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

COMMENTARY NUMBER 763
Third-Quarter Gross Domestic Product (GDP), Velocity of Money

October 29, 2015

Deepening Recession Continues

Sharp Slowing in Third-Quarter GDP Growth
Reflected Only a Reduced Pace of Inventory Build-Up, Not a Liquidation

Velocity of Money Slowed Minimally in Third-Quarter 2015

New FOMC Language, a New Speaker and a
Developing Budget Deal -- but Nothing Has Changed

PLEASE NOTE: The next regular Commentary*, scheduled for Wednesday, November 4th, will cover the September Trade Deficit and Construction Spending. A subsequent* Commentary *on Friday, November 6th, will review the October reporting on Employment and Unemployment.*

Best wishes to all! — John Williams

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OPENING COMMENTS AND EXECUTIVE SUMMARY

Outlook Remains Bleak for the Economy and Systemic Issues. Initial third-quarter 2015 GDP growth came in at a headline 1.5%, down sharply from 3.9% in the second-quarter GDP. Year-to-year growth slowed to 2.0% in the current quarter, from 2.7% annual growth in the prior quarter. While headline GDP activity was hit heavily by inventories, there was no inventory liquidation, only a reduction in the pace of growth in inventories. Accordingly, with softening demand, no sharp economic rebound is likely in the next quarter's activity. Instead, look for downside revisions to the current third-quarter GDP growth estimate in the two months ahead, and for still-weaker growth or a contraction in fourth-quarter activity.

Underlying economic fundamentals remain heavily negative, with severely impaired consumer liquidity. Better-quality series such as industrial production and retail sales have signaled an economy in recession. Corporate revenues continue to decline quarterly and annually, a separate, reliable indication of recession. The declining economic activity is of enough substance to generate formal recognition of a recession, one that eventually should be timed from December 2014.

Unexpected downturns in the economy generally are not good news for government fiscal operations, or for central operations having to deal with an increasing number of financially-stressed banks or having to provide funding liquidity to its central government.

FOMC Inaction. Despite all the huffing and puffing by those at the Federal Reserve who want to raise interest rates, the best that yesterday's (October 28th) Federal Open Market Committee (FOMC) meeting could come up with was new language in its post-meeting statement, restating how the FOMC would assess economic conditions in the future, among other factors, before raising interest rates.

Some market participants viewed a hardening in the language as indicating a rate hike in December. Perhaps, but if the FOMC really wanted to increase interest rates, all it had to do yesterday was vote to do so. The weak economy continues as political cover, likely masking serious FOMC concerns for other problems in the domestic and global financial systems. If the FOMC were to hold back on its rate increase until after the economy improved, the wait for a rate hike would be quite protracted.

Meaningful FOMC action still appears to be on hold until after the 2016 presidential election.

Unchanging Political Conditions. Paul Ryan has been elected Speaker of the House of Representatives, and we wish him success in his new position. That said, prospects still are nil for the existing Congress and White House to address seriously major issues that threaten U.S. financial, economic and social stability. Those issues include long-term solvency concerns for the United States, and structural problems preventing U.S. economic recovery.

Consider the current Budget Deal that puts off having to do anything about the intractable U.S. fiscal crisis until after the 2016 presidential election. It has passed the House and shortly will be considered by the Senate. Similar action was taken in the 2011 budget crisis—in the wake of Standard & Poor's

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downgrade of U.S. Treasury Securities—putting off until after the 2012 presidential election, the same politically-impossible decisions that are faced today.

Nothing has changed here, including the ShadowStats broad outlook for ongoing economic stagnation and downturn, intensifying systemic instabilities and a looming massive decline in the U.S. dollar. Along with the pending dollar crisis are the ongoing implications ultimately for severe inflation, hyperinflation (see for example *No. 742 Special Commentary: A World Increasingly Out of Balance*).

Today's *Commentary* (October 29th). The balance of these *Opening Comments* provides summary coverage of the first-estimate of third-quarter 2015 GDP. The *Hyperinflation Watch* includes updated *Monetary Conditions*, plotting the Velocity of Money using the headline GDP data and the most-recent estimates of quarterly money supply. The *Hyperinflation Outlook Summary* is not included today, but it will be updated in the November 4th *Commentary No. 764* for the latest FOMC, GDP and domestic political and fiscal developments. The *Week Ahead* previews reporting of October labor conditions, and the September trade deficit and construction spending.

Gross Domestic Product (GDP)—Third-Quarter 2015, "Advance" or First Estimate—Sharp Slowing in Quarterly and Annual Growth. The "advance" or first estimate of third-quarter 2015 GDP reflected a statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 1.49%, a sharp pullback from headline growth of 3.92% in the second-quarter, but still higher than the 0.64% in first-quarter.

Headline year-to-year real growth in third-quarter 2015 also slowed sharply, to 2.02%, down from annual growth of 2.72% in second-quarter 2015 and from 2.88% in first-quarter 2015. The latest quarterly year-to-year growth remained below the near-term peak of 3.08% in third-quarter 2010. 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. *Graphs 7* to *10* in the *Reporting Detail* plot the latest quarterly headline levels and annual growth rates.

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 first estimate of third-quarter 2015 GDP inflation, or the implicit price deflator (IPD), was an annualized quarterly increase of 1.22%, versus 2.13% in second-quarter 2015 and a gain of 0.12% in the first-quarter 2015.

Year-to-year, third-quarter 2015 IPD inflation was 0.88%, versus 0.98% in second-quarter 2015 and a 1.01% annual gain in first-quarter 2015.

For purposes of comparison, headline CPI-U inflation (Bureau of Labor Statistics), seasonally-adjusted, annualized quarter-to-quarter showed a gain of 1.58% in third-quarter 2015, versus a gain of 2.98% in second-quarter 2015 and a contraction of 3.01% (-3.01%) in first-quarter 2015. Unadjusted, year-to-year quarterly CPI-U inflation showed a year-to-year third-quarter 2015 gain of 0.11%, versus a second-quarter 2015 annual contraction of 0.04% (-0.04%) and a 0.10% (-0.10%) year-to-year decline in first-

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quarter 2015.

