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

COMMENTARY NUMBER 677
Third-Quarter 2014 GDP, First Revision

November 25, 2014

Gross Domestic Product Upside Revision Was Nonsense

Initial Gross Domestic Income Reporting
Suggested Major Revision Shenanigans that Boosted Headline GDP

Underlying Reality Remains Down-Trending Stagnation in
Broad Economic Activity

PLEASE NOTE: The next Commentary *is planned for tomorrow, Wednesday, November 26th, covering October new orders for durable goods and new-home sales, and November consumer conditions.*

Given abbreviated holiday schedules, we shall endeavor to publish tomorrow's Commentary No. 678 *by noon, New York time. Early best wishes to all for a Happy Thanksgiving! — John Williams*

OPENING COMMENTS AND EXECUTIVE SUMMARY

Third-Quarter GDP Boosted Sharply by Undisclosed Revision to Prior Quarter? The Bureau of Economic Analysis (BEA) reported its second estimate of third-quarter gross domestic product (GDP) growth at 3.9%, today (November 25th), up from initial reporting of 3.5%, and against an unrevised 4.6% pace of second-quarter growth. Once the third estimate (second revision) of a quarter is in place, the GDP is not revised again, publicly, except for annual benchmark revisions. As of the September 26th headline GDP reporting, second-quarter 2014 GDP growth was locked in place at 4.6%.

That restriction, however, does not apply to the GDP's accounting-equivalent counterpart, gross domestic income (GDI), which goes through three revisions, and much of today's headline growth in the GDI was due to a sharp-downside revision to second-quarter growth, suggestive of a similar pattern in the GDP, albeit with an undisclosed second-quarter revision.

GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a “statistical discrepancy” to the GDI-side of the equation. Although the GDI and GDP headline growth numbers may vary sharply on a quarterly basis, they do tend to revise together.

The first estimate of third-quarter 2014 real GDI growth was published today at 4.48%, versus revised headline growth of 3.95% (previously 5.25%) in second-quarter 2014. Net of the prior-period (second-quarter) revision, third-quarter GDI growth would have 3.19% instead of the new headline 4.48%. A somewhat parallel revision was likely for the GDP, but such would not be reported until the benchmark revisions of July 30, 2015.

On a consistent reporting basis, either second-quarter GDP growth likely was much weaker than the current headline number, or third-quarter growth likely was weaker on a relative basis against the overstated second-quarter number. The concept of not reporting period-period revisions, despite relative impact on current reporting, has been well established through the use of concurrent seasonal adjustments (see discussion in the *Reporting Detail* in *Commentary No. 672*).

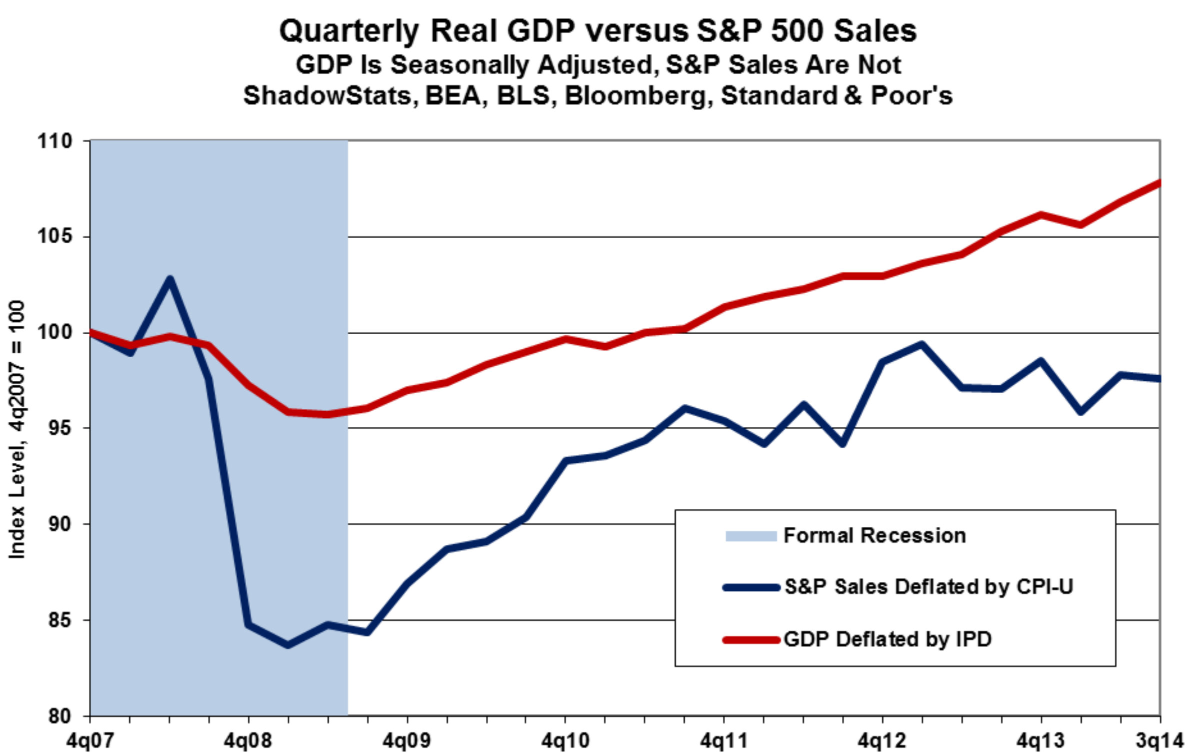
Upside GDP Revision Reflected Less-Negative Inventories, An Otherwise Nebulous Number. As to the internal details of the revision, where headline third-quarter 2014 real GDP growth revised higher, from 3.55% to 3.89%, the 0.34% upside change was more than accounted for by revised levels in the changes to business inventories, the traditional, primary fudge-factor used by the BEA in its GDP reporting. Underlying detail from series such as industrial production had suggested a more-negative inventory change, instead of a less-negative inventory change, which added 0.45% to the aggregate headline GDP growth. Other business investment, largely business equipment added another 0.23% to growth, along with a 0.29% growth pick-up in personal consumption, which was widely dispersed across the category. On the downside, a revised relative trade deterioration subtracted 0.54% from the growth rate, along with another 0.07% growth hit from revised state government spending.

Given the BEA's traditional, highly volatile estimation "errors" for inventory change, third-quarter GDP growth still could end up below the initial headline reporting of 3.55%, come the December 23rd second revision.

No Economic Recovery or Boom in Real-World Activity. Noted in the *Hyperinflation Outlook Summary*, if the economy had recovered from the 2007 recession, and if it were booming, as reported by the BEA, those circumstances normally would be seen in areas beyond the scope of possible government data manipulations. Discussed respectively in *Commentary No. 668* and in *Commentary No. 672*, two such areas that have not reflected, but should be reflecting, the purported happy economic news are revenues of publicly-held companies and the outlook of the electorate in the recent midterm election. Some comments and graphs are copied and updated here from those missives. Further detail on underlying economic reality follows in the *Economic Reality* section at the end of these *Opening Comments*, and in the *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*.

