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

COMMENTARY NUMBER 671
September Trade Deficit and Construction Spending

November 4, 2014

The Happy News Begins to Falter

**Third-Quarter GDP Growth Faces Downside Revision,
Given Deteriorating September Trade and Construction Reporting**

Trade Deficit Widened Sharply

Quarterly Construction Spending Growth Turned Negative from Positive

Risk of Unexpectedly Weak October Payrolls

**Craziness in the Financial Markets Cannot Prevail,
Assumed Underlying Reality Is Not There or Will Prove Fleeting**

PLEASE NOTE: The next regular Commentary *is planned for Friday, November 7th, covering October employment and unemployment, and M3.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

September Reporting Begins to Pummel Purported GDP Strength. September headline reporting for the trade deficit and construction spending, and accompanying revisions to prior detail, showed weaker economic activity than had been guessed at by the Bureau of Economic Analysis (BEA) in its "advance"

estimate of third-quarter GDP growth, published October 31st (see *Commentary No. 670*). So far, the November 25th "first revision" to that growth estimate is shaping up as a meaningfully-negative one, likely to knock the current headline 3.5% annualized growth number to well below 2.0%. By themselves, the new September trade and construction numbers should reduce the aggregate headline GDP growth rate by about 0.8%. Significant further downside revisions likely will become evident in the weeks ahead.

Given the happy hype of a booming U.S. economy, and a suddenly-virtuous Federal Reserve in play versus a promiscuous Japanese central bank, the markets have turned to a new level of insanity. The foreign exchange rate of U.S. dollar and domestic equity prices have soared; gold and silver prices have plummeted. These patterns should reverse massively as the strong-economy and virtuous-Fed canards quickly lose their credibility.

Actual underlying activity in the U.S. economy and underlying systemic stability never recovered from the 2008 Panic. The economy is turning down anew, and that means added stress for the still-troubled domestic banking system. The United States has the same, if not worse, economic and systemic issues as seen in Japan and Europe, it is just that the Fed and the U.S. have been masking their problems somewhat better than have the others. Soon enough, the Fed will find (likely already knows) that it still will have to provide systemic liquidity, going forward, either overtly or covertly.

Of particular near-term discomfort to the overly-joyous markets should be a rapid deterioration in post-election economic reporting and a significant downside shift in related consensus perceptions on business activity. Next up is Friday's (November 7th) report of October employment and unemployment. As discussed in the *Week Ahead* section, the internal trend modeling of the Bureau of Labor Statistics (BLS) for October payrolls shows an unusually low expected-headline number versus consensus expectations. The BLS trend is 60,000 jobs below consensus, and therein lies risk of a major downside reporting surprise.

Various market conditions will be discussed further in the Friday (November 7th) *Commentary*, post-election and post-payroll reporting.

Today's Missive (November 4th). The *Hyperinflation Summary Outlook* is unchanged, but it will be updated along with *Commentary No. 672* of November 7th. The balance of today's *Commentary* concentrates on the reporting details of the September 2014 trade deficit and September 2014 construction spending.

Trade Deficit—September 2014—Third-Quarter Net-Export Account Improvement Was Overstated. With initial, full reporting of trade deficit details for the third-quarter 2014 now in place, the 3.5% headline GDP "advance" estimate of annualized growth should revise lower by about 0.4%, based solely on the new and revised trade data. Further downside revisions also are likely from next month's reporting. The aggregate GDP first revision (November 25th) will be subject to a number of factors, including another roughly 0.4% hit to headline growth from the September construction spending detail and revisions, as covered separately in this *Commentary*.

Nominal (Not-Adjusted-for-Inflation) September 2014 Trade Deficit. The nominal, seasonally-adjusted monthly trade deficit in goods and services for September 2014, on a balance-of-payments basis, widened

to $43.032 billion, from a revised $39.991 billion in August, and from an unrevised $42.263 billion deficit in September 2013.

The $3.0 billion widening of the September 2014 deficit versus August 2014 reflected roughly a $3.0 billion drop in September exports, versus an unchanged level in September 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 headline deficit, again, in the October reporting, along with further revised widening to third-quarter real data.

Real (Inflation-Adjusted) September 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 September 2014 merchandise trade deficit (no services) widened sharply to $50.759 billion, from a revised August 2014 deficit of $48.221 billion, and a revised $47.737 billion deficit in July. In terms of year-to-year comparison, the September 2014 reading widened to $50.759 billion, from $50.401 billion in September 2013.

With the initial reporting of the full three months of the third-quarter 2014 trade deficit now in place, today's detail set a negative tone for the pending November 25th "first revision" to the growth estimate of third-quarter 2014 GDP. The "advance" third-quarter GDP estimate was based on only July and August reporting.

Consistent with today’s headline September 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 a revised $619.9 (previously $619.3) billion for second-quarter 2014. With full reporting, the real merchandise trade deficit for third-quarter 2014 annualized out at $586.9 billion, versus the prior estimate of $574.1 billion based on just the July and August reporting.

