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

COMMENTARY NUMBER 739
Second-Quarter GDP and Benchmark Revision, Velocity of Money

July 30, 2015

U.S. Economic Activity Was Just Downgraded;
Historical GDP Numbers Were Revised Meaningfully Lower;
Second-Half 2012 Now Is Shown at Near-Recession

Post-2007 Economic History Slowly Is Taking on a Revised Pattern of a Multiple-Dip Economic Collapse

Unfolding "New" Recession Remains Very Much in Play

Despite Below-Consensus 2.3% Second-Quarter Growth,
Benchmarked GDP Level Was Below Prior Reporting for First-Quarter GDP

First-Quarter GDP Revised to Small Gain from Minor Decline, but
Broader First-Quarter GNP Remained in Headline Contraction

PLEASE NOTE: The next regular Commentary*, scheduled for Wednesday, August 4th, will cover June Construction Spending and the full estimate of the June Trade Deficit, followed by a* Commentary *on Friday, August 8th covering July Employment and Unemployment.*

Best wishes to all — John Williams

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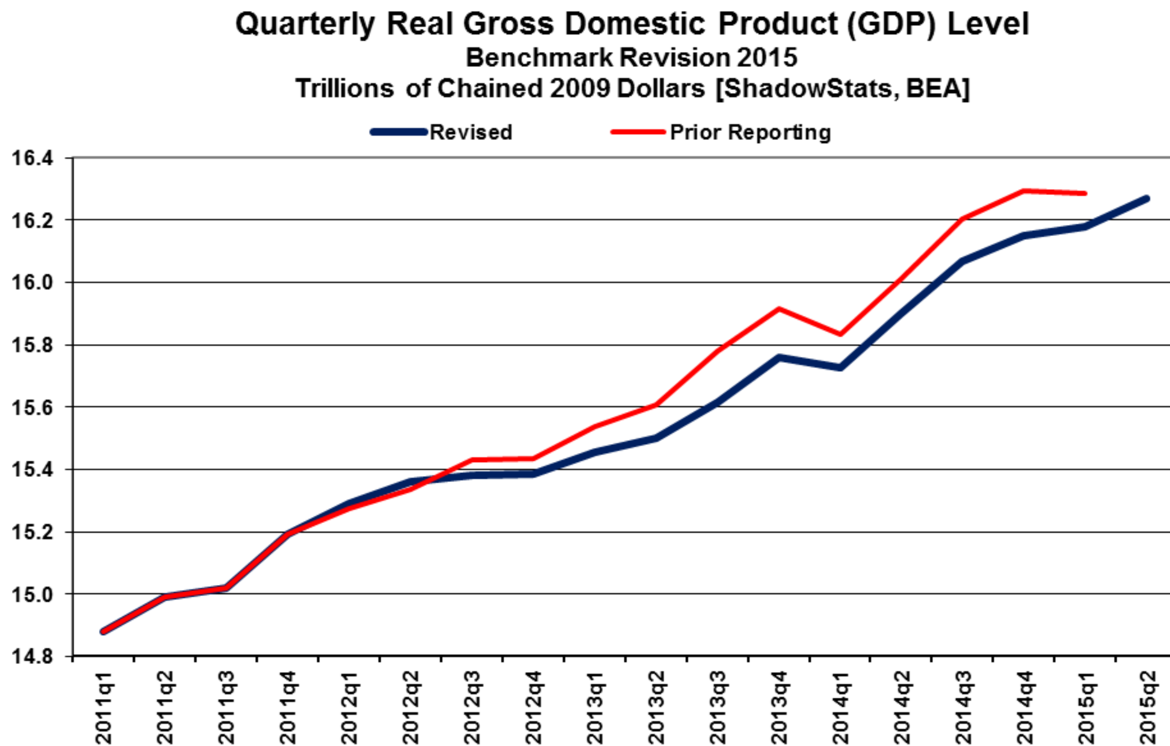
OPENING COMMENTS AND EXECUTIVE SUMMARY

Benchmark Revisions Evolve Towards Showing an Ongoing, Multiple-Dip Economic Crash. Through ShadowStats, I long have argued that after the U.S. economy began turning down in 2006 and then collapsed into 2008 and 2009, that it entered a protracted period of stagnation thereafter—never recovering. Further, in recent quarters, the domestic economy has begun to turn down anew. The Bureau of Economic Analysis (BEA) annual benchmark revisions to the GDP have started to confirm that.

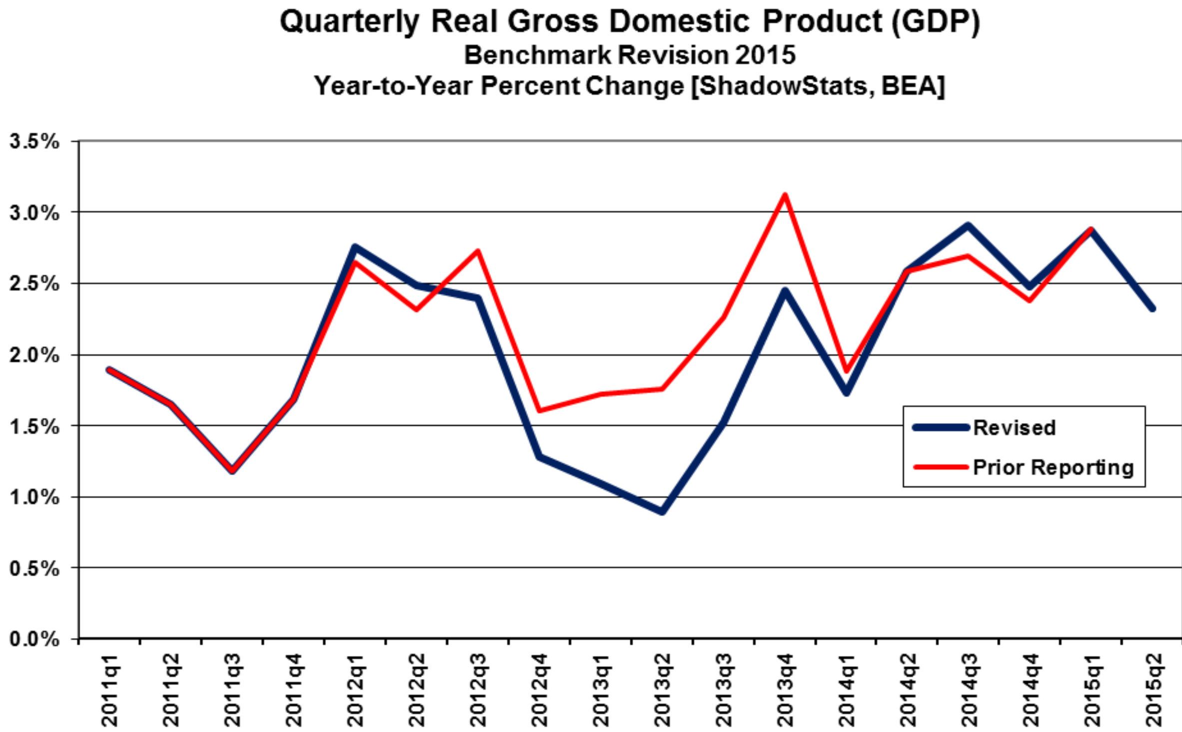
The BEA published its annual revisions to the Gross Domestic Product (GDP) and related series, today, July 30th, for the period 2012 to date, and those revisions largely were negative, showing broadly weaker growth in the benchmarking period. The following series of graphs plot some of the revised GDP detail, where the revisions generally reflected the availability of more-complete and accurate information. When more-accurate numbers are available, historical economic growth patterns usually revise lower.

As explained to me about three decades ago, by a friendly official involved with such numbers, that revision pattern happens because widely followed government statistics tend to have some upside biases built into them. Biases are added in order to prevent understating actual economic activity, and the related risk of political embarrassment for the reporting Bureau. Accordingly, when better data are available, growth in related numbers tends to slow in revision. Consider these three graphs on the GDP.