Real (Inflation-Adjusted) S&P 500 Sales Indicated Third-Quarter 2014 Business Contraction. Actual business activity—net of all the happy assumptions and modeling used by the BEA in putting together the overstated second- and third-quarter GDP growth estimates—has been flat-to-minus, with real sales of the S&P 500 showing a decline in third-quarter 2014 activity amidst a recent pattern of down-trending stagnation.

The following, updated graph (see *Commentary No. 668*) reflects an estimate of third-quarter 2014 real S&P 500 sales, adjusted for CPI-U inflation and varying shares outstanding, plotted versus headline real GDP reporting, with both series indexed to fourth-quarter 2007 = 100. That was the GDP's peak quarter leading into the official recession. Unlike the booming uptrend in the GDP, however, the recent S&P real sales pattern has been one of stagnation that has been trending lower.

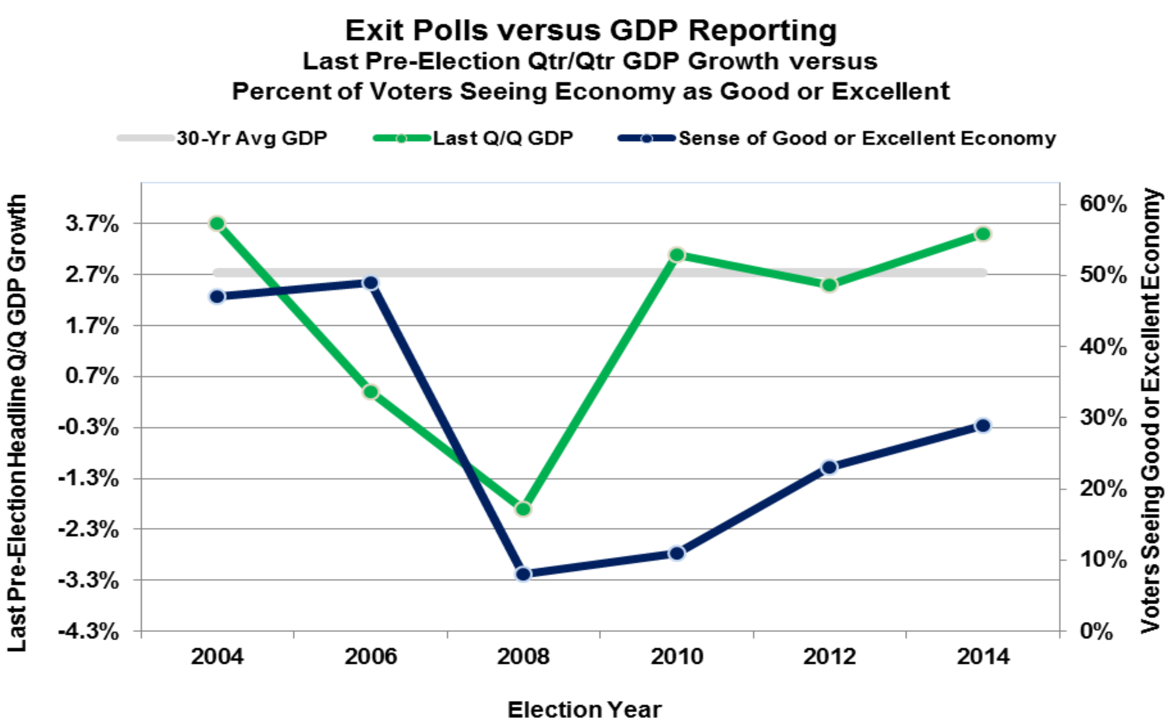


Although bottoming along with the GDP in 2009, not-seasonally-adjusted, real S&P 500 sales activity broadly has not reflected the ongoing and expanding recovery of the seasonally-adjusted headline real GDP. After declining in first-quarter 2014, sales did rise in second-quarter 2014, but they turned lower again in third-quarter 2014, unlike the headline real third-quarter 2014 GDP. In addition, unlike the GDP, real S&P 500 sales never recovered their pre-2007 recession peak and, correspondingly, have not expanded to new highs.

Sales of the S&P 500 are a real-world measure of domestic economic activity, not gimmicked by the modeling, imputations and assumptions underlying the headline GDP detail. Irrespective of potential seasonal factor issues, the real world is not showing the illusion of economic recovery otherwise published in the economic guesstimates of the BEA.

Election Polling Indicated No Economic Recovery. Separately, Main Street U.S.A. remains the ultimate judge of actual economic activity, and the 2014 election results and related exit polling confirmed no post-Panic economic recovery. Pocketbook issues—when voters are suffering financially—tend to dominate elections.

With headline economic activity crashing into 2009, but with GDP activity having fully recovered by early-2011 and expanding ever since, one might expect that a weak economy would not have been the prime area of voter concern for the 2014 Midterm Election. Yet, it was, and underlying economic reality was the major factor in driving voter discontent, helping to push control of the U.S. Congress into the hands of the Republicans (see *Commentary No. 672* for expanded detail).



In more-normal economic times, such as seen in 2004 and early-2006, exit polls from the Presidential or Midterm Elections of those years showed about half the voters rating the national economy as "excellent or good," with a 50% rating there being average. Not too surprisingly, that assessment of "excellent or good" dropped to 8% in 2008, as the economy was collapsing, inching higher to 11% in the early-recovery period of 2010. Yet, the "excellent or good" descriptor only recovered to 23% in 2012, and to 29% in 2014, despite the purported boom in GDP activity (exit poll numbers here reflect reporting of CNN, both current and historical, as well as detail from Wikipedia).

The preceding graph reflects the electorate's rating of economic activity, versus the initial headline GDP reporting of third-quarter 2014, the last GDP published before the election. Where the thirty-year average growth rate for headline real GDP is 2.7%, the 2014 voter assessment corresponded in the graph to what would be negative quarter-to-quarter growth in the accompanying graph. Instead, the headline third-quarter 2014 GDP growth before the election was at 3.5% (just revised to an even happier 3.9%). Again, Main Street U.S.A. historically has tended to have a much more realistic outlook on what is happening in the economy than have the government's various statistical bureaus.

Today's Missive (November 25th). Today's *Commentary* concentrates on the second estimate of, first revision to, third-quarter 2014 GDP, and the related GNP and GDI measures.

The *Hyperinflation Outlook Summary* has been revised to reflect the new GDP numbers. Separately, in the *Week Ahead* section, the outlooks are reviewed for tomorrow's durable goods orders and new-home sales.

Gross Domestic Product—Third-Quarter 2014, Second Estimate, First Revision—Nonsense. The upside first revision to third-quarter GDP growth to 3.9% from 3.5%, on top of headline second-quarter GDP growth of 4.6%, is not credible. An economy growing that quickly simply is not supported the current underlying fundamentals, and as discussed in the opening paragraphs of these *Opening Comments*, it also is not supported by major indicators of economic activity that are beyond the reporting purview of the federal government. Independent data generally support the contentions of ShadowStats that the U.S. economy never recovered from the recession, and that current business activity is stagnant and trending to the downside.

