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

COMMENTARY NUMBER 326
Double-Dip, Housing, Durable Goods

September 26, 2010

Officially It Will Be a Double-Dip Recession

Third-Quarter Contraction Suggested by Housing and Durable Goods Orders Data

Stock Market Hypesters Grasping at Straws

Gold Strength and Dollar Weakness Signal Problems Ahead

PLEASE NOTE: The next regular Commentary *is scheduled for Thursday, September 30th, following the release of the third estimate (second-revision) of second-quarter GDP.*
-- Best wishes to all, John Williams

What's in a Name? NBER Declares Recession Ended in June 2009. Speaking to her beloved Romeo, Juliet declares, "What's in a name? That which we call a rose, by any other name would smell as sweet." There is a corollary here involving economic contractions, recessions, double-dips and recoveries, but the final descriptive would involve something other than a sweet fragrance.

On September 20th, the National Bureau of Economic Research (NBER) -- official arbiter of the timing of the U.S. business cycle -- declared the December 2007 recession to have ended in June 2009. Officially, the economy has been in recovery ever since. The official call of the recession's end does not in any way alter the economic outlook, either as to existing underlying business activity or as to the course of likely future economic activity; only the nomenclature that will be used in describing current activity has been changed. The re-intensifying economic downturn -- already underway -- simply will be called the second-dip of a double-dip recession, at such time as the NBER gets around to recognizing the "new" contraction in economic activity.

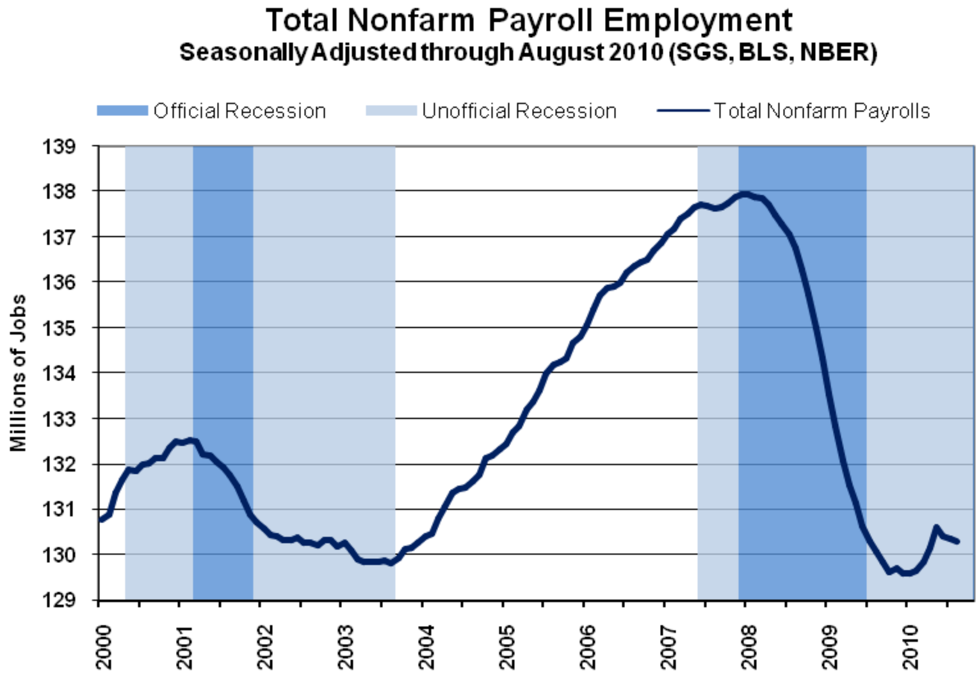
Once again, the NBER has been too early in timing the end of a recession (in recent cycles and the current cycle, the NBER also has tended to time the onset of recessions too late). Nonetheless, from the official December 2007 peak, when seasonally-adjusted nonfarm payrolls began a long series of month-to-month contractions, through the now-official June 2009 trough, with monthly payrolls still tumbling, the 18-month official recession was the longest since the first down-leg of the Great Depression (43 months, August 1929 to March 1933), eclipsing the second down-leg of the Great Depression (13 months, May 1937 to June 1938).