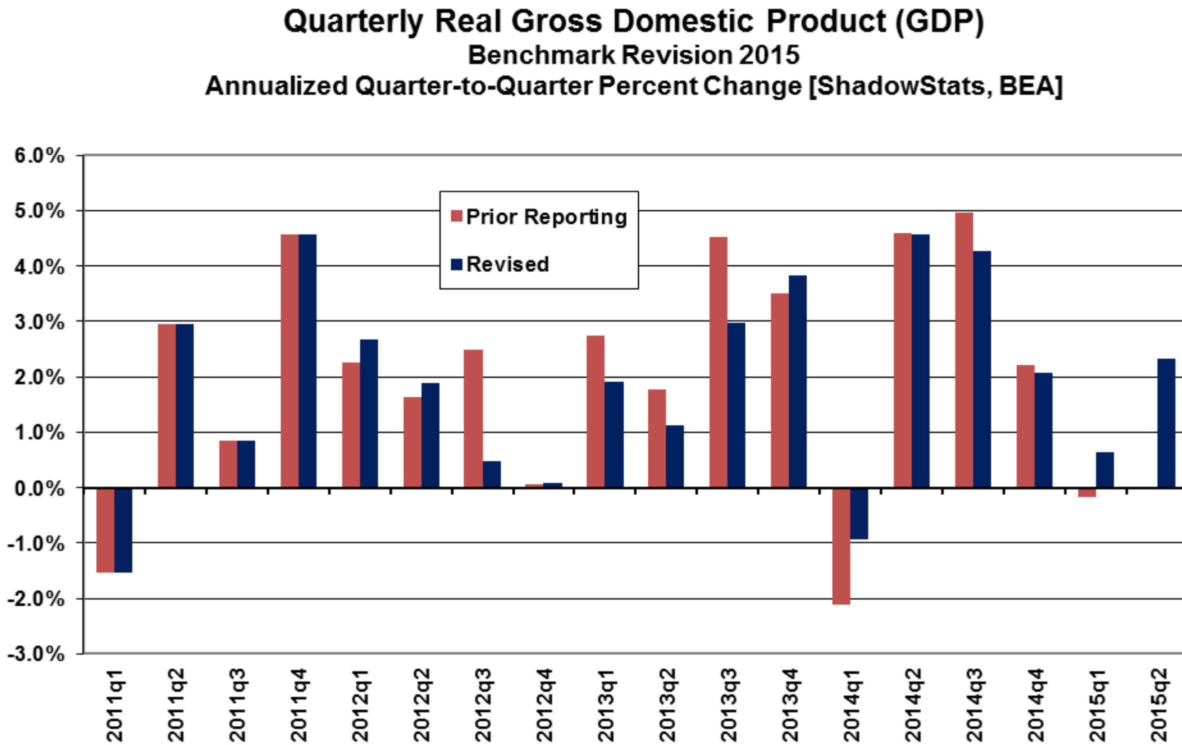
Graph 1: Gross Domestic Product (GDP) Level – Benchmark Revisions



Graph 2: Gross Domestic Product (GDP) Year-to-Year Growth – Benchmark Revisions



Graph 3: Gross Domestic Product (GDP) Quarter-to-Quarter Growth – Benchmark Revisions



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Seen recently with the benchmark revision to industrial production (*Commentary No. 737*), as well as with today's GDP revisions, the periods with new, better-quality data revised lower. Where new data were not available, the traditional upside biases remained in play or were increased.

Better data were available for GDP estimation in 2012 and 2013, which is where most of the downside growth revisions took place. Look at *Graph 3* of the revised quarterly real growth rates. Two negative numbers in row in that graph would give you a recession. In the third and fourth quarters of 2012, the annualized quarterly growth rates now are 0.48% (revised lower from 2.49%) in third-quarter 2012, and 0.09% (revised higher from 0.06%) in fourth-quarter 2012. Such flat growth is within statistical noise of being a recession.

The same thing would have happened in 2011, but, as noted in *Commentary No. 737* and *Commentary No. 738* that could not happen in this benchmarking, because 2011 was outside of the formal revision timeframe. The revision did not take place in the prior benchmarking, because the needed, better-quality data for 2011 were delayed by lingering impact from the 2013 government shutdown.

As noted in *No. 738*, "the [July 30th] GDP benchmark revision is a good bet to show flatter and weaker-than-previously reported GDP growth in the primary revision period of 2012-to-date. Patterns of more-stagnant, real quarterly GDP growth should be seen in the latter-part of 2012 and for much of 2013, leading into the existing GDP contraction for first-quarter 2014. A quarterly contraction for fourth-quarter 2012, currently showing headline growth of 0.06%, is a fair bet. [Instead, again, the prior quarter was revised lower from 2.49% to 0.48%, otherwise the revisions generally were in line with what could be expected.]

"Unfortunately, from the standpoint of getting earlier, more-accurate detail on the broad economy, the government shutdown of 2013 delayed the availability of certain corrective reporting that would have revised 2011 GDP much lower than was seen in last year's benchmarking. Such will have to await a more-comprehensive revision [probably a "comprehensive " benchmark revision in July of 2018]. Although the better-quality, subsidiary historical numbers now are available, revisions to 2011 and earlier generally are outside the scope of the pending 2012-to-2015 benchmarking."

There is a pattern of revisions here tied to better-quality data, which increasingly is eating away at the purported recovery from the economic collapse into 2008 and 2009. The likely heavily-inflated, headline growth of 2.32% in second-quarter 2015 GDP, which was calculated against the revised series, was not quite enough to get it to the pre-revision level seen for first-quarter 2015, as can be seen in *Graph 1*.

With headline detail for GDP coming out of the 2018 comprehensive revision likely to show an economic collapse into 2008 and 2009, starting to recover in 2009 but turning down again in 2011, 2012 and 2014, from the perspective of history, such a pattern likely would be viewed as something along the lines of a protracted, multiple-dip economic collapse, not an ongoing economic recovery from 2009 to date.

First-Quarter 2015 Volatility and Unusual Revisions. Coming out of the benchmark revision, first-quarter 2015 GDP, which previously had been "finalized," revised from a headline quarterly annualized contraction of 0.17% (-0.17%) to growth of 0.64%. While that revision is within the scope of statistical noise for growth rates raised to the fourth power, the change can be attributed primarily to a revised surge in the always-suspect inventory category, particularly so late in the reporting cycle.

Gross National Product (GNP), however, remained in first-quarter 2015 contraction. 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. Annualized real growth revised from a "final" contraction of 0.98% (-0.98%) to a contraction of 0.15% (-0.15%), largely due to the underlying GDP. Second-quarter 2015 growth estimates for the GNP and the GDI will not be published until next month.

Gross Domestic Income (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. Previously reported with an annualized real growth rate of 1.95% in first-quarter 2015, the GDI revised lower to 0.28% (now weaker than the GDP) as of the benchmarking.

Graphs of the revised quarterly growth rates for real GNP and Real GDI follow in *Graphs 4* and *5*.

The Implicit Price Deflator (IPD), the GDP's inflation measure, general revised higher by 0.1% to 0.2% in terms of year-to-year change in the 2012 to date period, which had the effect of helping to dampen real growth. The recently revised GDP and IPD rates of change are included in the regular text.

New Trade Deficit Reporting Does Not Appear to Add Much to Data Quality. Complicating the GDP reporting, the first "advance" trade deficit report (also released by the BEA and Census today, July 30th) provided limited, low-quality data about one week ahead of the usual "full" trade report. If the BEA is looking to improve the quality of initial GDP reporting, it might do better just to delay the GDP release by one week for full trade detail availability. In the headline data provided in the new report, the "advance" estimate of the June 2015 trade deficit in goods (no services estimated) widened to $62.256 billion, from a "final" $60.424 (previously $59.747 "advance") estimate in May.

In the previously unpublished history of this new series, the "advance" estimate understated the "final" deficit 11 out of 17 times, with errors as large as four-percent, just one-week in advance of the actual numbers. The new reporting is an indication of a widening trade deficit in June, but "final" detail to be published on August 5th still has fair shot to trigger a meaningful revision to the just-published headline second-quarter 2015 GDP (see *Week Ahead* section).

More detail from these revisions will be incorporated into various writings of the week and weeks ahead.