The GDP remains the most-worthless and the most-heavily modeled, massaged and politically-manipulated of government economic series. Beyond historical changes in reporting methodology that have built upside biases into headline GDP growth, a special-purpose political manipulation still appears to be a likely factor in recent and current reporting.

Headline Gross Domestic Product (GDP). The second estimate of, first revision to, third-quarter 2014 GDP was a statistically-significant, real (inflation-adjusted), annualized, quarterly headline gain of 3.9% (3.89% at the second decimal point). Third-quarter growth previously had been estimated at 3.5% (3.55% at the second decimal point). The revised, overstated headline growth was down from the still heavily-overstated estimate of 4.59% growth in second-quarter 2014, and versus a benchmarked 2.11%

contraction (-2.11%) [a pre-benchmark 2.93% drop (-2.93%) per *Commentary No. 646*)] in first-quarter 2014.

The third-quarter GDP growth estimate may revise lower in its "final" version, due for release on December 23rd. Separately, both the second- and third-quarter 2014 GDP estimates should face significant downside revisions in the annual benchmarking and revisions due in July 2015.

Headline year-to-year growth in real third-quarter 2014 GDP revised to 2.43%, versus 2.59% annual growth in the second-quarter and versus benchmarked growth of 1.89% (1.54% pre-benchmark) in the first-quarter. The annual growth patterns are graphed in the *Reporting Detail* section.

Implicit Price Deflator (IPD). The second estimate of third-quarter 2014 GDP inflation, or the implicit price deflator (IPD), was 1.39%, versus 2.15% in second-quarter 2014, and a benchmarked 1.33% in first-quarter 2014. The revised year-to-year, third-quarter 2014 IPD inflation was 1.57%, versus 1.64% in second-quarter 2014 and a benchmarked 1.37% in first-quarter 2014. The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

For comparison, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation published by the Bureau of Labor Statistics (BLS) was up by 1.10% for third-quarter 2014, versus 3.03% for second-quarter 2014 and 1.91% for first-quarter 2014. Unadjusted, year-to-year quarterly inflation was 1.78% for third-quarter 2014, versus 2.05% for second-quarter 2014 and 1.41% for first-quarter 2014.

Gross National Product (GNP). The first estimate of third-quarter 2014 real GNP growth was published along with the second estimate of third-quarter GDP growth.

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

With only minor relative shifts in third-quarter versus second-quarter factor-income activity, the headline annualized quarterly-growth rate in real third-quarter 2014 GNP was 3.80% (versus 3.89% GDP), down from 4.57% in the second-quarter, but up from a benchmarked 2.81% (-2.81%) contraction in first-quarter 2014. Pre-benchmark, headline first-quarter growth had shown a contraction of 3.61% (-3.61%). Year-to-year change was 2.28% in third-quarter 2014, versus 2.53% in the second-quarter 2014 and a benchmarked annual gain of 1.86% in first-quarter 2014.

Gross Domestic Income (GDI). The first estimate of third-quarter 2014 real GDI growth also was published along with the second estimate of third-quarter GDP growth. Unlike the GDP reporting, which is immune to further revisions until the July 2015 benchmarking, second-quarter 2014 GDI was revised sharply lower, which had the effect of spiking headline third-quarter GDI growth, discussed in the opening paragraphs of these *Opening Comments*.

GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a “statistical discrepancy” to the GDI-side of the equation, but the discrepancy just as easily could be added to the GDP number.

The headline annualized quarterly-growth rate in real third-quarter 2014 GDI was 4.48% (versus 3.89% GDP), versus revised headline growth of 3.95% in second-quarter 2014, up from a revised contraction of 0.78% (-0.78%) in first-quarter 2014. Pre-benchmark, headline first-quarter growth GDI had shown a 2.61% (-2.61%) contraction. Year-to-year change was 2.35% in third-quarter 2014, versus 1.72% in second-quarter 2014 and 1.41% in first-quarter 2014.

As discussed in the *Opening Comments*, however, net of the prior-period (second-quarter) revision, third-quarter GDI growth was 3.19% instead of the new headline 4.48%.

Distribution of Headline GDP Growth. Despite the severely-limited significance of the following detail, it is included for those interested in the reported internal patterns of GDP growth, as guessed at by the BEA. The second guesstimate of, first revision to, the headline growth in third-quarter 2014 GDP, was 3.89% (previously 3.55%, rounded to 3.5%), following 4.59% growth in second-quarter 2014, and a contraction of 2.11% (-2.11%) in first-quarter 2014 GDP.

The revised, annualized third-quarter growth rate is detailed in the following aggregation of contributed growth. Please note that the annualized growth number in each sub-category is the additive contribution to the aggregate, headline change in GDP, where 1.51% + 0.85% + 0.78% + 0.76% = 3.90% (rounding differential versus 3.89%).

- ***Consumer Spending Contributed 1.51% (Previously 1.22%) to Third-Quarter Growth; Contributed 1.75% to Second-Quarter.*** The upside revision to personal consumption was broadly spread across the category, where the bulk of the growth contribution here came from sales of autos, recreational goods and vehicles, surging financial services and insurance and healthcare costs, with a small offset from a weather-related decline in utility usage. Auto sales still were overstated, and the healthcare and health-insurance related numbers still lacked reporting substance.

- ***Business/Residential Investment Contributed 0.85% (Previously 0.17%) to Third-Quarter Growth; Contributed 2.87% to Second-Quarter.*** The biggest factor in the business sector was a less negative contribution to aggregate quarterly GDP growth of 0.12% (-0.12%) instead of 0.57% (-0.57%) from inventories, with a resulting net boost of 0.45% to the headline growth revision. Net of inventories, final sales rose by 4.01%. Otherwise, the biggest plus-side item was a revised 0.61% (previously 0.39%) positive contribution from transportation equipment. Nonresidential and residential construction activity was flat. Look for a more-negative inventory number in the next revision.

- ***Net Exports Contributed 0.78% (Previously 1.32%) to Third-Quarter Growth; Subtracted 0.34% (-0.34%) from Second-Quarter.*** Generally in line with a softer narrowing of the trade deficit, the growth contribution here was cut by 0.54%. A further negative revision to growth is likely in the next GDP revision, as well.

- ***Government Spending Contributed 0.76% (Previously 0.83%) to Third-Quarter Growth; Contributed 0.31% to Second-Quarter.*** A surge in quarterly defense spending still contributed 0.67% to the aggregate GDP growth rate. The downside revision to the category was in spending by state and local governments.