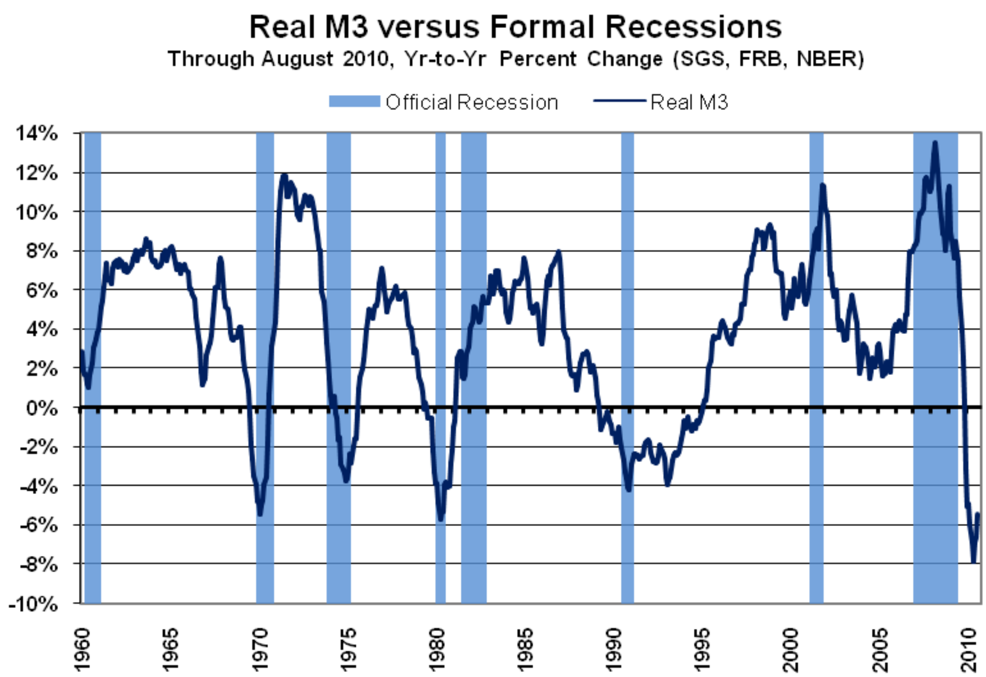
Happy days once again are upon us, per the NBER. With less than two months until the mid-term election, official recovery and economic good times purportedly have been in place now for 15 months. Yet, today's ongoing "recovery" is not evident in most economic data, and, like the mid-Great Depression recovery, most people will not recognize the "good times." Main Street U.S.A. usually has a pretty good sense of what is happening in the real world, and the pain of today's pocketbook issues still we be felt heavily at the polls, irrespective of any happy announcements or heavy political hype to the contrary.

In this last week's economic reporting of August housing starts, new and existing home sales, and new orders for durable goods, every series was reported with a pattern of monthly activity suggestive of a quarterly contraction for the current quarter: third-quarter 2010. Based on the average of July and August 2010 reporting, versus the average monthly level reported for second-quarter 2010, the annualized rates of quarterly-to-quarter contraction in place at the moment for these series are: housing starts down by 19.9%, new home sales down by 46.0%, existing home sales down by 73.8%, new orders for durable goods down by 1.2%. The rates here are annualized, the same way the GDP is, at an effective compounded annual rate of change. Keep in mind that the home sales contractions were exacerbated by the expiration of tax credit incentives, and the durable goods contraction is before adjustment for inflation. These numbers are on top of the prior week's data, which suggested a quarterly contraction in inflation-adjusted retail sales and slowing quarterly growth in industrial production (see *Commentary No. 325*).

The NBER usually attempts to wait long enough on its timing calls of peaks and troughs in business activity so that they do not get revised. The NBER also does not necessarily wait until a "recovery" regains the prior peak in activity to make its call. That considered, the heavily relied-on nonfarm payroll series likely faces major, near-term downside revisions, with the next benchmark revision's order-of-magnitude be announced with the October 8th release of September's payroll and unemployment data.

Further, a key factor in determining the end-of-recession timing call was recent GDP reporting. That seems nonsensical, given the extreme short-term unreliability of and regular massive revisions in that series. Such factors lend weight to speculation of political considerations in the timing of this call.