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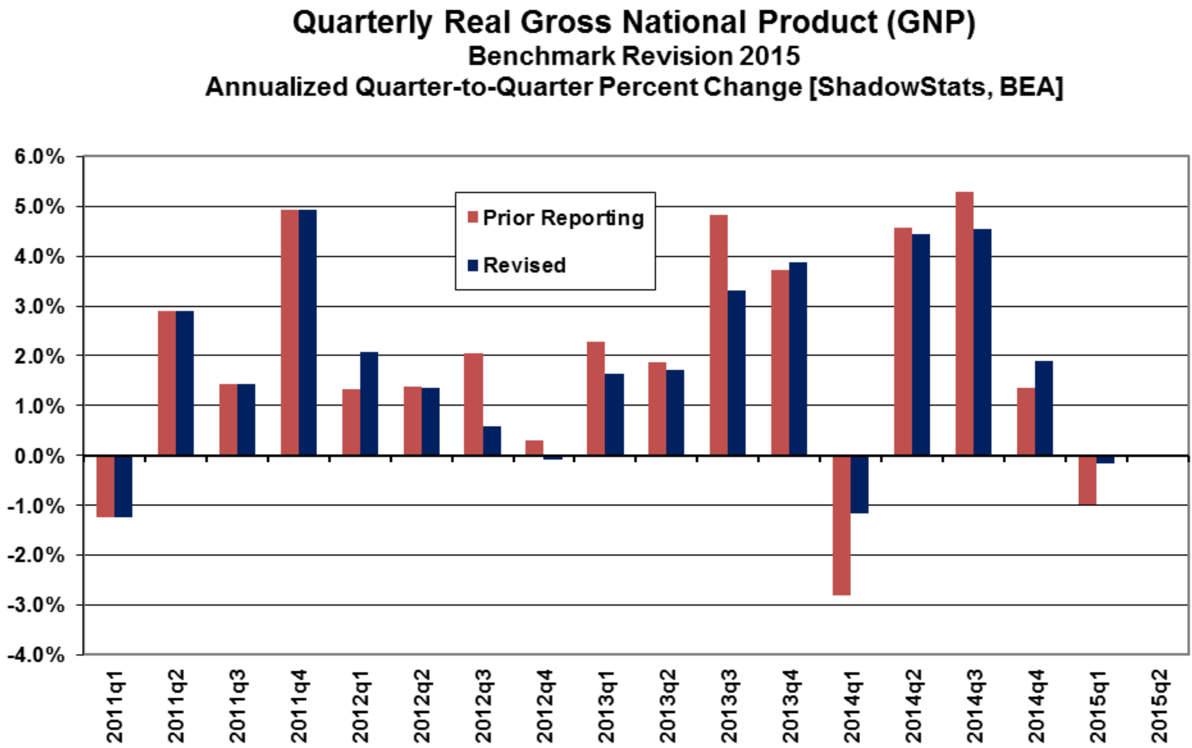
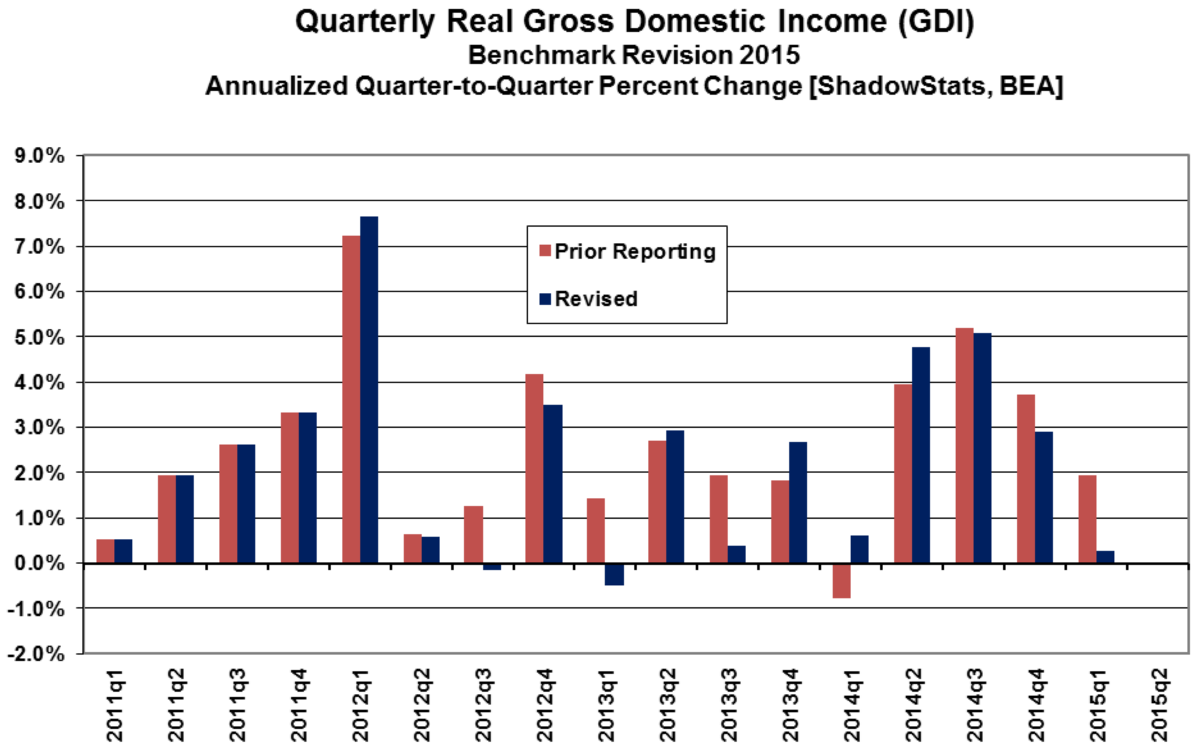
Graph 4: Gross National Product (GNP) Quarter-to-Quarter Growth – Benchmark Revisions



Graph 5: Gross Domestic Income (GDI) Quarter-to-Quarter Growth – Benchmark Revisions



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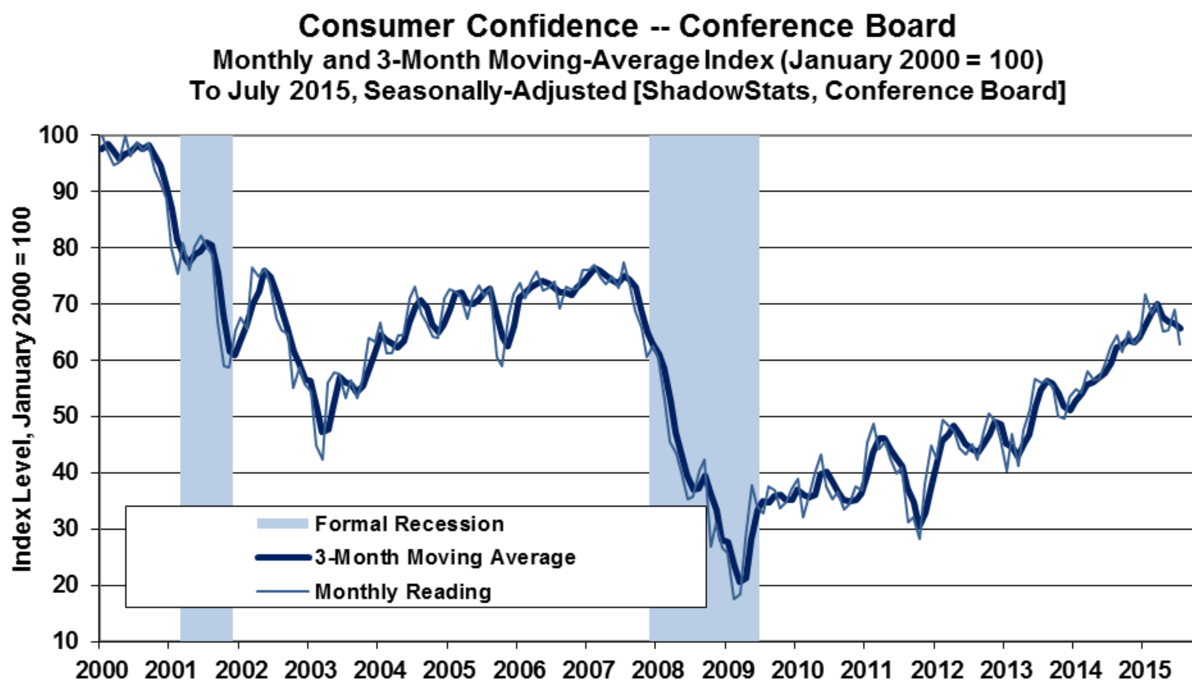
Today's Missive (July 30th). The balance of today's *Opening Comments* addresses the GDP headline detail and its revisions, as well as a brief update to consumer conditions, specifically July Consumer Confidence.

Incorporating recent discussions on the gold circumstance and evolving economic activity, the outlook for domestic hyperinflation and unfolding systemic crises will be updated in the *Hyperinflation Watch* section most likely next week. Portions of the update have been discussed piecemeal in recent *Opening Comments* (including today's). The basic outlook and underlying fundamentals have not changed. The most-recent version of the summary outlook remains available in Commentary No. 735.

The *Week Ahead* section provides a preview of next week's reporting of June Construction Spending, the full June Trade Deficit and the July detail on Employment and Unemployment.

Graph 6: Consumer Confidence



Updating Consumer Conditions—July Confidence Plummeted. The accompanying *Graph 6* of Consumer Confidence numbers updates the detailed review of troubled consumer liquidity conditions found in Commentary No. 734, also updated in Commentary No. 738. *Graph 6* reflects the just-released July 2015 reading on the Conference Board's Consumer Confidence measure, which pulled back sharply.

Impaired consumer liquidity and its direct constraints on consumption have dominated the last eight-plus years of economic turmoil, driving the housing-market collapse and ongoing stagnation in consumer-related real estate and construction activity, as well as constraining retail sales activity and the related, personal-consumption-expenditures category of the GDP. Those sectors account for more than 70% of aggregate U.S. GDP activity. The hard numbers in those sectors, however, contributed much of the

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positive growth to today's headline reporting of second-quarter 2015 GDP, a pattern that is likely neither to survive revisions nor to be sustainable.

Gross Domestic Product (GDP)—Second-Quarter 2015, "Advance" Estimate—Below-Consensus 2.3% Growth, Accompanied by Significant Downside Revisions to Recent Activity. The headline gain of 2.3% in second-quarter 2015 GDP was below consensus [Bloomberg at 2.9%, MarketWatch at 2.8%] and was accompanied by a major, downside-benchmark revision to GDP activity since 2012. The revisions are covered in the opening paragraphs of these *Opening Comments.* Also discussed are prospects for headline growth—post-2007 economic collapse into 2009—being revised into a string of multiple-downturns, or multiple-dips in that post-2009 environment.

Discussed frequently, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. It remains the most worthless of the popular government economic series, in terms of determining what really is happening to U.S. business activity. The GDP is the most heavily-modeled, politically-massaged and gimmicked government indicator of broad economic activity.