Economic Reality. Even with the headline second estimate of annualized third-quarter 2014 GDP growth at 3.89%, following 4.59% growth in second-quarter 2014 and a contraction of 2.11% (-2.11%) in first-quarter 2014, the general outlook as to underlying economic reality has not changed. The broad economy still is turning down anew, and a wide variety of monthly economic detail still should confirm that in reporting of the next month or two, including a still-possible downside revision to the third estimate of third-quarter GDP growth estimate on December 23rd. Accordingly, the gist of much of the following text remains along the lines of other recent GDP *Commentaries*, but the details and numbers have been updated for the latest third-quarter reporting.

Discussed frequently, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity shows that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in recent quarters. Irrespective of the reporting gimmicks introduced in the July 2013 and July 2014 GDP benchmark revisions, a consistent, fundamental pattern of faltering historical activity is shown in the accompanying sets of "corrected" GDP graphs.

Please note that the pattern of activity shown for the "corrected" GDP series is much closer to the patterns shown in the graphs of monthly real median household income and other liquidity measures. Similar patterns are found in recent indications of annual consumer expenditures (see *Commentary No. 656* and *Commentary No. 673*) and economic series not otherwise reliant on understated inflation for their reported growth, such as housing starts (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* and the opening paragraphs of the *Opening Comments*). A sustainable business recovery could not have taken place since 2009, and a recovery will not be forthcoming until the consumer's structural income and liquidity problems are resolved.

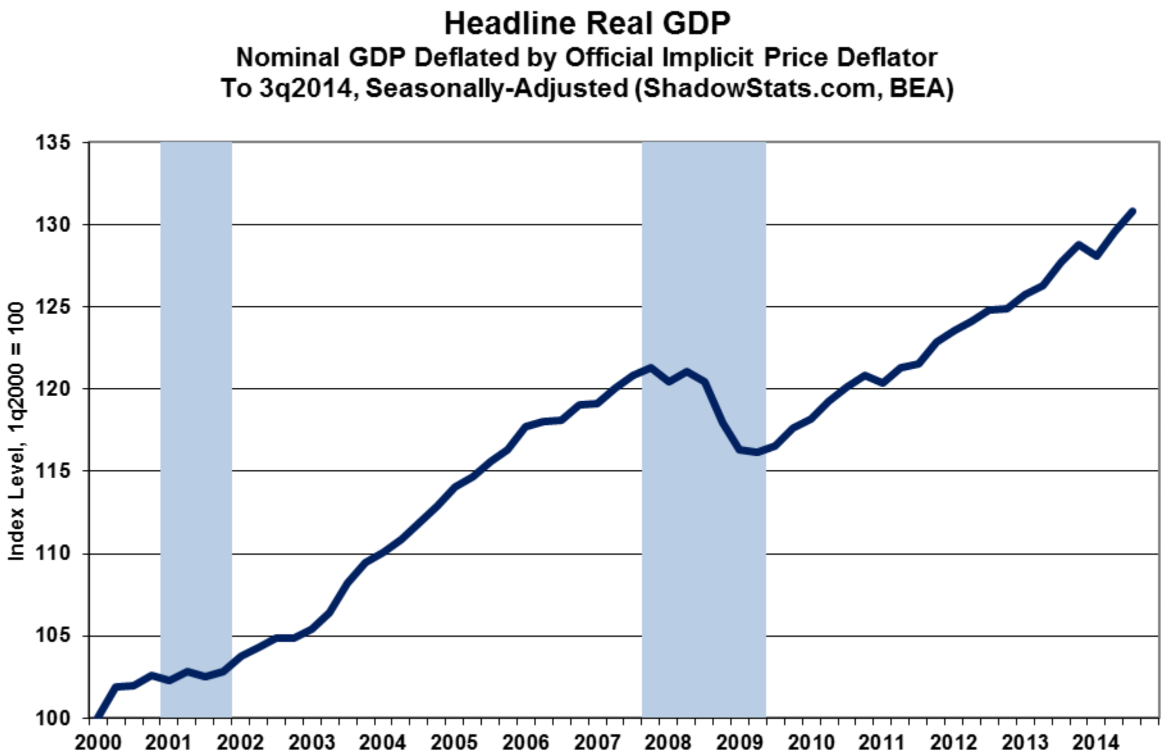
Official and Corrected GDP. As usually discussed in the *Commentaries* covering the quarterly GDP reporting and monthly revisions, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating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

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

Shown in the first graph of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (with a growth interruption in first-quarter 2014). Adjusted for official GDP inflation (the implicit price deflator), the level of third-quarter 2014 GDP currently now stands at 7.8% above the pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, shows third-quarter 2014 GDP activity at 6.5% (-6.5%) below the pre-recession peak of first-quarter 2006.

Further, as discussed in the second installment of the *Hyperinflation Report*, no other major economic series has shown a parallel pattern of official full economic recovery and meaningful expansion beyond, consistent with the GDP reporting (see discussions on the real retail sales series in *Commentary No. 676* and the industrial production series in *Commentary No. 674*). Either the GDP reporting is wrong, or all other major economic series are wrong. While the GDP is heavily modeled, imputed, theorized and gimmicked, it also encompasses reporting from those various major economic series and private surveys, which still attempt to survey real-world activity. Flaws in the GDP inflation methodologies and simplifying reporting assumptions have created the "recovery."

The second graph in each series plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates (see *Public Commentary on Inflation Measurement*), with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in the *Hyperinflation Reports*. Both graphs in the first set are indexed to first-quarter 2000 = 100, and show official periods of recession as shaded areas.


