

SHADOWSTATS BULLET EDITION NUMBER ONE

March 7, 2019

Some Observations on a Sharply Deteriorating Trade Deficit

**Real Merchandise Trade Deficit Just Hit Its Worst Level Ever;
Annual and Fourth-Quarter 2018 Deficits Were Deepest in History**

Unfolding Trends Have Horrendous Implications for GDP

WELCOME TO THE BULLET EDITION! Supplemental to the regular *ShadowStats Commentaries*, *Watches* and the *Daily Update* postings on the *ShadowStats* home page (www.ShadowStats.com), I am pleased to introduce the *ShadowStats Bullet Edition*, a concept used some years ago by my old business associate, the late Doug Gillespie. Simply put, the *Bullet Edition* conveys brief communications and analyses on limited topics of particular near-term significance. The issue at hand is to provide some assessment of the March 6th headline release of the U.S. Trade Deficit for 2018, fourth-quarter 2018 and December 2018, with its revisions, record-setting deficits and generally negative implications for the Gross Domestic Product (GDP).

Separately, the much-delayed *Special Commentary No. 983-B* will be published over this coming weekend, reviewing in extended detail how the current economic and financial-market perils developed and what likely follows in the months and year ahead.

The *Daily Update* postings are made as new economic releases are published, with the next concurrent coverage posted on the *ShadowStats* home page by 12:00 noon Eastern Time, tomorrow, Friday, March 8th, covering the February Employment and Unemployment and January Housing Starts numbers.

Your comments and suggestions always are invited.

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A Rapidly Deteriorating Trade Deficit Will Hit GDP Growth Hard

Fourth-Quarter GDP Should Revise Lower Despite a Quirk in the Trade Revisions

The December 2018 Trade Deficit Widened Sharply, Deepening Both the Annual and Quarterly Real Merchandise Trade Deficits to the Worst Levels Ever Seen. Reported by the Census Bureau and Bureau of Economic Analysis, yesterday (March 6th, Shutdown Delayed), the headline December 2018 Trade Deficit widened sharply, beyond what had been suggested in the “advance” estimate of the Real Goods Trade-Deficit estimate used in generating the “initial” estimate of fourth-quarter GDP. That headline December 2018 Trade Deficit also was in the context of meaningful revisions that widened the headline Deficit for 2018, particularly in the first and third quarters, reflecting weaker than previously estimated real exports of goods. On an annual basis, the trade revisions were enough by themselves to reduce headline annual 2018 Real GDP growth by 0.1% (-0.1%), from the current 2.9% to 2.8%, come the July 26th annual GDP benchmark revisions (see *Table 1*).

Table 1: Estimated Impact of Real Merchandise Trade Deficit Revisions on 2018 Real GDP

Estimated Impact of December 2018 Revisions to the Real Merchandise Trade Deficit on Real GDP Growth				
Period	Current Headline Growth	Adjusted for Trade Revisions	Current Headline Growth	Adjusted for Trade Revisions
	Yr/Yr	Yr/Yr	Yr/Yr	Yr/Yr
2017	2.2%	2.2%	2.2%	2.2%
2018	2.9%	2.8%	2.9%	2.8%
	Qtr/Qtr	Qtr/Qtr	Yr/Yr	Yr/Yr
4q2017	2.3%	2.3%	2.5%	2.5%
1q2018	2.2%	2.0%	2.6%	2.5%
2q2018	4.2%	4.2%	2.9%	2.8%
3q2018	3.4%	3.3%	3.0%	2.9%
4q2018	2.6%	2.7%	3.1%	3.0%
Sources: Census Bureau, Bureau of Economic Analysis (BEA), www.ShadowStats.com (ShadowStats)				

A Deepening Deficit in Revision Has Negative Implications for Revised GDP Growth. The trade-deficit revisions and full initial December detail implied pending downside revisions to the *level* of real fourth-quarter 2018 GDP (see *Graph 1*), but due to a quirk in the revisions, it possibly could end up increasing the relative annualized real fourth-quarter GDP growth by 0.1% in its “final” reporting of March 28th. What happened was the level of third-quarter real deficit revised lower by an amount greater than was seen in the fourth-quarter downside revision, boosting the relative growth (narrowing the relative decline) in fourth-quarter versus the third-quarter activity. Nonetheless, those same numbers should generate downside revisions to the annual 2018 and first- and third-quarter GDP growth rates, come the July 26th annual GDP benchmarking, as calculated/estimated by ShadowStats and reflected in *Table 1*.