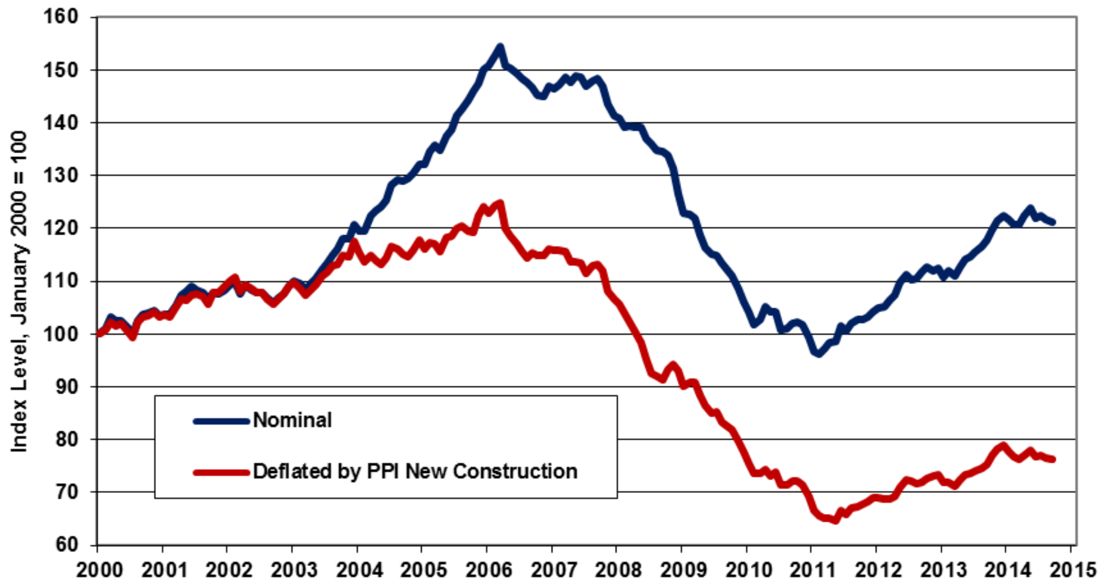
Although there still is a meaningful real merchandise trade deficit narrowing in the headline third-quarter 2014 reporting, versus the second-quarter, that annualized deficit narrowing was reduced by about 27% in today's reporting and revisions. The initial estimate of the narrowing of the third-quarter trade shortfall contributed 1.32% of the 3.55% (rounds to 3.5%) headline gain in third-quarter GDP (see *Commentary No. 670*). Given the guesstimation involved with the official massaging of these merchandise trade numbers into the headline GDP reporting, one could expect a rough reduction in the headline third-quarter GDP growth rate approximating 0.4%, just as a result of today's new trade detail.

Construction Spending—August 2014—Tumbled in September, in Prior-Period Revisions and for Third-Quarter 2014. As with the trade numbers, full reporting of third-quarter 2014 construction spending detail now shows that the 3.5% headline GDP "advance" estimate of annualized growth should revise to the downside. By itself, the change in construction numbers should reduce headline GDP growth by about 0.4%. Further downside revision to GDP is likely, as well, from next month's construction reporting revisions. The aggregate GDP first revision (November 25th) will be subject to a number of factors, including a further, roughly 0.4% hit to growth from the September trade detail, covered separately in this *Commentary*.

The 0.4% (-0.4%) headline monthly decline in September construction spending was on top of major downside revisions to July and August, which significantly altered the third-quarter growth pattern. Before August's revisions, headline nominal September would have been down by 1.0% (-1.0%).

Third-quarter 2014 real (inflation-adjusted using the PPI New Construction Index) growth suggested an imputed annualized 0.27% quarterly gain, as of the August reporting, following an annualized second-quarter gain then of 2.18%. As of headline September reporting and revisions, however, the annualized quarterly real rate of change was a contraction of 2.55% (-2.55%) for the third-quarter, following revised annualized 1.99% gain in second-quarter 2014, along with the implications for a downside revision to GDP growth.

Although the PPI inflation used in deflating the series is well shy of reality, net of that inflation, as shown in the accompanying graph, real activity still has trended lower since late-2013, with third-quarter 2014 activity contracting versus second-quarter 2014. Third-quarter activity contracted at an annualized pace of 2.40% in nominal terms, before inflation adjustment.



PPI New Construction Index (NCI)—Well Shy of Reality. There is no perfect inflation measure for deflating construction spending, but the PPI's New Construction Index (NCI) remains the closest found in publicly-available series. For September 2014, the NCI month-to-month inflation was a negative 0.14%

(-0.14%), following a 0.05% gain August, with year-to-year inflation at 1.52% in September, versus 1.61% in August.

Headline Reporting for September 2014. The headline, total value of construction put in place in the United States for September 2014 was $950.9 billion, on a seasonally-adjusted—but not-inflation-adjusted—annual-rate basis. That estimate was down month-to-month by a statistically-insignificant 0.4% (-0.4%). That followed a revised $955.2 billion in August, which, in turn was down by a revised 0.5% (-0.5%) from a revised $960.0 billion level of activity in July.

Adjusted for the NCI inflation measure in the PPI, aggregate real spending in September 2014 was down month-to-month by 0.3% (-0.3%), versus a revised 0.6% (-0.6%) decline in August.