Headline Real GDP
Nominal GDP Deflated by Official Implicit Price Deflator
To 3q2014, Seasonally-Adjusted (ShadowStats.com, BEA)
Index Level, 1q2000 = 100
135
130
125
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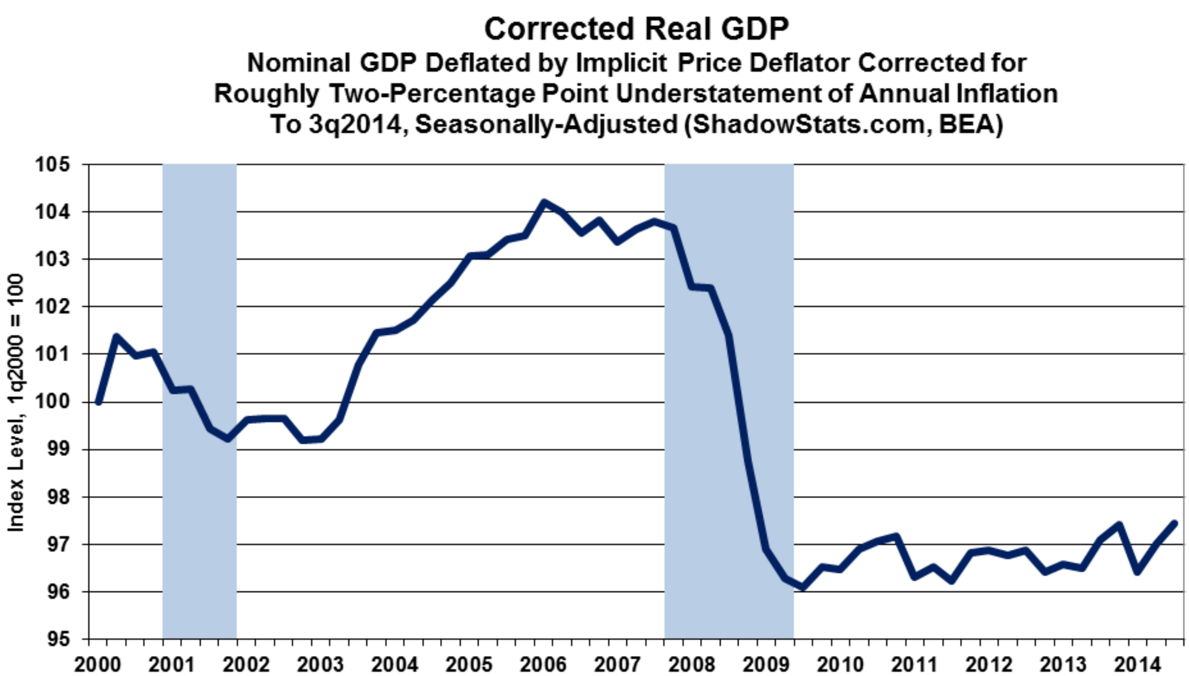
Corrected Real GDP
Nominal GDP Deflated by Implicit Price Deflator Corrected for
Roughly Two-Percentage Point Understatement of Annual Inflation
To 3q2014, Seasonally-Adjusted (ShadowStats.com, BEA)
Index Level, 1q2000 = 100
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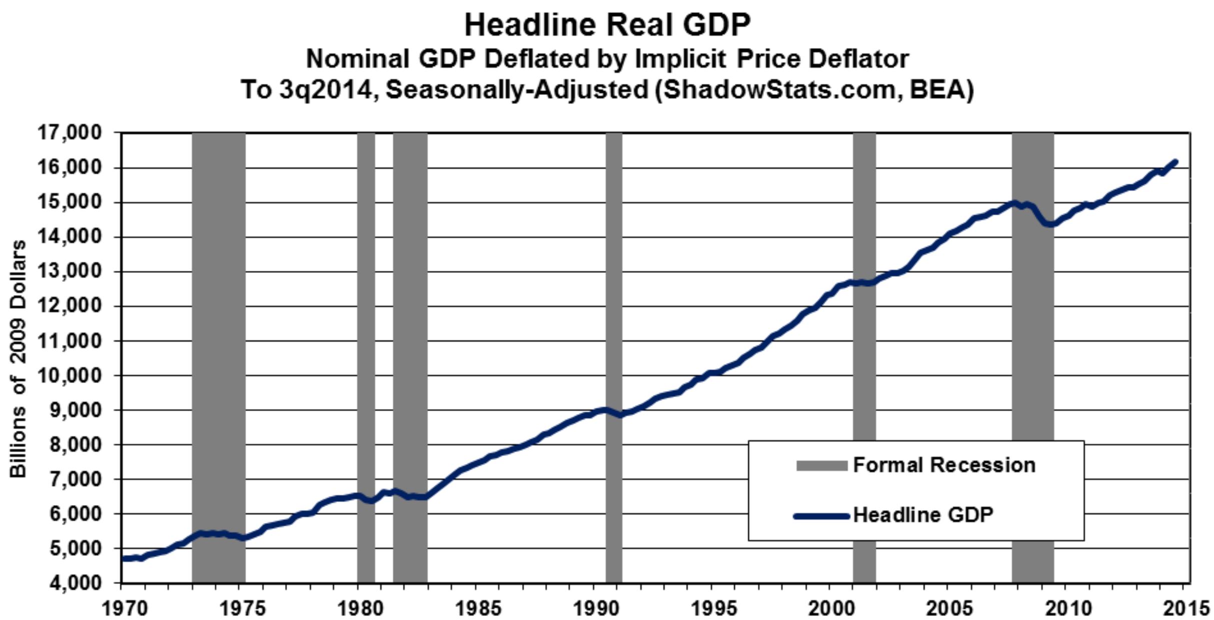
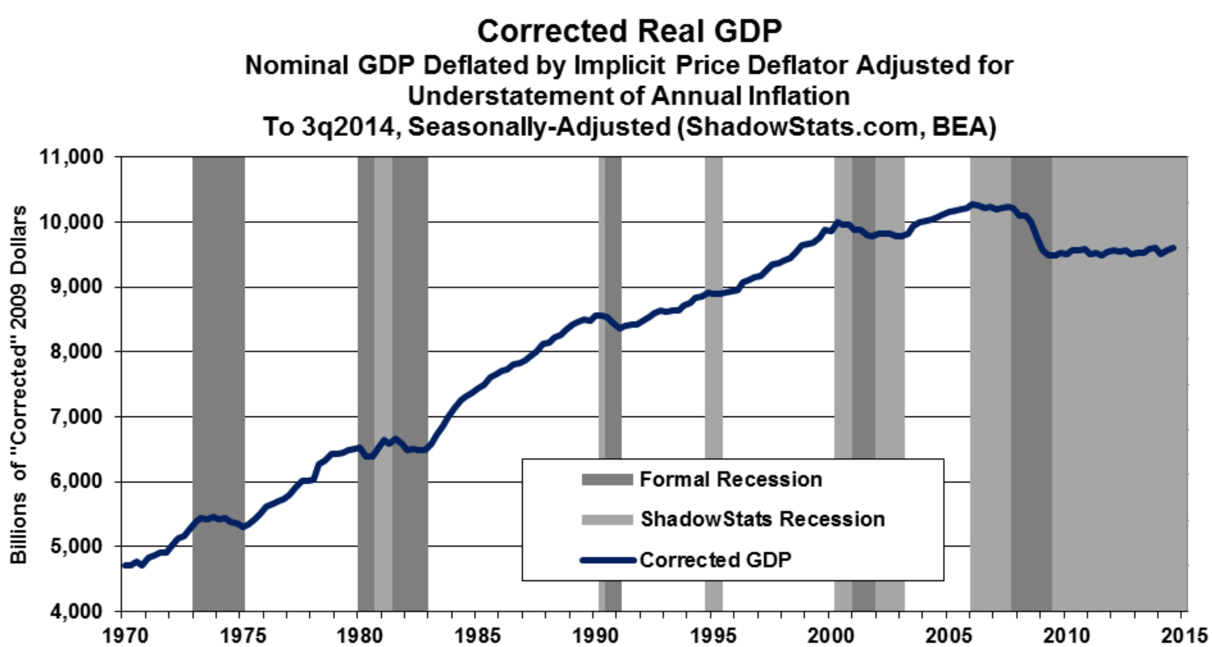


The shaded areas in the "corrected" graph that follows reflect official as well as ShadowStats-defined recessions, again as discussed in detail in the second installment of the *Hyperinflation Report.*



[For further detail on the second estimate of third-quarter 2014 GDP, see the **Reporting Detail** ***section. Various drill-down and graphics options on the headline GDP data are available to ShadowStats subscribers at our affiliate:* www.ExpliStats.com*].***

HYPERINFLATION WATCH

Hyperinflation Outlook Summary. This *Summary* has been revised, from the prior version in *Commentary No. 673*, to reflect the second estimate of third-quarter 2014 GDP. Revised or new text is underlined.