Third-Quarter 2015 GDP Growth Distribution. Despite the severely-limited significance of the following detail, it is included for those interested in the reported internal patterns of GDP growth, as reported by the BEA. The first estimate of annualized quarterly third-quarter 2015 GDP growth was 1.49%, versus annualized real gains of 3.92% in second-quarter 2015 and 0.64% in first-quarter 2015.

The BEA's first guess at real third-quarter GDP growth is detailed in the following aggregation of contributed growth. The annualized growth number in each sub-category is the additive contribution to the total, headline change in GDP, where 2.19% - 0.97% - 0.03% + 0.30% = 1.49%. *Commentary No. 755* of September 25th detailed the growth-distribution estimate for the second-quarter GDP.

Headline growth in third-quarter GDP came primarily from personal consumption and fixed investment, offset by a slowdown in inventory buildup.

- ***Consumer Spending Contributed 2.19% to Third-Quarter GDP Growth; Second-Quarter Growth Contribution was 2.42%.*** The contribution from personal consumption was split about evenly between goods and services, with goods split about evenly between durable and nondurable goods, and with services split about evenly between health care and everything else.

- ***Business/Residential Investment Subtracted 0.97% (-0.97%) from Third-Quarter GDP Growth; Second-Quarter Growth Contribution was 0.85%.*** Fixed investment growth of 0.47% primarily reflected construction, which was offset by an inventory-change swing that subtracted 1.44% from aggregate GDP growth. As a result, final sales (GDP net of inventories) increased by 2.93% in third-quarter 2015, versus 3.90% growth in second-quarter 2015. The inventory change reflected a quarterly gain in third-quarter inventories of $56.8 billion, instead of the excessive $113.5 billion increase in second-quarter 2015.

- ***Net Exports Subtracted 0.03% (-0.03%) from Third-Quarter GDP Growth; Second-Quarter Growth Contribution Was 0.18%.*** Discussed in the *Week Ahead* section, a suspect, sharp narrowing in the September "advance" merchandise trade deficit brought net exports into a neutral growth contribution as to third-quarter GDP, instead subtracting roughly 0.30% (-0.30%) that was in place before yesterday's (October 28th) estimate. Look for a later revision, here, towards a more-substantial negative contribution to the quarter's growth rate.

- ***Government Spending Contributed 0.30% to Third-Quarter GDP Growth; Second-Quarter Growth Contribution was 0.46%.*** Virtually all of the growth in the government sector was from state and local government spending.

Economic Reality. The U.S. economy continues in an as-yet-unrecognized "new" recession, despite headline 1.5% growth in the "advance" estimate of third-quarter 2015 GDP activity. That followed a second-quarter gain of 3.9%. The headline GDP gains continue to run well above economic reality as signaled by a number of business indicators and a variety of better-quality economic series. Headline second-quarter 2015 national-income reporting had shown some respite from the surging, gimmicked GDP growth, with the GDI-equivalent Gross Domestic Income (GDI) showing flat economic activity for first-half 2015, but initial reporting of third-quarter 2015 GDI still is one month off.

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Discussed in *Commentary No. 755*, the GDI is just as valid a measure of broad U.S. economic activity as GDP. The GDI showed that the domestic economy stagnated in first-half 2015, more in line with the detail seen series such as industrial production and retail sales. While the GDI circumstance currently appears to be a better reflection of underlying economic reality than the GDP, the initial estimate of third-quarter GDI is delayed by one month versus the GDP, until November 24th. Such delay is standard, where the BEA lacks timely and significant underlying detail for the GDI. That problem also is common to the GDP guesstimate. Still, under pressure to produce results, the BEA publishes an "advance" GDP estimate, which rarely is meaningful or statistically significant, and which commonly is misleading during periods of economic stress, such as seen at present.

The broad ShadowStats economic outlook has not changed, and the gist of most of the following text remains along the lines of other recent GDP *Commentaries*. The details and numbers, however, are updated for the latest reporting.

Discussed in *Commentary No. 739*, which covered the 2015 GDP annual revisions, the annual benchmarkings 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 the evolving, current downturn in broad, domestic economic activity, discussed previously in *No. 742 Special Commentary: A World Increasingly Out of Balance*. The present "new" recession or multiple-dip downturn remains likely to be timed from December 2014, although without headline back-to-back contractions of quarterly GDP currently in place, formal recognition of same still could be delayed for months. Recognition of the onset of the December 2007 recession 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 GDP.

Frequently discussed here, the headline 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. 756*), monthly real median household income and other consumer measures (see *Commentary No. 758*). This also has been detailed in *No. 742 Special Commentary: A World Increasingly Out of Balance* and *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. 761* 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, including more-normal credit functioning of the domestic banking system.

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 initial estimate of third-quarter 2015 GDP.

The first set of graphs (2000-to-date) is the one that traditionally has been incorporated in the GDP *Commentaries*. *Graphs 1* and *2* show short-term detail, expressed on an index base where first-quarter 2000 = 100.0. The second set of graphs (*Graphs 3* and *4*) updates the longer-term detail (1970-to-date), expressed in billions of 2009 dollars as used in the headline GDP reporting. The graphs also show official periods of recession as shaded areas, with ShadowStats-defined recessions indicated by the lighter shading in *Graph 4*, the second graph of the second set, as detailed and published initially in *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*.