Total Nonfarm Payroll Employment
Seasonally Adjusted through August 2010 (SGS, BLS, NBER)
Official Recession
Unofficial Recession
Total Nonfarm Payrolls
Millions of Jobs
139
138
137
136
135
134
133
132
131
130
129
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010


Real M3 versus Formal Recessions
Through August 2010, Yr-to-Yr Percent Change (SGS, FRB, NBER)
Official Recession
Real M3
14%
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
-8%
-10%
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010

The preceding graphs are updated from *Special Commentary No. 323*, revised only in terms of the shaded official recession areas. The first graph shows official recession timing in dark blue, with my estimate of recession timing in light blue, plotted versus the levels of monthly payroll employment. Note that both the 2001 and 2007 recessions began coincident with regular contractions in monthly payrolls, yet both ended well before the bottoming in payrolls, which is a key benchmark. The concept of payrolls as lagging a lagging indicator was a creation largely of Wall Street hypesters, based on the much-too-early call of the 2001 recession. As to current payrolls, beyond the pending likely major downside revisions to last year's history, the recent up- and down-ticks in the graph reflect the hiring and firing of temporary census workers.

The second graph shows the relationship between the year-to-year change in real (inflation-adjusted) broad money supply M3 (SGS-Ongoing Measure). Whenever annual growth has turned negative, a recession (or an intensified recession) always has followed, usually within six-to-nine months.

The signal for an economic downturn is independent of the depth or the duration of the annual contraction in real M3. A number of contractions have taken place without the M3 signal. M3 rising to the upside does not necessarily signal and economic upturn. Yet, every time annual growth in real broad liquidity turns negative, the economy follows.

Real M3 generated a signal in December 2009 for a downturn. Due to the new NBER timing call, the M3 signaled now has signaled a new recession within six-to-nine months, around the current time frame. The difference here, again, is semantics and not of substance.

With the economy turning down again, following a protracted period of bottom-bouncing and a short-lived stimulus bounce being interpreted as "recovery," the current weakness eventually will gain official recognition as the second down-leg of a double-dip recession. Eventually, that likely will be timed to have started before September 2010, before last week's announcement of the prior recession's end.

Gold and Dollar Signal Problems. Beyond the games being played with semantics by economist-politicians, the continued rally in precious metal prices and renewed weakness in the U.S. dollar appear to be signaling growing global concern of the implications of an actual re-intensification of the downturn in U.S. economic activity. Particularly destabilizing to the markets are fears of the likely responses of the Federal Reserve and the federal government to forestall systemic collapse through significant debasement of the U.S. dollar, as discussed in *Special Commentary No. 323*.

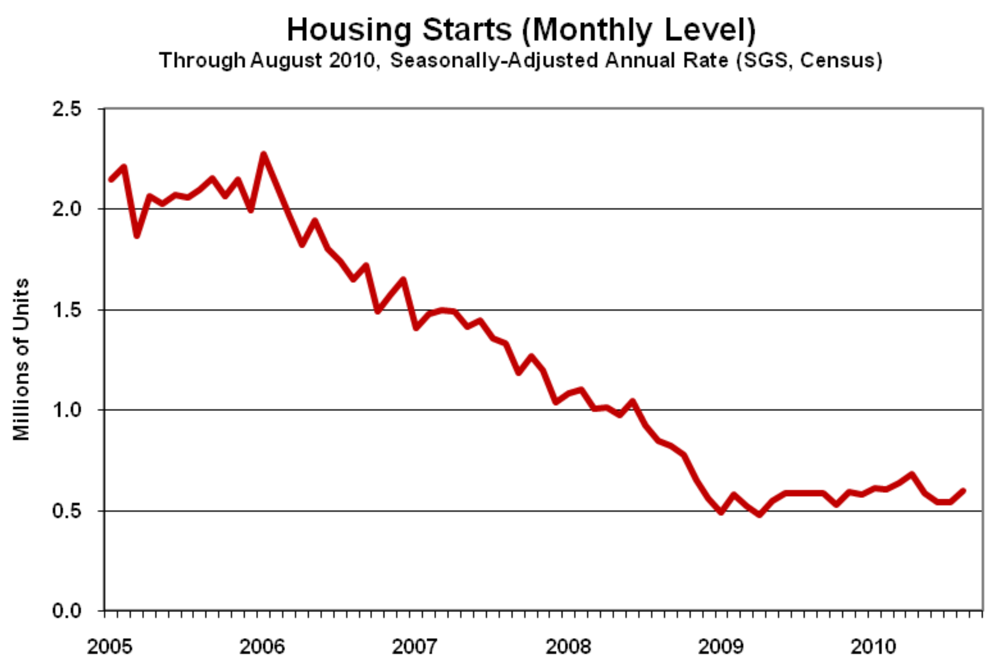
The current circumstances are of a nature that could trigger further central bank activity -- overt or covert -- in terms of slamming the price of gold or attempting to prop the value of the U.S. dollar with short-lived actions ranging from direct intervention in the markets to jawboning. As dollar-defensive efforts get more serious, such will signal an intensification of dollar-dumping desires by holders of the U.S. currency, and the rapid nearing of the ultimate crisis-of-confidence in the dollar. The broad outlook for the economy, for the financial markets and for systemic stability is unchanged.