On a year-to-year or annual-growth basis, September 2014 construction spending rose by a statistically-significant 2.9%. Net of construction costs indicated by the NCI, year-to-year growth in spending was 1.4% in September, versus a revised 2.7% in August. 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 0.4% (-0.4%) monthly decline in September 2014 construction spending, versus the 0.5% (-0.5%) decline in August, included a 1.3% (-1.3%) drop in September public spending, versus a 1.0% (-1.0%) decline in August. September private construction fell by 0.1% (-0.1%) for the month, versus a 0.3% (-0.3%) decline in August.

In terms of total private construction spending, the residential sector gained 0.4% in September, having declined by 0.3% (-0.3%) in August, while the nonresidential sector fell by 0.6% (-0.6%), following a 0.3% (-0.3%) decline in August.

[For further detail on the September Trade Deficit and Construction Spending numbers, see the **Reporting Detail** ***section. Various drill-down and graphics options on the headline trade data are available to ShadowStats subscribers at our affiliate:*** **www.ExpliStats.com*****].***

HYPERINFLATION WATCH

Hyperinflation Outlook Summary. This *Summary* has not changed from prior *Commentary No. 670*. If this is being read for the first time, reading it in the context of the *Opening Comments* of *Commentary No. 664* of October 10th still is suggested, and as well as today's *Opening Comments*.

The long-standing hyperinflation and economic outlooks were updated with the publication of 2014 Hyperinflation Report—The End Game Begins – *First Installment Revised*, on April 2nd, and publication of 2014 Hyperinflation Report—Great Economic Tumble – *Second Installment*, on April 8th, along with ongoing updates in the regular *Commentaries*, including Commentary No. 661. The two *2014 Hyperinflation Report* installments remain the primary background material for the hyperinflation and economic analyses and forecasts.

Primary Summary. Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation. The 2008 Panic and near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same, pulled the elements of the eventual hyperinflation crisis into the 2014 period. The primary and basic summary of the broad outlook and the story of how and why this fiscal, financial and economic crisis has unfolded and developed over the years—particularly in the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked above). The following section summarizes the underlying current circumstance and recent developments.

Consistent with the above *Special Commentaries*, the unfolding economic circumstance, in confluence with other fundamental issues, should place mounting and massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic. Physical gold and silver, and holding assets outside the U.S. dollar, remain the primary hedges against the pending total loss of U.S. dollar purchasing power, despite sharp recent rallies in the U.S. dollar's exchange rate and related heavy selling in the gold and silver markets.

Current relative U.S. economic strength versus major U.S. trading partners is seriously over-estimated, with a crash back to recognition of realistic domestic-economic circumstances likely to be accompanied by a crash in the U.S. dollar versus major currencies, such as the euro, yen, pound, Swiss franc, Canadian dollar and Australian dollar; related rallies in precious metals and oil; and related sell-offs in the domestic stock and bond markets.

Current Economic Issues versus Underlying U.S. Dollar Fundamentals. U.S. economic activity is turning down anew, despite gimmicked GDP reporting. The headline contraction in first-quarter 2014 GDP was the reality; the headline second-quarter GDP boom was the aberration. The headline third-quarter growth of 3.5% appears to have been spiked by overly-optimistic trade-deficit and inventory numbers, which will be subject to downside revisions. Such should become increasingly and painfully obvious to the financial markets in the domestic economic reporting and accompanying revisions of the weeks and months ahead.

Recent reporting of relatively hard annual numbers from 2013 showed ongoing economic contraction, with no trend towards sustainable economic growth (see *Commentary No. 656*). Also, as discussed in *Commentary No. 668*, real business activity—net of all the happy assumptions and modeling used by the Bureau of Economic Analysis in putting together the overstated third-quarter GDP growth estimate—has been flat-to-minus, with real sales of the S&P 500 showing a decline in third-quarter 2014 activity.

Despite short-term pre-election fluff, those basic underlying and increasingly-negative economic conditions should show up soon with mounting frequency in various series, such as the trade deficit, retail sales, industrial production, payroll employment and inventories, providing consensus expectations with

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downside shocks. In turn, that should shift the popular outlook quite rapidly towards a "new recession," with negative shifts in the economic consensus further disrupting the already-disintegrating stability in the financial markets.

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

Unexpected economic weakness intensifies the known stresses on an already-impaired banking system, hence a perceived need for expanded, not reduced, quantitative easing. The highly touted "tapering" by the FOMC finally has run its course. Future, constructive Federal Reserve behavior—purportedly moving towards normal monetary conditions in the currently unfolding, perfect economic environment—is pre-conditioned by a continued flow of "happy" economic news. Suggestions that all is right again with world are nonsense. The 2008 Panic never has been resolved.

The economy has not recovered; the banking system is far from stable and solvent; and the Federal Reserve and the federal government still have no way out. Significant banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs will be provided, as needed, by the Fed, under the ongoing political cover of a weakening economy—a renewed, deepening contraction in business activity. The Fed has no choice. Systemic collapse is not an option for the Board of Governors. This circumstance does not have a happy solution.