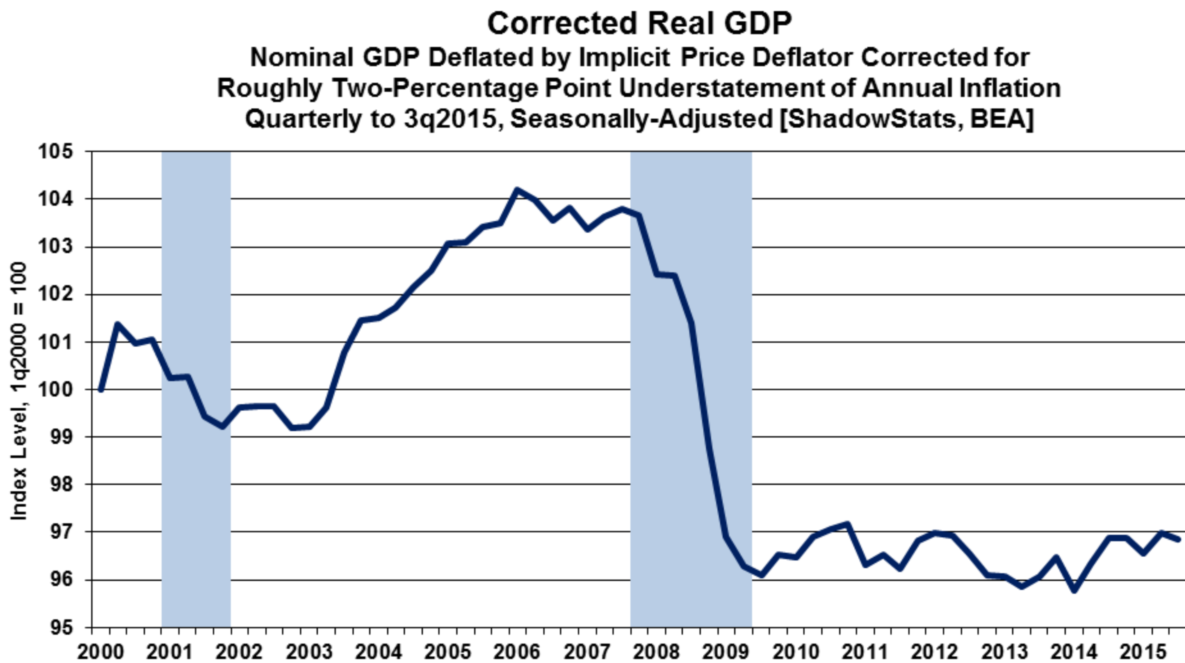
Shown in the first graph of each set (*Graphs 1* and *3*) of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (growth pauses or interruptions for second-half 2012 and first-quarter 2014 excepted). Adjusted for official GDP inflation (the implicit price deflator - IPD), the headline third-quarter 2015 GDP currently stands at 9.4% above its pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph of each set (*Graphs 2* and *4*), now shows third-quarter 2015 GDP activity down by 7.1% (-7.1%), from its pre-recession peak of first-quarter 2006.

Further, discussed broadly in the second installment of the *Hyperinflation Report*, no other major economic series has shown a pattern of official full economic recovery and meaningful expansion thereafter, consistent with the headline GDP reporting. Such is covered in the recent discussions on industrial production, real retail sales and real durable goods orders respectively in *Commentary No. 760*, *Commentary No. 759* and *Commentary No. 762*. 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."

Again, the second graph in each series (*Graphs 2* and *4*) 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, also as discussed in the *Hyperinflation Reports*.

Graph 1: Real GDP Index – Headline Real GDP (2000-2015)

Graph 2: "Corrected" Real GDP Index (2000-2015)



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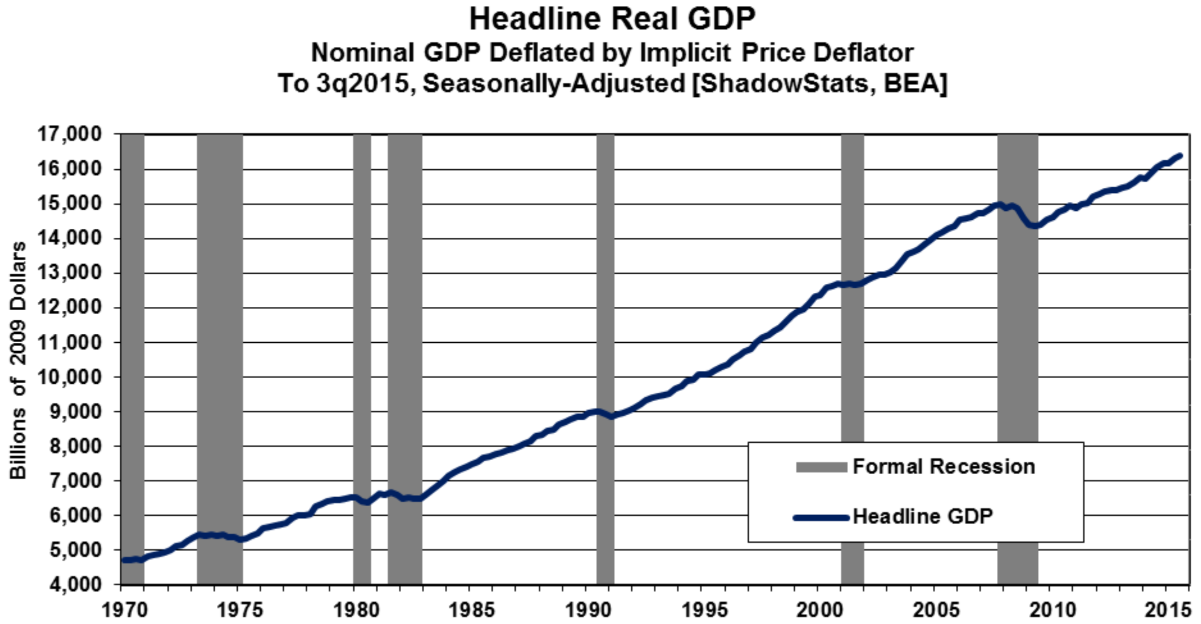
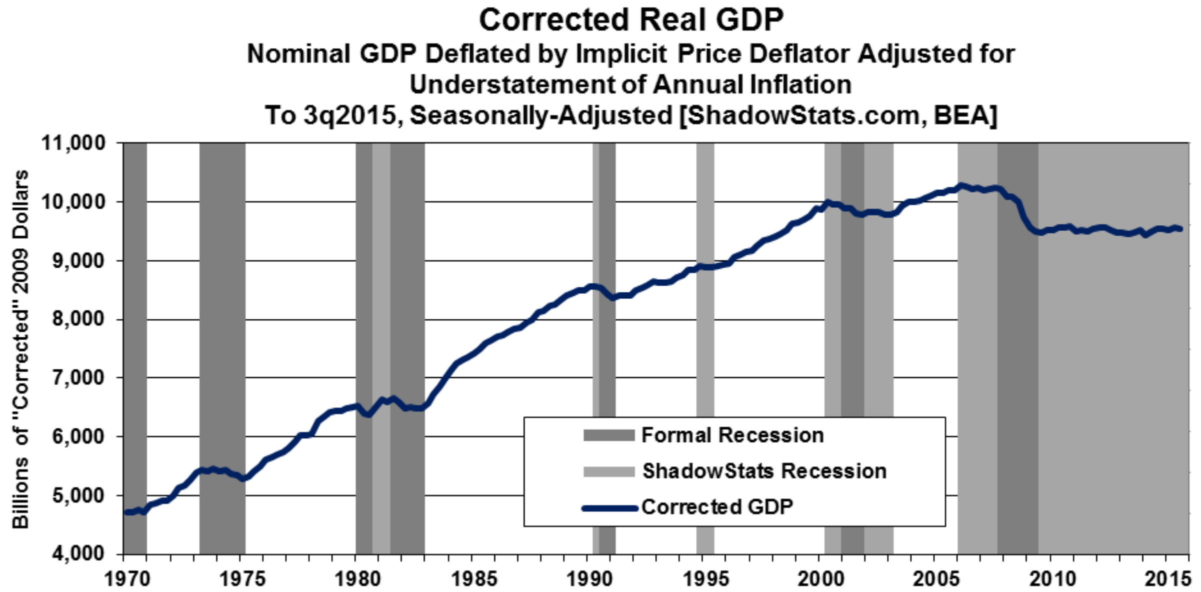
Graph 3: Real GDP Index (1970-2015)