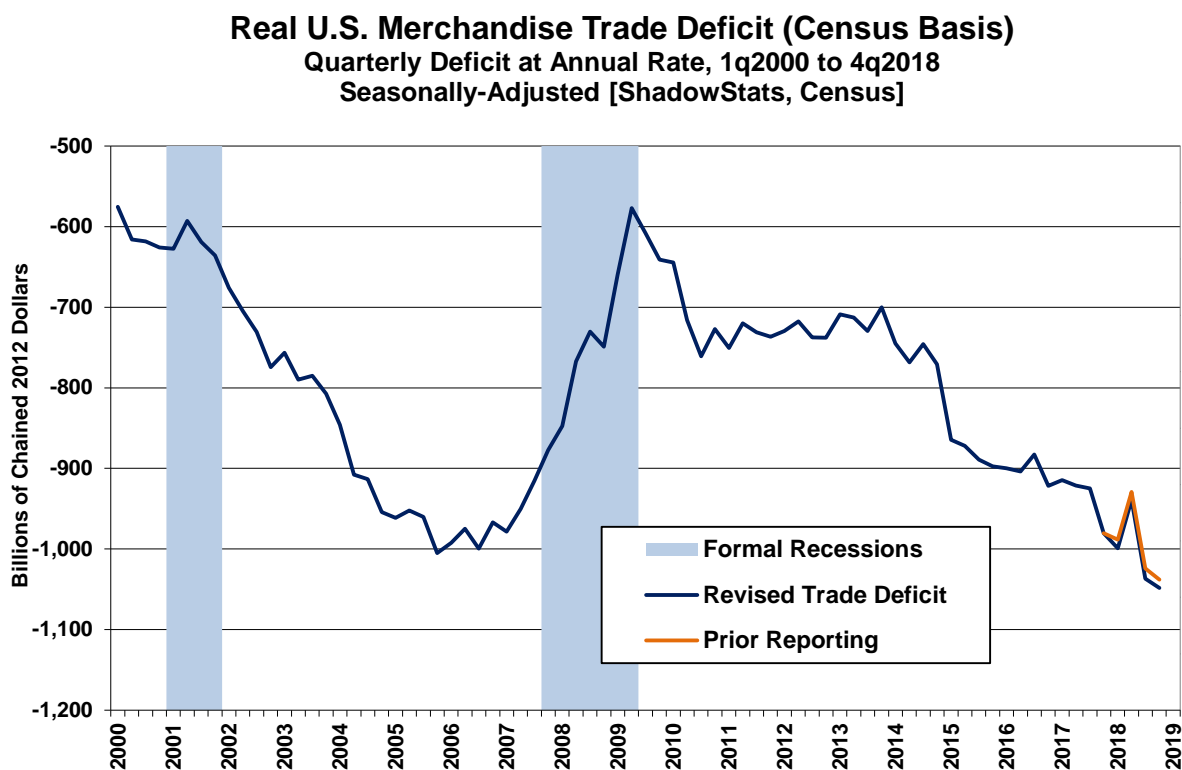
The trade deficit revisions to the inflation-adjusted Goods Sector (Real Merchandise Trade) reflected a correction to the November 2018 numbers, along with an annual revision to seasonal adjustments so that that annual total of the seasonally-adjusted numbers was made equal to that of the unadjusted numbers. The actual revisions and prior levels are reflected in *Graph 1*. *Graph 2* reflects the *Net Exports Account for Goods* as reported with the “Initial” estimate of Fourth-Quarter 2018 GDP, which should be revised in tandem in the “Final” estimate of Fourth-Quarter 2018 GDP to be released on March 28th. *Graph 3* reflects the updated full *Real Merchandise Trade Deficit* detail since 1994, while *Graph 4* reflects the GDP’s full *Real Net Exports Account for Goods and Services* (only the combined Goods and Services is available back to 1994), which again should revise with its March 28th “final” Fourth-Quarter GDP, and then more fully with the annual benchmarking of July 26th.