Accordingly, some speculation already has begun to circulate as to an added round of Federal Reserve quantitative easing, QE4. That would be a major factor behind crashing the dollar and boosting the price of gold. The Fed has strung out its options for propping up the system as much as it could, with continual, negative impact on the U.S. economy. The easing to date, however, appears to have been a prop to the now-faltering equity markets (see *Commentary No. 663*).

In the event of QE4, any resulting renewed boost to U.S. equities likely would be a fleeting illusion, at least in terms of real value (purchasing power of the dollar). Such gains would tend to be losses, in real terms, with the stocks valued in terms of Swiss francs, for example, or valued against what would be a rapidly-increasing pace of domestic U.S. inflation.

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

All these crises should combine against the U.S. dollar, likely in the very-near future. That said, recent faux market perceptions of domestic economic, financial-system and monetary tranquility have boosted the U.S. dollar's strength significantly in global trading and have contributed to savaging the prices of precious metals. Again, such should not prevail in the context of underlying reality. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed. The key issues include, but are not limited to:

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- ***A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew.*** The circumstance includes a sharply widening trade deficit (initial reporting of third-quarter 2014 excepted, revisions there are pending), as well as ongoing severe, structural-liquidity constraints on the consumer, which are preventing a normal economic rebound in the traditional, personal-consumption-driven U.S. economy.

- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of will to address long-term U.S. solvency issues, but also the current political impossibility of doing so. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version has continued to run in the $6-trillion-plus range for annual shortfall—and should have done so again in the just-completed fiscal-2014—while those in Washington continue to increase spending and to take on new, unfunded liabilities. The history and issues here are explored in the first installment of the *Hyperinflation Report*, as previously linked.

- ***Monetary malfeasance by the Federal Reserve, as seen in central bank efforts to provide liquidity to a troubled banking system, and also to the U.S. Treasury.*** Despite the end of the Fed's new asset purchases, the current pace of the Fed's monetization was at 58.9% of effective net issuance of federal debt to be held by the public in calendar-year 2014, as late as October 8th. The pace then of effective monetization had been 66.0%, since the January 2013 expansion of QE3. It would not be surprising in this period of changing, overt Federal Reserve activities to see increasingly covert purchases of Treasury debt by nations financially friendly to the United States.

- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The relative positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, with a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. The weaker the rating, the weaker tends to be the U.S. dollar. Positive ratings for both the President and Congress are at historic lows and plummeting.

- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the situation in Ukraine versus Russia and the extremely-volatile circumstances in the Middle East.

- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar have been seen with Russia, China, France and India, along with some rumblings in OPEC and elsewhere.

When the selling pressure breaks massively against the U.S. currency, the renewed and intensifying weakness in the dollar will place upside pressure on oil prices and other commodities, boosting domestic inflation and inflation fears. Domestic willingness to hold U.S. dollars will tend to move in parallel with global willingness, or lack of willingness, to do the same. These circumstances will trigger the early stages of a hyperinflation.

Both the renewed dollar weakness and the resulting inflation spike should boost the prices of gold and silver, where physical holding of those key precious metals remains the ultimate hedge against the pending inflation and financial crises.

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REPORTING DETAIL

U.S. TRADE BALANCE (September 2014)

Improvement in Third-Quarter Net-Export Account Was Overstated. With initial, full reporting of trade deficit details for the third-quarter 2014 now in place, the 3.5% headline GDP "advance" estimate of annualized growth should revise lower by about 0.4%, based solely on the new trade numbers. Further downside revisions also are likely from next month's reporting. The aggregate GDP first revision (November 25th) will be subject to a number of factors, including another roughly 0.4% hit to headline growth from the September construction spending detail, covered separately in this *Commentary*.

Nominal (Not-Adjusted-for-Inflation) September 2014 Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported today, November 4th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for September 2014, on a balance-of-payments basis, widened to $43.032 billion, from a revised $39.991 (previously $40.109) billion in August, and from an unrevised $42.263 billion deficit in September 2013.

The $3.0 billion widening of the September 2014 deficit versus the August 2014 number reflected roughly a $3.0 billion drop in September exports, versus an unchanged level in September 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 headline deficit, again, in the October reporting, along with a further revised widening to third-quarter real data.

Energy-Related Petroleum Products. For September 2014, the not-seasonally-adjusted average price of imported oil declined further to $92.54 per barrel from $96.32 in August, and was down from $102.00 per barrel in September 2013. Also not-seasonally-adjusted, physical oil import volume in September 2014 averaged 7.550 million barrels per day, up from 6.947 million in August, but down from 7.653 million in September 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 too heavily on the accuracy of the monthly headline data.

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Real (Inflation-Adjusted) September 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 September 2014 merchandise trade deficit (no services) widened sharply to $50.759 billion, from a revised August 2014 deficit of $48.221 (initially $47.893) billion, and a revised $47.737 (previously $47.784, initially $48.177) billion deficit in July. In terms of year-to-year comparison, the September 2014 reading widened to $50.759 billion, from $50.401 billion in September 2013.

With the initial reporting of the full three months of the third-quarter 2014 trade deficit now in place, today's detail set a negative tone for the pending November 25th "first revision" to the growth estimate of third-quarter 2014 GDP. The "advance" third-quarter GDP estimate was based on only July and August reporting.