Graph 4: "Corrected" Real GDP (1970-2015)



[The* Reporting Detail *section includes expanded detail of the GDP estimate.]

HYPERINFLATION WATCH

MONETARY CONDITIONS—VELOCITY OF MONEY

Money Supply Velocity Slowed Minimally in Third-Quarter 2015. Incorporating the headline detail of nominal third-quarter 2015 GDP, as well as the latest detail from regular Federal Reserve reporting of and benchmark revisions to money-supply-related data through third-quarter 2015, *Graphs 5* and *6* show estimates of the velocity of money, broken out for money supply M1, M2 and M3 (the ShadowStats Ongoing-M3 Measure).

Generally slowing into third-quarter 2015 for each money-supply measure, velocity had notched slightly higher in second-quarter activity. Where nominal GDP is in the numerator and the nominal money measure is in the denominator of the velocity ratio, slowing velocity indicates relatively faster money growth than economic growth. While headline GDP growth slowed sharply, versus a jump in third-quarter 2015 money supply measures, growth in the money measures appears to be falling off sharply in early-fourth-quarter reporting.

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. While all velocity measures turned minimally higher in second-quarter 2015, the pattern reversed with the third-quarter estimates.

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 "advance" 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

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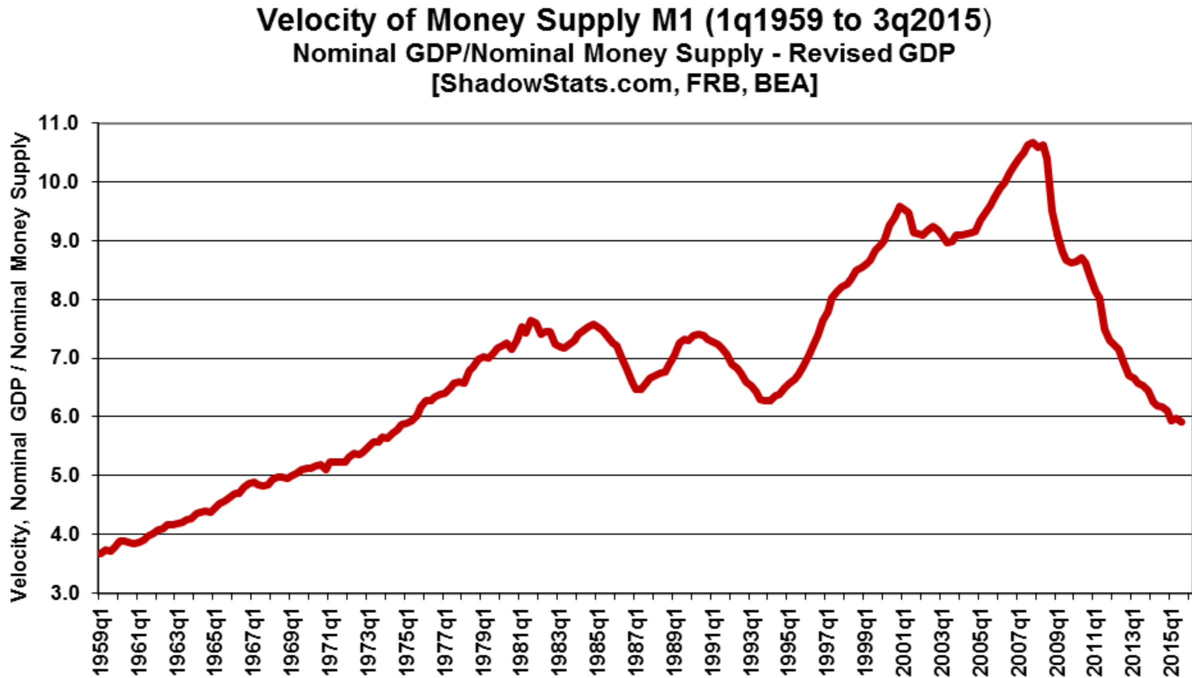
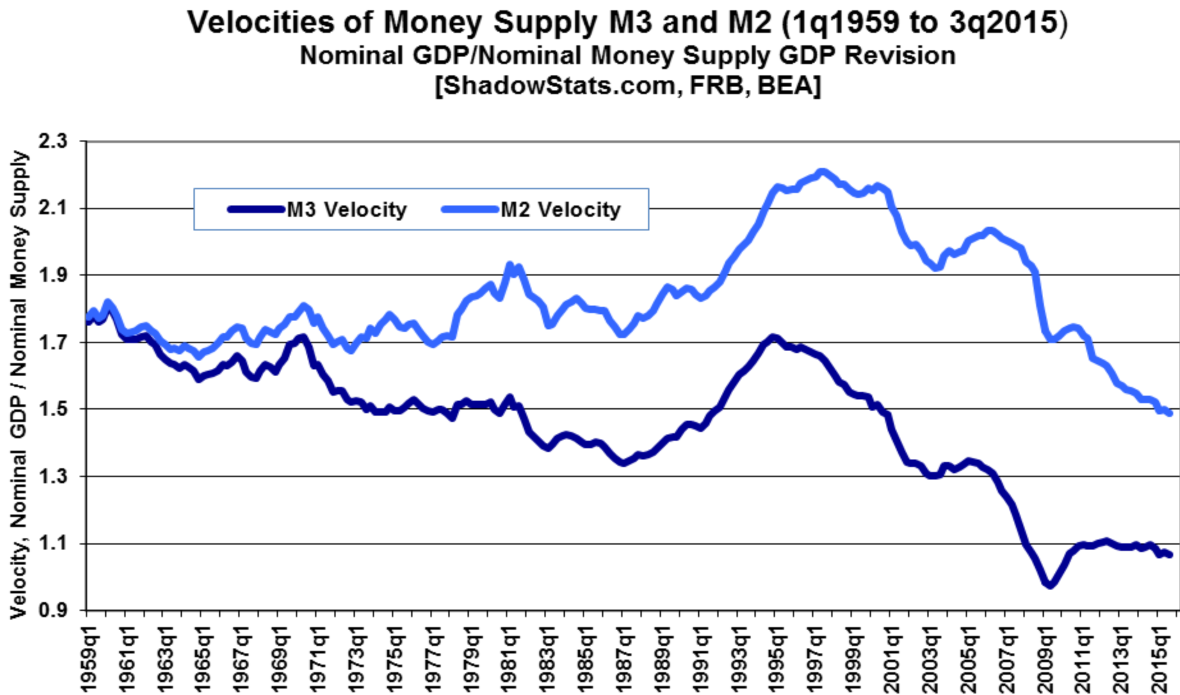
numbers, its actual estimate is of limited value. As an inflation predictor, it has to be viewed in the context of accompanying money-supply growth, and vice versa, generally as a coincident indicator. Again, full definitions can be found in the *Money Supply Special Report*.