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. The outlooks also are updated in regular *Commentaries*, such as *Commentary No. 661*, *Commentary No. 664*, and *Commentary No. 672*, and the *Opening Comments* of *Commentary No. 673* should be considered in terms of near-term, proximal triggers for massive dollar selling. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts.

Hyperinflation Timing Shifted to 2015. Discussed in the *Opening Comments* of *Commentary No. 673*, as 2014 draws to a close, the U.S. dollar has strengthened significantly in recent months, instead of being dumped in a panicked sell-off as predicted for 2014. Nonetheless, the outlook for the dollar panic remains in place. It could be triggered or otherwise just start at any time, with little or no warning, and still before year-end.

From a practical standpoint, though, where a dollar-selling panic will be the likely immediate precursor to and trigger of the early stages of a hyperinflation, the outlook for the timing of the hyperinflation as detailed in the *Hyperinflation Reports* has been shifted to 2015, from 2014. I had put 80% odds in favor of the hyperinflation breaking this year, in 2014. Other than for the calendar shift, the general outlook was not changed, with the ultimate currency panic and financial crises still highly likely in the very near-term (80%), virtual certainties (95% in the not-so-distant future, *i.e.*, the year ahead).

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 (see *Commentary No. 672*). 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 2014-2015 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 earlier). The following sections summarize 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. Further, a sharp deterioration in near-term domestic U.S. political stability appears to be developing and is of meaningful near-term risk for triggering heavy selling of the dollar.

Current Economic Issues versus Underlying U.S. Dollar Fundamentals. U.S. economic activity is turning down anew, despite overstated growth in recent GDP reporting. The headline contraction in first-quarter 2014 GDP was the reality; the headline second-quarter GDP boom and continued strong headline GDP growth in third-quarter 2014 were not. The more-recent data appear to have been spiked, at best, by overly-optimistic assumptions on the part of the Bureau of Economic Analysis (BEA). At worst, the bloated growth estimates reflect heavy political massaging. Where third-quarter GDP still may see some near-term downside revision, both second- and third-quarter 2014 GDP growth patterns should suffer heavy downside revisions in the July 30, 2015 benchmark revision. The weak, underlying economic reality should become increasingly and painfully obvious to the financial markets in the domestic economic reporting and accompanying data revisions of the weeks and months ahead, including early indications for an outright contraction in fourth-quarter 2014 GDP.

As expanded upon in the *Opening Comments*, 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, discussed in *Commentary No. 668*, actual 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. Further, Main Street U.S.A. remains the ultimate judge of actual economic activity, and the 2014 election results and related exit polling confirmed no post-Panic economic recovery (see *Commentary No. 672*).

Despite short-term pre-election fluff, those basic underlying and increasingly-negative economic conditions should show with mounting frequency in various series, such as the trade deficit, retail sales, industrial production, payroll employment and inventories, providing consensus expectations with downside shocks. In turn, that should shift the popular outlook quite rapidly towards a "new recession," with negative shifts in the economic consensus negatively roiling the extraordinarily unstable financial markets.

As financial-market expectations shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, particularly deteriorating domestic political conditions, 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, and the Fed soon will find that it has no easy escape from its quantitative easing.

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 simply 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 only a prop to the increasingly unstable equity markets (see *Commentary No. 663*).

In the event of QE4, any resulting renewed boost to U.S. equities 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 (see *Commentary No. 672*).

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:

- ***A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew.*** The circumstance includes a widening trade deficit (an initial improvement reported for the third-quarter 2014 trade balance should prove to be transitory, with a negative first revision already in place), 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 (see *Opening Comments* of *Commentary No. 673*). Sharply-negative economic reporting shocks, versus unrealistically-positive consensus forecasts, remain a heavily-favored, proximal trigger for the pending dollar debacle.

- ***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. The impact of the shift in control of Congress will be assessed in the weeks ahead, but the change does not appear likely to alter the systemic willingness to address the underlying fundamental issues, specifically to bring the GAAP-based deficit into balance. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version continues to run in the $6-trillion-plus range for annual shortfall, 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; the initial fiscal-2014 details are discussed in *Commentary No. 672*.

- ***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 Federal Reserve's formal asset purchases, the U.S. central bank monetized 78% of the U.S. Treasury's fiscal-2014 cash-based deficit, as discussed in *Commentary No. 672*. The quantitative easing QE3 asset purchase program effectively monetized 66% of the total net issuance of federal debt to be held by the public during the productive life of the program (beginning with the January 2013 expansion of QE3). The monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury. With highly tenuous liquidity conditions for the banking system and the Treasury, it would not be surprising in this period of increasing instability to see covert Federal Reserve activities masked in the purchases of Treasury debt by nations or other entities financially friendly to or dependent upon the United States.

- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, usually 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. The positive rating for the President is at an historic low, post-election. Early post-election activity continues to show disintegrating chances of a shift towards constructive cooperation between the White House and the new Congress in addressing fundamental issues such as non-recovered, faltering economic activity and the consumer liquidity crisis, and addressing the nation's long-range solvency issues, let alone addressing the contentious immigration circumstance. Conditions here still could devolve rapidly into an extreme political crisis (see *Opening Comments* of *Commentary No. 673*)

- ***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 ongoing 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 continue to expand. In particular, anti-dollar rhetoric and actions 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.

REPORTING DETAIL

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

Most-Worthless of Economic Series. The upside first revision to third-quarter 2014 GDP growth to 3.9%, from 3.5%, on top of headline second-quarter GDP growth of 4.6%, simply is not credible. Discussed in the *Opening Comments*, an economy growing that quickly is not supported by the current underlying economic fundamentals. It also is not supported by major indicators of economic activity that are beyond the reporting purview of the federal government. Independent data generally support ShadowStats contentions that the U.S. economy never recovered from the recession, and that current business activity is stagnant and trending to the downside.

The GDP remains the most-worthless and the most-heavily modeled, massaged and politically-manipulated of government economic series. Beyond historical changes in reporting methodology that have built upside biases into headline GDP growth, a special-purpose political manipulation still appears to be a likely factor in recent and current reporting. While it may take some time for the full story to surface, key underlying data of the next several months likely will see significant downside reporting and revisions.

Otherwise, the headline GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Again, underlying real-world economic activity suggests that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in recent quarters (see *2014 Hyperinflation Report—The End Game Begins – First Installment Revised*, and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*).

