the headline labor force, which generally continues to shrink. The labor force containing all unemployed (including total discouraged workers) plus the employed, however, tends to be correlated with the population, so the employment-to-population ratio tends to be something of a surrogate indicator of broad unemployment, and it has a strong correlation with the ShadowStats unemployment measure.

The two graphs reflect detail back to the 1994 redefinitions of the household survey. Before 1994, data consistent with today's reporting are not available.



**Headline Unemployment Rates—September 2014.** Subject to the various reporting issues and lack of real-world relevance discussed elsewhere, the headline September 2014 unemployment (U.3) rate declined by 0.21-percentage point (-0.21%) to 5.94%, from 6.15% (rounds to 6.1%) in August. On an unadjusted basis, the unemployment rates are not revised and at least are consistent in reporting methodology. September's unadjusted U.3 unemployment rate declined to 5.7% from 6.3% in August.

With a minor seasonally-adjusted decline in people working part-time for economic reasons, and a decline in short-term (unadjusted) discouraged workers, headline September 2014 U.6 unemployment declined to



11.8% in September 2014, from 12.0% in August 2014. The unadjusted U.6 declined to 11.3% in September, from 12.0% in August.

Adding back into the total unemployed and labor force the ShadowStats estimate of the growing ranks of excluded, long-term discouraged workers—more in line with common experience—broad unemployment, the September 2014 ShadowStats-Alternate Unemployment Measure, notched lower to 23.1% from 23.2% in August. That still was down minimally from 23.4% in October 2013, which was the series high (back to 1994). The ShadowStats estimate generally shows the toll of long-term unemployed leaving the headline labor force.

**U.S. Trade Deficit—August 2014—Likely 0.5% Boost to Third-Quarter GDP.** In the context of a minor revision narrowing the nominal monthly trade deficit in July, the headline August 2014 deficit narrowed slightly for the month. Adjusted for inflation, the July and August trade-deficit details will be used to estimate third-quarter performance of the net-export account, as part of the "advance" estimate of third-quarter GDP growth on October 30th (the last GDP and last major-economic release before the November 4th election). Discussed in the *Real Trade Deficit* section, the growth contribution from the estimated quarterly trade deficit should be a positive one, likely contributing 0.5% or more to the aggregate headline GDP growth.

***Nominal (Not-Adjusted-for-Inflation) August 2014 Trade Deficit.*** The seasonally-adjusted, headline monthly trade deficit in goods and services for August 2014, on a balance-of-payments basis, narrowed to \$40.109 billion from a revised \$40.321 billion in July, but widened versus a \$39.515 billion deficit in August 2013. The minor narrowing of the August 2014 deficit versus the July 2014 number was no more than statistical noise and reflected minor, largely offsetting increases in both aggregate monthly exports and imports.

The ongoing trend should be for significant monthly, quarterly and annual deterioration in the U.S. trade deficit, both before and after adjustment for inflation. Look for a sharp widening of the deficit in September along with a revised widening to August data in the next reporting. That will be post-election and will tend to reduce, in revision, whatever headline growth rate will have been reported for the "advance" estimate of third-quarter 2014 GDP.

***Real (Inflation-Adjusted) August 2014 Trade Deficit.*** Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, used for GDP deflation), the August 2014 merchandise trade deficit (no services) widened slightly to \$47.893 billion from a revised \$47.784 (billion in July and versus \$47.653 billion in August 2013. With the first-two months of the third-quarter 2014 trade deficit in place—the only two months that will be published for the third-quarter in advance of the initial estimate of third-quarter GDP—today's detail set a positive tone for the initial GDP report.

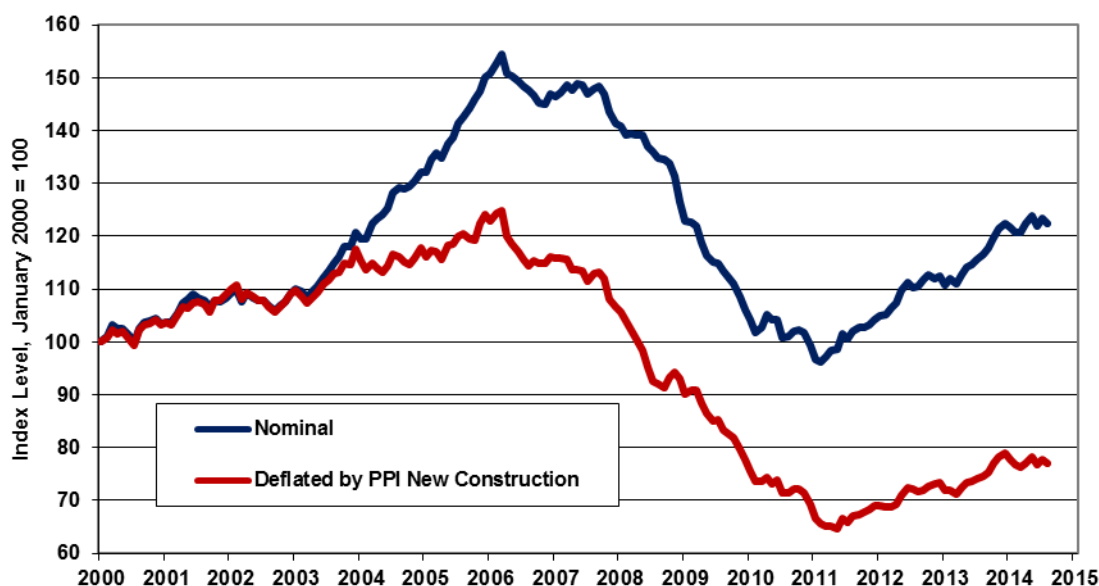
Consistent with today's headline August reporting, the annualized quarterly real merchandise trade deficit stood at \$554.7 billion as of fourth-quarter 2013, at \$591.0 billion as of first-quarter 2014, and at \$619.3 for second-quarter 2014. Based on the July and August reporting, the real merchandise trade deficit currently annualizes out at \$574.1 billion for third-quarter 2014, a meaningful narrowing of the trade shortfall versus second-quarter 2014, and a solid boost for the initial third-quarter GDP growth estimate. A narrowing trade deficit boosts GDP growth; a widening trade deficit reduces GDP growth.

Not all of the relative trade deterioration seen in second-quarter 2014, however, ended up appropriately in offsetting other areas of heavily-overstated growth in headline second-quarter GDP (see prior [Commentary No. 662](#)). Accordingly, the magnitude of the likely impact on third-quarter GDP growth is somewhat open to question, but it would exceed a 0.5% positive contribution to the annualized headline GDP growth rate in normal circumstances.

**Construction Spending—August 2014—Headline Drop Minimized by Sharp Downside Revision to July Activity.** Construction spending declined by 0.8% (-0.8%) for the month of August 2014, but that followed sharp downside revisions to previously-estimated activity in June and July. Against initial reporting for July 2014, August sales dropped by an unusually-steep 2.1% (-2.1%), and growth slowed sharply on a year-to-year basis, from 8.2% to 5.0%. All that was before any adjustment for rising inflation.

Net of inflation, as shown in the accompanying graph, activity has been trending lower since late-2013, with real (inflation-adjusted) activity in the two months reported so far in third-quarter 2014, virtually unchanged from real activity in second-quarter 2014.

**Index of Value of Construction Put in Place  
Nominal versus Inflation-Adjusted (Jan 2000=100)  
Deflated by the PPI New Construction Index  
(Sources: ShadowStats.com, Census Bureau, BLS)**



**PPI New Construction Index (NCI)—Well Shy of Reality.** There is no perfect inflation measure for deflating construction, but the PPI’s New Construction Index (NCI) remains the closest found in publicly-available series. The NCI’s only benefit over the “final demand construction” inflation number in the PPI

is that it has a lengthy history, which enables placing the adjusted data in historical perspective. Both the final-demand and private-survey measures, however, tend to be more closely linked to real-world activity and have been showing higher annual construction costs than seen in the government's NCI data.

Even so, using the PPI's NCI as the deflator still shows real construction spending to have been in ongoing downtrend reporting, from 2013 into 2014.

**Headline Reporting for August 2014.** The headline, total value of construction put in place in the United States for August 2014 was \$961.0 billion, on a seasonally-adjusted—but not-inflation-adjusted—annual-rate basis. That estimate was down month-to-month by a statistically-insignificant 0.8% (-0.8%). August activity followed a revised \$968.8 billion level of activity in July, which was up by a revised 1.2% from a revised \$957.1 billion level in June spending.

