John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 700
Fourth-Quarter 2014 GDP, First Revision

February 27, 2015

Downside GDP Revision Reflected Corrections to Excess Inventory Levels

Downside Revisions Loom for Historic GDP Growth

First-Quarter 2015 Economic Outlook Is Troubled

PLEASE NOTE: The next regular Commentary, *scheduled for Friday, March 6th, will cover the February Employment and Unemployment Numbers, and the January trade deficit and construction spending.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Further Downside Ahead in GDP Revisions and First-Quarter Estimate. Noted in yesterday's *Commentary No. 699*, both retail sales and new orders for durable goods showed slowing or contracting fourth-quarter 2014 growth, with indications of outright first-quarter 2015 contractions already in play, irrespective of the series being, or not being, adjusted for inflation. Those patterns should become increasingly obvious in headline reporting of the next month or so, exacerbated by long-planned revisions. The effects of the weakening underlying data, on both forthcoming and soon-to-be-revised historical GDP growth patterns, should be distressing to the consensus outlook of a fully-recovered and expanding U.S. economy.

Major benchmark revisions loom for retail sales, industrial production and new orders for durable goods. Those historical revisions should be massively negative in this government-shutdown-delayed, catch-up reporting. Related, serious downside revisions to recent and current GDP reporting also should follow, come the annual benchmark revisions of July 30, 2015.

Separately, further downside growth adjustment to the fourth-quarter 2014 GDP estimate remains a good bet for the next regular, monthly revision on March 27th. Eventually, fourth-quarter 2014 GDP should be close to flat, but such is not likely before the July benchmarking.

Today's Missive (February 27th). Today's *Commentary* concentrates on the detail from the second estimate, first revision of fourth-quarter 2014 GDP.

The *Week Ahead* section previews the reporting of the January trade deficit and construction spending, plus the reporting of the headline February labor data.

Gross Domestic Product (GDP)—Fourth-Quarter 2014, Second Estimate—Downside Revisions Were Largely in Fluff Elements Used to Boost Initial Reporting. Discussed extensively in last month's GDP *Commentary No. 691*, when the Bureau of Economic Analysis (BEA) brought in its initial estimate of fourth-quarter GDP growth at 2.6%—well below consensus estimates of 3.2%—it likely was signaling consensus forecasters that BEA's fourth-quarter GDP growth estimate was well below consensus, and that subsequent revisions would follow.

Such was seen in the second estimate of fourth-quarter GDP at 2.2% (near consensus), and that likely will be seen again with a revision to below 2.0% in next month's third revision. Today's revision to the downside primarily was from one of the BEA's regular fluff elements—business inventories—and significant other fluff remains for extraction in next round of reporting.

Headline Fourth-Quarter 2014 GDP. The second estimate of, first revision to fourth-quarter 2014 GDP reflected statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline growth of 2.19%, revised lower from initial reporting 2.64%.

That followed headline annualized real growth of 4.97% in third-quarter 2014, 4.59% real growth in second-quarter 2014, and a real annualized contraction of 2.11% (-2.11%) in first-quarter 2014. All these numbers face likely significant downside revisions in the annual benchmarking. The fourth-quarter estimate faces a final monthly revision on March 27th. Distribution of the headline quarterly GDP growth is detailed below.

Shown in the graphs of the *Reporting Detail* section, headline year-to-year growth in real fourth-quarter 2014 GDP revised lower to 2.37%, versus 2.70% in third-quarter 2014, 2.59% annual growth in the second-quarter 2014, and 1.89% in the first-quarter 2014. Year-to-year growth in fourth-quarter 2013 was 3.13%.

Implicit Price Deflator (IPD). As general guidance, the weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

The second estimate of fourth-quarter 2014 GDP inflation, or the implicit price deflator (IPD), revised to an annualized quarterly gain of 0.13%, up from an initial estimate of annualized quarter-to-quarter contraction of 0.09% (-0.09%). The revision, which had the effect of dampening quarterly real GDP growth, was in the same direction as the recent revisions to the CPI-U (see *Reporting Detail*). The small fourth-quarter inflation gain was versus annualized inflation of 1.38% in third-quarter 2014, 2.15% in second-quarter 2014, and 1.33% in first-quarter 2014.

In the initial reporting, the unusual fourth-quarter 2014 contraction in the IPD meant that the initial real fourth-quarter growth of 2.64% actually was higher than the nominal fourth-quarter growth of 2.55%. In the latest version, the revised headline fourth-quarter real growth of 2.19% is against revised nominal growth of 2.33%.

Year-to-year, fourth-quarter 2014 IPD inflation was a revised 1.25% (previously 1.19%), versus 1.57% in third-quarter 2014, 1.64% in second-quarter 2014, 1.37% in first-quarter 2014, and 1.40% in fourth-quarter 2013. Annual average IPD inflation revised to 1.46% (previously 1.44%) in 2014, versus 1.49% in 2013.