The latest headline GDP reporting through the “Initial” Fourth-Quarter 2018 and the last sequence of revisions for Third-Quarter 2018 are detailed in *Table 2*. They show how heavily trade-deficit deterioration can affect GDP growth.

Nominal Trade Deficit Remained Dominated by the Deteriorating U.S. Net Trade Position With China. The headline nominal deficit in December 2018 goods and services widened by \$9.5 billion, with the goods deficit widening by \$9.0 billion, reflecting monthly gyrations in petroleum imports and exports, and with the services surplus narrowing by \$0.5 billion. For all of 2018, the goods and services deficit widened by \$68.8 billion to \$621.0 billion, with an increase of \$148.9 billion in Exports (a positive) more than offset by an increase of \$217.7 billion in Imports (a negative). By far, the largest trade deficit was with China at \$419.2 billion in 2018, up from \$375.2 billion in 2017. Trailing in second place was Mexico at \$81.5 billion in 2018, up from \$71.1 billion in 2017.

**[Graphs 1 to 4, Table 2, Pending Headline Reporting and GDP Considerations
All Begin on the next page]**

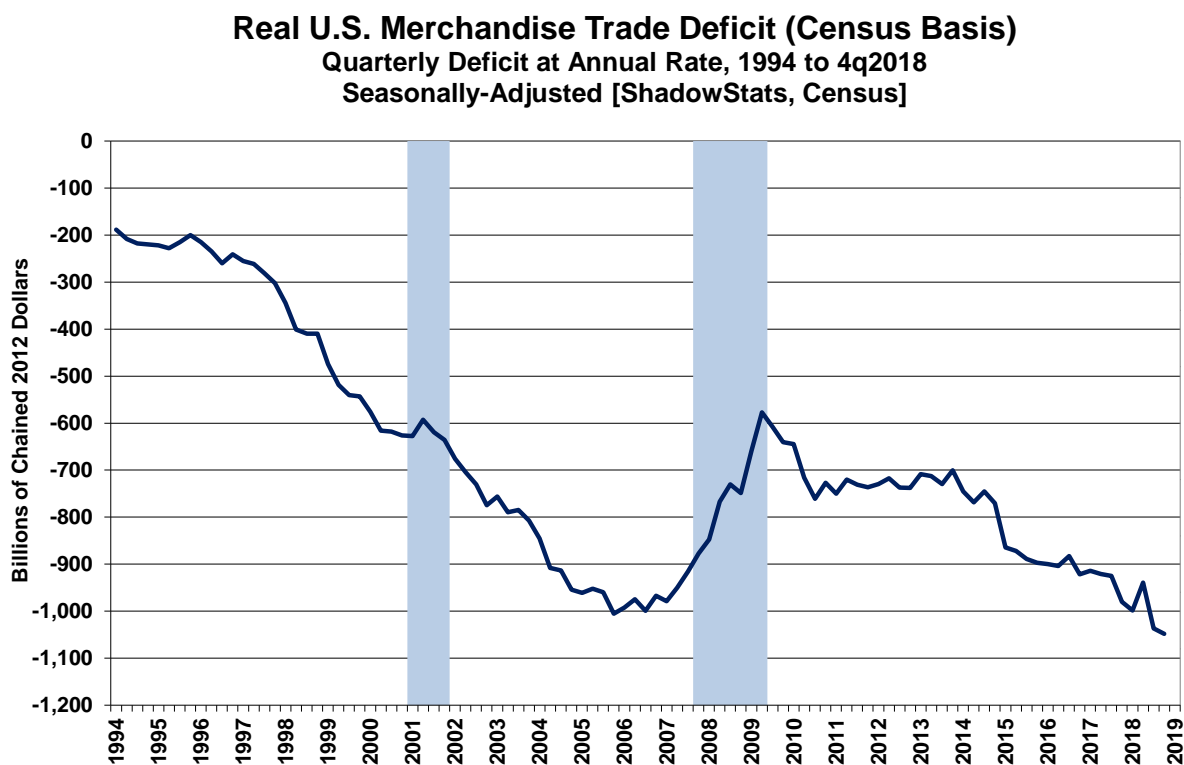
Graph 1: Revised - Real U.S. Merchandise Trade Deficit (2000 to Date)