Consistent with today’s headline September 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 a revised $619.9 (previously $619.3) billion for second-quarter 2014. With full reporting, the real merchandise trade deficit currently annualized out at $586.9 billion in third-quarter 2014, versus the prior estimate of $574.1 billion based on just the July and August reporting.

Although there still is a meaningful real merchandise trade deficit narrowing in the headline third-quarter 2014 data, versus the second-quarter, that annualized deficit narrowing was reduced by about 27% in today's reporting and revisions. The initial estimate of the narrowing of the third-quarter trade shortfall contributed 1.32% of the 3.55% (rounds to 3.5%) headline gain in third-quarter GDP (see *Commentary No. 670*). Given the guesstimation involved with the official massaging of these merchandise trade numbers into the headline GDP reporting, one could expect a rough reduction in the headline third-quarter GDP growth rate approximating 0.4%, just as a result of today's new trade reporting and revisions.

CONSTRUCTION SPENDING (September 2014)

Construction Spending Tumbled in September, in Prior-Period Revisions and for Third-Quarter 2014. As with the trade numbers, full reporting of third-quarter 2014 construction spending detail now shows that the 3.5% headline GDP "advance" estimate of annualized growth should revise lower. By itself, the change in construction numbers should reduce headline GDP growth by about 0.4%. Further downside revision to GDP is likely, as well, from next month's construction reporting revisions. The aggregate GDP first revision (November 25th) will be subject to a number of factors, including a further, roughly 0.4% hit to growth from the September trade detail, covered separately in this *Commentary*.

The 0.4% (-0.4%) decline in headline September construction spending was on top of major downside revisions to July and August activity, which significantly altered the third-quarter growth pattern. Before the revision to August's detail, headline nominal September would have been down by 1.0% (-1.0%).

Third-quarter real (inflation-adjusted using the PPI New Construction Index) growth suggested an annualized 0.27% quarterly gain, as of the August reporting, following an annualized second-quarter gain then of 2.18%. As of the headline September reporting and revisions, however, the annualized quarterly real rate of change now stands at a contraction of 2.55% (-2.55%), following revised annualized 1.99% gain in second-quarter 2014, along with the implications for a downside revision to third-quarter GDP

growth. Third-quarter activity contracted at an annualized pace of 2.40% in nominal terms, before inflation adjustment.

PPI New Construction Index (NCI)—Well Shy of Reality. There is no perfect inflation measure for deflating construction spending, but the PPI's New Construction Index (NCI) remains the closest found in publicly-available series. For September, the NCI month-to-month inflation was at a negative pace of 0.14% (-0.14%), following a 0.05% gain August, with year-to-year inflation at 1.52% in September, versus 1.61% in August.

While well shy of real-world inflation, the PPI's NCI—used as a deflator—still shows real construction spending to have been in ongoing downtrend reporting, from 2013.

Headline Reporting for September 2014. The Census Bureau reported November 3rd that the headline, total value of construction put in place in the United States for September 2014 was $950.9 billion, on a seasonally-adjusted—but not-inflation-adjusted—annual-rate basis. That estimate was down month-to-month by a statistically-insignificant 0.4% (-0.4%) +/- 2.3% (all confidence intervals are at the 95% level). That followed a revised $955.2 (previously $961.0) billion in August. In turn, August was down by a revised 0.5% (-0.5%) [previously down by 0.8% (-0.8%)] from a revised $960.0 (previously $968.8, initially $981.3) billion level of activity in July.

Adjusted for the NCI inflation measure in the PPI, aggregate real spending in September 2014 was down month-to-month by 0.3% (-0.3%), versus a revised 0.6% (-0.6%) decline in August [previously down by 0.9% (-0.9%)].

On a year-to-year or annual-growth basis, September 2014 construction spending rose by a statistically-significant 2.9% +/- 2.5%, versus a revised 4.4% (previously 5.0%) gain In August. Net of construction costs indicated by the NCI, year-to-year growth in spending was 1.4% in September, versus a revised 2.7% (previously 3.3%) in August. 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 0.4% (-0.4%) monthly decline in September 2014 construction spending, versus the 0.5% (-0.5%) decline in August, included a 1.3% (-1.3%) drop in September public spending, versus a 1.0% (-1.0%) decline in August. September private construction fell by 0.1% (-0.1%) for the month, versus a 0.3% (-0.3%) decline in August.

In terms of total private construction spending, the residential sector gained 0.4% in September, having declined by 0.3% (-0.3%) in August, while the nonresidential sector fell by 0.6% (-0.6%), following a 0.3% (-0.3%) decline in August.

The following graphs reflect latest extended detail.