Yet, despite all the upside biases and gimmicks built into the GDP reporting, the real world occasionally surfaces in formal GDP estimates. With major monthly economic series, such as retail sales, industrial production and durable goods orders showing regular contractions, underlying economic reality has become weak enough, once again, for headline GDP activity to start signaling outright economic contraction and the onset of a "new" recession.

Gross Domestic Product (GDP)—Headline Detail. The first estimate of second-quarter 2015 GDP reflected a statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 2.32%, following a benchmark revised gain of 0.64% [previously a contraction of 0.17% (-0.17%)] in first-quarter 2015, and a benchmarked gain of 2.07% [previously 2.22%] in fourth-quarter 2014.

Nominal Detail. As the cash register recorded business activity, nominal second-quarter 2015 GDP rose at an annualized quarterly pace of 4.40%, versus a revised 0.76% benchmarked gain [previously down at an annualized pace of 0.23% (-0.23%)] in first-quarter 2015, and a revised 2.16% [previously 2.38%] annualized gain in fourth-quarter 2014. Year-to-year, nominal annual growth in second-quarter 2015 was 3.30%, versus a benchmark-revised 3.92% [previously 3.81%] annual gain in first-quarter 2015 GDP, and a benchmarked 3.88% [previously 3.66%] gain in fourth-quarter 2014.

Real Year-to-Year Growth. Headline year-to-year real growth in second-quarter 2015 was 2.32%, down sharply from a benchmarked but unrevised 2.88% in first-quarter 2015, and a benchmarked 2.47% [previously 2.38%] annual gain in fourth-quarter 2014. Graphs in the *Reporting Detail* section show the annual growth detail.

The latest quarterly year-to-year growth remained below the near-term peak of 3.08% seen in the pre-benchmark period of third-quarter 2010 (previous 3.13% seen in fourth-quarter 2013). The current-cycle trough in annual change was in second-quarter 2009, reflecting a year-to-year decline of 4.09% (-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.

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Real Average Annual Growth. Real annual growth in the GDP held at a benchmarked gain of 2.43% [previously 2.39%] in 2014, the last full year, versus a benchmarked 1.49% [previously 2.22%] in 2013, and a benchmarked 2.22% [previously 2.32%] in 2012. Annual growth was unrevised in 2011 at 1.60%.

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 "advance" estimate of second-quarter 2015 GDP inflation, or the implicit price deflator (IPD), was an annualized quarterly increase of 2.04%, versus a benchmarked gain of 0.12% [previously a contraction of 0.06% (-0.06%)] in the first-quarter 2015 IPD, and a benchmarked 0.08% [previously 0.16%] gain in fourth-quarter 2014.

Year-to-year, second-quarter 2015 IPD inflation was 0.96%, versus a benchmarked 1.01% [previously a 0.90%] annual gain in first-quarter 2015, and a benchmarked gain of 1.37% [previously 1.25%] in fourth-quarter 2014.

For purposes of comparison, headline CPI-U inflation (Bureau of Labor Statistics), seasonally-adjusted, annualized quarter-to-quarter showed an annualized gain of 2.98% in second-quarter 2015, versus a contraction of 3.01% (-3.01%) in first-quarter 2015, and a contraction of 0.85% (-0.85%) in fourth-quarter 2014. Unadjusted, year-to-year quarterly CPI-U inflation showed a year-to-year second-quarter 2015 contraction of 0.04% (-0.04%), versus a 0.10% (-0.10%) year-to-year drop in first-quarter 2015, and a gain of 1.25% in fourth-quarter 2014.

Revamped Distribution of Headline First-Quarter 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 estimate of annualized quarterly change in second-quarter 2015 GDP was 2.32% versus a benchmark-revised gain of 0.64% [previously a contraction of 0.17% (-0.17%)] in first-quarter 2015.

The BEA's first guess at the real second-quarter growth rate is detailed in the following aggregation of contributed growth. Please note that the annualized growth number in each sub-category is the additive contribution to the total, headline change in GDP, where 1.99% + 0.06% + 0.13% + 0.14% = 2.32%. *Commentary No. 731* detailed the prior growth-distribution estimate and other pre-benchmark headline reporting for first-quarter GDP.

The bulk of the upside benchmark revision to first-quarter 2014 GDP growth came from an upside revision to an inventory build-up. Such a revision is unusual at this point of reporting cycle.

- ***Consumer Spending Contributed 1.99% to Second-Quarter Growth [Revised First-Quarter GDP Growth Contribution was 1.19%, 1.43% Pre-Benchmark].*** Evenly split between goods and services, the largest single growth contributors by major category were the nebulous healthcare area, food services and motor vehicles. The purported growth in "healthcare" is a major problem for broad economic activity, which is being hit elsewhere by consumer liquidity issues hurting actual automobile sales.

- ***Business/Residential Investment Contributed 0.06% to Second-Quarter Growth [Revised First-Quarter Contribution was 1.39%, 0.40% Pre-Benchmark].*** The largest contributing components were in the gimmicked "intellectual property" field and residential investment, largely offset by declining equipment sales.

- ***Net Exports Contributed 0.13% to Second-Quarter Growth [Revised Subtraction to First-Quarter Growth was 1.92% (-1.92%), versus a Pre-Benchmark Subtraction of 1.89% (-1.89%)].*** Reflecting the relatively neutral trade circumstance discussed in *Commentary No. 733*, and the negative "advance" deficit estimate for June, one would have expected a negative growth contribution here. Such should be seen in the next round of reporting (see *Week Ahead* section).

- ***Government Spending Contributed 0.14% to Second-Quarter Growth [Revised First-Quarter Subtraction was 0.01% (-0.01%), versus a Pre-Benchmark Subtraction of 0.11% (-0.11%)].*** The BEA introduced seasonal adjustments to federal spending, which helped to raise the growth contribution by 0.08% in the first-quarter 2015, which then reversed in the second. The balance of upside second-quarter growth all was in purported spending by state and local governments.

Economic Reality. With the "advance" estimate of second-quarter 2015 GDP activity showing headline quarterly growth of 2.3%, following a revised 0.6% gain [previously a contraction of 0.2% (-0.2%)] in first-quarter 2015—all in the context of annual GDP benchmark revisions—the broad outlook has not changed. Discussed in the opening paragraphs of these *Opening Comments*, benchmark revisions increasingly are reshaping the GDP-reporting history into a post-2007 collapse pattern of successive multiple dips. By the likely next comprehensive GDP benchmark revision in July 2018, post-2007 historical GDP reporting should be confirming a non-recovering, multiple-dip economic collapse.

That circumstance should encompass an evolving, current downturn in broad, domestic economic activity, discussed previously in *No. 692 Special Commentary: 2015 - A World Out of Balance*. The present "new" recession or multiple-dip downturn still remains likely to be timed from December 2014, although without headline back-to-back contractions of quarterly GDP in place, formal recognition of same could be delayed for months. Recognition of the onset of the December 2007 recession, for example, was not formalized until November 28, 2008. Ongoing monthly economic-reporting detail for key series increasingly should confirm the patterns of declining economic activity, which should engender a formal recession call, irrespective of the timing of actual, headline quarterly contractions in real (inflation-adjusted) GDP.

With the ShadowStats broad outlook basically unchanged, the gist of much of the following text remains along the lines of other recent GDP *Commentaries*, but the details and numbers are updated for the 2015 GDP benchmark revisions and headline second-quarter 2015 reporting.

Again, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy, at present. Fundamental, 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 "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 unemployment (see *Commentary No. 732*), monthly real median household income and other consumer measures (see *Commentary No. 734* and *Commentary No. 738*). This also has been detailed 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 *Commentary No. 736* and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*).

With liquidity-strapped consumers unable to fuel sustainable growth in consumption, a full business recovery could not have taken place since 2009, and a recovery will not be forthcoming until consumer structural income and liquidity problems are resolved.

Official and Corrected GDP. 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 at least partially 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 today's first estimate of second-quarter 2015 GDP and the 2015 annual benchmark revisions.

The first set of graphs (2000-to-date) is the one traditionally that has been incorporated in the GDP *Commentaries*, modified today so as to show reporting both before and after the benchmark revisions. These graphs show short-term detail, expressed on an index base where first-quarter 2000 = 100.0. The second set of graphs updates the longer-term detail (1970-to-date), expressed in billions of 2009 dollars as used in headline GDP reporting, and as detailed and 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).