Graph 2: U.S. Net Exports of Goods (2002 to "Initial" GDP Reporting of Fourth-Quarter 2018)



Graph 3: Revised - Real U.S. Merchandise Trade Deficit (1994 to Date)



Graph 4: U.S. Net Exports of Goods and Services (1994 to "Initial" GDP Reporting of Fourth-Quarter 2018)



Table 2: Gross Domestic Product (GDP), 2018 Quarterly Detail by Major Sector to "Initial" Fourth-Quarter 2018

(Please Note: This is Table III from pending Commentary No. 983, graphs references in the notes are to No. 983.)

Annualized Quarterly Real Growth in Headline Gross Domestic Product Initial Estimate of Fourth-Quarter 2018 GDP and Earlier Headline Data Growth Contribution by Consumption and Product Sector						
GDP COMPONENTS	1st-Q 2018 Final	2nd-Q 2018 Final	3rd-Q 2018 First Estimate	3rd-Q 2018 Second Estimate	3rd-Q 2018 Final	4th-Q 2018 "Initial" Estimate
CONTRIBUTING ECONOMIC SECTOR						
Personal Consumption Expenditures						
- Goods	-0.13%	1.16%	1.20%	1.00%	0.90%	0.80%
-- Motor Vehicles	-0.35%	0.16%	0.09%	-0.04%	-0.05%	0.22%
- Services	0.49%	1.42%	1.49%	1.45%	1.47%	1.11%
Gross Private Domestic Investment						
- Fixed Investment	1.34%	1.10%	-0.04%	0.25%	0.21%	0.69%
-- Residential	-0.14%	-0.05%	-0.16%	-0.10%	-0.14%	-0.14%
- Change in Private Inventories	0.27%	-1.17%	2.07%	2.27%	2.33%	0.13%
Net Exports of Goods and Services	-0.02%	1.22%	-1.78%	-1.91%	-1.99%	-0.22%
Government Consumption/Investment	0.27%	0.43%	0.56%	0.44%	0.44%	0.07%
GDP ANNUALIZED REAL GROWTH	2.22%	4.16%	3.50%	3.50%	3.36%	2.59%
Final Sales, GDP Less Inventories	1.95%	5.33%	1.43%	1.23%	1.03%	2.46%
CONTRIBUTING PRODUCT SECTOR						
Goods	1.20%	1.91%	1.89%	1.81%	1.76%	1.93%
Services	0.73%	1.78%	1.82%	1.77%	1.77%	1.01%
Structures	0.28%	0.47%	-0.21%	-0.07%	-0.17%	-0.35%
GDP Annualized Real Growth	2.22%	4.16%	3.50%	3.50%	3.36%	2.59%
SUPPLEMENTAL						
Annualized Quarter-to-Quarter Real GDP Change and Headline Implicit Price Deflator Inflation						
Gross Domestic Product (GDP)	2.22%	4.16%	3.50%	3.50%	3.36%	2.59%
Gross Domestic Income (GDI)	3.90%	0.87%	--	4.03%	r 4.55%	--
Gross National Product (GNP)	2.20%	4.04%	--	3.49%	3.05%	--
ShadowStats Corrected-Inflation GDP*	0.15%	2.05%	1.41%	1.41%	1.27%	0.51%
Implicit Price Deflator (IPD) Inflation	2.02%	3.31%	1.38%	1.40%	1.51%	1.95%
Year-to-Year Real GDP Change and Headline Implicit Price Deflator Inflation						
Gross Domestic Product (GDP)	2.58%	2.87%	3.04%	3.04%	3.00%	3.08%
Gross Domestic Income (GDI)	2.36%	1.88%	--	2.56%	r 2.69%	--
Gross National Product (GNP)	2.73%	3.09%	--	3.07%	2.96%	--
ShadowStats Corrected-Inflation GDP*	0.51%	0.79%	0.95%	0.95%	0.92%	0.99%
Implicit Price Deflator (IPD) Inflation	1.95%	2.50%	2.36%	2.36%	2.39%	2.20%
Sources: Bureau of Economic Analysis (BEA), www.ShadowStats.com (ShadowStats). r-Previously 4.26%, 2.62%. *Real GDP corrected for understated headline inflation (see <i>Special Commentary No. 968-Extended</i> , and and accompanying <i>Graphs 25 to 28</i> here). Standard headline GDP is reflected in <i>Graphs 11 to 19</i> .						