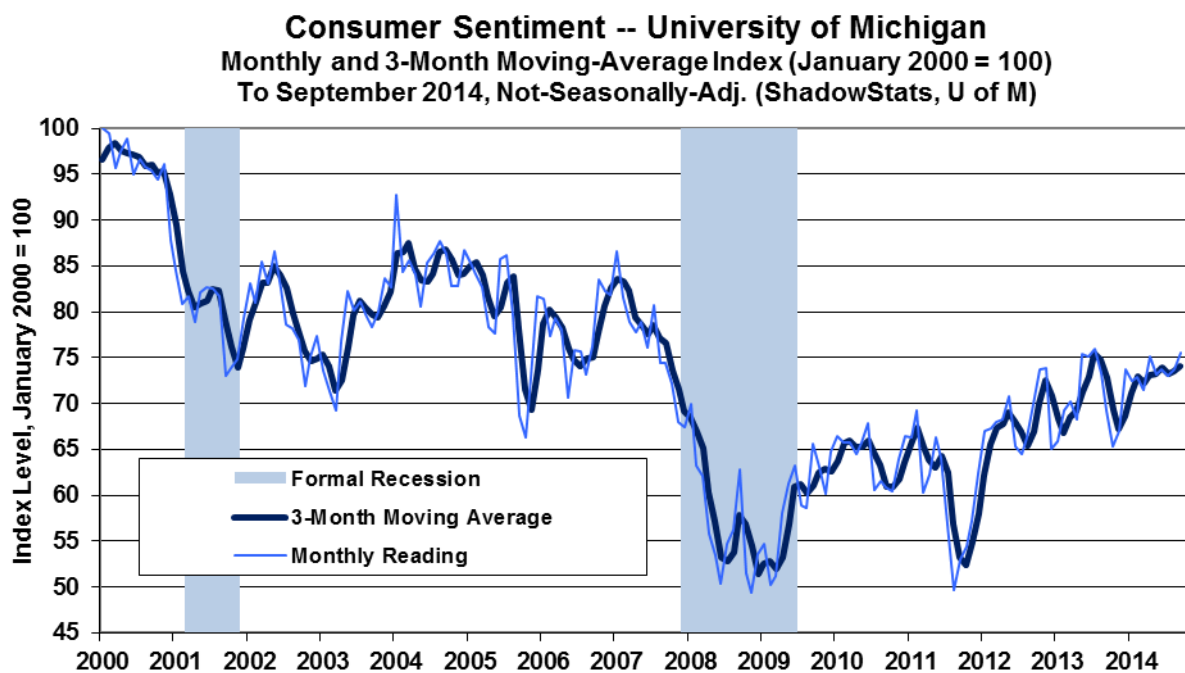
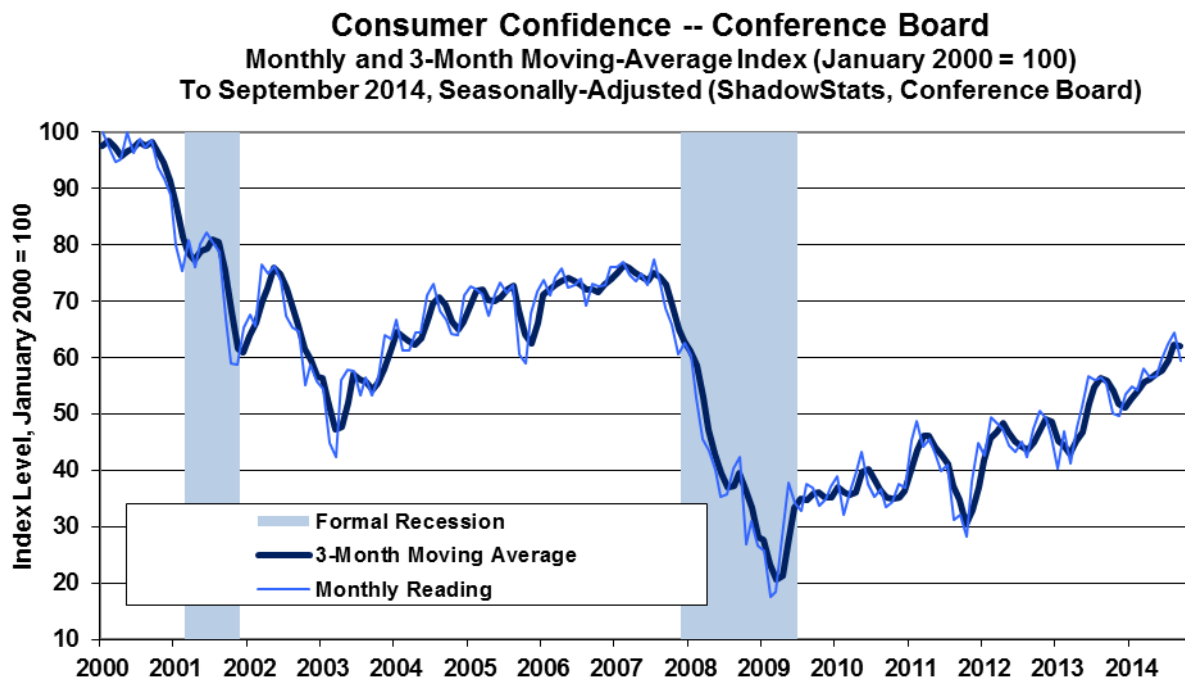
Adjusted for the NCI inflation measure in the PPI, aggregate real spending in August 2014 was down month-to-month by 0.9% (-0.9%), versus a revised monthly gain of 1.2% in July.

On a year-to-year or annual-growth basis, August 2014 construction spending rose by a statistically-significant 5.0%, versus a revised 6.9% gain July. Net of construction costs indicated by the NCI, year-to-year growth in spending was 3.3% in August, versus a revised 4.8% in July. Again, more-realistic private surveying suggests annual costs to be up by enough to come close to turning some of those annual construction-spending growth rates flat or into annual contractions.

The graphs shown in the *Reporting Detail* section reflect latest extended detail of the series. The headline 0.8% (-0.8%) decline in August total construction, encompassed private residential construction down by 0.1% (-0.1%), private nonresidential construction down by 1.4% (-1.4%), and public construction down by 0.9% (-0.9%). Also reflected is the downwardly revised headline 1.2% monthly gain in July total construction, with private residential construction up by 0.4%, private nonresidential construction up by 1.3%, and public construction up by 2.1%.

**Constrained Consumer Liquidity Restrains Residential Construction.** As most recently graphed and discussed in [Commentary No. 656](#), [Commentary No. 658](#) and [Commentary No. 659](#), the primary structural issue preventing meaningful, domestic U.S. economic growth remains impaired consumer liquidity. Repeated regularly in these *Commentaries*, without real growth in income, and without the ability and/or willingness to offset declining purchasing power with debt expansion, the consumer lacks the ability to fuel traditional, consumption-based growth or recovery in U.S. economic activity, including residential investment and related construction spending.

The following two graphs show the latest, month-end September 2014 readings for the Conference Board's Consumer Confidence Index and the University of Michigan's Consumer Sentiment Index. Although confidence fell and sentiment rose in September, both series remained deep in historical-recession territory. There has been no economic recovery here, as shown by plunge in activity into 2009 and then a purported recovery, to-date, in headline GDP activity. Instead, as indicated in these and other consumer-related measures, economic reality remains an economic plunge into 2009, followed by a period of prolonged, low-level stagnation, with activity now turning down anew.



*[For greater detail on September Employment and Unemployment, the August Trade Deficit and August Construction Spending, see the Reporting Detail section.]*

*[Drill-down detail and customized graphic options for the headline Employment and other data are available to subscribers at ShadowStats affiliate [www.ExpliStats.com](http://www.ExpliStats.com).]*

## HYPERINFLATION WATCH

**Recent Monetary Conditions—Monetary Base One-Week Removed from All-Time High; M3 Growth Dropped to 4.3%; Pace of Fed Monetization Slowed.** Despite increased “tapering,” by the Federal Reserve Board, the U.S. central bank’s reduced pace of purchases of U.S. Treasury securities has not been matched by a downturn in the monetary base. Still, annual growth in money supply M3 dropped sharply in September, while the effective pace of Federal Reserve monetization of net Treasury issuance has slowed somewhat further.

***Money Supply M3 Annual Growth Eased to 4.3% in September 2014.*** On track to hit 4.3% annual growth in September 2014, M3’s year-to-year percent growth rate dropped from an unrevised 4.6% in August. Annual growth patterns have shifted recently, minimally, due to revisions in underlying Federal Reserve data. Monthly year-to-year growth began to slow after hitting a near-term peak of 4.6% in each of the months of January, February and March 2013, the onset of expanded QE3. Growth then fell to a near-term trough of 3.2% in January 2014, but that period of slowing growth had reversed fully as of May 2014, with annual growth then at 4.7%, the highest since the “end” of the recession, in July 2009. Annual growth pulled back to 4.5% in June 2014, but rose again to a revised 4.6% (previously 4.7%) in July, where it held in August. The formal M3 estimates and the first readings of annual growth for M2 and M1 in September 2014 will be posted on the [Alternate Data](#) tab of [www.ShadowStats.com](http://www.ShadowStats.com) by tomorrow, October 4th.

Any revisions in the following numbers generally are attributable to recent revisions in underlying data by the Federal Reserve. The seasonally-adjusted, preliminary estimate of month-to-month change for September 2014 money supply M3 was roughly a gain of 0.1%, the same as in August. Estimated month-to-month M3 changes, however, remain less reliable than are the estimates of annual growth.

***Growth for September M1 and M2.*** For September 2014, year-to-year and month-to-month changes follow for the narrower M1 and M2 measures (M2 includes M1; M3 includes M2). See the [Money Supply Special Report](#) for full definitions of those measures. M2 for September 2014 showed roughly 6.4% year-to-year growth, down from an unrevised 6.5% in August, with a month-to-month gain of about 0.3% in September, the same as in August. For M1 in September 2014, year-to-year growth was about 11.6%, up versus a revised 10.2% (previously 10.1%) in August, with a month-to-month September gain of 2.2%, versus a revised contraction of 1.3% (-1.3%), previously down by 1.4% (-1.4%) in August.

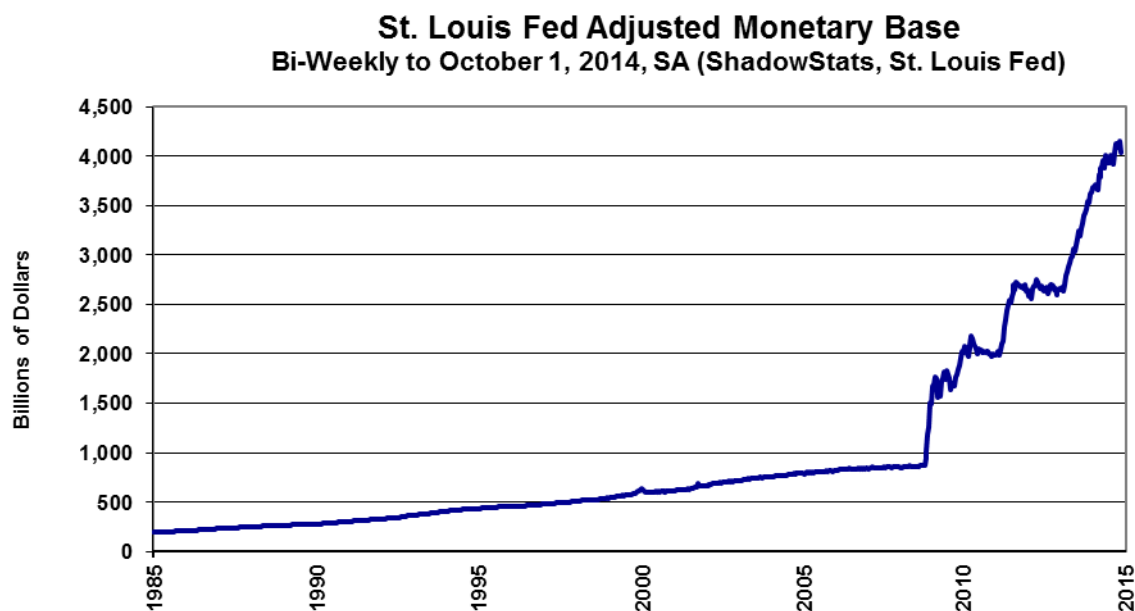
***Fed Has Monetized 65.2% of Net Treasury Debt Issuance for the Public, Since January 2013 Onset of Expanded QE3.*** In the context of rapidly declining purchases of U.S. Treasuries—the continued “tapering” in the Federal Reserve’s quantitative easing program QE3—effective monetization of Treasury debt slowed markedly, as the pace of Fed purchases of Treasury securities finally dropped below the pace of Treasury issuance, but it tended to stabilize in the most-recent month.