Gross National Product (GNP) and Gross Domestic Income (GDI) Reporting Delayed Due to Usual Lack of Meaningful Data. Given the poor-quality of broad economic data available, year-end reporting tradition has been to delay the initial fourth-quarter and annual estimates of Gross National Product (GNP) and Gross Domestic Income (GDI), until the second (next) revision of the fourth-quarter GDP (on March 27th, this year). Such a delay in GDP reporting would have been of value, as well, given the usual lack of significance to the early headline reporting (see *Reporting Detail* for descriptions of the GNP and GDI).

Distribution of Headline GDP Growth. Despite the severely-limited significance of the following detail, it is included for those interested in the reported internal patterns of GDP growth, as guessed at by the BEA. The first revision, second guesstimate of headline, annualized quarterly growth in fourth-quarter 2014 GDP was 2.19% (previously 2.64%), following 4.97% headline growth in third-quarter 2014, 4.59% growth in second-quarter 2014, and a contraction of 2.11% (-2.11%) in first-quarter 2014 GDP. The first revision here encompassed a sharp downturn in inventory building, with some offset to the inventory decline from a gain in nonresidential fixed investment.

The second estimate of the fourth-quarter 2014 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 2.83% + 0.84% - 1.15% - 0.32% = 2.20% (rounding difference versus 2.19%). When all the dust settles from revisions in the next six months, headline fourth-quarter 2014 GDP quarter-to-quarter growth, again, should be flat-to-minus.

- ***Consumer Spending Contributed 2.83% [Previously 2.87%] to Fourth-Quarter Growth; Contributed 2.21% to Third-Quarter.*** Little changed in aggregate, headline fourth-quarter personal consumption remained heavily bloated by the questionable effects and measurement of the Affordable Care Act (ACA), which likely still contributed in excess of 0.8% of the overall 2.2% headline GDP growth. Nebulous changes (such as "other") shifted about 0.2% of the aggregate growth from goods to services in personal consumption, always a suspect change. Goods usually are reasonably hard measures, while services are relatively soft. .

- ***Business/Residential Investment Contributed 0.84% [Previously 1.20%] to Fourth-Quarter Growth; Contributed 1.18% to Third-Quarter.*** An involuntary inventory build-up added 0.82% to the aggregate GDP growth rate in the first estimate, but that fell apart in the first revision, subtracting 0.70% (-0.70%) from the second estimate of GDP growth. As a result of the downward revision to inventory building, final sales (GDP minus inventory change) rose to 2.07%, from the previous estimate of 1.82%. The inventory hit to GDP growth partially was offset by a greater increase in nonresidential fixed investment.

- ***Net Exports Subtracted 1.15% (-1.15%) [Previously 1.02% (-1.02%)] from Fourth-Quarter Growth; Contributed 0.78% to Third-Quarter.*** Little changed, the net export account subtracted extra 0.13% (-0.13%) from the aggregate growth rate, but most of the initial trade-deficit deterioration was picked up in the first GDP estimate, where it already reflected much of the widening in the headline December 2014 trade reporting (see *Week Ahead* section).

- ***Government Spending Subtracted 0.32% (-0.32%) [Previously 0.40% (-0.40%)] from Fourth-Quarter Growth; Contributed 0.80% to Third-Quarter.*** All the change here was from pick-up in state and local government "gross investment." The federal government's numbers did not change.

Economic Reality. Even with the second estimate of annualized fourth-quarter 2014 GDP growth slowing to a revised 2.19%, following 4.97% growth in third-quarter 2014, 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, as discussed in *No. 692 Special Commentary: 2015 - A World Out of Balance*. The broad economy is turning down anew. A wide variety of monthly economic detail is showing that (see *Commentary No. 699*) and should continue to confirm same in reporting of the months ahead.

Major benchmark revisions loom in the next several months for key series such as retail sales, industrial production and new orders for durable goods. The historical revisions should be massively negative in this government-shutdown-delayed, catch-up reporting. Related, serious downside revisions to recent and current GDP reporting also are likely, come the annual benchmark revision of July 30, 2015. Separately, further downside growth adjustment to the fourth-quarter 2014 estimate should follow in the next regular, monthly revision (March 27th). Accordingly, the gist of much of the following text remains along the lines of other recent GDP *Commentaries,* but the details and numbers updated for the latest 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, including a recent pattern of inclusion and estimation of highly-questionable data on the Affordable Care Act (ACA), 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 employment and monthly real median household income and other consumer measures as detailed, again, in *No. 692 Special Commentary: 2015 - A World Out of Balance*. 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*). 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.