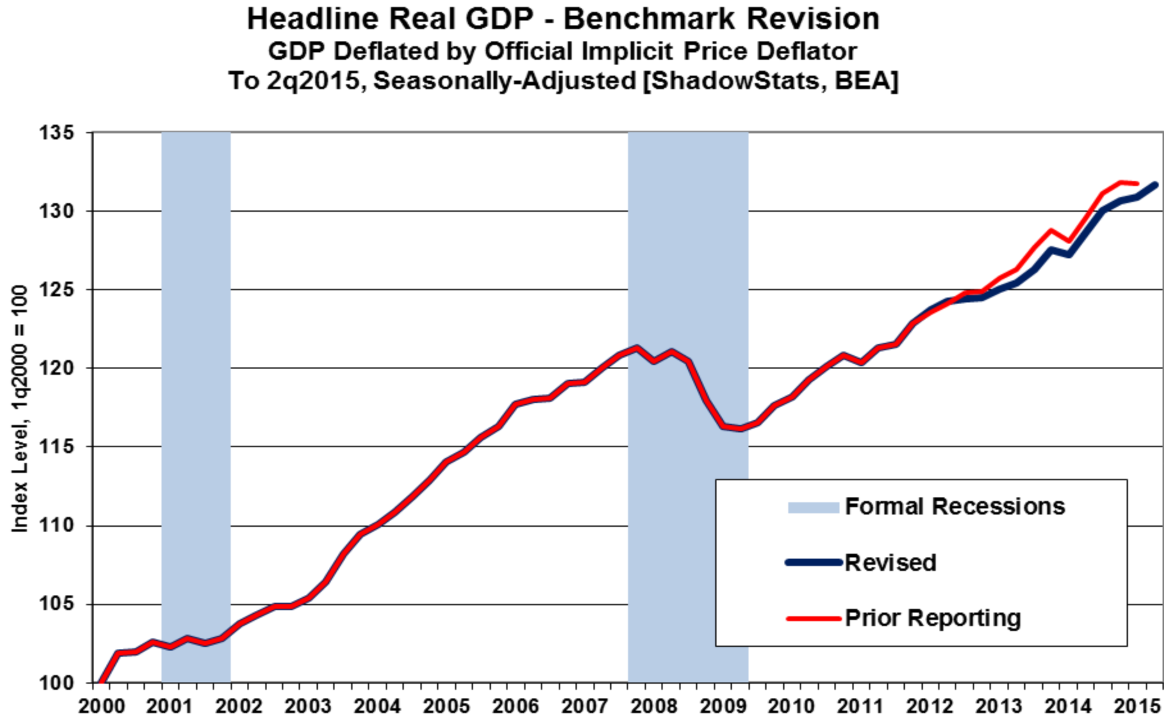
Shown in the first graph of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (growth pauses or interruptions for second-half 2012 and first-quarter 2014 excepted). Adjusted for official GDP inflation (the implicit price deflator - IPD), the post-benchmark level of headline second-quarter 2015 GDP currently stands at 8.5% [first-quarter stands now at 7.9% post-bench, it was previously at 8.6%] above its pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, now shows post-benchmark second-quarter 2015 GDP activity down by 7.3% (-7.3%), with the benchmarked first-quarter 2015 down by 6.7% (-6.7%), unrevised at the first decimal point, from 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 thereafter, consistent with the GDP reporting. Such is covered in the recent discussions on industrial production, real retail sales and real durable goods orders respectively in *Commentary No. 737*, *Commentary No. 736* and *Commentary No. 738*. 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."

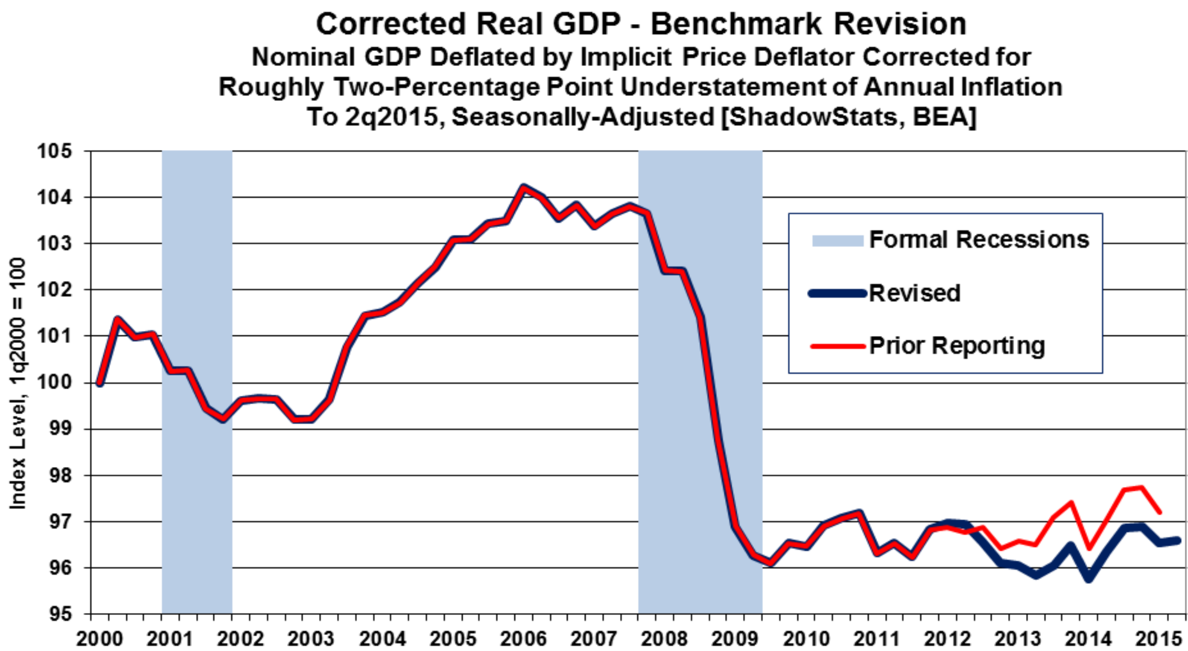
The second graph in each series plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates (see *Public Commentary on Inflation Measurement*), with the deflation by

the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation in recent years. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in the *Hyperinflation Reports*.

Graph 7: Real GDP Index – Benchmark Revision



Graph 8: "Corrected" Real GDP Index – Benchmark Revision



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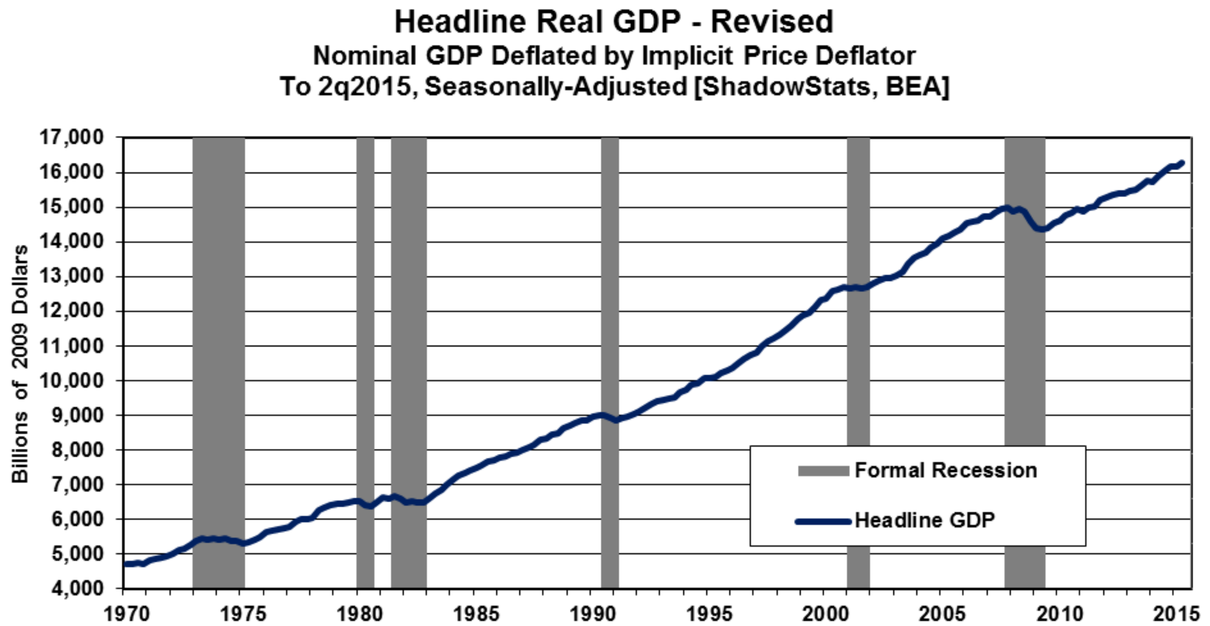
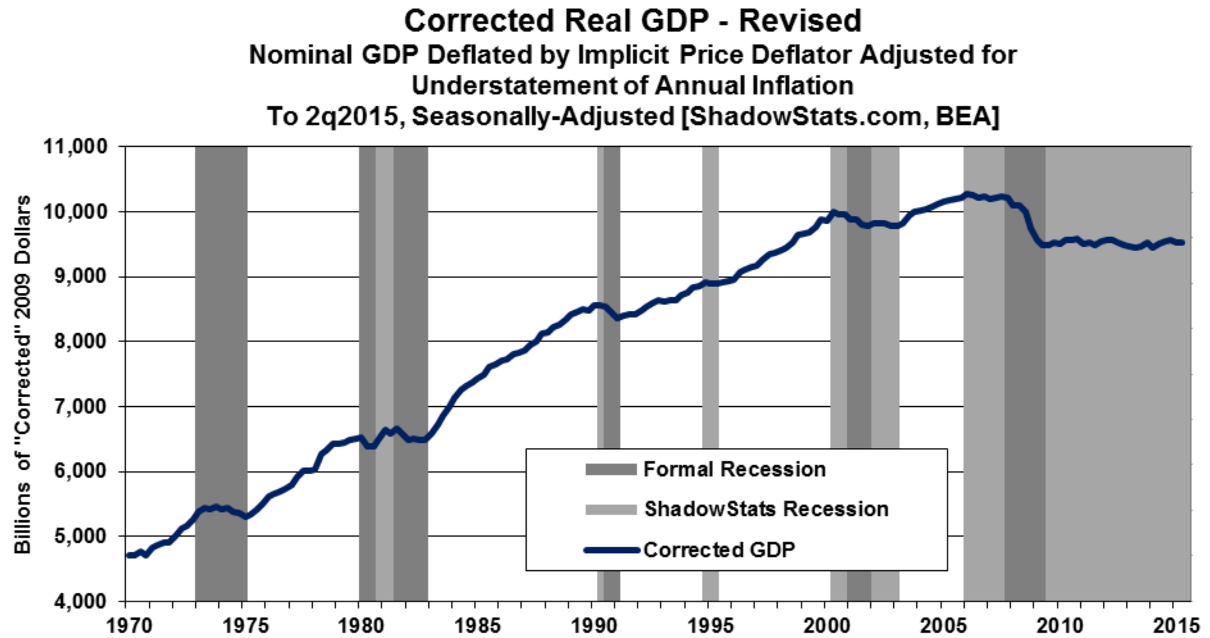
Graph 9: Real GDP Index (1970-2015)