Notes on GDP-Related Nomenclature and Definitions

For purposes of clarity and the use of simplified language in the text of the GDP analysis, here are definitions of several key terms used related to GDP reporting:

Gross Domestic Product (GDP) *is the headline number and the most widely followed broad measure of U.S. economic activity. It is published quarterly by the Bureau of Economic Analysis (BEA), with two successive monthly revisions, and with an annual revision in the following July.*

Gross Domestic Income (GDI) *is the theoretical equivalent to the GDP, but it generally is not followed by the popular press. Where GDP reflects the consumption side of the economy and GDI reflects the offsetting income side. When the series estimates do not equal each other, which almost always is the case, since the series are surveyed separately, the difference is added to or subtracted from the GDI as a "statistical discrepancy." Although the BEA touts the GDP as the more accurate measure, the GDI is relatively free of the monthly political targeting the GDP goes through.*

Gross National Product (GNP) *is the broadest measure of the U.S. economy published by the BEA. Once the headline number, now it rarely is followed by the popular media. GDP is the GNP net of trade in factor income (interest and dividend payments). GNP growth usually is weaker than GDP growth for net-debtor nations. Games played with money flows between the United States and the rest of the world tend to mute that impact on the reporting of U.S. GDP growth.*

Real *(or* ***Constant Dollars****) means the data have been adjusted, or deflated, to reflect the effects of inflation.*

Nominal *(or* ***Current Dollars****) means growth or level has not been adjusted for inflation. This is the way a business normally records revenues or an individual views day-to-day income and expenses.*

GDP Implicit Price Deflator (IPD) *is the inflation measure used to convert GDP data from nominal to real. The adjusted numbers are based on "Chained 2009 Dollars," as introduced with the 2013 comprehensive revisions, where 2009 is the base year for inflation. "Chained" refers to the substitution methodology which gimmicks the reported numbers so much that the aggregate of the deflated GDP sub-series missed adding to the theoretically-equivalent deflated total GDP series by $41.8 billion in "residual," as of the initial estimate of second-quarter 2013.*

Quarterly *growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by multiplying it by four, the BEA uses the compounding method, raising the quarterly growth rate to the fourth power. So a one percent quarterly growth rate annualizes to 1.01 x 1.01 x 1.01 x 1.01 = 1.0406 or 4.1%, instead of 4 x 1% = 4%.*

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

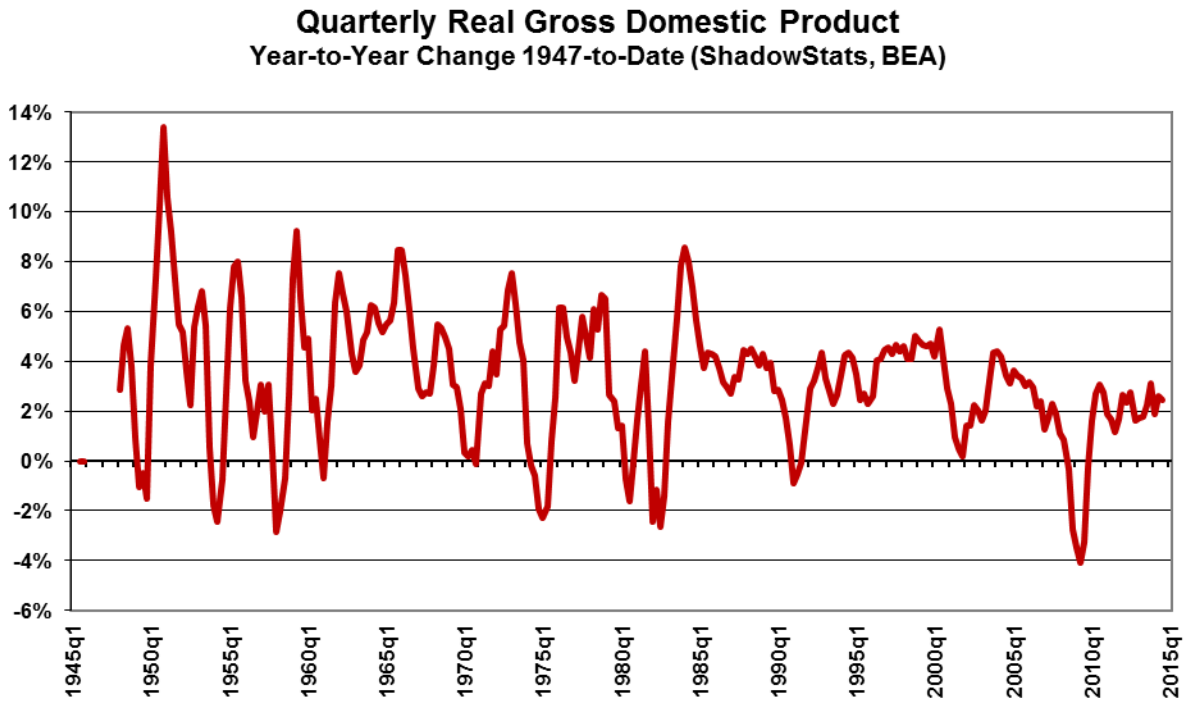
Gross Domestic Product (GDP). Published this morning, November 25th, by the Bureau of Economic Analysis (BEA), the second estimate of, first revision to, third-quarter 2014 GDP was a statistically-significant, real (inflation-adjusted), annualized, quarterly headline gain of 3.9% (3.89% at the second decimal point) +/- 3.5% (95% confidence interval). Third-quarter growth previously had been estimated at 3.5% (3.55% at the second decimal point). The revised, overstated headline growth was down from the still heavily-overstated estimate of 4.59% growth in second-quarter 2014, and versus a benchmarked 2.11% contraction (-2.11%) [a pre-benchmark 2.93% drop (-2.93%) per *Commentary No. 646*)] in first-quarter 2014.

The third-quarter GDP growth estimate is not credible, and may revise lower in its "final" version, due for release on December 23rd. Separately, both the second- and third-quarter 2014 GDP estimates should face significant downside revisions in the annual benchmarking and revisions due in July 2015.

Distribution of the headline quarterly GDP growth rate by major components is detailed in the *Opening Comments*.

Shown in the two following graphs, headline year-to-year growth in real third-quarter 2014 GDP revised to 2.43% (previously 2.35%), versus 2.59% annual growth in the second-quarter and versus benchmarked growth of 1.89% (1.54% pre-benchmark) in the first-quarter. The first graph shows current detail, from 2000-to-date, where the second graph shows the series in terms of its full quarterly history.

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



Implicit Price Deflator (IPD). The second estimate of third-quarter 2014 GDP inflation, or the implicit price deflator (IPD), was 1.39% (previously 1.28%), versus 2.15% in second-quarter 2014, and a benchmarked 1.33% in first-quarter 2014. The revised year-to-year, third-quarter 2014 IPD inflation was 1.57% (previously 1.54%), versus 1.64% in second-quarter 2014 and a benchmarked 1.37% in first-quarter 2014.

For comparison, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation published by the Bureau of Labor Statistics (BLS) was up by 1.10% for third-quarter 2014, versus 3.03% for second-quarter 2014 and 1.91% for first-quarter 2014. Unadjusted, year-to-year quarterly inflation was 1.78% for third-quarter 2014, versus 2.05% for second-quarter 2014 and 1.41% for first-quarter 2014.