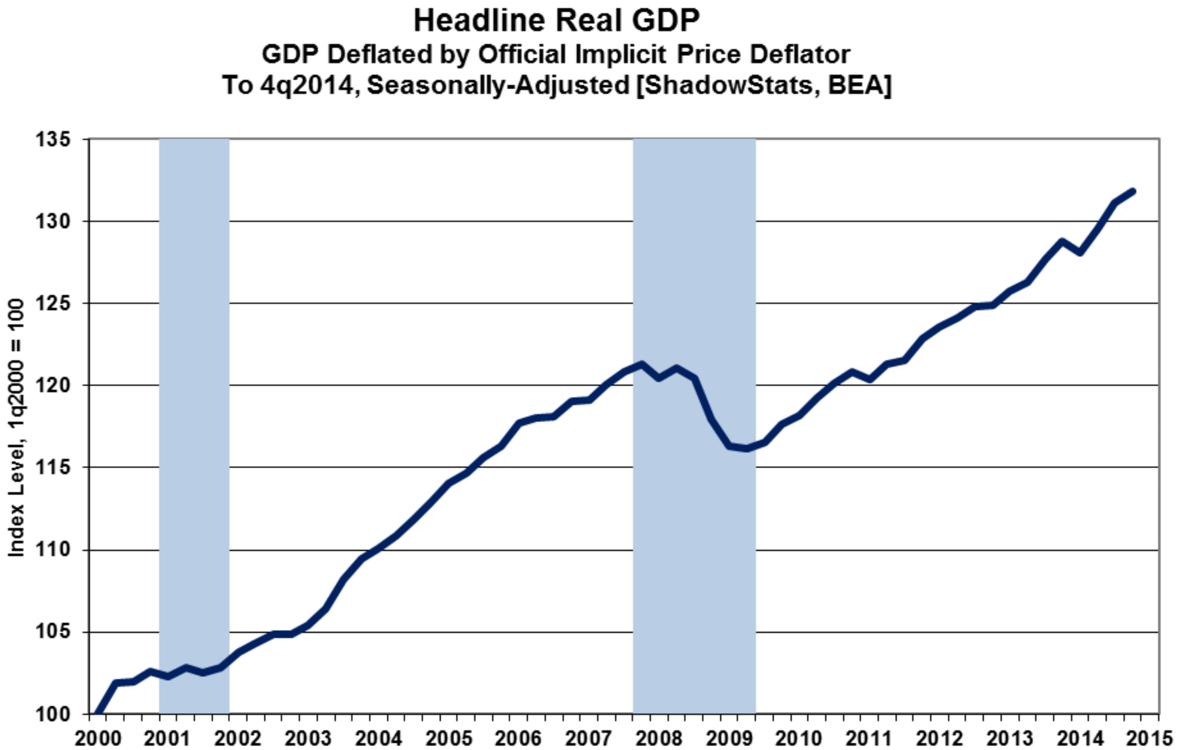
Official and Corrected GDP. As usually discussed in these *Commentaries* covering the quarterly GDP reporting and monthly updates, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. The accompanying two sets of graphs tell that story, updated for the second estimate of fourth-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* and updated in *No. 692 Special Commentary* (both linked above). The graphs also show official periods of recession as shaded areas (the ShadowStats-defined recessions are indicated by the lighter shading in the second graph of the second set).

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 (a growth interruption for first-quarter 2014 excepted). Adjusted for official GDP inflation (the implicit price deflator), the level of fourth-quarter 2014 GDP currently stands 8.7% above its pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, shows fourth-quarter 2014 GDP activity at 6.2% (-6.2%) below its pre-recession peak of first-quarter 2006.

Further, discussed in the second installment of the *Hyperinflation Report*, and again in *No. 692 Special Commentary*, no other major economic series has shown a parallel pattern of official full economic recovery and meaningful expansion beyond, consistent with the GDP reporting. Such is covered in discussions on the real retail sales, industrial production and real durable goods orders series in *Commentary No. 697* and *Commentary No. 699*. 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 measure 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*.


Headline Real GDP
GDP Deflated by Official Implicit Price Deflator
To 4q2014, Seasonally-Adjusted [ShadowStats, BEA]
Index Level, 1q2000 = 100
135
130
125
120
115
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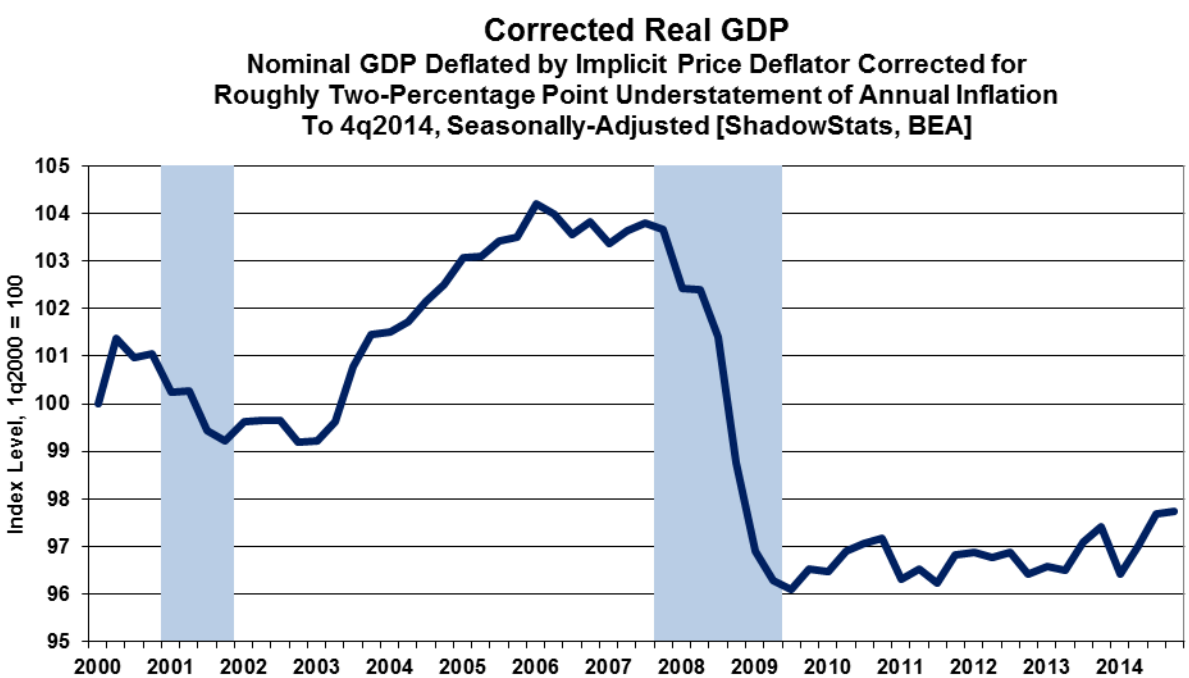
105
100
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015