The Fed's net acquisition of U.S. Treasury securities in calendar-year 2014, through September 3rd, versus net debt issuance of the U.S. Treasury for the public in the same period, had reflected effective monetization of 58.2% of the increase in debt. That pace was down from over 90% just two months before. That was against effective monetization of 69.7% of the net issuance of publicly-held debt in the full calendar-year 2013. From the onset of expanded quantitative easing QE3 in January 2013 to September 3, 2014, the Fed had monetized 65.9% of the increased Treasury debt held by the public.

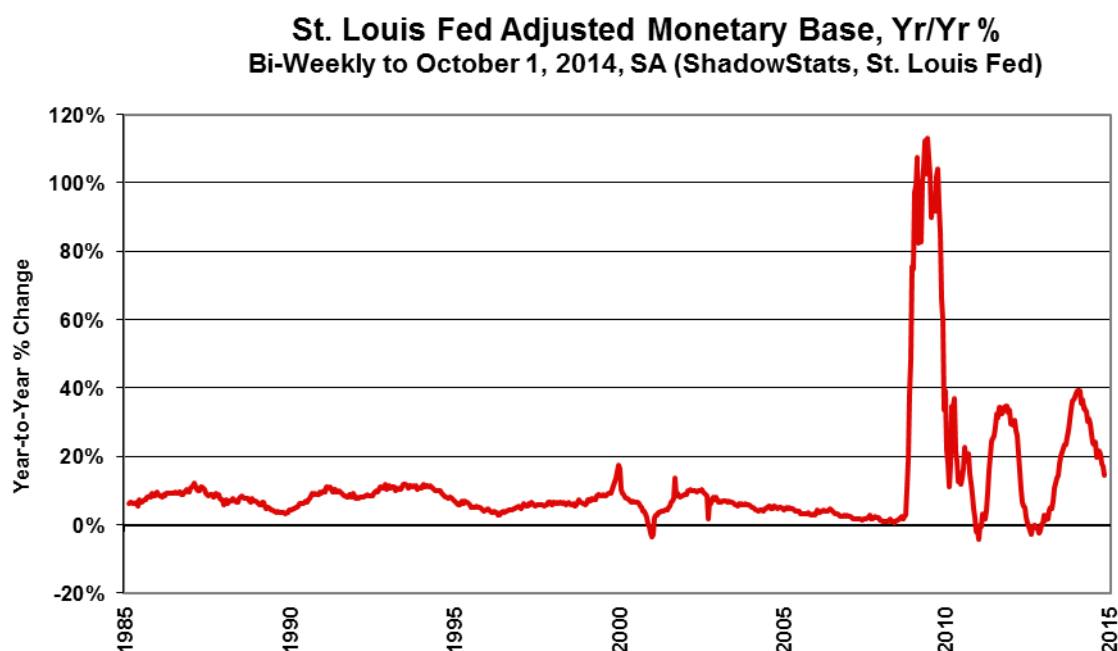
One month later, as of October 1, 2014, following the tax-receipt-rich month of September, the Fed had monetized 57.1% of the increase in debt held by the public, year-to-date 2014. From the onset of expanded quantitative easing QE3 in January 2013 to October 1, 2014, the Fed had monetized 65.2% of the increased Treasury debt held by the public.

The ongoing monetization of the Treasury debt likely had been a contributing factor to the recent pickup, albeit minimal, seen in broad money supply (M3) growth. The slowdown in monetization may well have been a contributing factor to the slowing M3 growth in September. It also has continued to confirm that the market in U.S. Treasury securities remains anything but free and open, with artificially-depressed yields and artificially-inflated bond prices.

***Monetary Base Just off Record High.*** Reflected in the following graphs, again, in the context of what has been ongoing “tapering” in debt purchases, the monetary base (St. Louis Fed measure) hit an all-time high in the two weeks ended September 17, 2014, at \$4.150 trillion, but then backed off sharply in the two-week period ended October 1, 2014 to \$4.036 trillion. Such period-to-period volatility in recent months has not been unusual. Year-to-year growth, with current changes compared to even faster growth the year before, was at 17.0% in the September 17th period, with annual growth at 14.4% in the October 1st period.







**Hyperinflation Outlook Summary: To Be Updated in *Commentary No. 664*, October 10, 2014.** See the *Opening Comments* and *Hyperinflation Outlook Summary* of [Commentary No. 661](#) for the most-recent version.

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## REPORTING DETAIL

### EMPLOYMENT AND UNEMPLOYMENT (September 2014)

**Payroll Employment Annual Benchmark Revision—March 2014—Aggregate Increase of Just 7,000 Jobs.** Discussed in [Commentary No. 660](#) of September 18th, the Bureau of Labor Statistics (BLS) announced its aggregate annual benchmark revision of payroll employment activity for 2014. Comparing its headline estimates to state unemployment insurance records, the BLS upped its estimate of not-seasonally-adjusted payroll employment by 7,000 for the targeted month of March 2014 (a gain of 47,000

in aggregate private payrolls versus a loss of 40,000 in aggregate government payrolls). The net benchmark revision was the smallest in memory and is preliminary. The changes will be massaged into the aggregate payroll data from March 2013 through January 2015, where final revisions will be published along with the release of the January 2015 payroll data in February 2015. Barring unusual reporting gimmicks, the aggregate impact on historical payroll reporting should be close to nil.

**Seriously-Flawed Headline Reporting of Jobs Growth and Unemployment Intensifies.** Both the September 2014 headline jobs growth of 248,000 and headline unemployment rate at 5.9% remained far removed from common experience and underlying reality. As discussed frequently in these *Commentaries*, common experience generally would suggest flat headline monthly payroll employment, plus or minus in September; with an unemployment rate, encompassing all short- and long-term discouraged workers, running above 23%.

As was evident again in September, headline employment gains were no more than statistical illusions resulting from hidden shifts in seasonal factors, and from phantom-jobs creation with the Birth-Death Model's upside bias factors (see the *Birth-Death/Bias-Factor Adjustment* and *Concurrent Seasonal Factor Distortions* sections for extended detail).

Further, as seen in September reporting, much of the improvement in the headline U.3 unemployment rate again reflected the BLS removal of discouraged workers, from the counts of the unemployed and the labor force (see *ShadowStats-Alternate Unemployment Rate*). Separately, month-to-month comparisons of these numbers have no meaning; they simply are not comparable thanks to the concurrent-seasonal-factor adjustment process as practiced by the BLS (see *Concurrent Seasonal Adjustment Distortions*).

A new issue has arisen as to the falsification of the household survey. Details on the related Congressional investigation are discussed in the *Opening Comments* section.

**PAYROLL SURVEY DETAIL.** Published today, October 3rd, by the Bureau of Labor Statistics (BLS), the seasonally-adjusted, month-to-month headline payroll-employment gain for September 2014 was 248,000 +/- 129,000 (95% confidence interval), above both trend and market expectations. The September gain followed a revised August gain of 180,000 (previously 142,000), and a July gain of 243,000 (previously 212,000, initially a 209,000 gain). The reported July gain, however, was an outright fraud by the BLS.

**Fraudulent Monthly Gains.** Frequently discussed here are the implications of the BLS use of concurrent-seasonal-adjustment factors, which restates seasonally-adjusted historical monthly payroll levels each-and-every month, as the new headline number is created in its own, unique seasonally-adjusted environment. The reporting fraud comes not from the adjustment process, but from the BLS not publishing the revised history each month, allowing for honest comparisons of the numbers.

In today's headline reporting, for example, only headline monthly changes for September and August were comparable with each other. Due to unreported historical revisions to June data from the seasonal-adjustment process generating the headline September number, the headline July change from June

actually was a gain of 225,000, based on consistent and comparable reporting, instead of the purported 243,000 increase.

Separately, as can be seen in the wild month-to-month revisions of the seasonally-adjusted data in the graph found in the *Concurrent Seasonal Factor Distortions* section, significant changes were made to historical September seasonal adjustments, indicating unusual distortions in the headline September 2014 that cannot be tracked, shy of a private recalculation of the series, as done by ShadowStats. The detail required for such calculations is available from the BLS, but only for the payroll reporting. The monthly unemployment-related detail from the troubled household survey simply is not comparable month-to-month, and there are no options for private recalculation on a consistent basis.

Where the current employment levels have been spiked by misleading and inconsistently-reported concurrent-seasonal-factor adjustments, the reporting issues suggest that a 95% confidence interval around the monthly headline payroll gain should be well beyond +/- 200,000 around the formal modeling of the headline gain, instead of the official +/- 129,000. Encompassing Birth-Death Model biases, it should be in excess of +/- 300,000.