August Housing Starts Still Suggest Third-Quarter Contraction. The Census Bureau reported a statistically-insignificant monthly gain for August 2010 housing starts, on September 21st. The monthly data had the average July and August seasonally-adjusted monthly level lower than the monthly average for the second-quarter, consistent with a 19.9% annualized quarterly contraction, third-quarter versus second quarter.

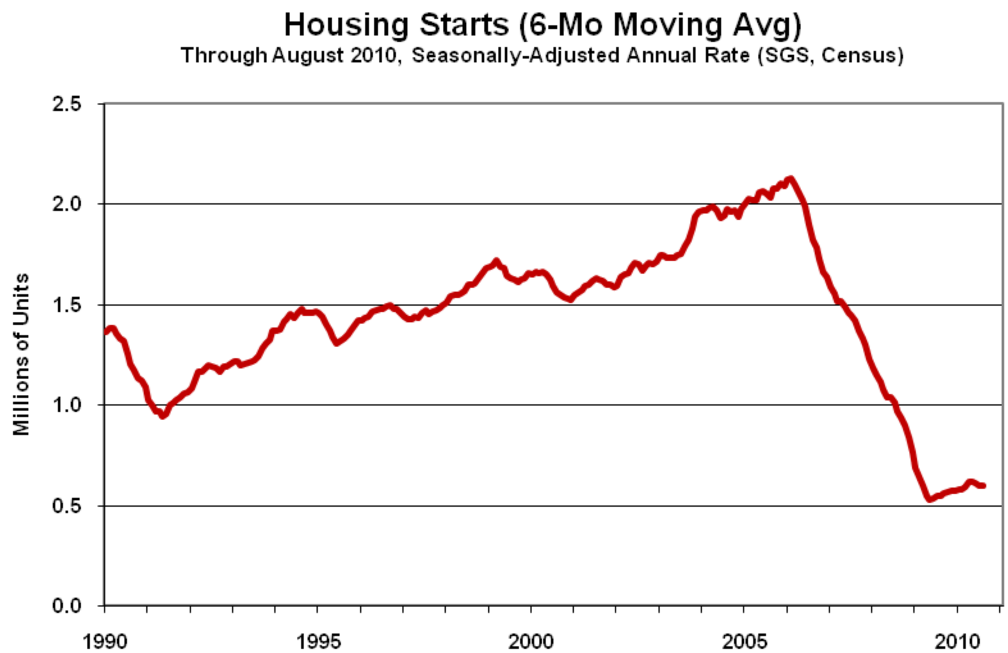
As reported, August housing starts rose by a statistically-insignificant 10.5% (up by 9.5% before prior-period revisions) +/- 13.9% (95% confidence interval). July's starts were revised to a 0.4% (previously 1.7%) monthly gain. Activity has started to slow anew, although the pattern of housing starts generally remains one of bottom-bouncing at an historically low-level plateau of activity, as seen over the last 21 months. Much weaker monthly numbers remain likely in the months ahead.

Year-to-year change in August starts was a statistically-insignificant gain of 2.2% +/-11.3% (95% confidence interval), following a downwardly revised annual decline of 7.8% (previously 7.0%) in July.