Corrected Real GDP
Nominal GDP Deflated by Implicit Price Deflator Corrected for
Roughly Two-Percentage Point Understatement of Annual Inflation
To 4q2014, Seasonally-Adjusted [ShadowStats, BEA]
Index Level, 1q2000 = 100
105
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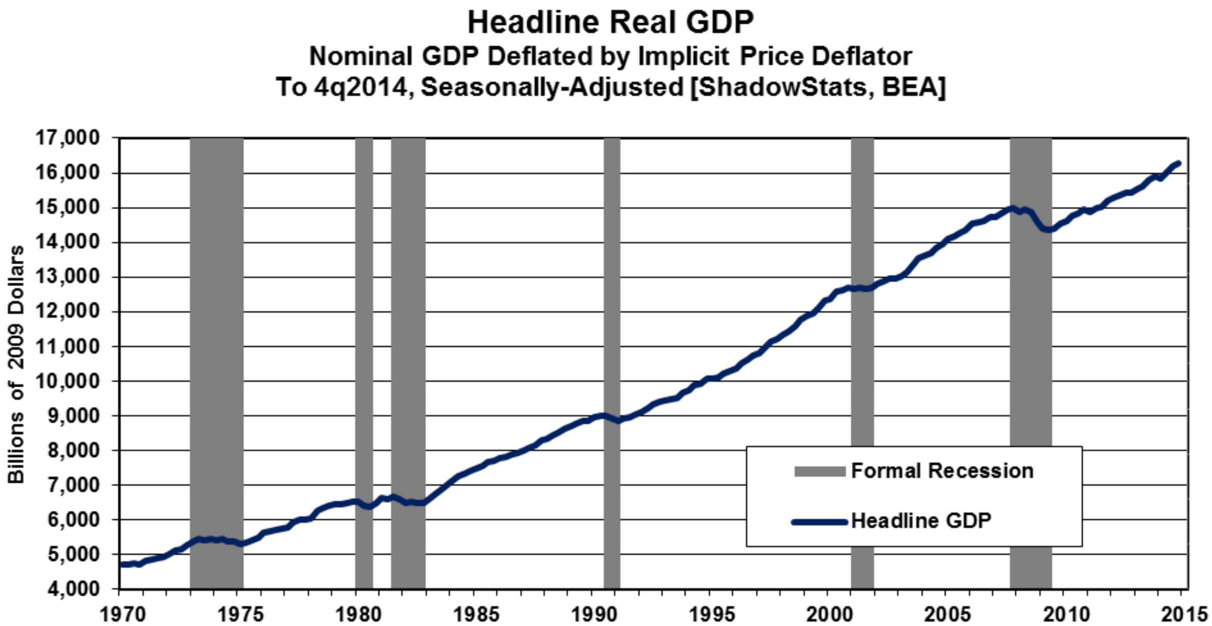
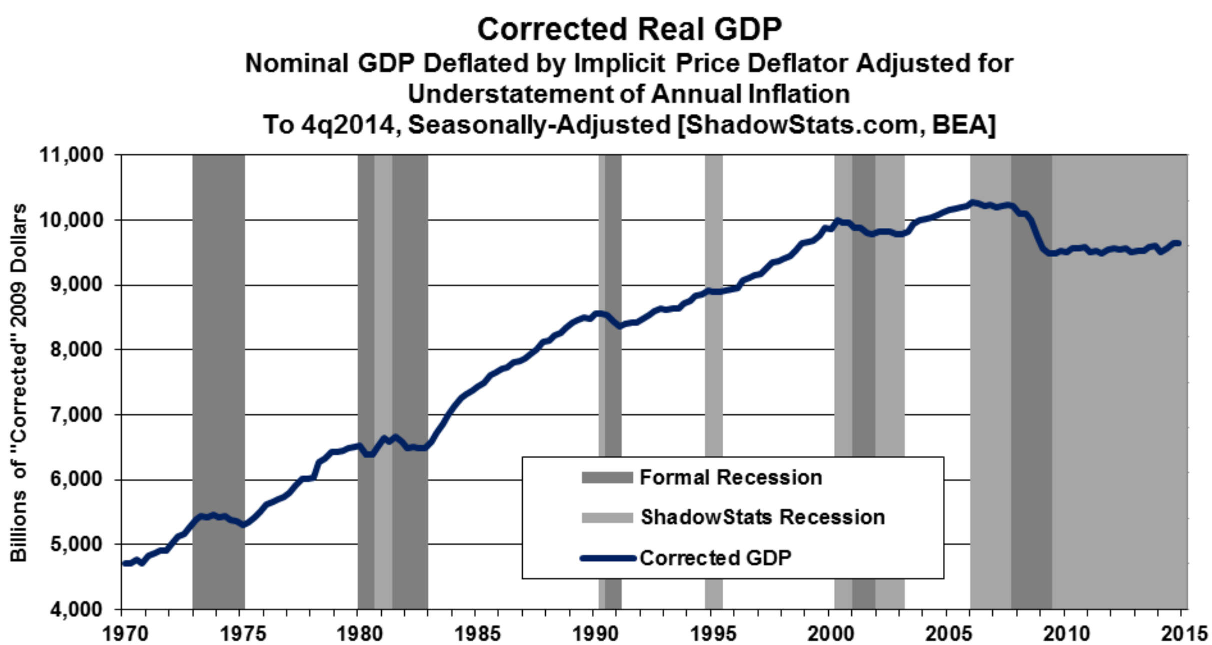