Graph 10: "Corrected" Real GDP (1970-2015)



[The **Reporting Detail** *section includes further coverage of Second-Quarter GDP.]*

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HYPERINFLATION WATCH

VELOCITY OF MONEY

Money Supply Velocity Slowed Minimally with the GDP Benchmarking, but Up-Ticked Minimally in Second-Quarter 2015. Incorporating the benchmarked nominal GDP data and the headline detail of second-quarter 2015 GDP, as well as continued and regular Federal Reserve benchmark revisions to money supply-related data, graphed below are updated estimates for the velocity of money, broken out for money supply M1, M2 and M3 (ShadowStats Ongoing-M3 Measure).

Where velocity generally had slowed into first-quarter 2015 for each money-supply measure, as shown in *Graphs 11* and *12*, such was exacerbated slightly by downside revisions to GDP levels after 2011, where nominal GDP is in the numerator of the velocity ratio. Velocity had plunged into first-quarter 2015 for M1 and M2. Since the end of 2010, M3 velocity had been steady through third-quarter 2014, when it also turned lower. All velocity measures flattened out or turned minimally higher with the second-quarter 2015 estimate. Where velocity simply is the ratio of the nominal GDP to the nominal money supply, the recent declines in the ratios generally have reflected somewhat stronger money growth than GDP growth.

As to M1, consider that perhaps 70% or more of the cash-in-circulation component of that measure (with cash accounting for about 43% of M1) could be physically outside the United States, per the Federal Reserve. Where that has been an increasing trend, a true measure of domestic M1 velocity well could be showing a significant uptrend. In like manner, where M1 includes cash, M2 includes M1, and M3 includes M2, M2 and M3 velocities also would be somewhat higher (cash is 11% of M2, 8% of M3).

M3 versus M1 and M2 had been showing opposite patterns since 2011, because growth in M3 had been weaker than growth in M1 and M2. The reason behind that difference was that much of the relatively stronger M1 and M2 growth reflected cash moving out of M3 categories—such as large time deposits and institutional money funds—into M2 or M1 accounts. The clarity of what happened there is why ShadowStats still tracks what had been the broadest money measure (M3) available.

Subscribers often ask for specifics on the velocity of the money supply, with the result that this section has become a standard feature for *Commentaries* covering the first GDP reporting of a given quarter. The nature of velocity is discussed in some detail in the 2008 *Money Supply Special Report*. Velocity simply is the number of times the money supply turns over in the economy in a given year, or the ratio in nominal terms (not adjusted for inflation) of GDP to the money supply. It is a residual number, not otherwise open to calculation or independent surveying.

Velocity has theoretical significance. In combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is a ratio of two not-particularly-well or realistically-measured numbers, its actual estimate is of limited value. As an inflation predictor, it has to be viewed in the

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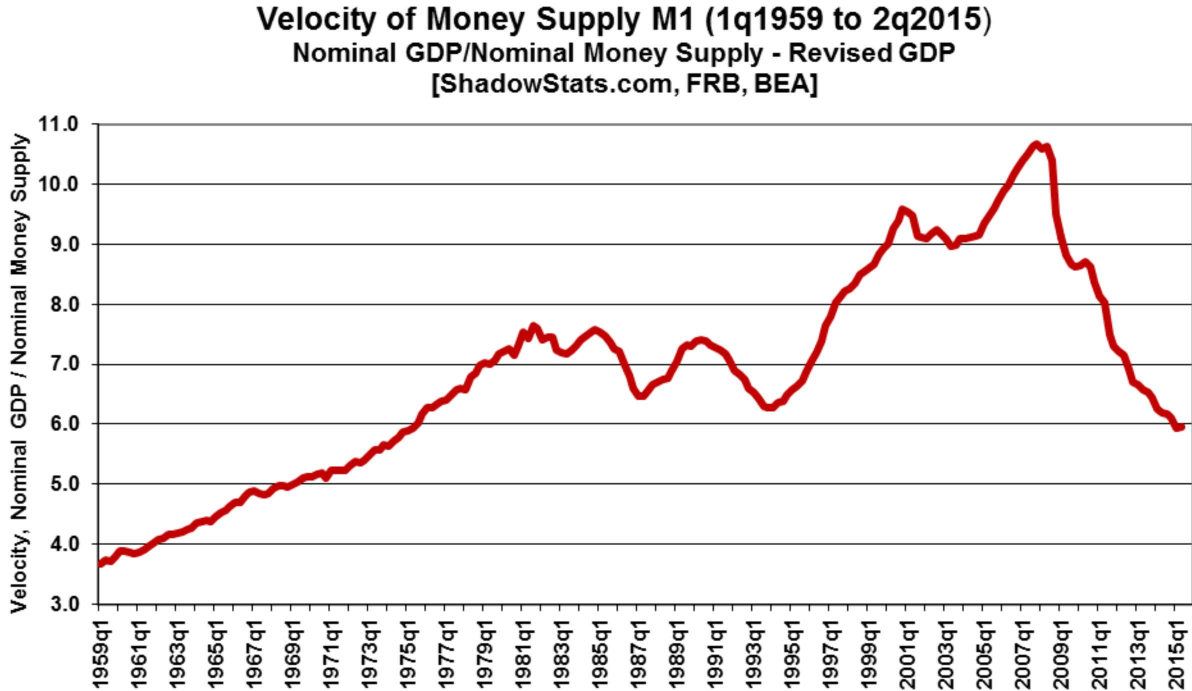
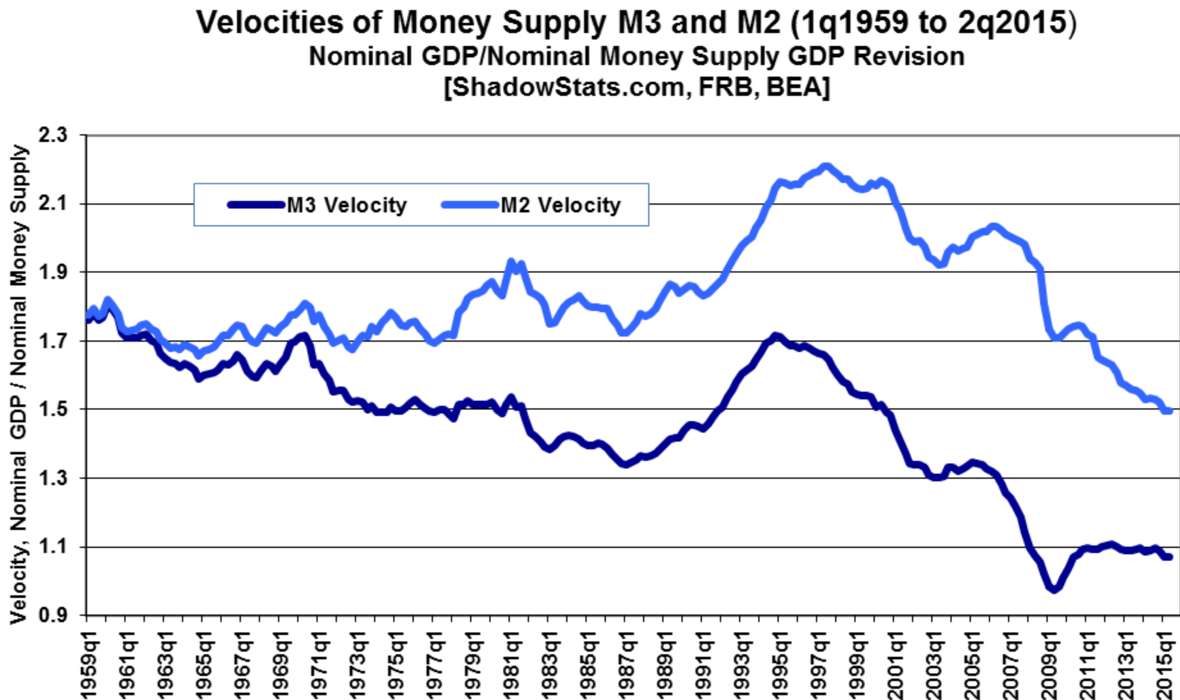
context of accompanying money-supply growth, and vice versa, generally as a coincident indicator. Again, full definitions can be found in the *Money Supply Special Report*.