Since December 2008, as noted, housing starts have been bottom-bouncing at an historically low level, averaging a seasonally-adjusted annual rate of 571,800. In the past 21 months, all monthly readings have been within the normal range of monthly volatility for the series around that average, including August 2010's reading of 598,000.



The "recovery" in housing is shown in these graphs. The graph above reflects the level of monthly activity in terms of the annualized monthly rate of housing starts, which is randomly volatile and subject to large revisions on a monthly basis. The second graph shows the six-month moving average, which tends to smooth out that monthly volatility.



Home Sales Distorted by Increasing Number of Foreclosures. Even allowing for the exacerbated drop-off in home sales activity post-tax break incentives (see quarterly decline rates in the opening economic comments), the residential sales environment is abysmal at the moment, both from an anecdotal standpoint and as shown in industry reporting. Hit by consumer confidence and liquidity woes, home sales hold no near-term prospects of helping to boost broad economic activity; rather they likely will continue sapping strength from broad business activity, further impairing residential construction and new orders for durable goods, which benefit from home sales activity in more-positive times.

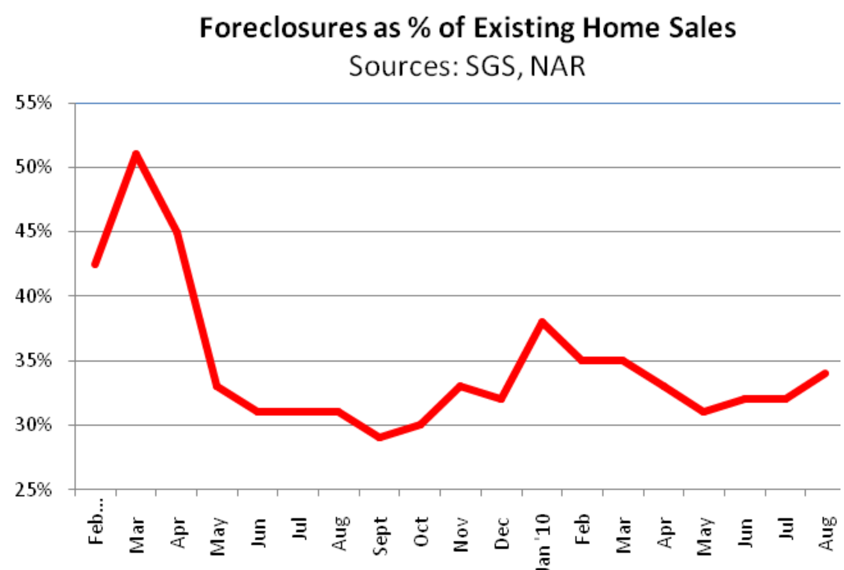
Friday's (September 24th) reporting of August new home sales (counted based on contract signings, Census Bureau) were unchanged (up 4.3% before prior-period revisions) +/- 19.5% (95% confidence interval) from July. The 0.0% change in August was statistically indistinguishable from nearly a 20% plunge or 20% jump. Such followed a revised decline of 7.7% in July (previously a 12.4% drop). The year-to-year decline in the new home sales series in August 2010 narrowed to 28.9% from a revised 29.4% (previously 32.4%) decline in July.