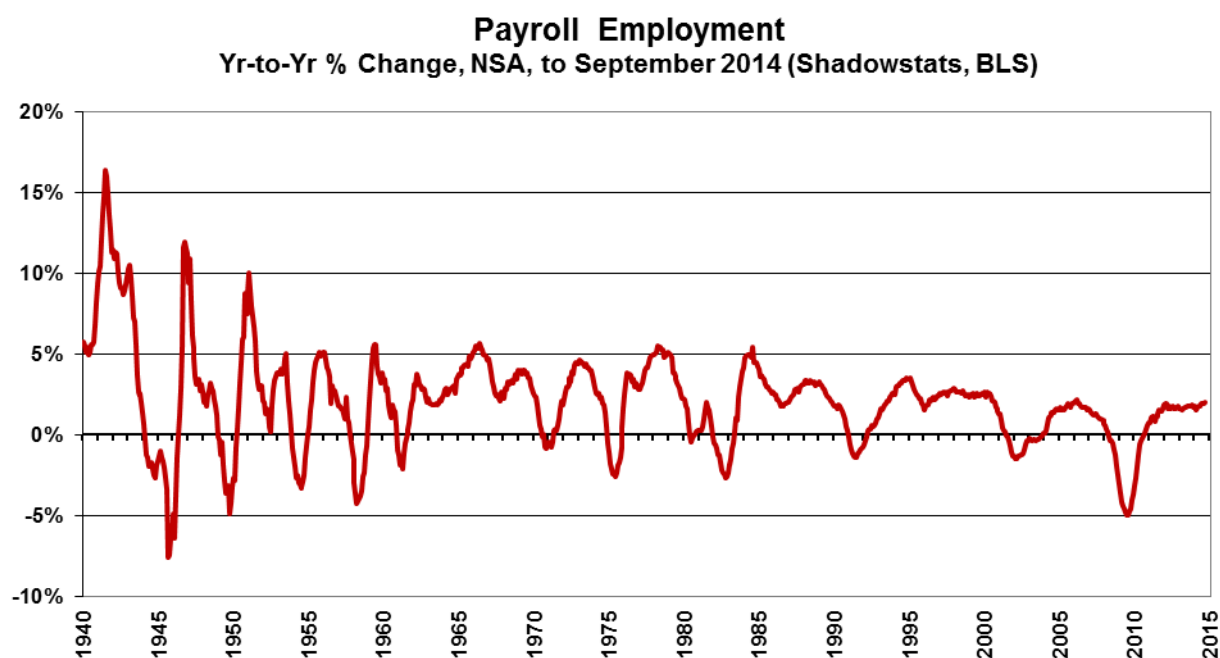
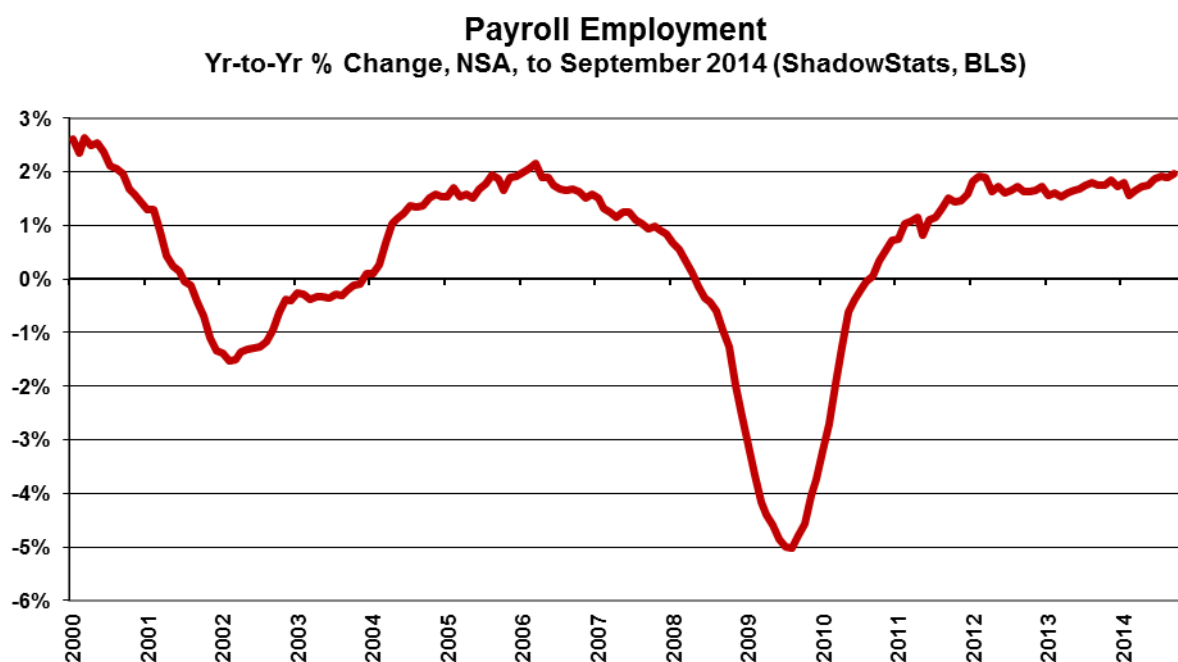
**“Trend Model” Estimate Suggests Slowing Payroll Growth in October.** As discussed in [Commentary No. 655](#), and as described generally in [Payroll Trends](#), the trend indication from the BLS’s concurrent-seasonal-adjustment model—prepared by our affiliate [www.ExpliStats.com](#)—was for a September 2014 monthly payroll gain of 225,000, based on the BLS trend model structured into August’s actual reporting. The late-consensus for September appears to have been about 210,000 to 215,000, where the headline gain came in at 248,000. Full detail on the headline payroll data, including various drill-down and graphics options are available to ShadowStats subscribers at ShadowStats-affiliate [www.ExpliStats.com](#).

**October Trend Estimate.** Based on the September 2014 BLS seasonal-adjustment modeling, the trend number calculations show an unusual downtrend for a headline gain of 180,000 in October 2014. The consensus outlook for October, eventually, most likely will settle-in around that number.

**Construction Payrolls.** In the context of a downside revision to August activity, headline September 2014 construction rose by 16,000 in the month. That was against a revised 16,000 (previously 20,000) gain in August, and a revised 30,000 (previously 31,000 (initially 22,000) gain in July. Total September 2014 construction jobs still were 21.3% shy of the pre-recession peak for the series in April 2006. The detail is plotted in the *Construction Spending* section

**Annual Change in Payrolls—New Post-Recession Growth Peak.** Not-seasonally-adjusted, year-to-year change in payroll employment is untouched by the concurrent-seasonal-adjustment issues, so the monthly comparisons of year-to-year change are reported on a consistent basis, although the redefinition of the series—not the standard benchmarking process—recently boosted reported annual growth in the last year, as discussed and graphed in the benchmark detail of [Commentary No. 598](#).

For September 2014, year-to-year or annual nonfarm payroll growth was 1.96%, which was a new post-recession high, versus revised annual growth of 1.89% (previously 1.84%) in August, and revised 1.93% (previously and initially 1.92%) annual growth in July 2014. Had the 2013 benchmark revision been standard, not a gimmicked redefinition, year-to-year jobs growth as of September 2014 would have been about 1.5%, consistent with near-term peak annual growth of about 1.9% in February 2012.



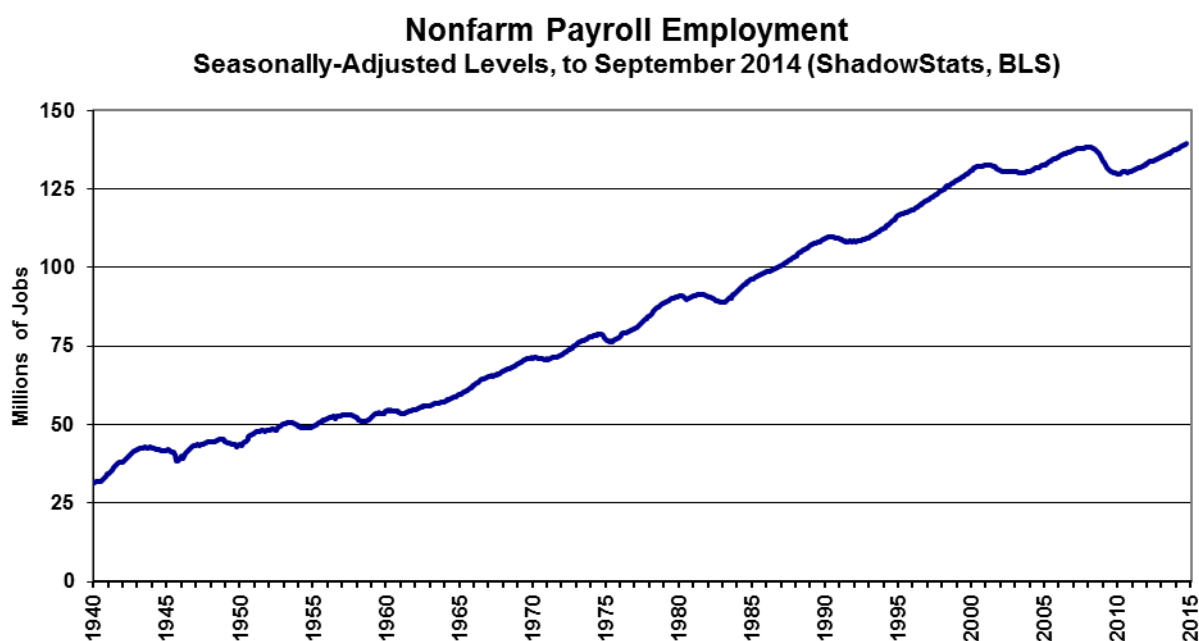
With bottom-bouncing patterns of recent years, current headline annual growth has recovered from the post-World War II record 5.02% decline seen in August 2009, as shown in the accompanying graphs. That 5.02% decline remains the most severe annual contraction since the production shutdown at the end of World War II (a trough of a 7.59% annual contraction in September 1945). Disallowing the post-war

shutdown as a normal business cycle, the August 2009 annual decline was the worst since the Great Depression.