Graph 5: Velocity of Money Supply M1



Graph 6: Velocities of Money Supply M2 and M3



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HYPERINFLATION OUTLOOK SUMMARY

Pending Update: The *Hyperinflation Outlook Summary* is being updated for the next *Commentary No. 764* of November 4th. There is no fundamental shift pending in the broad outlook, just some needed text changes to review and address the latest FOMC, GDP and domestic political and fiscal developments, as touched upon in today's *Opening Comments*. The most recent *Hyperinflation Outlook Summary* is available in *Commentary No. 762*.

REPORTING DETAIL

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

Sharp Slowing in Headline GDP Growth. After an incredible—as in unbelievable—3.9% surge in second-quarter 2015 GDP, headline third-quarter growth slowed to 1.5%, with year-to-year annual growth slowing to 2.0% in the current quarter, versus 2.7% in the prior quarter.

The headline GDP gains continue to run well above economic reality, as signaled by a number of business indicators and a variety of better-quality economic series. Headline second-quarter 2015 national-income reporting had shown some respite from the surging, gimmicked GDP growth, with the GDI-equivalent Gross Domestic Income (GDI) showing flat economic activity for first-half 2015 (see *Commentary No. 755*). Initial reporting of third-quarter 2015 GDI, however, still is one month off.

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 reality has become weak enough, once again, for headline GDP or GDI to signal 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 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.*

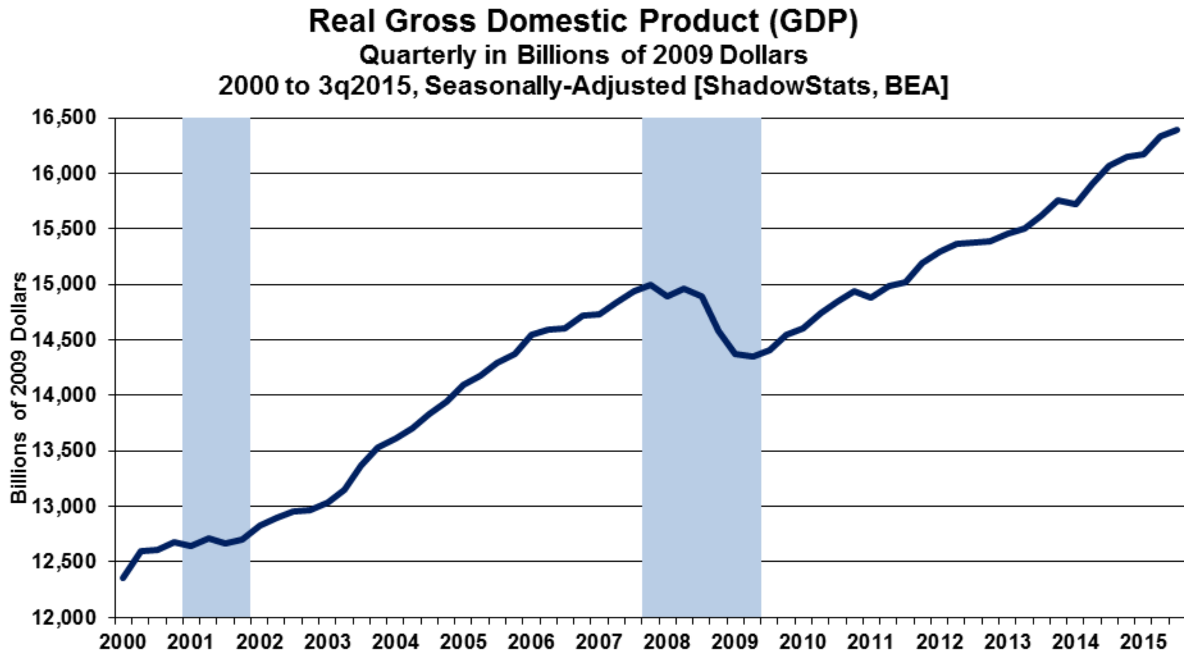
Quarterly *growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by multiplying 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.*