Construction and Related Graphs. The first two graphs following reflect total construction spending through September 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 renewed

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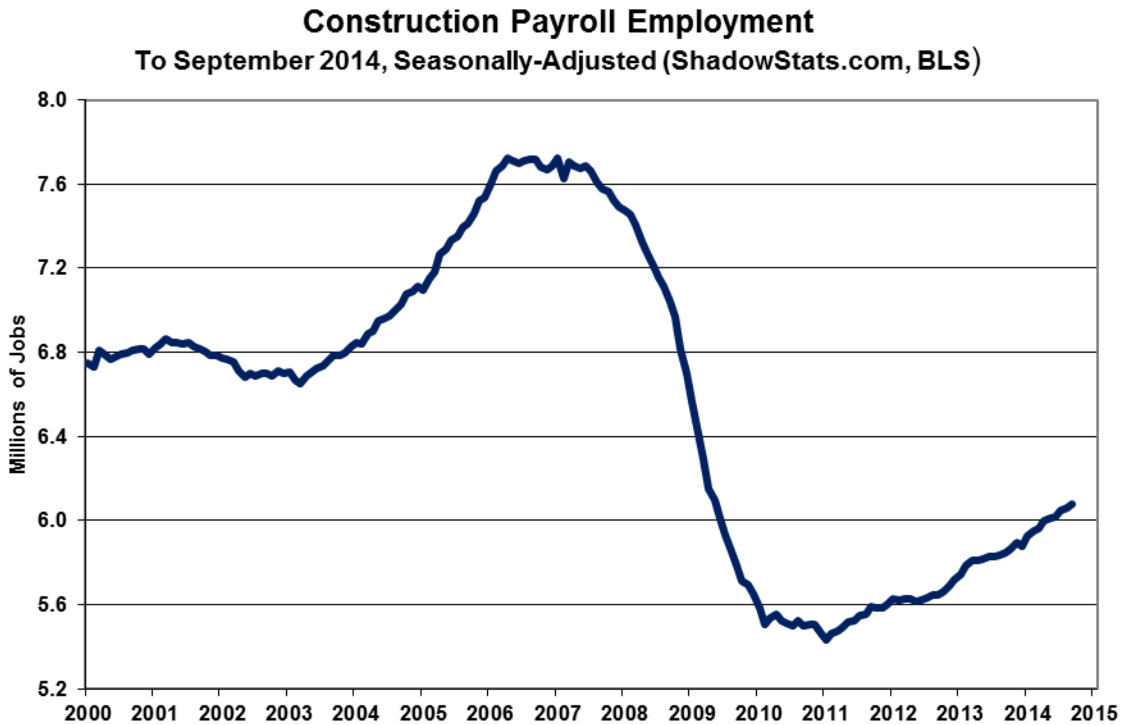
downturn in the most recent reporting. Activity has been trending lower since late-2013, with real (inflation-adjusted) third-quarter activity contracting versus second-quarter 2014.

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. 670*). 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 the previously published September 2014 construction employment (see *Commentary No. 663*). The monthly detail for October will be published in the next *Commentary No. 672* scheduled for Friday, November 7th. 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 most other recent indications of construction activity, including the real 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).



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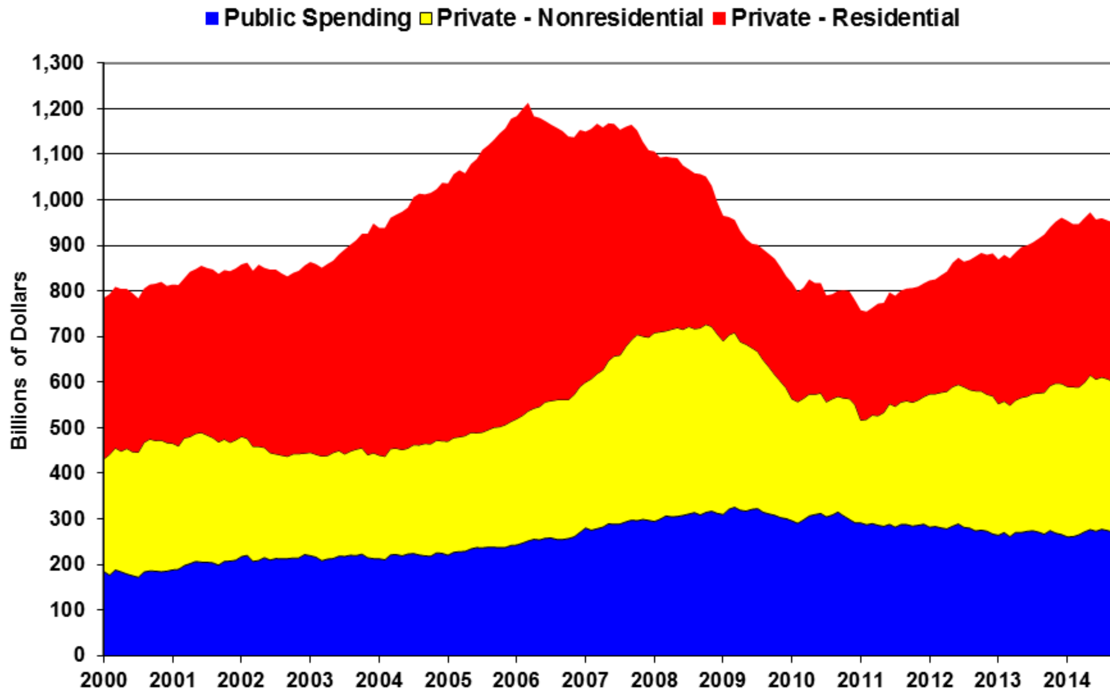

The next two graphs following cover private residential construction along with housing starts (single- and multiple-unit starts) for September (see *Commentary No. 667*). Keep in mind that the construction spending series is in nominal (not-adjusted-for-inflation) dollars, while housing starts reflect 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.