Graph 11: Velocity of Money Supply M1



Graph 12: Velocities of Money Supply M2 and M3



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HYPERINFLATION OUTLOOK SUMMARY

Broad Outlook Generally Is Unchanged: Economy Remains in Downturn; Dollar Faces Massive Decline with Ongoing Implications for a Hyperinflation Crisis. The *Hyperinflation Outlook Summary* will be revised shortly (probably next week). Although not fundamentally altered from its most-recent incarnation found in *Commentary No. 735*, the pending version will be updated to incorporate the most-recent writings on the economy, global systemic instabilities, the gold circumstance and today's detail on GDP reporting and revisions.

The U.S. economy remains in ongoing downturn, while the U.S. dollar still faces a massive decline, with implications for a meaningful upturn in inflation evolving into a great hyperinflationary crisis. Signs of systemic instability continue to mount.

Beyond the last summary version available at *Commentary No. 735*, the supporting documents for the general outlook remain *No. 692 Special Commentary: 2015 - A World Out of Balance* of February 2, 2015, which updated the *Hyperinflation 2014* reports and the broad economic outlook. Previously, 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 2, 2014, and publication of *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*, on April 8, 2014. The outlooks also are updated regularly in the weekly *Commentaries*. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts. One other reference should be considered here, in terms of underlying economic reality, and that is the *Public Commentary on Inflation Measurement*.

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Second-Quarter 2015, First or "Advance" Estimate)

Second-Quarter Headline Growth of 2.3% Was Below Consensus and Accompanied by a Major Downward Restatement of Recent Economic History. *[Note: The bulk of the text in the next several paragraphs largely repeats material otherwise in the* Opening Comments*].* The headline gain of 2.3% in second-quarter 2015 GDP was below consensus estimates [Bloomberg at 2.9%, MarketWatch at 2.8%] and was on top of a major, downside-benchmark revision to GDP growth since 2012. The revisions are covered in the *Opening Comments.* Also discussed there are the unfolding prospects of headline growth

post-2007 economic collapse into 2009 being revised into a string of multiple-downturns, or multiple-dips in that post-2009 economic activity.

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 then would return them to the Commerce Department, if Commerce had gotten them "wrong," and would keep doing so until Commerce got the numbers "right."

Nonetheless, despite all the upside biases and gimmicks built into the GDP reporting, the real world occasionally surfaces in formal GDP estimates. With major monthly economic series, such as retail sales, industrial production and durable goods orders showing regular contractions, underlying economic reality has become weak enough, once again, for headline GDP activity to start signaling outright economic contraction and the onset of a "new" recession.

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*

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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, July 30th, by the Bureau of Economic Analysis (BEA), the first estimate of second-quarter 2015 GDP reflected a statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 2.32% +/- 3.5% (95% confidence interval), following a benchmark revised gain of 0.64% [previously a contraction of 0.17% (-0.17%)] in first-quarter 2015. Such followed benchmarked gain of 2.07% [previously 2.22%] in fourth-quarter 2014. Distribution detail of the headline second-quarter 2015 GDP growth is outlined in the *Opening Comments*.

Nominal Detail. As the cash register recorded business activity, nominal second-quarter 2015 GDP rose an annualized quarterly pace of 4.40%, versus a revised 0.76% benchmarked gain [previously down at an annualized pace of 0.23% (-0.23%)] in first-quarter 2015, and a revised 2.16% [previously 2.38%] annualized gain in fourth-quarter 2014. Year-to-year, nominal annual growth in second-quarter 2015 was 3.30%, versus a benchmark-revised 3.92% [previously 3.81%] annual gain in first-quarter 2015 GDP, and a benchmarked 3.88% [previously 3.66%] gain in fourth-quarter 2014.

Real Year-to-Year Growth. Shown in the accompanying graphs, headline year-to-year real growth in second-quarter 2015 was 2.32%, down sharply from a benchmarked but unrevised 2.88% in first-quarter 2015, and a benchmarked 2.47% [previously 2.38%] annual gain in fourth-quarter 2014.

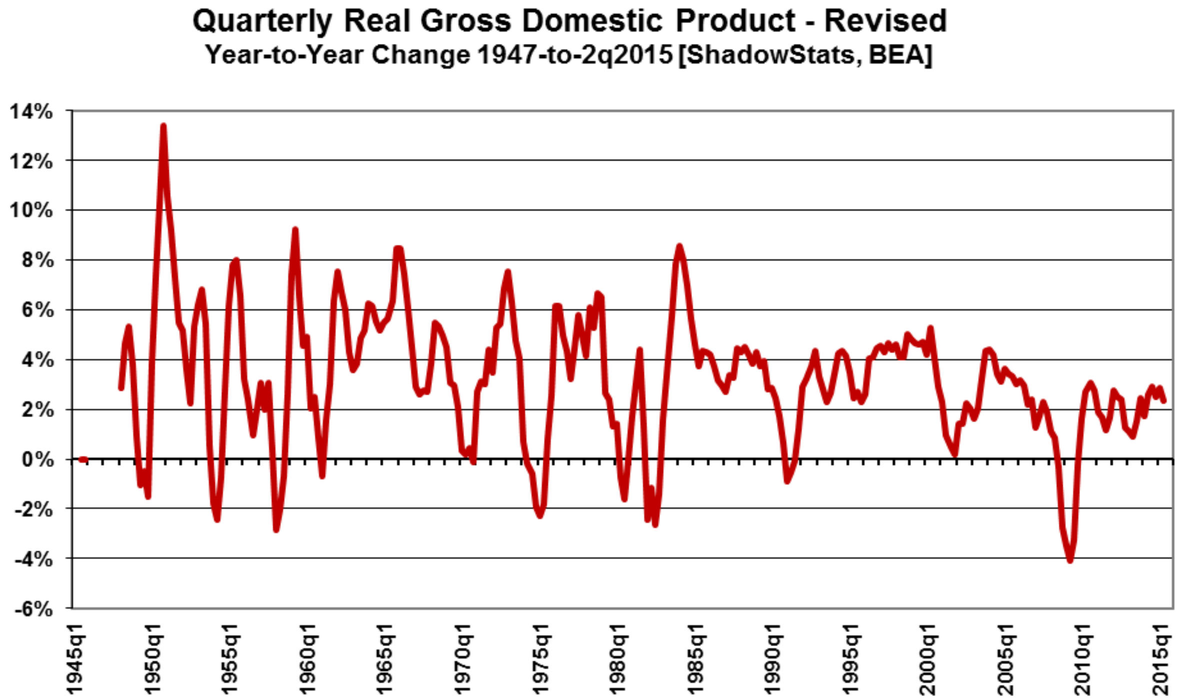
The latest quarterly year-to-year growth remained below the near-term peak of 3.08% seen in the pre-benchmark period of third-quarter 2010 (previous 3.13% seen in fourth-quarter 2013). The current-cycle trough in annual change was in second-quarter 2009, reflecting a year-to-year decline of 4.09% (-4.09%). That was the deepest year-to-year contraction for any quarterly GDP in the history of the series, which began with first-quarter 1947.

Real Average Annual Growth. Shown in *Graph 15*, real annual growth in the GDP held at a benchmarked gain of 2.43% [previously 2.39%] in 2014, the latest full year, versus a benchmarked 1.49% [previously 2.22%] in 2013, and a benchmarked 2.22% [previously 2.32%] in 2012. Annual growth was unrevised in 2011 at 1.60%.