The shaded areas in the "corrected" graph that follows reflect official as well as ShadowStats-defined recessions, again as discussed in detail in the *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* and in *No. 692 Special Commentary: 2015 - A World Out of Balance*.



[Further background material on Fourth-Quarter GDP is included the* Reporting Detail*. Various drill-down and graphics options are available to subscribers at our affiliate:* www.ExpliStats.com*.]

REPORTING DETAIL

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

Headline GDP Reporting Is Not Credible, Further Downside Revisions Likely for Fourth-Quarter GDP, First-Quarter GDP Outlook Is Weakening. As was discussed here in some detail, with last month's GDP *Commentary No. 691*, when the Bureau of Economic Analysis (BEA) brought in its initial estimate of fourth-quarter GDP growth at 2.6%—well below a 3.2% consensus—it likely was signaling consensus forecasters that the BLS-calculated fourth-quarter GDP growth was well below consensus, and that subsequent revisions would follow.

Such was seen with today's publication of a downside first revision to near-consensus 2.2% growth, and that likely will be seen again with a revision to below 2.0% next month. The first revision to the downside came from one of the BEA's regular fluff elements—business inventories—and significant other fluff remains for extraction in next round of reporting.

Discussed in *No. 692 Special Commentary: 2015 - A World Out of Balance*, headline GDP reporting is not credible. Contrary to common experience, second- and third-quarter 2014 growth estimates were the strongest in more than a decade. The headline growth for fourth-quarter 2014, although growing at half the pace of preceding quarters, still significantly overstated economic reality. While downside revisions to earlier periods await the July 30, 2015 annual GDP revisions, the headline fourth-quarter growth estimate should be lowered, again, on March 27th.

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.

The GDP simply remains the most worthless of the popular government economic series, in terms of determining what really is happening to U.S. business activity. The series is the most heavily-modeled, politically-massaged and gimmicked government indicator of the economy. It has been so since at least the days when President Lyndon Johnson reportedly reviewed the numbers before their release, and would return them to the Commerce Department, if Commerce had gotten them wrong.

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 $60.4 billion in "residual," as of the second estimate of fourth-quarter 2014.*

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 today, February 27th, by the Bureau of Economic Analysis (BEA), the second estimate of, first revision to fourth-quarter 2014 GDP reflected statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline growth of 2.2% (2.19% at the second decimal point) +/- 3.5% (95% confidence interval), revised lower from initial headline reporting of 2.6% (2.64% at the second decimal point).