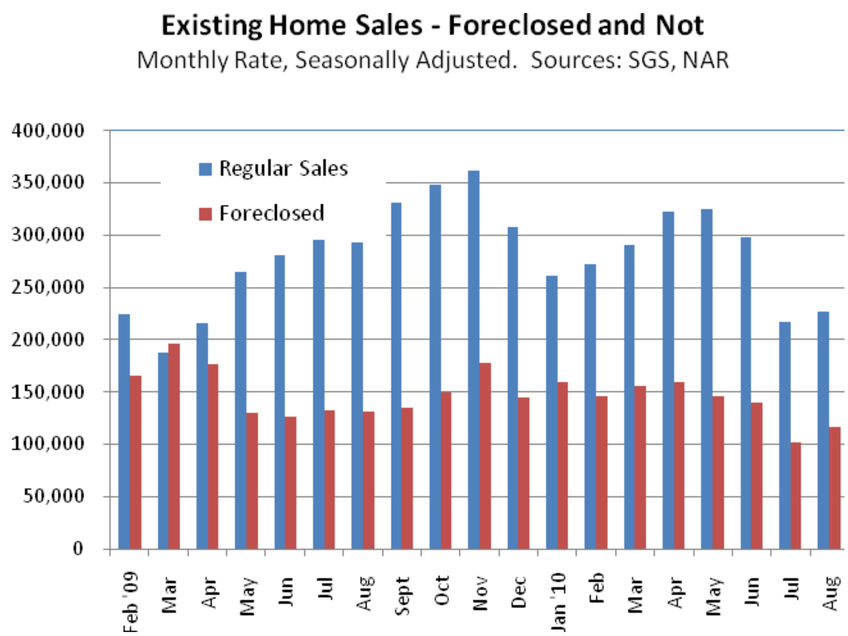
Thursday's (September 23rd) release of August existing home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a little rebound in activity from July, but basically still at historically-low levels.

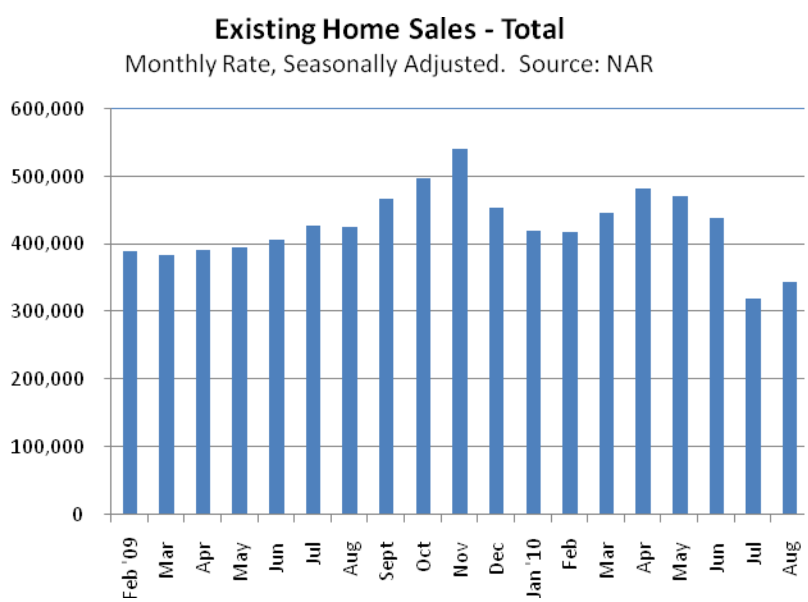
August sales gained 7.6% (7.8% before prior-period revisions), following a revised 27.0% (previously 27.2%) decline in July. On a year-to-year basis, sales were down by 29.0% in August versus a revised 25.3% (previously 25.5%) annual contraction in July.

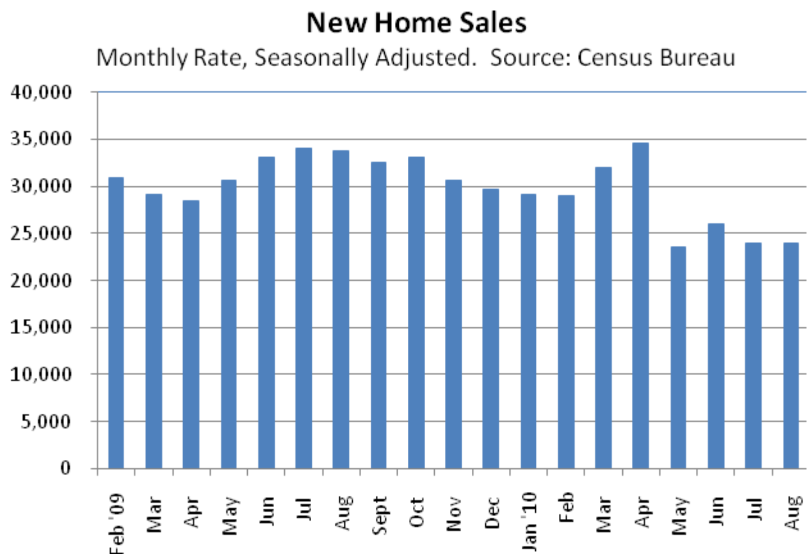
Foreclosure activity remains a major distorting factor for home sales, with "distressed" activity accounting for 34% of existing sales in August, up from 32% in June and July. With other reporting showing foreclosures on the rise, and with forced or distressed sales not likely to soften in proportionate tandem with regular sales, one might expect that foreclosure levels will continue rise in the months ahead, at least as a portion of monthly sales. Separately, the Census Bureau acknowledges that a portion of new home sales also is from foreclosure activity but offers no estimates as to the scope of the issue. Some in the construction trade have difficulty competing with the pricing of foreclosed properties. Until the foreclosure problems get worked out in the system, monthly changes in these home sales numbers cannot be taken as meaningful positive indicators (when the numbers are positive) of underlying activity in homeowner real estate, as it relates to general economic activity.