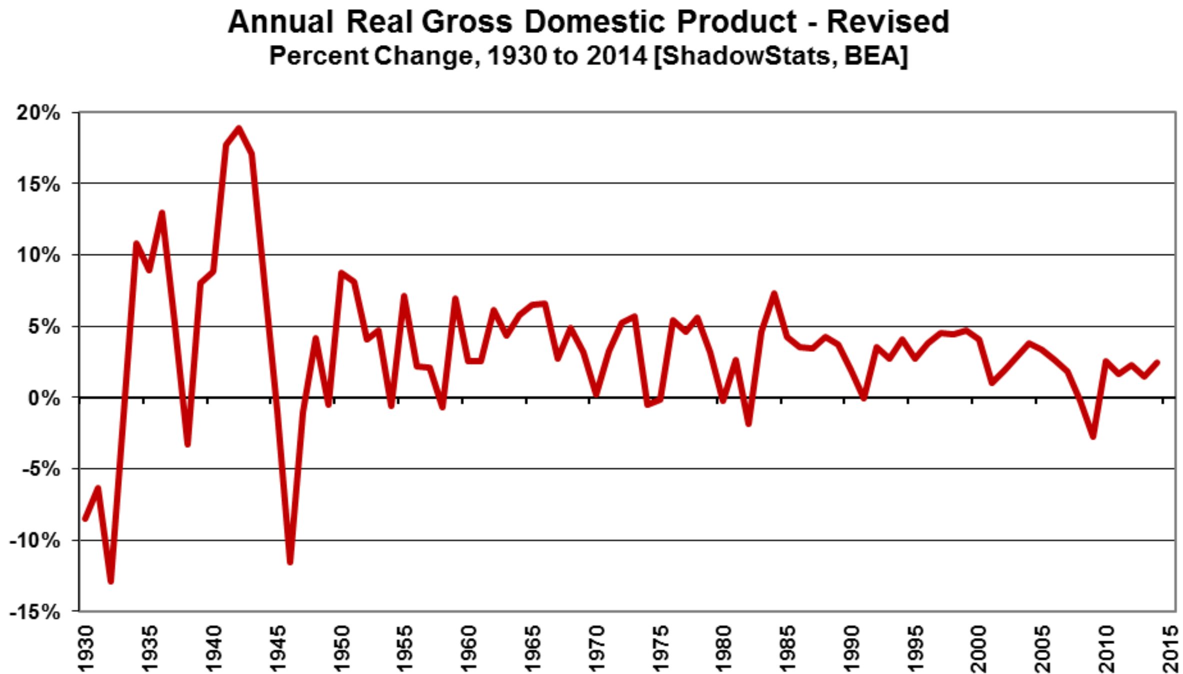
Graph 13 shows current year-to-year quarterly detail, from 2000-to-date, where *Graph 14* shows the same series in terms of its full quarterly history, and, again, *Graph 15* shows updated annual average growth

Graph 13: Quarterly GDP Real Year-to-Year Change (2000-2015)

Graph 14: Quarterly GDP Real Year-to-Year Change (1947-2015)



Graph 15: Annual GDP Real Year-to-Year Change (1930-2014)



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 "advance" estimate of second-quarter 2015 GDP inflation, or the implicit price deflator (IPD), was an annualized quarterly increase of 2.04%, versus a benchmarked gain of 0.12% [previously a contraction of 0.06% (-0.06%)] in the first-quarter 2015 IPD, and a benchmarked 0.08% [previously 0.16%] annualized gain in fourth-quarter 2014.

Year-to-year, second-quarter 2015 IPD inflation was 0.96%, versus a benchmarked 1.01% [previously a 0.90%] annual gain in first-quarter 2015, and a benchmarked gain of 1.37% [previously 1.25%] in fourth-quarter 2014.

For purposes of comparison, headline CPI-U inflation (Bureau of Labor Statistics), seasonally-adjusted, annualized quarter-to-quarter showed an annualized gain of 2.98% in second-quarter 2015, versus a contraction of 3.01% (-3.01%) in first-quarter 2015, and a contraction of 0.85% (-0.85%) in fourth-quarter 2014. Unadjusted, year-to-year quarterly CPI-U inflation showed a year-to-year second-quarter 2015 contraction of 0.04% (-0.04%), versus a 0.10% (-0.10%) year-to-year drop in first-quarter 2015, and an annual gain of 1.25% in fourth-quarter 2014.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for second-quarter 2015 GDP was a year-to-year contraction of 1.2% (-1.2%) versus the headline second-quarter GDP year-to-year gain of 2.3%. That was against an unrevised ShadowStats estimate of a first-quarter 2015 year-to-year contraction of 1.3% (-1.3%), versus the benchmarked but unrevised headline first-quarter GDP year-to-year gain of 2.9% (see the Alternate Data tab).

While the annualized, real quarterly growth rate is not estimated formally on an alternate basis, the headline 2.3% annualized quarter-to-quarter gain in second-quarter 2015 most likely was a much weaker, deeper contraction, net of all the regular reporting gimmicks. Today's benchmark revision did remove some of recent, gimmicked headline quarterly growth rates 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

Economic Reporting and Revisions Should Trend Much Weaker than Expected; Inflation Will Rise Anew, Along with Higher Oil Prices. In a fluctuating trend to the downside, amidst mixed reporting in headline data, market expectations for business activity nonetheless tend to respond to the latest economic hype in the popular media. The general effect holds the market outlook at overly-optimistic levels, with current expectations still exceeding any potential, underlying economic reality.

Headline reporting of the regular monthly economic numbers increasingly should turn lower in the weeks and months ahead, along with significant downside revisions to and reporting in second-quarter 2015 GDP and at least the next several quarters that follow into 2016.

CPI-U consumer inflation—driven lower earlier this year by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low, having turned positive in June 2015, for the first time in six months. Early July indicators are signaling higher inflation in the next monthly reporting. Separately, year-to-year CPI inflation for the balance of the year increasingly will be going against weak or negative year-ago numbers.

Upside inflation pressures will continue to build, as oil prices rebound, a process that should accelerate rapidly with the 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* and will be updated soon in the *Hyperinflation Watch* section.

A Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. Beyond the pre-announced gimmicked changes to reporting methodologies of the last several decades, which have tended to understate actual inflation and to overstate actual economic activity, ongoing headline reporting issues are tied largely to systemic distortions of monthly seasonal adjustments. Data instabilities—induced partially by the still-evolving economic turmoil of the last eight-to-ten years—have 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, discussed and explored in the labor-numbers related *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 (June2015). The Commerce Department will release its estimate of June 2015 construction spending on Monday, August 3rd. Detail will be covered by ShadowStats in *Commentary No. 740* of Wednesday, August 5th.

The headline monthly changes, as usual, should not be statistically-significant, while previous data will be subject to large and irregular revisions. Irrespective of almost perpetually-positive market expectations for this series [MarketWatch early-consensus is for a 0.7% monthly gain], the detail tends to continue in down-trending stagnation, net of inflation. Related inflation [PPI – Final Demand Construction] gained 0.09% month-to-month and 1.81% year-to-year for June 2015, on a seasonally-adjusted basis, consistent with the headline construction spending number.

U.S. Trade Balance (June 2015). The Commerce Department and Bureau of Economic Analysis (BEA) will release their full version of what was today's (July 30th) limited "advance" estimate of the June 2015 trade deficit (see *Opening Comments*), on Wednesday, August 5th. That detail potentially could signal a revision to today's initial estimate of second-quarter 2015 GDP.

Used by the BEA in guessing at the second-quarter GDP, the first "advance" trade deficit report (again, released by the BEA and Census today) provided limited, low-quality data about one week ahead of the usual "full" trade report. The new report showed that the "advance" estimate for the June 2015 trade deficit in goods (no services estimated) widened to $62.256 billion, from a "final" $60.424 (previously

$59.747 "advance") estimate in May. ShadowStats will assess this detail in the context of the August 5th headline reporting as to whether there is any meaningful information or potential GDP revision detail that can be gleaned from the combined new information.

Early-consensus expectations are for a widening in the nominal (not-inflation-adjusted) headline June deficit. MarketWatch showed a widening of the nominal June deficit to $45.8 billion from $41.9 billion in May, but such was the estimate in place both before and after today's "advance" report.

In any event, significant, catch-up deterioration in the headline monthly trade deficit is due, both in nominal and real (inflation-adjusted) terms. The broad trend going forward still should be for regular monthly and quarterly deteriorations in the real trade deficit.

Employment and Unemployment (July 2015). The Bureau of Labor Statistics (BLS) will publish its July 2015 labor data, on Friday, August 7th. Both employment and unemployment numbers remain due for heavily-negative, headline surprises, given the still ongoing, weak general tone of recent reporting of most other, regular economic series.

Established monthly distortions to payroll employment (excessive upside biases, and publishing irregularities with the concurrent-seasonal-factor process) continue, however, as do the regular monthly distortions to headline unemployment (definitional issues with "discouraged workers," and publishing irregularities with the concurrent-seasonal-factor process).

Early-market expectations [MarketWatch] are for a slower pace of payroll growth in July 2015, up by 215,000 versus the initial headline gain of 223,000 jobs in June, with July's headline U.3 unemployment rate expected to hold at 5.3%, versus the 5.3% estimate in June.

As with the narrowing of the headline unemployment rate in recent months and years, any further narrowing of the July 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 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.

Early-July Expectations Are Well Below Implied Monthly Trend. As published previously by ShadowStats-affiliate www.ExpliStats.com, in its analysis of the biases built into the BLS's concurrent-seasonal-factor modeling of the June 2015 payroll-employment reporting, the built-in-bias trend for July 2015 is for a headline monthly employment gain of 243,000 (see *Commentary No. 732*). Where consensus forecasts usually settle-in near the trend level, the early-consensus expectations level is 28,000 jobs below trend, at present.

To the extent that underlying fundamentals will continue to shine through all the regular monthly volatility and distortions, headline activity should continue to favor much weaker-than-expected payroll gains, and higher-than-expected unemployment rates.

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