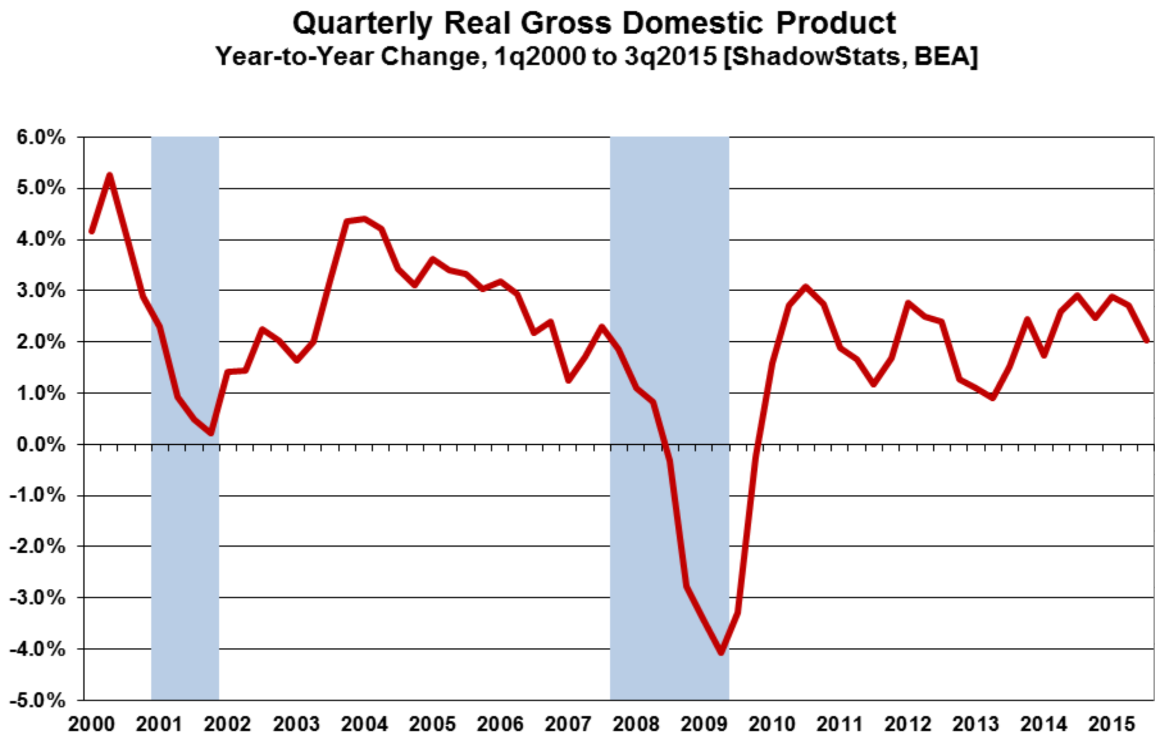
Gross Domestic Product (GDP). Published today, October 29th, by the Bureau of Economic Analysis (BEA), the "advance" or first estimate of third-quarter 2015 GDP reflected a statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 1.49% +/- 3.5% (95% confidence

interval). That followed headline growth of 3.92% in second-quarter 2015 GDP, and a previously benchmarked gain of 0.64% [a pre-benchmarking contraction of 0.17% (-0.17%)] in first-quarter 2015.

Graph 7: Quarterly GDP in Billions of 2009 Dollars (2000-2015)

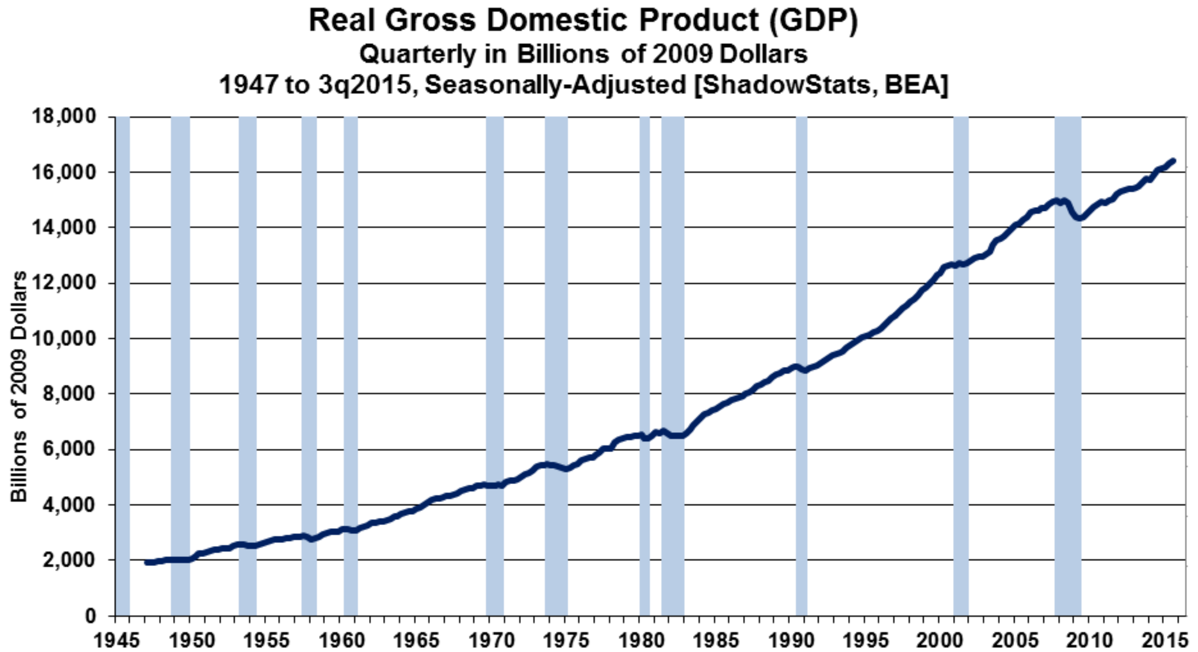


Graph 8: Quarterly GDP Real Year-to-Year Change (2000-2015)