**Historical Payroll Levels.** Headline payroll employment moved to above its pre-recession high in May 2014, and it has continued to rise, although, as discussed in the *Opening Comments*, the number of employed individuals had not reached that milestone until today's fortuitous reporting. The difference remains that the payroll survey count reflects the number of jobs, irrespective of how many jobs an individual holds. The household survey count of employment reflects the number of people who are employed, not the number of jobs.

The pattern of recovery in the payroll level count was redefined favorably with the January 2014 benchmarking, despite the actual benchmark having been negative. This can be seen in the shorter-term graph of payroll employment level (again see *Opening Comments*). The yellow points in that graph reflect the ShadowStats assessment of what payroll employment would be showing, with just a regular benchmarking, rather than the gimmicked redefinition of the series, which added a new upside bias. Even with what should have been a standard benchmarking, the pre-recession level was broken, as expected, with the September 2014 reporting.

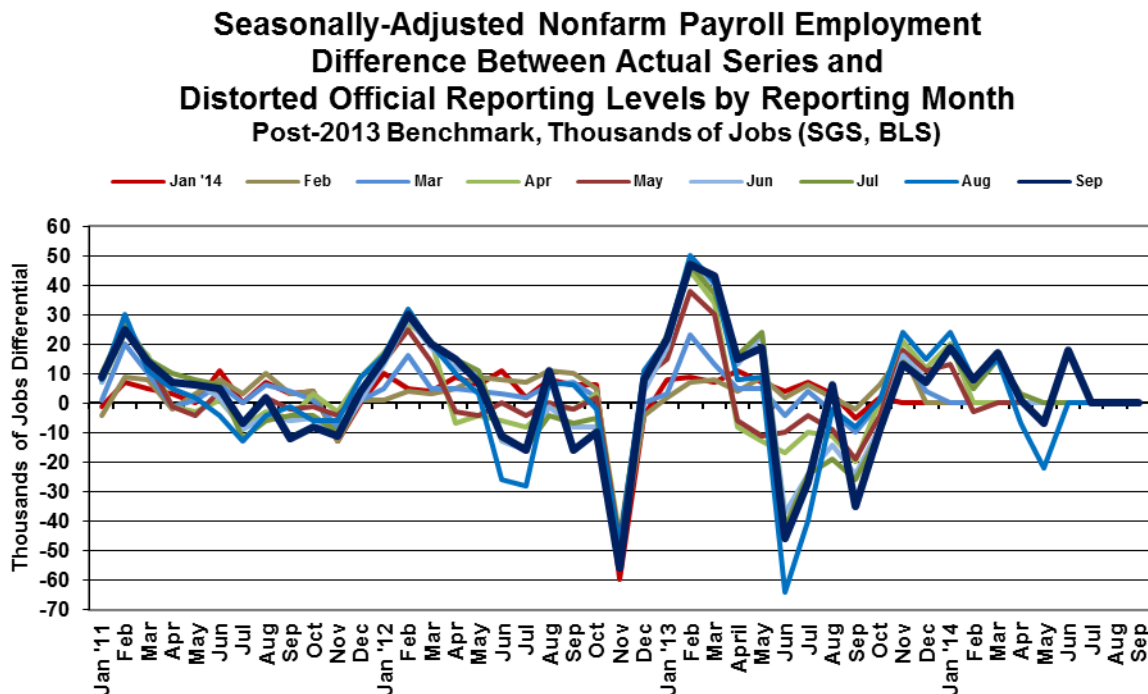
In perspective, the following longer-term graph of the headline-employment level shows the extreme duration of what had been the official non-recovery in payrolls, the worst such circumstance of the post-Great Depression era.



**Concurrent-Seasonal-Factor Distortions.** There are serious and deliberate reporting flaws with the government's seasonally-adjusted, monthly reporting of both employment and unemployment. Each

month, the BLS uses a concurrent-seasonal-adjustment process to adjust both the payroll and unemployment data for the latest seasonal patterns. As each series is calculated, the adjustment process also revises the monthly history of each series, recalculating prior reporting for every month, going back five years, on a basis that is consistent with the new seasonal patterns of the headline numbers.

The BLS, however, uses and publishes the current estimate, but it does not publish the revised history, even though it calculates the consistent new data each month. As a result, headline reporting generally is neither consistent with, nor comparable to earlier reporting, and month-to-month comparisons of these popular numbers usually are of no substance, other than for market hyping or political propaganda.



The BLS explains that it avoids publishing consistent, prior-period revisions so as not to “confuse” its data users. No one seems to mind if the published earlier numbers are wrong, particularly if unstable seasonal-adjustment patterns have shifted prior jobs growth or reduced unemployment into current reporting, without any formal indication of the shift from the previously-published historical data. The preceding, accompanying graph shows how far the monthly data have strayed from being consistent, as of the latest September 2014 reporting, versus the most recent benchmark revision to the series. Note the shifting patterns coming into the current reporting, and the sharp downside revision to September 2013, which has an implied parallel in the seasonals for September 2014.

*Note: Issues with the BLS’s concurrent-seasonal-factor adjustments and related inconsistencies in the monthly reporting of the historical time series are discussed and detailed further in the ShadowStats.com posting on May 2, 2012 of [Unpublished Payroll Data](#).*



***Birth-Death/Bias-Factor Adjustment.*** Despite the ongoing, general overstatement of monthly payroll employment, the BLS adds in upside monthly biases to the payroll employment numbers. The continual overstatement is evidenced usually by regular and massive, annual downward benchmark revisions (2011 and 2012, excepted). As discussed in the benchmark detail of [Commentary No. 598](#), the regular benchmark revision to March 2013 payroll employment was to the downside by 119,000, where the BLS had overestimated standard payroll employment growth. At the same time, the BLS separately redefined the payroll survey so as to include 466,000 workers who had been in a category not previously counted in payroll employment. The latter event was little more than a gimmicked, upside fudge-factor, used to mask the effects of the regular downside revisions to employment surveying, and likely is the excuse behind the increase in the annual bias factor, where the new category cannot be surveyed easily or regularly by the BLS. The preliminary announcement of the 2014 benchmark revision was for relatively insignificant upside adjustment of 7,000 (see [Commentary No. 660](#)).

Indeed, particularly unusual here is that despite the BLS modeling having overstated jobs creation through March 2013 by 119,000, adjustment to the annual upside biases added into payroll estimation process each month, thereafter, was increased by about 150,000 on an annual basis, instead of being reduced, which would have been expected otherwise (see short-term graph of nonfarm payrolls and comments on payroll levels in the *Opening Comments*).

Historically, the upside-bias process was created simply by adding in a monthly “bias factor,” so as to prevent the otherwise potential political embarrassment to the BLS of understating monthly jobs growth. The “bias factor” process resulted from such an actual embarrassment, with the underestimation of jobs growth coming out of the 1983 recession. That process eventually was recast as the now infamous Birth-Death Model (BDM), which purportedly models the effects of new business creation versus existing business bankruptcies.

***September 2014 Bias.*** The not-seasonally-adjusted September 2014 bias was a monthly add-factor of minus 26,000 (-26,000), versus what was (post-2013 benchmark) a minus 30,000 (-30,000) bias in September 2013, versus a plus 102,000 add-factor in August 2014. The aggregate upside bias for the trailing twelve months was 744,000, from the pre-benchmark 624,000 twelve-month aggregate as of December 2013, or to a monthly average of 62,000 (52,000 pre-benchmark) jobs created out of thin air, on top of some indeterminable amount of other jobs that are lost in the economy from business closings. Those losses simply are assumed away by the BLS in the BDM, as discussed below.

***Problems with the Model.*** The aggregated upside annual reporting bias in the BDM reflects an ongoing assumption of a net positive jobs creation by new companies versus those going out of business. Such becomes a self-fulfilling system, as the upside biases boost reporting for financial-market and political needs, with relatively good headline data, while often also setting up downside benchmark revisions for the next year, which traditionally are ignored by the media and the politicians. Where the BLS cannot measure meaningfully the impact of jobs loss and jobs creation from employers starting up or going out of business, on a timely basis (within at least five years, if ever), or by changes in household employment that just have been incorporated into the redefined payroll series, such information is guesstimated by the BLS along with the addition of a bias-factor generated by the BDM.

Positive assumptions—commonly built into government statistical reporting and modeling—tend to result in overstated official estimates of general economic growth. Along with these happy guesstimates, there usually are underlying assumptions of perpetual economic growth in most models. Accordingly, the

functioning and relevance of those models become impaired during periods of economic downturn, and the current, ongoing downturn has been the most severe—in depth as well as duration—since the Great Depression.

Indeed, historically, the BDM biases have tended to overstate payroll employment levels—to understate employment declines—during recessions. There is a faulty underlying premise here that jobs created by start-up companies in this downturn have more than offset jobs lost by companies going out of business. Recent studies have suggested that there is a net jobs loss, not gain, in this circumstance. So, if a company fails to report its payrolls because it has gone out of business (or has been devastated by a hurricane), the BLS assumes the firm still has its previously-reported employees and adjusts those numbers for the trend in the company's industry.

Further, the presumed net additional “surplus” jobs created by start-up firms are added on to the payroll estimates each month as a special add-factor. These add-factors are set now to add an average of 62,000 jobs per month in the current year. In current reporting, the aggregate average overstatement of employment change easily exceeds 200,000 jobs per month.

***HOUSEHOLD SURVEY DETAILS.*** Generally, the seasonally-adjusted household-survey data are meaningless in terms of month-to-month changes or comparisons. The monthly concurrent-seasonal-factor adjustment process used in generating the headline numbers regenerates all seasonal factors every month, unique to the most-recent month. Yet, the revamped and consistent historical detail is not published, except once per year, in December. All the historical data shift anew with subsequent monthly reporting, but that new consistent detail never is published.