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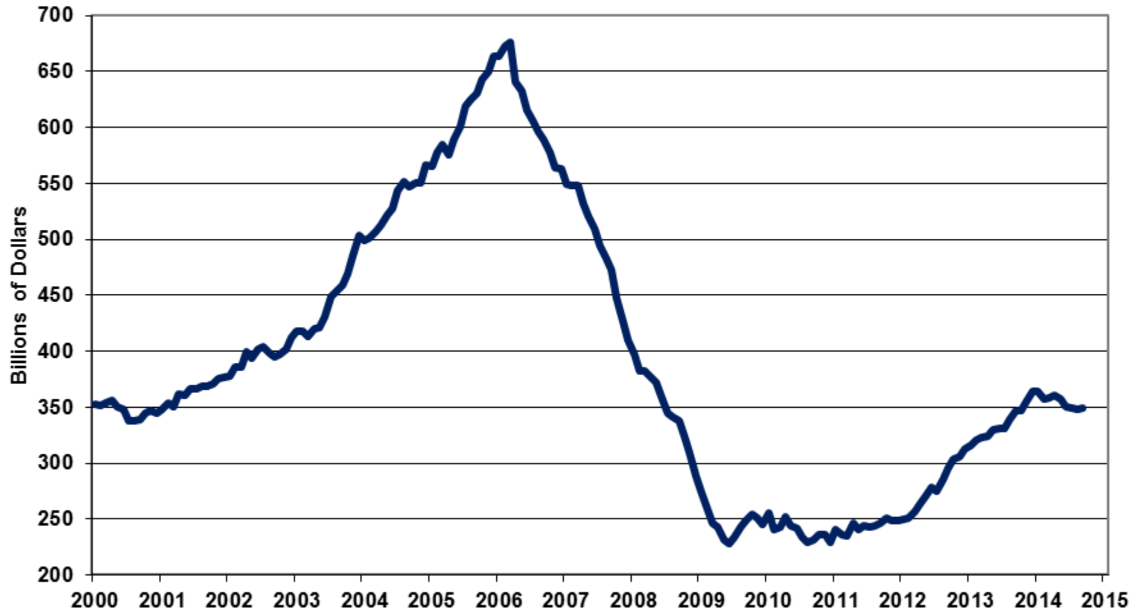