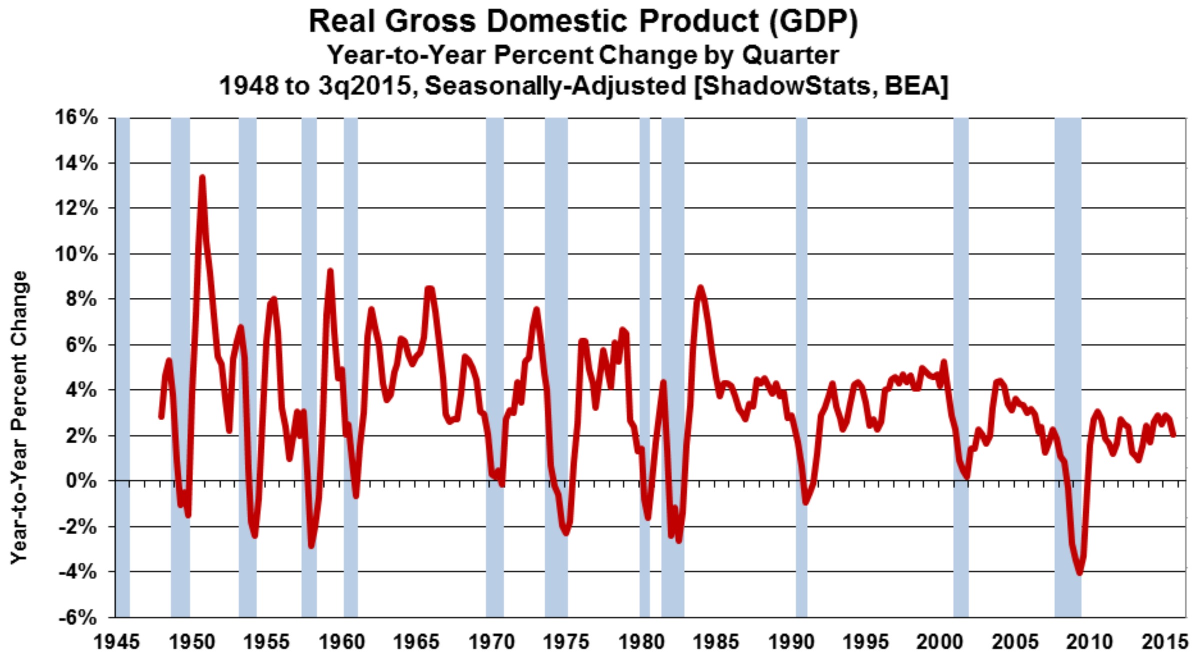


Graphs 7 and *9* plot the latest headline levels of real quarterly GDP activity, respectively showing short-term (since 2000) and long-term (since the historical onset of the quarterly GDP series in 1947) perspectives. Distribution detail of third-quarter 2015 GDP growth is outlined in the *Opening Comments*.

Graph 9: Quarterly GDP in Billions of 2009 Dollars (1947-2015)



Graph 10: Quarterly GDP Real Year-to-Year Change (1948-2015)



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Shown in *Graphs 8* and *10*, headline year-to-year real growth in third-quarter 2015 slowed sharply to 2.02%, down from annual growth of 2.72% in second-quarter 2015 and from 2.88% in first-quarter 2015. The latest quarterly year-to-year growth remained below the near-term peak of 3.08% in third-quarter 2010. 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.

Graph 8 shows current year-to-year quarterly detail, from 2000-to-date, where *Graph 10* shows the same series in terms of its full quarterly, year-to-year history back to 1948.

In terms of first-half 2015 versus second-half 2014, annualized GDP growth held at 2.26%, versus 1.87% for the GDP and just 0.57% for the GDI. The GDP and GDI are updated next month.

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 first estimate of third-quarter 2015 GDP inflation, or the implicit price deflator (IPD), was an annualized quarterly increase of 1.22 %, versus 2.13% in second-quarter 2015 and a benchmarked gain of 0.12% in the first-quarter 2015.

Year-to-year, third-quarter 2015 IPD inflation was 0.88%, versus 0.98% in second-quarter 2015 and a benchmarked 1.01% annual gain in first-quarter 2015.

For purposes of comparison, headline CPI-U inflation (Bureau of Labor Statistics), seasonally-adjusted, annualized quarter-to-quarter showed a gain of 1.58% in third-quarter 2015, versus a gain of 2.98% in second-quarter 2015 and a contraction of 3.01% (-3.01%) in first-quarter 2015. Unadjusted, year-to-year quarterly CPI-U inflation showed a year-to-year third-quarter 2015 gain of 0.11%, versus a second-quarter 2015 annual contraction of 0.04% (-0.04%) and a 0.10% (-0.10%) year-to-year decline in first-quarter 2015.

Gross National Product (GNP). The initial estimate of third-quarter 2015 GNP will be published on November 24th. Gross National Product (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. The unrevised, headline second-quarter 2015 annualized real growth was estimated at 3.93% versus an annualized contraction of 0.15% (-0.15%) in first-quarter 2015.

Gross Domestic Income (GDI). The initial estimate of third-quarter 2015 GDI will be published on November 24th. 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. The unrevised headline second-quarter 2015 annualized real growth was estimated at 0.71% versus 0.42% in first-quarter 2015.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for third-quarter 2015 GDP is a year-to-year contraction of 1.4% (-1.4%) versus the headline third-quarter GDP year-to-year gain of 2.0%. That was against a ShadowStats estimate of a second-quarter 2015 year-to-year contraction of

1.2% (-1.2%) versus the headline second-quarter GDP year-to-year gain of 2.7% (see the Alternate Data tab).