Where, for example, the seasonally-adjusted headline unemployment rate for September 2014 of 5.94% was based on a set of seasonal adjustments unique to September 2014, and the adjusted unemployment rate for August was revised along with the September seasonal-adjustment calculations, the new historical and comparable result for August was not, and never will be, published. The prior headline reporting of 6.15% (rounds to 6.1%) for the August 2014 unemployment rate remained in place, although it now is inconsistent and not comparable with the September 2014 number, even though the consistent August estimation is available internally to the BLS. This is true for every month going back for at least five years of BLS accounting, and it is done deliberately by the BLS, even though the consistent and comparable, historical data are calculated by and known to the Bureau.

***Headline Household Employment.*** The household survey counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including multiple job holders more than once). Covered in the *Opening Comments*, headline employment just recovered its pre-recession high by 5,000, in this final pre-election labor report.

On a not comparable basis, headline September 2014 employment rose by 232,000, following an unrevised and again not comparable 16,000 gain in August. The employment changes were in the context of a decline in unemployment of 329,000 (-329,000) in September, following an 80,000 (-80,000) decline in August. With the headline September labor force declining by 97,000 (-97,000) in September, and by 64,000 (-64,000) in August, much of the so-called reduction in unemployment has continued to be individuals leaving the labor force, as opposed to finding jobs.

Again, though, the reporting here is virtually worthless. The household-survey numbers are highly volatile and unstable, inadequately defined in that they do not reflect common experience, and simply are not comparable on a month-to-month basis.

**Headline Unemployment Rates.** In the context of the preceding background, the headline September 2014 unemployment (U.3) rate declined by 0.21-percentage point (-0.21%) to 5.94%, from 6.15% (again, rounds to 6.1%) in August.

Technically that was not a statistically-significant change, although it was close, where the official 95% confidence interval around the monthly change in headline U.3 is +/- 0.23-percentage point. That is meaningless, however, in the context of the comparative month-to-month reporting-inconsistencies created by the concurrent seasonal factors, let alone new questions as to overall survey significance.

On an unadjusted basis, the unemployment rates are not revised and at least are consistent in reporting methodology. September's unadjusted U.3 unemployment rate declined to 5.7% from 6.3% in August.

**U.6 Unemployment Rate.** The broadest unemployment rate published by the BLS, U.6 includes accounting for those marginally attached to the labor force (including short-term discouraged workers) and those who are employed part-time for economic reasons (*i.e.*, they cannot find a full-time job).

With a minor seasonally-adjusted decline in people working part-time for economic reasons, and a decline in short-term (unadjusted) discouraged workers, headline September 2014 U.6 unemployment declined to 11.8% in September 2014 from 12.0% in August 2014. The unadjusted U.6 declined to 11.3% in September, from 12.0% in August.

**Discouraged Workers.** The count of short-term discouraged workers in September 2014 (never seasonally-adjusted) eased to 698,000, from 775,000 in August, versus 741,000 in July, 676,000 in June 2014, and 697,000 in May 2014. The current, official discouraged-worker number reflected the flow of the unemployed—increasingly giving up looking for work—leaving the headline U.3 unemployment category and being rolled into the U.6 measure as short-term “discouraged workers,” net of the increasing number of those moving from short-term discouraged-worker status into the netherworld of long-term discouraged-worker status.

It is the long-term discouraged-worker category that defines the ShadowStats-Alternate Unemployment Measure. There appears to be a relatively heavy, continuing rollover from the short-term to the long-term category, with the ShadowStats measure encompassing U.6 and the short-term discouraged workers, plus the long-term discouraged workers.

In 1994, “discouraged workers”—those who had given up looking for a job because there were no jobs to be had—were redefined so as to be counted only if they had been “discouraged” for less than a year. This time qualification defined away a large number of long-term discouraged workers. The remaining short-term discouraged workers (those discouraged less than a year) were included in U.6.

**ShadowStats-Alternate Unemployment Rate.** Adding back into the total unemployed and labor force the ShadowStats estimate of the growing ranks of excluded, long-term discouraged workers, broad unemployment—more in line with common experience, as estimated by the ShadowStats-Alternate Unemployment Measure—notched lower to 23.1% in September 2014, from 23.2% in August and July, versus 23.1% in June, and at 23.2% for the prior five months. That still was down minimally from 23.4%

in October 2013, which was the series high (back to 1994). The ShadowStats estimate reflects the increasing toll of unemployed leaving the headline labor force. Where the ShadowStats-Alternate estimate generally is built on top of the official U.6 reporting, it tends to follow its relative monthly movements and its annual revisions. Accordingly, the alternate measure often will suffer some of the same seasonal-adjustment woes that afflict the base series, including underlying annual revisions.

*[The remaining text in this Household Survey section is unchanged from the Commentary covering the September 2014 labor data.]* As seen in the usual graph of the various unemployment measures (in the *Opening Comments*), there continues to be a noticeable divergence in the ShadowStats series versus U.6, and the ShadowStats series and U.6 versus U.3. The reason for this is that U.6, again, only includes discouraged workers who have been discouraged for less than a year. As the discouraged-worker status ages, those that go beyond one year fall off the government counting, even as new workers enter “discouraged” status. A similar pattern of U.3 unemployed becoming “discouraged” and moving into the U.6 category also accounts for the early divergence between the U.6 and U.3 categories.

With the continual rollover, the flow of headline workers continues into the short-term discouraged workers category (U.6), and from U.6 into long-term discouraged worker status (a ShadowStats measure). There was a lag in this happening as those having difficulty during the early months of the economic collapse, first moved into short-term discouraged status, and then, a year later into long-term discouraged status, hence the lack of earlier divergence between the series. The movement of the discouraged unemployed out of the headline labor force has been accelerating. While there is attrition in long-term discouraged numbers, there is no set cut off where the long-term discouraged workers cease to exist. See the [Alternate Data](#) tab for historical detail.

Generally, where the U.6 largely encompasses U.3, the ShadowStats measure encompasses U.6. To the extent that the decline in U.3 reflects unemployed moving into U.6, or the decline in U.6 reflects short-term discouraged workers moving into the ShadowStats number, the ShadowStats number continues to encompass all the unemployed, irrespective of the series from which they otherwise may have been ejected.

Two further related graphs, also found in the *Opening Comments* section, are of the ShadowStats-Alternate Unemployment Measure, with an inverted scale, the employment-to-population ratio, which has a high correlation with the inverted ShadowStats measure.

**Great Depression Comparisons.** As discussed in the regular *Commentaries* covering the monthly unemployment circumstance, an unemployment rate above 23% might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%. Hard estimates of the ShadowStats series are difficult to generate on a regular monthly basis before 1994, given the reporting inconsistencies created by the BLS when it revamped unemployment reporting at that time. Nonetheless, as best estimated, the current ShadowStats level likely is about as bad as the peak actual unemployment seen in the 1973-to-1975 recession and in the double-dip recession of the early-1980s.

The Great Depression unemployment rate of 25% was estimated well after the fact, with 27% of those employed working on farms. Today, less than 2% of the employed work on farms. Accordingly, a better measure for comparison with the ShadowStats number would be the Great Depression peak in the nonfarm unemployment rate in 1933 of roughly 34% to 35%.

## U.S. TRADE BALANCE (August 2014)

**August Trade Deficit Indicated Likely Boost to Third-Quarter GDP.** In the context of a minor revision narrowing the nominal monthly trade deficit in July, the headline August deficit narrowed slightly for the month. Adjusted for inflation, the July and August trade-deficit details will be used to estimate third-quarter performance of the net-export account, as part of the "advance" estimate of third-quarter GDP growth on October 30th (the last GDP and last major economic release before the November 4th election). Discussed in the *Real Trade Deficit* section, the growth contribution from the estimated quarterly trade deficit should be a positive one, likely adding 0.5% or more to headline GDP growth.

**Nominal (Not-Adjusted-for-Inflation) August 2014 Trade Deficit.** The Bureau of Economic Analysis (BEA) and the Census Bureau reported today, October 3rd, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for August 2014, on a balance-of-payments basis, narrowed to \$40.109 billion from a revised \$40.321 (previously \$40.546) billion in July. The August 2014 monthly trade deficit, however, widened versus a \$39.515 billion deficit in August 2013.

The minor narrowing of the August 2014 deficit versus the July 2014 number was no more than statistical noise and reflected minor, largely offsetting increases in both aggregate monthly exports and imports.

The ongoing trend should be for significant monthly, quarterly and annual deterioration in the U.S. trade deficit, both before and after adjustment for inflation. Look for a sharp widening of the deficit in September along with a revised widening to August data in the next reporting. That will be post-election and will tend to reduce, in revision, whatever headline growth rate will be reported for the "advance" estimate of third-quarter 2014 GDP.

**Energy-Related Petroleum Products.** For August 2014, the not-seasonally-adjusted average price of imported oil declined to \$96.32 per barrel, from \$97.81 in July, and was down from \$100.27 per barrel in August 2013. Also not-seasonally-adjusted, physical oil import volume in August 2014 averaged 6.947 million barrels per day, down from 7.701 million in July, and down from 7.747 million in August 2013.

**Ongoing Cautions on Data Quality.** Potentially heavy distortions in headline data continue from seasonal adjustments. Similar issues are seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. Discussed frequently (see [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#) for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not rely heavily on the accuracy of the monthly headline data.

**Real (Inflation-Adjusted) August 2014 Trade Deficit.** Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, used for GDP deflation), the August 2014 merchandise trade deficit (no services) widened slightly to \$47.893 billion from a revised \$47.784 (previously \$48.177) billion in July, and widened versus \$47.653 billion in August 2013. With the first-two months of the third-quarter 2014 trade deficit in place—the only two months that will be published for the third-quarter in advance of the initial estimate of third-quarter GDP—today's detail set a positive tone for the pending, "advance" GDP report.



Consistent with today's headline August reporting, the annualized quarterly real merchandise trade deficit stood at \$554.7 billion as of fourth-quarter 2013, at \$591.0 billion as of first-quarter 2014, and at \$619.3 for second-quarter 2014. Based on the July and August reporting, real merchandise trade deficit currently annualizes out at \$574.1 billion for third-quarter 2014, a meaningful narrowing of trade shortfall versus second-quarter 2014, and a solid boost for the initial third-quarter GDP growth estimate.