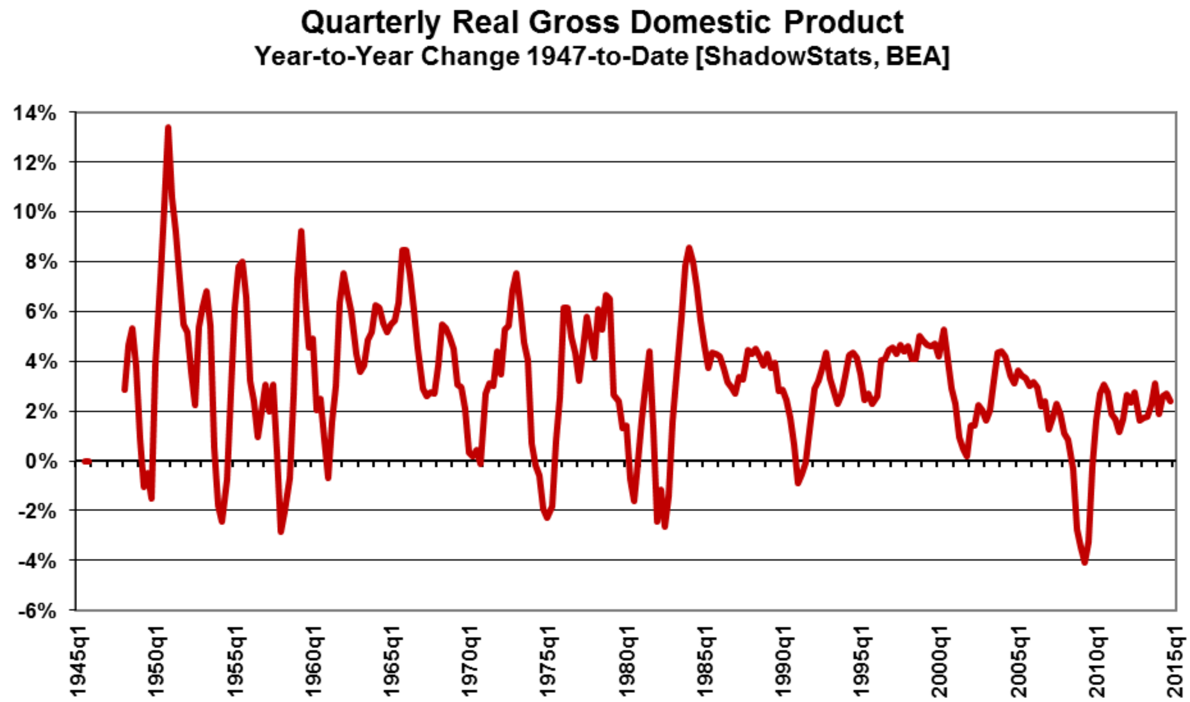
That followed headline annualized real growth of 4.97% in third-quarter 2014, 4.59% real growth in second-quarter 2014, and a real annualized contraction of 2.11% (-2.11%) in first-quarter 2014. All these numbers face likely significant downside revisions in the annual benchmarking of July 30, 2015. The fourth-quarter estimate faces a final monthly revision on March 27th. Distribution of the headline quarterly GDP growth is detailed in the *Opening Comments*.

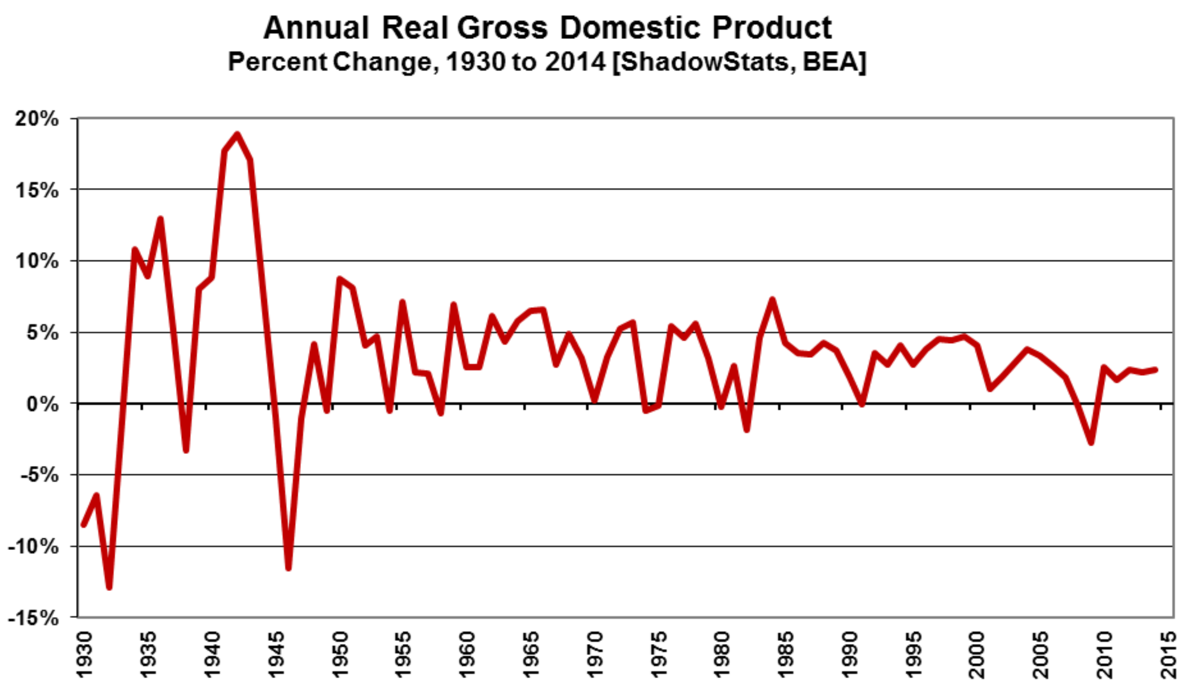
Shown in the accompanying graphs, headline year-to-year growth in real fourth-quarter 2014 GDP revised to 2.37% (previously 2.48%), versus 2.70% in third-quarter 2014, 2.59% annual growth in the second-quarter 2014, and 1.89% in the first-quarter 2014. Year-to-year growth in fourth-quarter 2013 was 3.13%.