The following updated graphs reflect different measures of home sales activity since February 2009. The numbers, through August 2010, reflect the seasonally-adjusted level of monthly sales, rather than the annual rates usually published by the industry.




Existing Home Sales - Foreclosed and Not
Monthly Rate, Seasonally Adjusted. Sources: SGS, NAR
400,000
350,000
300,000
250,000
200,000
150,000
100,000
50,000
0
Regular Sales
Foreclosed
Feb '09
Mar
Apr
May
Jun
Jul
Aug
Sept
Oct
Nov
Dec
Jan '10
Feb
Mar
Apr
May
Jun
Jul
Aug


Existing Home Sales - Total
Monthly Rate, Seasonally Adjusted. Source: NAR
600,000
500,000
400,000
300,000
200,000
100,000
0
Feb '09
Mar
Apr
May
Jun
Jul
Aug
Sept
Oct
Nov
Dec
Jan '10
Feb
Mar
Apr
May
Jun
Jul
Aug



New Orders for Durable Goods Suggest Quarterly Contraction. Friday's stock market hype partially was centered on reports of surging capital goods orders. When the market hypesters beginning pick at scattered straws of "good" news, the broad business environment likely is not good. Keep in mind that the durable goods series and its components are highly volatile and often randomly so, month-to-month. In July, capital orders were boosted by the success of Boeing's salespeople in booking significant business. With airplane orders down in August, the hypesters viewed capital goods net of aircraft in order to come up with a monthly gain of 4.1% in capital goods orders. While that is good news in its limited scope, that gain was shy of offsetting July's 5.3% decline in the same capital goods category, net of aircraft.

The Census Bureau reported Friday (September 24th) that the regularly volatile, seasonally-adjusted new orders for durable goods fell by 1.3% (down by 1.0% before prior-period revisions) month-to-month in August 2010, after a revised 0.7% (previously 0.3%) decline in July. Unadjusted, year-to-year change in August new orders was a gain of 12.1%, up from a revised 9.1% (previously 8.6%) annual increase reported for July.

While recent benchmark revisions appear to have built-in something of an upside sampling bias to the monthly numbers, the three most recent reports have shown flat-to-negative pressures on total new orders before consideration of the effects of inflation, which would make data appear weaker. As discussed in the opening economic comments, third-quarter 2010 new orders for durable goods are on track for an annualized quarterly contraction of 1.2% versus the second-quarter.

Widely followed nondefense capital goods declined by 0.9% (up 1.2% net of revisions), seasonally-adjusted, for the month in August, after a revised 0.7% (previously 2.8%) decline in July. For August, the unadjusted year-to-year change in the series was 22.6%, versus a revised 12.3% (previously 9.7%) gain in July.

Week Ahead. Given the unfolding reality of an intensifying double-dip recession and more-serious inflation problems than generally are expected by the financial markets, risks to reporting will tend towards higher-than-expected inflation and weaker-than-expected economic reporting in the months ahead. Increasingly, previously unreported economic weakness is showing up in prior-period revisions.

Gross Domestic Product -- GDP (Second-Quarter 2010 -- Third Estimate). Due for release on Thursday, September 30th, the second revision to second-quarter GDP is expected to be nil (Briefing.com), with annualized real quarterly growth holding at 1.6%. While nothing more than statistical noise is likely at this point, the last trade data would allow for a minor downward revision to reported growth.