Not all of the relative trade deterioration seen in second-quarter 2014, however, ended up appropriately in offsetting other areas of heavily-overstated growth in headline second-quarter GDP reporting (see prior [Commentary No. 662](#)). Accordingly, the magnitude of the likely impact on third-quarter GDP growth is somewhat open to question, but it would exceed a 0.5% positive contribution to the annualized headline growth rate in normal circumstances.

## CONSTRUCTION SPENDING (August 2014)

### **August Construction Spending Drop Was Minimized by Sharp Downside Revision to July Activity.**

Construction spending declined by 0.8% (-0.8%) for the month of August 2014, but that followed sharp downside revisions to previously-estimated activity in June and July. Against initial reporting for July 2014, August sales dropped by an unusually-steep 2.1% (-2.1%), and growth slowed sharply on a year-to-year basis, from 8.2% to 5.0%. All that was before any adjustment for rising inflation.

Net of inflation, as shown in the accompanying graph, activity has been trending lower since late-2013, with real (inflation-adjusted) activity in the two months reported so far in third-quarter 2014, virtually unchanged from real activity in second-quarter 2014.

**PPI New Construction Index (NCI)—Well Shy of Reality.** There is no perfect inflation measure for deflating construction, but the PPI's New Construction Index (NCI) remains the closest found in publicly-available series. The NCI's only benefit over the "final demand construction" inflation number in the PPI is that it has a lengthy history, which enables placing the adjusted data in historical perspective. Both the final-demand and private-survey measures, however, tend to be more closely linked to real-world activity and have been showing higher annual construction costs than seen in the government's NCI data.

Even so, using the PPI's NCI as the deflator still shows real construction spending to have been in ongoing downtrend reporting, from 2013 into 2014.

**PPI Final Demand Construction Inflation (FDC)—More Realistic, Inadequate History, Still Shy of Reality.** In contrast to the NCI's headline construction inflation for August, up by 0.1% month-to-month, and up by 1.6% year-to-year, the headline Final Demand Construction (FDC) inflation for August was unchanged month-to-month, but up by 3.1% year-to-year. The FDC, however, along with the recently redefined PPI series has a history that has been estimated/constructed by the Bureau of Labor Statistics (BLS) going back less than five years. The historical data all are post-2008 financial panic and after the economic collapse, which makes the series of limited value for purposes of historical analysis.

**Headline Reporting for August 2014.** The Census Bureau reported October 1st that the headline, total value of construction put in place in the United States for August 2014 was \$961.0 billion, on a seasonally-adjusted—but not-inflation-adjusted—annual-rate basis. That estimate was down month-to-month by a statistically-insignificant 0.8% (-0.8%) +/- 2.1% (all confidence intervals are at the 95%



level). That followed a revised \$968.8 (previously \$981.3) billion level of activity in July, which was up by a revised 1.2% (previously up by 1.8%) from a revised level of \$957.1 (previously \$963.7, initially \$950.2) billion level in June spending. In turn, the contraction in June spending revised to a monthly decline of 1.6% (-1.6%) [previously down by 0.9% (-0.9%), initially down by 1.8% (-1.8%)] versus May.

Adjusted for the NCI inflation measure in the PPI (see the PPI comments), aggregate real spending in August 2014 was down month-to-month by 0.9% (-0.9%), versus a revised monthly gain of 1.2% (previously 1.8%) in July.

On a year-to-year or annual-growth basis, August 2014 construction spending rose by a statistically-significant 5.0% +/- 2.7%, versus a revised 6.9% (previously 8.2%) gain July. Net of construction costs indicated by the NCI, year-to-year growth in spending was 3.3% in August, versus a revised 4.8% (previously 6.1%) in July. Again, more-realistic private surveying suggests annual costs to be up by enough to come close to turning some of those annual construction-spending growth rates flat or into annual contractions.

The statistically-insignificant 0.8% (-0.8%) monthly decline in August 2014 construction spending, versus the 1.2% gain in July, included a 0.9% (-0.9%) drop in August public spending, versus a 2.1% gain in July. August private construction fell by 0.8% (-0.8%) for the month, versus a 0.9% gain in July.

The following graphs reflect latest extended detail. The headline 0.8% (-0.8%) decline in August total construction, encompassed private residential construction down by 0.1% (-0.1%), private nonresidential construction down by 1.4% (-1.4%), and public construction down by 0.9% (-0.9%). Also reflected is the downwardly revised headline 1.2% monthly gain in July total construction, with private residential construction up by 0.4%, private nonresidential construction up by 1.3%, and public construction up by 2.1%.

**Construction and Related Graphs.** The first two graphs following reflect total construction spending through August 2014, both in the headline nominal dollar terms, and in real terms, after inflation adjustment. The inflation-adjusted graph is on an index basis, with January 2000 = 100.0. Adjusted for the PPI's NCI measure, real construction spending showed the economy slowing in 2006, plunging into 2011, then turning minimally higher in an environment of low-level stagnation and now showing some pullback in the most recent reporting.

**Total Construction Spending, Monthly to August 2014**  
**Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)**



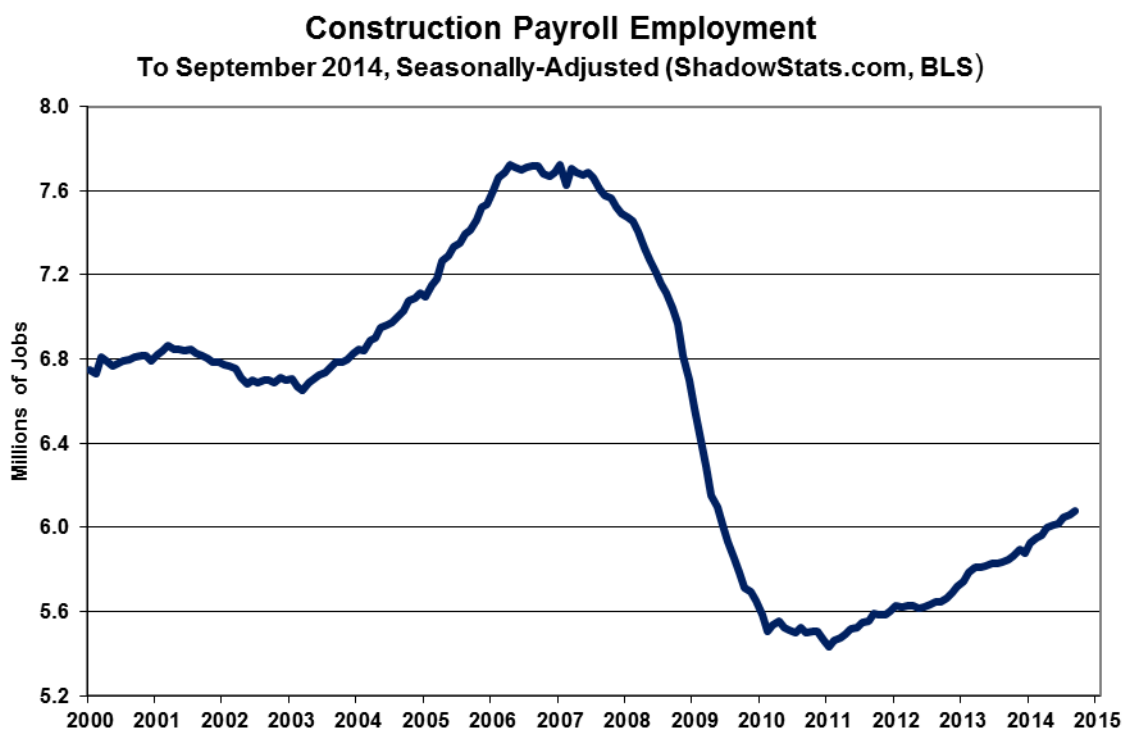
**Real Index of Value of Construction Put in Place**  
**To August 2014, Inflation-Adjusted (Jan 2000=100)**  
**Deflated by the PPI New Construction Index**  
**(Sources: ShadowStats.com, Census Bureau, BLS)**

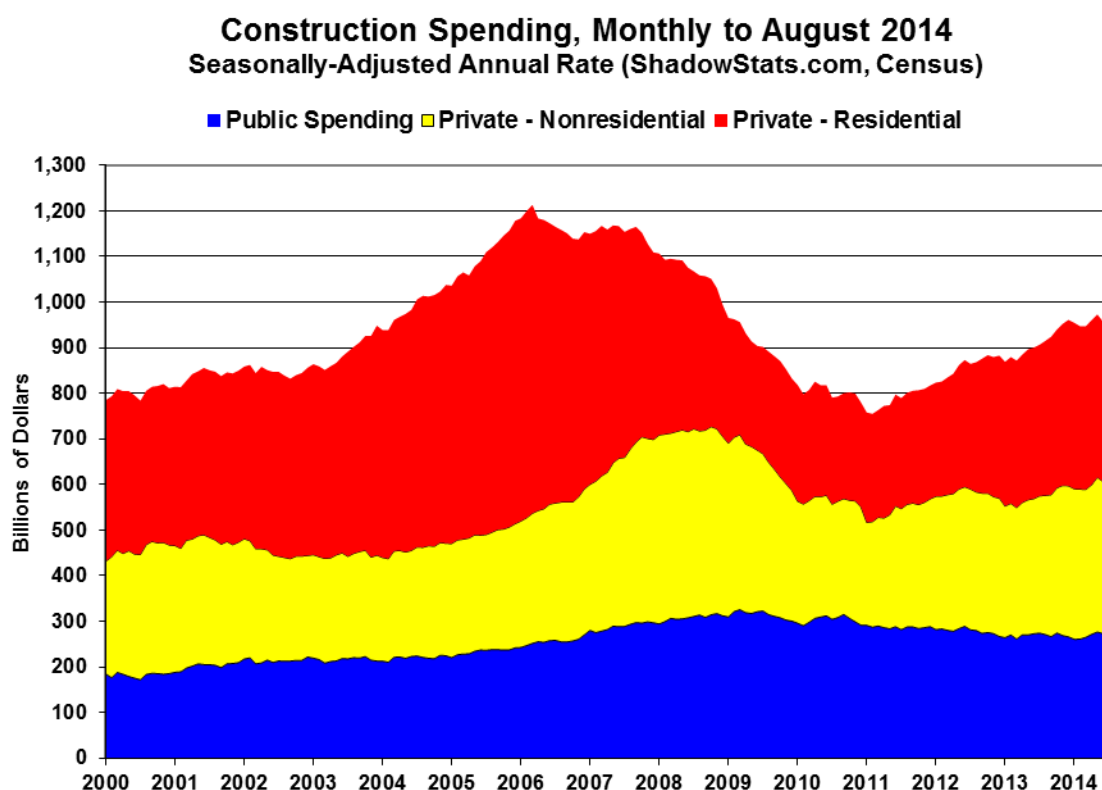


The pattern of inflation-adjusted activity here—net of government inflation estimates—does not confirm the economic recovery indicated by the headline GDP series (see prior [Commentary No. 662](#)). To the contrary, the latest construction reporting, both before (nominal) and more prominently after (real) inflation adjustment, shows a pattern of down trending stagnation, as reflected in the preceding two graphs.