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.

In terms of annual average growth, average real 2014 GDP was up by a revised 2.39% (previously 2.42%) over 2013, which, in turn was up by 2.22% over 2012. The annual decline in real GDP activity of 2.78% (-2.78%) in 2009 was the deepest since the 11.58% (-11.58%) plunge in the 1946 post-war production shutdown. War disruptions excluded, the headline 2009 decline was the worst since the economic plunge of 3.31% (-3.31%) in 1938, the second down leg of the Great Depression.

The first graph following shows current year-to-year quarterly detail, from 2000-to-date, where the second graph shows the same series in terms of its full quarterly history. The third graph shows the plot of historical average annual real growth, also for the full history of the series.





Implicit Price Deflator (IPD). As general guidance, the weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth. The second estimate of fourth-quarter 2014 GDP inflation, or the implicit price deflator (IPD), revised to an annualized quarterly gain of 0.13%, up from an initial estimate of annualized quarter-to-quarter contraction of 0.09% (-0.09%). The revision, which had the effect of dampening quarterly real GDP growth, was in the same direction as the recent revisions to the CPI-U (see below). The small fourth-quarter inflation gain was versus annualized inflation of 1.38% in third-quarter 2014, 2.15% in second-quarter 2014, and 1.33% in first-quarter 2014.

In the initial reporting, the unusual fourth-quarter 2014 contraction in the IPD meant that the initial real fourth-quarter growth of 2.64% actually was higher than the nominal fourth-quarter growth of 2.55%. In the latest version, the revised headline fourth-quarter real growth of 2.19% is against revised nominal growth of 2.33%.

Year-to-year, fourth-quarter 2014 IPD inflation was a revised 1.25% (previously 1.19%), versus 1.57% in third-quarter 2014, 1.64% in second-quarter 2014, 1.37% in first-quarter 2014, and 1.40% in fourth-quarter 2013.

Annual average IPD inflation revised to 1.46% (previously 1.44%) in 2014, versus 1.49% in 2013.

The following comparison of headline CPI-U inflation versus the IPD, on a seasonally-adjusted, annualized quarter-to-quarter basis, incorporates the annual revisions to CPI-U seasonal adjustments, published by the Bureau of Labor Statistics (BLS) on February 20th (see *Commentary No. 698*).

As revised, fourth-quarter CPI-U contracted at an annualized rate of 0.85% (-0.85%) [previously down by 1.20% (-1.20%)], versus revised gains of 1.18% [previously 1.10%] in third-quarter 2014, 2.44% [previously 3.03%] in second-quarter 2014, and 2.09% [previously 1.91%] in first-quarter 2014.

Unadjusted, year-to-year quarterly inflation was unrevised at 1.25% in fourth-quarter 2014, versus 1.78% in third-quarter 2014, 2.05% in second-quarter 2014, 1.41% in first-quarter 2014, and 1.23% in fourth-quarter 2013

Annual average CPI-U was unrevised at 1.62% in 2014 versus 1.46% in 2013.

Gross National Product (GNP) and Gross Domestic Income (GDI) Reporting Delayed Due to Usual Lack of Meaningful Data. Given the poor-quality of broad economic data available, year-end reporting tradition has been to delay the initial fourth-quarter and annual estimates of Gross National Product (GNP) and Gross Domestic Income (GDI), until the second (next) revision of the fourth-quarter GDP (on March 27th, this year). Such a delay in GDP reporting would have been of value, as well, given the usual lack of significance to the early headline reporting.

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.

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.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for fourth-quarter 2014 GDP was a year-to-year contraction of 1.6% (-1.6%) versus the revised headline fourth-quarter GDP gain of 2.4% (previously 2.5%). Those fourth-quarter 2014 estimates were against a ShadowStats estimated 1.7% (-1.7%) year-to-year contraction and a headline year-to-year gain of 2.7% in third-quarter 2014 GDP (see the Alternate Data tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, the headline 2.2% annualized quarter-to-quarter initial gain for fourth-quarter 2014 likely was much weaker, flat-to-minus, net of all the regular reporting gimmicks. Some further downside revision may follow in next month's GDP reporting, but the July 30, 2015 annual benchmark revision remains 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, software and recent accounting for the largely not-measurable and questionable impact of the Affordable Care Act (ACA)—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 *No. 692 Special Commentary: 2015 - A World Out of Balance* and *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.