Upcoming Releases Should Hit 4th-Quarter GDP and Take Subsequent Quarters Negative

What to Watch for in the Pending Employment and Housing Data

Economic Indicators Should Turn Increasingly Negative. Between now and the second and “final” estimate of Fourth-Quarter 2018 GDP on March 28th, a variety of indicators will be published that should pressure that “final” growth estimate to the downside, in revision, and likely will take expectations for First-Quarter 2019 GDP negative, before its “advance” release on April 26th.

Subsequent to the February 28th “Initial” (combined first and second) estimate of Fourth-Quarter 2018 GDP, releases of December Construction Spending and New-Home Sales both signaled downside revisions to the fourth-quarter GDP estimate. Beyond tomorrow’s (March 8th) reporting of February Labor Conditions and January Housing Starts (shutdown delayed), and the March 15th release of February Industrial Production, all the other pending economic releases have been shutdown delayed, and normally would have been current (and more-negative) for the “Initial” fourth-quarter GDP estimate:

Date	Series	Agency
11 Mar	Retail Sales, January 2019	Census
13 Mar	New Orders for Durable Goods, January 2019	Census
13 Mar	Construction Spending, January 2019	Census
14 Mar	New-Home Sales, January 2019	Census
26 Mar	New Residential Construction, February 2019	Census
27 Mar	Trade Deficit, January 2019	BEA/Census

The Government Shutdown Affected January/ February Employment and Unemployment Data; Watch for Negative Surprises. Housing Starts are a Good Bet to Deteriorate in Revision.

Tomorrow, Friday, March 8th at 8:30 a.m. Eastern Time, February 2019 Employment and Unemployment will be released by the Bureau of Labor Statistics (BLS), and New Residential Construction (Housing Starts and Building Permits), January 2019, will be released by the Census Bureau (Census). Again, ShadowStats-posted assessments on both releases will be in place by 12:00 noon Eastern Time, with the employment/unemployment detail to be posted first.

Labor Data. Consensus expectations for the February labor data are for a reversal to the impact of the government’s shutdown on January data. Expected is a drop back to 3.9% in February U.3 Unemployment, from 4.0% in January, which had gained 0.1% from December, attributable to the shutdown. Expectations are for an increase in February Payroll Employment of about 180,000 jobs,

versus a January gain of 308,000, which was boosted by downside revisions to December payrolls and by some furloughed government employees taking part-time jobs.

Where those expectations are reasonable, watch out for likely negative surprises against the consensus. Such would suggest that with the special factors from January removed, underlying economic activity deteriorated otherwise in the second month of first-quarter 2019.

Housing Starts. This series usually is nonsensically volatile, but commonly with downside revisions to annual growth in prior reporting. Irrespective of the headline January detail, watch for downside revisions to fourth-quarter activity, which would be reflected in a downside revision to fourth-quarter GDP growth.

ShadowStats Continues to Predict First- and Second-Quarter 2019 GDP Contractions. Some downside revision is likely in the final estimate of, and still catch-up reporting to fourth-quarter 2018 GDP. ShadowStats continues to forecast a formal recession in first- and second-quarter 2019, which likely will force the Federal Reserve back into an easing mode, irrespective of any current comments offered by the FOMC or the Fed Chairman.

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