The first of the two following graphs reflects today's (October 3rd) reporting of September 2014 construction employment. The monthly numbers are detailed in the *Employment Section*, with headline construction jobs gaining 16,000 in September. In theory, payroll levels should move more closely with the inflation-adjusted aggregate series, where the nominal series reflects the impact of costs and pricing, as well as a measure of the level of physical activity. Nonetheless, the heavily-upside-biased construction payroll numbers (officially bloated by 5,000 jobs per month, unofficially at an order of magnitude of 20,000 jobs per month), as well as the heavily-guessed-at related construction activity in the GDP, have been running counter to the most other recent indications of construction activity, including real August 2014 construction spending detailed here.

The second graph following shows total nominal construction spending, broken out by the contributions from total-public (blue), private-nonresidential (yellow) and private-residential spending (red).

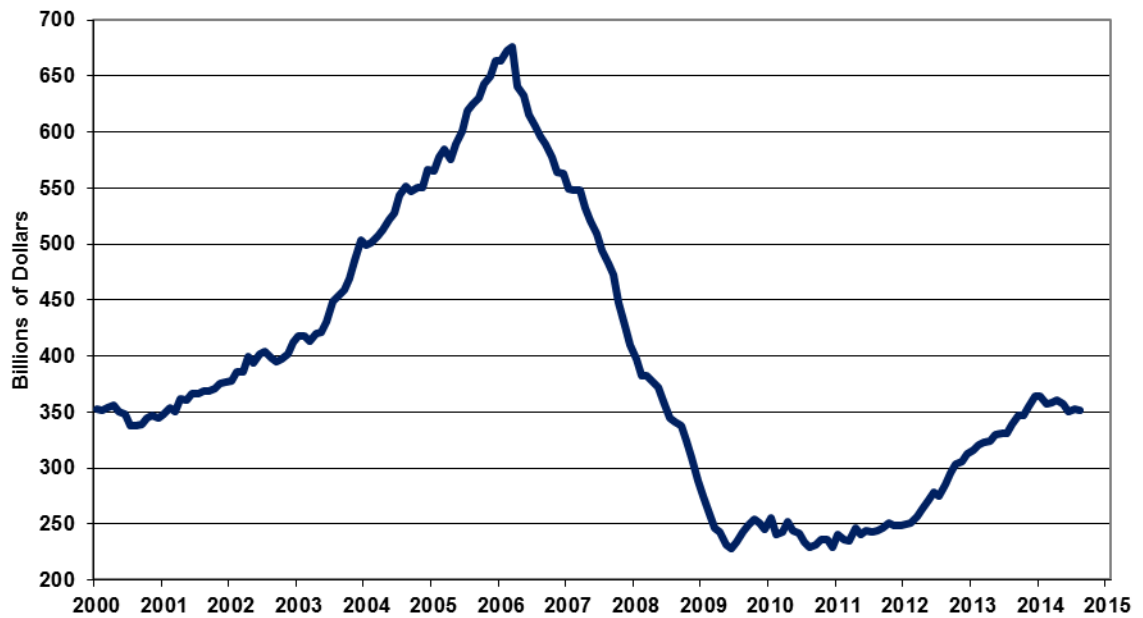




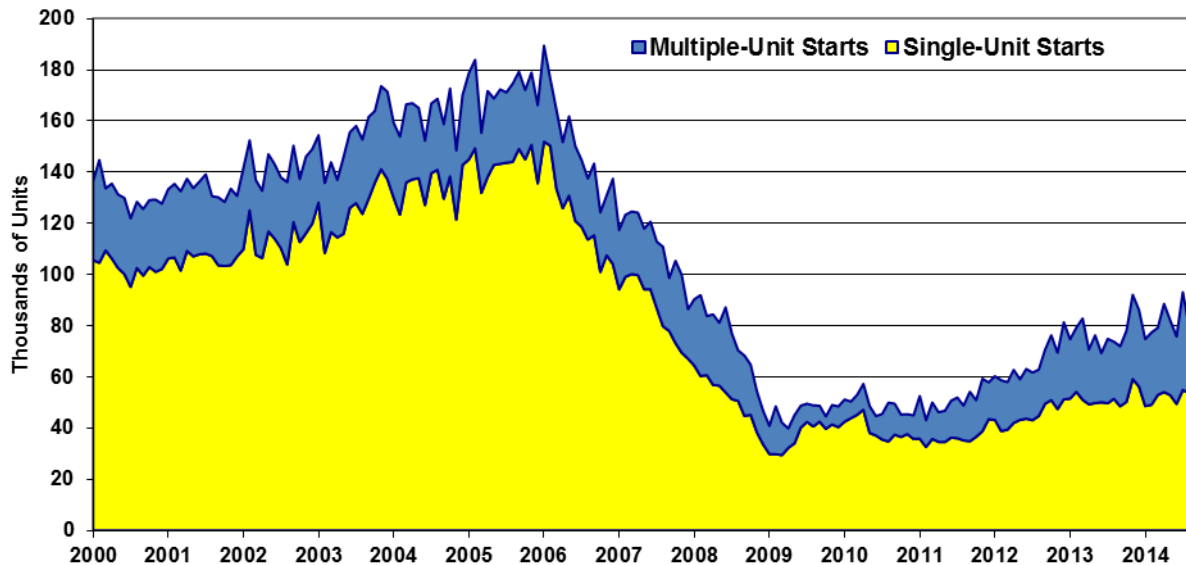
The next two graphs following cover private residential construction along with housing starts (single- and multiple-unit starts) for August (see [Commentary No. 660](#)). Keep in mind that the construction spending series is in nominal (not-adjusted-for-inflation) dollars, while housing starts reflect unit volume, which should tend to be more parallel to the real (inflation-adjusted) series. Where the private residential construction spending had been in recent upturn through most of 2013, that now has turned lower, trending to the downside in 2014, even before adjustment for inflation.

The final set of two graphs, the third and fourth, following, show the patterns of the monthly level of activity in private nonresidential construction spending and in public construction spending. The spending in private nonresidential construction remains well off its historic peak, but had bounced higher off a secondary, near-term dip in late-2012, and then heading higher, again, with a topping pattern seen recently. Public construction spending, which is 98% nonresidential, has continued in a broad downtrend with intermittent bouts of fluttering stagnation and some upturn, most recently.

**Private Residential Construction to August 2014**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)



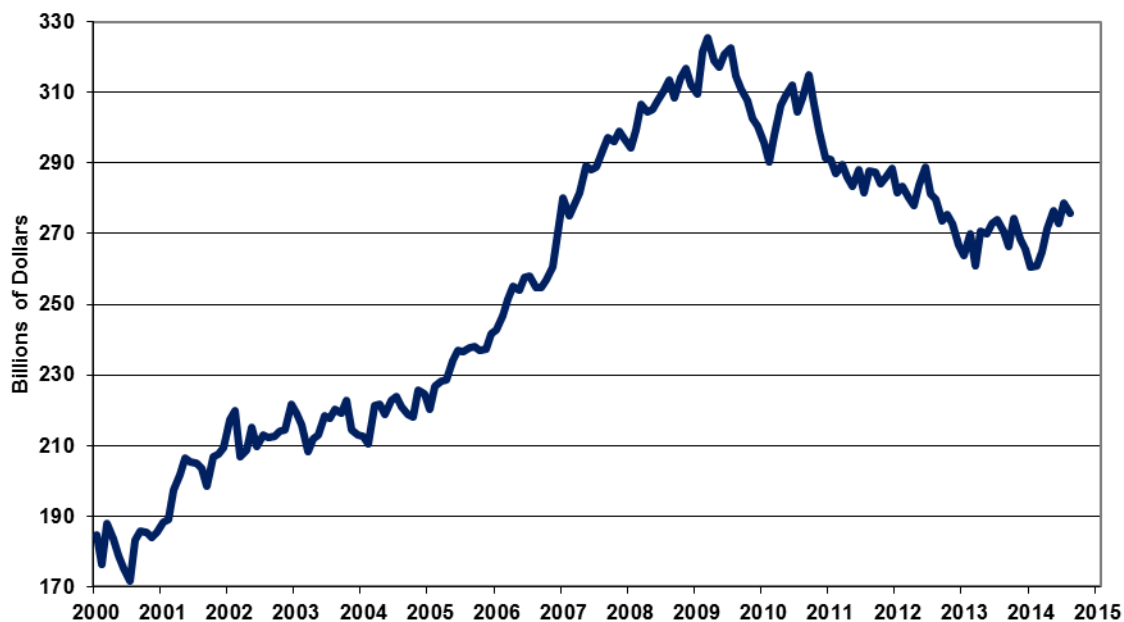
**Single- and Multiple-Unit Housing Starts (Monthly Rate)**  
To August 2014, Seasonally-Adjusted (ShadowStats.com, Census)



**Nonresidential Construction, Monthly to August 2014**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)



**Public Construction, Monthly to August 2014**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)





**WEEK AHEAD: NO MAJOR ECONOMIC RELEASES**

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