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WEEK AHEAD

Headline Reporting and Revisions Should Trend Much Weaker versus an Overly-Optimistic Economic Consensus; Inflation Will Rise Anew, Following the Bottoming of Oil-Prices. Shifting some to the downside, again, amidst wide fluctuations in the numbers, market expectations for business activity remain overly optimistic in the extreme. They exceed any potential, underlying economic reality. Downside corrective revisions and an accelerating pace of downturn in broad-based, monthly headline economic reporting should hammer those expectations heavily through mid-year. Recent GDP excesses will not face downside revisions until the July 30, 2015 GDP benchmark revision, other than for the one monthly revision still pending for fourth-quarter 2014 GDP.

Headline consumer inflation—recently driven lower by collapsing prices for gasoline and other oil-price related commodities—likely hit or was close to a near-term low in January 2015 reporting. Significant upside inflation pressures should resume as oil prices begin to rebound, a process that already appears to be underway, and one that would accelerate rapidly with an eventual sharp downturn in the exchange-rate value of the U.S. dollar. These areas, the general economic outlook and longer range reporting trends are reviewed broadly in *No. 692 Special Commentary: 2015 - A World Out of Balance*.

A Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. Beyond gimmicked changes to reporting methodologies of the last several decades, ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. Data instabilities were induced partially 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. The severity and ongoing nature of the downturn provide particularly unstable headline economic results, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment, and unemployment data, see *Commentary No. 695*). Combined with recent allegations 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 (see *Commentary No. 669*).

PENDING RELEASES:

Construction Spending (January 2015). The Commerce Department will release its estimate of January 2015 construction spending on Monday, March 2nd. The detail will be covered by ShadowStats in the *Commentary* of Friday, March 6th.

The headline monthly changes, as usual, should not be statistically significant, while previous data will be subject to large and unstable revisions. Most frequently, revisions here are to the downside. Irrespective of almost perpetually-positive market expectations for this series, the detail tends to be in down-trending stagnation, net of inflation.

U.S. Trade Balance (January 2015). The Commerce Department and Bureau of Economic Analysis (BEA) will release their estimate of the January 2015 trade deficit on Friday, March 6th. Early market expectations appear to be for a sharp narrowing of the headline trade shortfall, but as with the prior month's reporting, a wider-than-expected trade deficit usually is a good bet. Key to the final monthly revision of fourth-quarter GDP, on March 27th, will be any revisions to the December data in conjunction with the headline January detail.

While there may be some narrowing of the nominal January trade deficit—before inflation adjustment—thanks to what still will be declining in oil prices, the important consideration for the real, inflation-adjusted GDP impact is the change in the real merchandise-trade deficit. The effects of low oil prices are backed out of those calculations.

A wild card in the pending reporting also will be any effects of trade-flow disruptions from labor disputes and work slowdowns at major ports in The United States.

Otherwise, look for further widening of the headline January deficit, along with some widening of December shortfall, in revision. The general trend going forward should be for regular monthly and quarterly deteriorations in the real trade deficit, despite any short-lived narrowing of the nominal shortfall. The latter circumstance will end once the current downtrend in oil prices has run its course, a process that appears to be underway.

Noted with last month's GDP reporting (*Commentary No. 691*), published in advance of the headline December trade numbers, "the net export account subtracted more from GDP growth than was suggested by November trade deficit reporting; the impact should have been about neutral. So, there could be some 'surprise' widening in the real merchandise trade deficit in the pending December number." That happened, and today's relatively small headline revision to the net export account also implied that the BEA used early-December trade data in its "advance" fourth-quarter GDP estimate.

Employment and Unemployment (February 2015). The Bureau of Labor Statistics (BLS) will release its February 2015 labor data on Friday, March 6th. With all the annual revisions out of the way, reporting will resume in the context of the regular monthly distortions to payroll employment (excessive upside biases, and publishing irregularities with the concurrent-seasonal-factor process), and the regular monthly distortions to headline unemployment (definitional issues with "discouraged workers," and publishing irregularities with the concurrent-seasonal-factor process."

Early market expectations appear to be for softening in monthly payroll growth from January's initial headline 257,000 monthly jobs gain and, also, for a somewhat lower headline U.3 unemployment rate.

Any narrowing of the headline U.3 unemployment rate likely would encompass more employed being redefined off the unemployment rolls and out of the headline labor force, rather than gaining new employment. Underlying economic fundamentals continue to suggest ongoing deterioration in the broader unemployment rates such as U.6 and the ShadowStats Alternate Unemployment measure, as well as slowing or negative month-to-month growth in headline payrolls.

Monthly Payroll Bias Is Stronger than Early Expectations. As published previously by ShadowStats-affiliate www.ExpliStats.com, in its analysis of the biases built into the concurrent-seasonal-factor modeling of benchmark-revised January 2015 payroll employment, the implied built-in-bias trend for February 2015 is a headline jobs gain of 253,000 (see *Commentary No. 695*). Early expectations appear to be running about 20,000 jobs below the trend.

To the extent that underlying fundamentals eventually will shine through all the regular monthly volatility and distortions, the developing trend increasingly should favor weaker-than-expected payrolls gains, and higher-than-expected unemployment rates.