While the annualized, real quarterly growth rate is not estimated formally on an alternate basis, the headline 1.5% annualized quarter-to-quarter gain in third-quarter 2015 most likely was much weaker, net of all the regular reporting gimmicks and likely will revise sharply lower in the next two months of reporting. An actual quarterly contraction appears to have been a realistic possibility for inflation-adjusted 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 (see *Graphs 2* and *4*), updated from *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* (see the *Opening Comments* section), are based on the removal of the impact of hedonic quality adjustments that have reduced the reporting of official annual GDP inflation by roughly two-percentage points. It is not the same measure as the ShadowStats-Alternate GDP, here, which reflects reversing additional methodological distortions ("Pollyanna Creep") of recent decades.

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WEEK AHEAD

Economic Reporting Generally Should Trend Much Weaker than Expected; Inflation Will Rise Anew, Along with a Renewed Rebound in Oil Prices. Still in a fluctuating, general trend to the downside, amidst mixed reporting in headline data, market expectations for business activity nonetheless can gyrate some with the latest economic hype in the popular media. That general effect holds the consensus outlook still at overly-optimistic levels, with current expectations still exceeding any potential, underlying economic reality. Where the net trend still has been towards weakening expectations, movement towards recession recognition appears to be at something of an accelerating pace.

Headline reporting of the regular monthly economic numbers increasingly should turn lower in the weeks and months ahead, along with likely downside or otherwise much weaker-than-expected reporting for at least the next several quarters of GDP (and GDI and GNP) into 2016, including the November 24th first revision to today's "advance" third-quarter 2015 GDP estimate.

CPI-U consumer inflation—intermittently driven lower this year by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low. Annual CPI-U

turned positive in June 2015, for the first time in six months, notched somewhat higher in July and August, with a minimal fallback in September, tied to renewed weakness in gasoline prices. Gasoline prices appear to be bottoming out again, with a combination of temporarily-stable gasoline prices and related, positive seasonal adjustments likely to boost headline October 2015 CPI-U.

Meaningful upside inflation pressures should mount anew, once oil prices begin to rebound. Again, that process eventually should accelerate, along with a pending sharp downturn in the exchange-rate value of the U.S. dollar. Those areas, the general economic outlook and longer range reporting trends were reviewed broadly, recently, in *No. 742 Special Commentary: A World Increasingly Out of Balance*, *No. 692 Special Commentary: 2015 - A World Out of Balance* and will be updated in the *Hyperinflation Outlook Summary* of the next *Commentary No. 764*.

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 (September 2015). The Commerce Department will release its estimate of September 2015 construction spending on Monday, November 2nd. Detail will be covered in ShadowStats *Commentary No. 764* of Wednesday, November 4th.

As usual, headline monthly changes 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, the detail should continue in down-trending stagnation, net of inflation.

In what will have mixed impact on nominal (not-inflation-adjusted) growth, relative to real (inflation-adjusted) growth, related inflation (PPI – Final Demand Construction) was unchanged at 0.00% month-to-month, but rose by 1.80% year-to-year for September 2015, on a seasonally-adjusted basis, consistent with the headline construction-spending number.

U.S. Trade Balance (September 2015). The Commerce Department and Bureau of Economic Analysis (BEA) will release their full version of the monthly U.S. trade balance for September 2015 on

Wednesday, November 4th, updating the limited and questionable “advance” September merchandise trade detail published yesterday, October 28th.

Based on the “advance” detail, the September trade shortfall narrowed sharply versus August—reflecting stronger exports and weaker imports—fully reversing the deficit surge seen in August, versus July. The “advance” August deficit also narrowed slightly in revision. Against what previously had been the full reporting for August, yesterday’s unusually-large swing in the “advance” monthly detail boosted today’s headline GDP growth to 1.5%, from what otherwise would have been about 1.2%.

Full September trade reporting generally should be consistent with the “advance” numbers, but there have been reasonably sharp revisions to this newly introduced trade report. A more-negative third-quarter trade picture likely will come out of revisions in the next month or two. Some of that may surface in the pending headline full-report, setting up part of a likely downside revision to headline third-quarter GDP in its second reporting, next month.

Significant, catch-up deterioration in the headline monthly trade deficit is back in play, both in nominal and real (inflation-adjusted) terms. The broad trend going forward should remain for regular monthly and quarterly deteriorations in the real trade deficit.

Employment and Unemployment (October 2015). The Bureau of Labor Statistics (BLS) will publish its October 2015 labor data on Friday, November 6th. Both employment and the broader unemployment numbers are open for further negative, headline surprises, given the ongoing, general weakening tone in a number of business indicators.

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).

Underlying economic fundamentals continue to suggest slowing or negative month-to-month growth in headline payrolls, as well as deterioration in the broader unemployment rates such as U.6 and the ShadowStats Alternate Unemployment Measure.

Already at the Brink of Headline 5.0% U.3. As seen with the reduction in the narrow, headline U.3 unemployment rate in recent months and years, any meaningful further narrowing of the headline October unemployment rate likely would encompass more unemployed being redefined off the headline unemployment rolls and out of the headline labor force, than the number of unemployed gaining new employment.

In the context of no legitimate month-to-month comparability in the headline monthly unemployment detail, however, the September 2015 headline U.3 unemployment rate of 5.1% was only shy by a count of 1,000 fewer “unemployed” from rounding to a headline unemployment rate of 5.0%. Accordingly, a drop from 5.1% in September to 5.0% in October easily could be in the offing.

Implied Weak Monthly Trend in Payroll Employment. 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 September 2015 payroll-employment reporting, the built-in-bias trend for October 2015

is for a headline monthly employment gain of 152,000 (see *Commentary No. 756*). Consensus forecasts usually settle-in near the trend level.

To the extent that underlying fundamentals continue to shine through all the regular monthly volatility and distortions, headline activity should continue to favor much weaker-than-expected payroll gains. With headline payrolls up by a below-consensus 142,000 in September, odds favor a further downside "surprise" to payroll growth in October.

Also, keep in mind that the advance estimate of the 2015 benchmarking for payroll employment indicated a pending downside revision of 208,000 (-208,000) jobs to the base-March 2015 payroll employment levels (see *Commentary No. 753* of September 17th).

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