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

Gross National Product (GNP). The first estimate of third-quarter 2014 real GNP growth was published today (November 25th) along with the second estimate of third-quarter GDP growth.

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

With only minor relative shifts in third-quarter versus second-quarter factor-income activity, the headline annualized quarterly-growth rate in real third-quarter 2014 GNP was 3.80% (versus 3.89% GDP), down from 4.57% in the second-quarter, but up from a benchmarked 2.81% (-2.81%) contraction in first-quarter

2014. Pre-benchmark, headline first-quarter growth had shown a contraction of 3.61% (-3.61%). Year-to-year change was 2.28% in third-quarter 2014, versus 2.53% in the second-quarter 2014 and a benchmarked annual gain of 1.86% in first-quarter 2014.

Gross Domestic Income (GDI). The first estimate of third-quarter 2014 real GDI growth was published today (November 25th) along with the second estimate of third-quarter GDP growth. Unlike the GDP reporting, which is immune to further revisions until the July 2015 benchmarking, second-quarter 2014 GDI was revised sharply lower, which had the effect of spiking headline third-quarter GDI growth.

GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a "statistical discrepancy" to the GDI-side of the equation, but the discrepancy just as easily could be added to the GDP number.

The headline annualized quarterly-growth rate in real third-quarter 2014 GDI was 4.48% (versus 3.89% GDP), versus revised headline growth of 3.95% (previously 5.25%) in second-quarter 2014, up from a revised 0.78% (-0.78%) contraction [previously benchmarked as a 0.44% contraction (-0.44%)] in first-quarter 2014. Pre-benchmark, headline first-quarter growth GDI had shown a 2.61% (-2.61%) contraction. Year-to-year change was 2.35% in third-quarter 2014, versus 1.72% in second-quarter 2014 and 1.41% in first-quarter 2014.

As discussed in the *Opening Comments*, however, net of the prior-period (second-quarter) revision, third-quarter GDI growth was 3.19% instead of the new headline 4.48%.

The statistical discrepancy has been unstable, as usual, in recent reporting. In nominal terms (all negative), the third-quarter discrepancy was \$180.4 billion, versus a revised \$153.5 (previously \$202.5) billion as of second-quarter 2014 and \$177.5 billion as of a benchmarked first-quarter 2014, which had been \$105.3 billion pre-benchmark.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for third-quarter 2014 GDP remained a 1.7% year-to-year contraction (-1.7%) versus the revised headline third-quarter GDP gain of 2.4% (previously 2.3%). Those third-quarter 2014 estimates were against a similar ShadowStats estimated 1.7% (-1.7%) year-to-year contraction but a headline year-to-year gain of 2.6% in second-quarter GDP (see the Alternate Data tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, the headline 3.9% quarter-to-quarter gain for third-quarter 2014 likely was much weaker, flat-to-minus, net of all the regular reporting gimmicks. Some downside revision may follow in next month's GDP reporting, but the July 30, 2015 annual benchmark revision now is the most likely vehicle for moving recent, gimmicked headline growth to more-reasonable levels. An actual quarterly contraction appears to have been a realistic possibility for the real GDP in most quarters since the official, second-quarter 2009 end to the 2007 recession.

Adjusted for understated inflation and other methodological changes (such as the inclusion of intellectual property, including software), the business downturn that began in 2006/2007 is ongoing; there has been no meaningful economic rebound. The "corrected" real GDP graph, and the longer-term "corrected" graph updated from *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* (see the *Opening Comments* section) are based on the removal of the impact of hedonic quality adjustments that have reduced the reporting of official annual GDP inflation by roughly two-percentage points. It is not the same measure as the ShadowStats-Alternate GDP, which reflects reversing additional methodological distortions ("Pollyanna Creep") of recent decades.

WEEK AHEAD

Against Overly-Optimistic Expectations, Pending Economic Releases and Revisions Should Trend Much Weaker; Inflation Releases Should Be Increasingly Stronger. Shifting some to the downside, again, from the upside, amidst wide fluctuations in the numbers, market expectations for business activity still are overly optimistic in the extreme. They exceed any potential, underlying economic reality. Continuing, downside corrective revisions and an accelerating pace of downturn in broad-based headline economic reporting, however, increasingly should hammer those expectations.

Longer-Range Reporting Trends. While gradual process of downside shifting in economic-growth expectations has been sporadic, underlying fundamental activity has remained extraordinarily negative. Allowing for the nonsense-growth in the headline second-quarter and third-quarter GDP (see *Opening Comments*), renewed weakness has been, and increasingly will be seen in the post-election headline reporting of other major economic series (see *2014 Hyperinflation Report—Great Economic Tumble* – *Second Installment*). 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 (which most likely will involve reporting of fourth-quarter 2014 GDP).

A generally stronger consumer inflation trend remains likely, as seen before August, although headline inflation is muted at present by a temporary decline in oil prices. 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, covert financial sanctions 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). Combined with recent allegations (see *Commentary No. 669*) of Census Bureau falsification of data in its monthly Current Population Survey (the source for the Bureau of Labor Statistics' Household Survey), these issues have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

PENDING RELEASES:

New Orders for Durable Goods (October 2014). Reporting of October 2014 new orders for durable goods is scheduled for tomorrow Wednesday, November 26th, by the Census Bureau. Reflecting massive, irregular swings in commercial aircraft orders, aggregate orders surged by 22.5% in July and then plunged by an offsetting 18.3% (-18.3%) in August, but were relatively quiet in September, down by 1.3% (-1.3%). Aircraft orders are long-term—years in advance—so they have limited impact on near-term production. Further, by their nature, they do not lend themselves to meaningful seasonal adjustment.

The headline durable goods orders series, net of that extreme volatility, has been reasonably stagnant and should remain stagnant-to-lower in October reporting. Market expectations appear to be for a small decline in orders, well within the normal month-to-month volatility of the series.

As discussed in *Commentary No. 675*, however, the October PPI inflation measure for manufactured durable goods showed a 0.54% headline monthly pickup, and that, in turn, suggests that the headline durable goods change in October will be reduced, in real terms, net of inflation.

New-Home Sales (October 2014). The October 2014 new-home sales report also is due from the Census Bureau tomorrow, Wednesday, November 26th. Smoothed for extreme and nonsensical monthly gyrations, a pattern of stagnation or intensifying downturn appears to be in play for the new-home sales series. While monthly changes in activity here rarely are statistically-significant, still-unstable reporting and revisions (both likely to the downside) remain a fair bet for October. Consensus outlook appears to be for little change

Home sales activity, in general, continues to be restricted by severe liquidity constraints on the U.S. consumer (see discussion in *Commentary No. 673*). Both the existing-home sales (see today's *Opening Comments* and *Reporting Details* sections) and the new-home sales series remain highly unstable, but increasingly they should move to the downside in activity, looking increasingly like the graph of smoothed single-unit housing starts shown in the *Opening Comments* section.

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