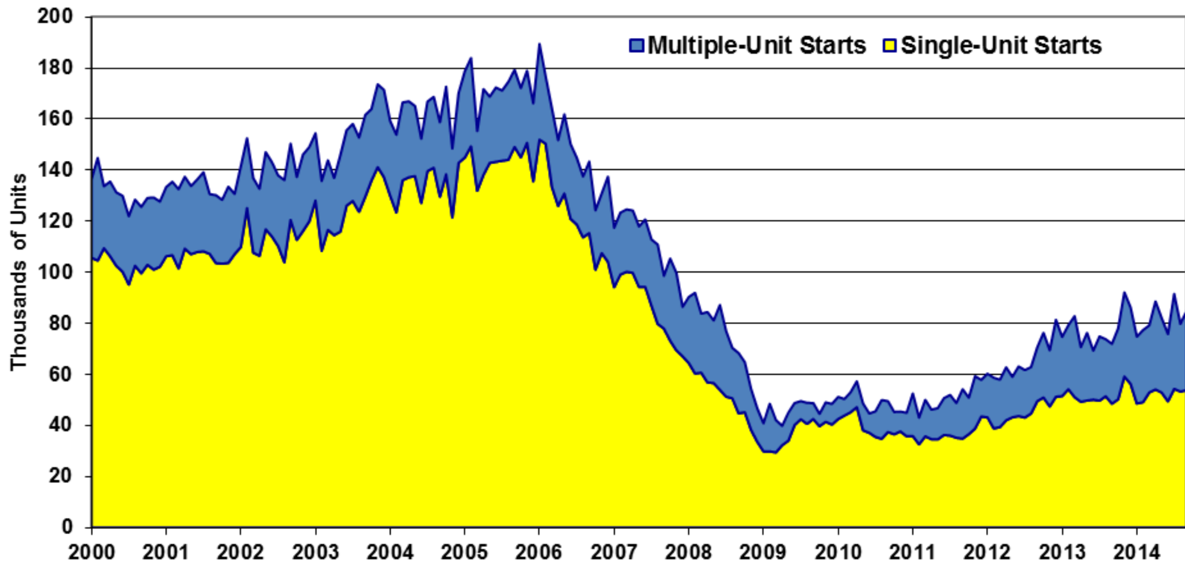

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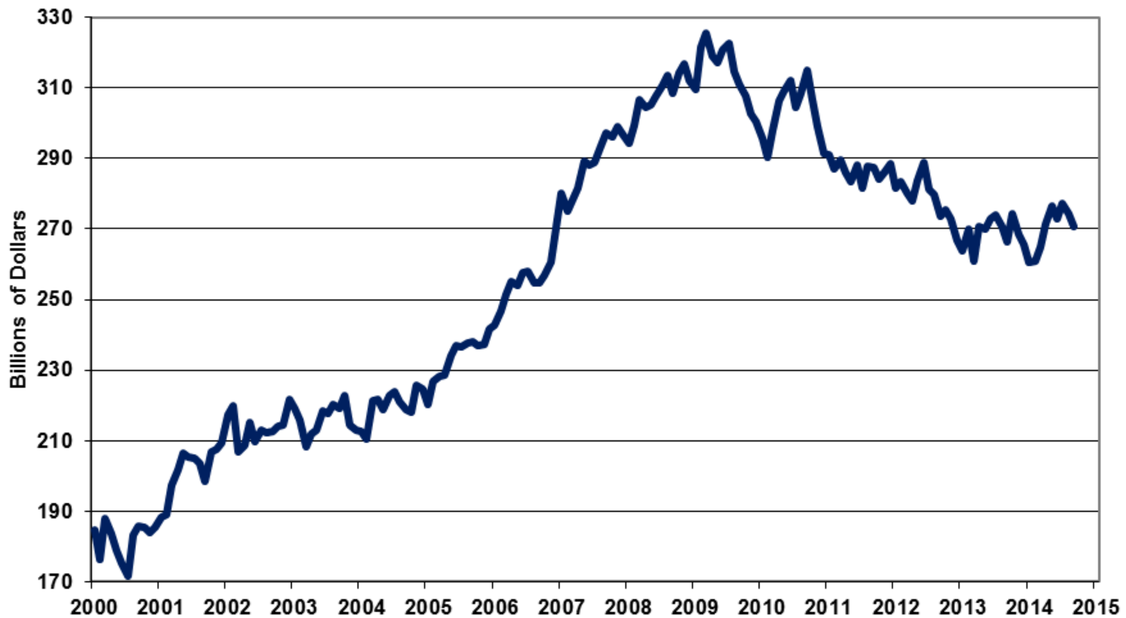

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WEEK AHEAD

Against Overly-Optimistic Expectations, Pending Economic Releases and Revisions Should Trend Much Weaker; Inflation Releases Should Be Increasingly Stronger. Having shifted some to the upside, again, from the downside, amidst wide fluctuations, market expectations for business activity are overly optimistic in the extreme. They exceed any potential, underlying economic reality. Market outlooks increasingly should be hammered, though, by ongoing, downside corrective revisions and by an accelerating pace of downturn in broad-based headline economic activity.

Longer-Range Reporting Trends. The gradual process of downside shifting in economic-growth expectations has been sporadic, but the underlying fundamentals remain extraordinarily negative. Other than for nonsense-growth in the headline second-quarter GDP (see *Commentary No. 662*), and today's (October 30th) overstated and subject-to-downside revision third-quarter GDP growth estimate, renewed weakness has been, and increasingly will be seen in the headline reporting of other major economic series (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*), particularly subsequent to (possibly coincident with) next week's November 4th election. Indeed, weaker-than-consensus economic reporting should become the general trend until the unfolding "new" recession receives broad recognition, which minimally would follow the next reporting of a headline contraction in real GDP growth (very possibly a sharp downside revision to today's headline GDP estimate).

A generally stronger consumer inflation trend remains likely, 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. Such excludes any near-term financial sanction actions against Russia that are pushing oil prices lower.

The dollar faces eventual pummeling from the weakening economy, continuing perceptions of needed, ongoing quantitative easing, 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 prospective, significantly-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.

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PENDING RELEASE:

Employment/Unemployment (October 2014). The Bureau of Labor Statistics (BLS) will release its October 2014 labor data on Friday, November 7th. 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 October reporting. Nonetheless, amidst an unusual trend signal, the system is due for continuing, negative surprises against persistently overly-optimistic market expectations.

Below-consensus reporting in the October payroll numbers would help to set a negative tone for fourth-quarter GDP activity and for a variety of economic indicators due for release in the month ahead.

As published previously by ShadowStats-affiliate www.ExpliStats.com, in its analysis of the biases built into the concurrent seasonal factor modeling of September 2014 payroll employment, the implied built-in bias trend for October 2014 suggests a headline October jobs gain of 180,000, versus the 248,000 headline payroll employment gain reported in September. Where consensus forecasts tend to settle in around the trend number, market expectations currently seem to be running well above the trend level—at 240,000 per Bloomberg, some 60,000 jobs more than the BLS model—with the trend accordingly suggesting a relative downside surprise for the markets in the pending headline reporting. Again, underlying economic reality also would suggest a downside surprise to the market expectations for payrolls.

Separately, the market outlook appears to be for the October U.3 unemployment rate to hold at 5.9% for a second month. That is a seriously troubled level of unemployment, where those that have disappeared from the unemployment rolls have been unable to find work and have given up looking for a job, instead of the much happier circumstance of rejoining the ranks of the employed.

While underlying economic reality and the fundamental drivers of economic activity would suggest a general increase in the U.3 rate, 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 again, there should 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.

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