John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 327
Second-Quarter GDP Revision, September Employment Outlook

September 30, 2010

2nd-Quarter GDP at 1.7%, GDI at 1.3%

Census Jobs Reduce September Payrolls by Roughly 78,000

New Online Help-Wanted Advertising Drops 2.6%

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, October 8th, following the release of the September payroll and unemployment data.*

-- Best wishes to all, John Williams

September Reporting Should Show Marked Business Deterioration. In an otherwise statistically quiet week, the third-estimate of second-quarter GDP was just statistical noise in a generally worthless and heavily politicized series. Nonetheless, as noted in the prior *Commentary No. 326*, risk continues to mount for reporting of a quarterly contraction in third-quarter GDP, particularly, if the monthly economic reporting for September turns sharply lower, which is my expectation.

The first big report is on September labor market conditions, due on October 8th. Not only should the data show deterioration in employment -- net of revisions and temporary census hires -- and a good boost in at least the broader unemployment measures, but also a indication of pending downside revisions to 2010 payroll data, with an initial 2011 benchmark revision estimate (see *Week Ahead*). A general update to economic condition will be included in next Friday's *Commentary* on the labor numbers. The broad, general outlook remains unchanged (see *Special Commentary No. 323*).

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 2005 Dollars," at present, where the 2005 is the base year for inflation, and "chained" refers to the methodology which gimmicks the reported numbers so much that the total of the deflated GDP sub-series misses the total of the deflated total GDP series by nearly $40 billion in "residual" as of second-quarter 2010.*

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.*

GDP Revision Little More Than Statistical Noise -- Except for GDI. The second revision to second-quarter 2010 GDP had annualized real (inflation-adjusted) growth notching higher to 1.7%. Nearly half of the quarter's growth still was in inventory (growth in final sales -- GDP net of inventory changes -- was 0.9%), which will help set up a possible contraction for third-quarter GDP, as production is cut back to help work off excess inventories in an general environment of softening to negative consumption.

Showing perhaps a little more honest, less politicized picture of what is happening in the national income data related to the GDP, the GDP's income-side equivalent, GDI, had its initial second-quarter annualized real growth rate shrink from 2.3% to 1.3%, in revision.

GDP. Published today (September 30th) by the BEA, the second revision, or third estimate, of second-quarter 2010 Gross Domestic Product (GDP) was a statistically-insignificant annualized real growth rate of 1.72% +/- 3% (95% confidence interval), up from the second estimate of 1.61%, but down from the "advance" estimate of 2.39%, and down from the estimated growth rate of 3.73% in the first-quarter. The year-to-year change in real second-quarter GDP revised to 3.00% from the first revision of 2.98%, and from initial reporting of 3.17%. Such was higher than the year-to-year 2.39% growth estimated for the first-quarter.

The GDP implicit price deflator -- inflation measure -- showed an unrevised annualized pace of inflation in second-quarter 2010 of 1.96% versus initial reporting of 1.83%, which was up from 1.05% in the first-quarter. In an unusual divergence, annualized inflation for the CPI-U in the second-quarter was a contraction of 0.72% versus a positive 1.53% in the first-quarter. The higher the inflation rate used in deflating the GDP, the weaker is the inflation-adjusted number and vice versa. In this case, lower prices for imported oil spiked the implicit price deflator, because imports are subtracted from the GDP, which reverses the impact of the oil price changes in the aggregate number.

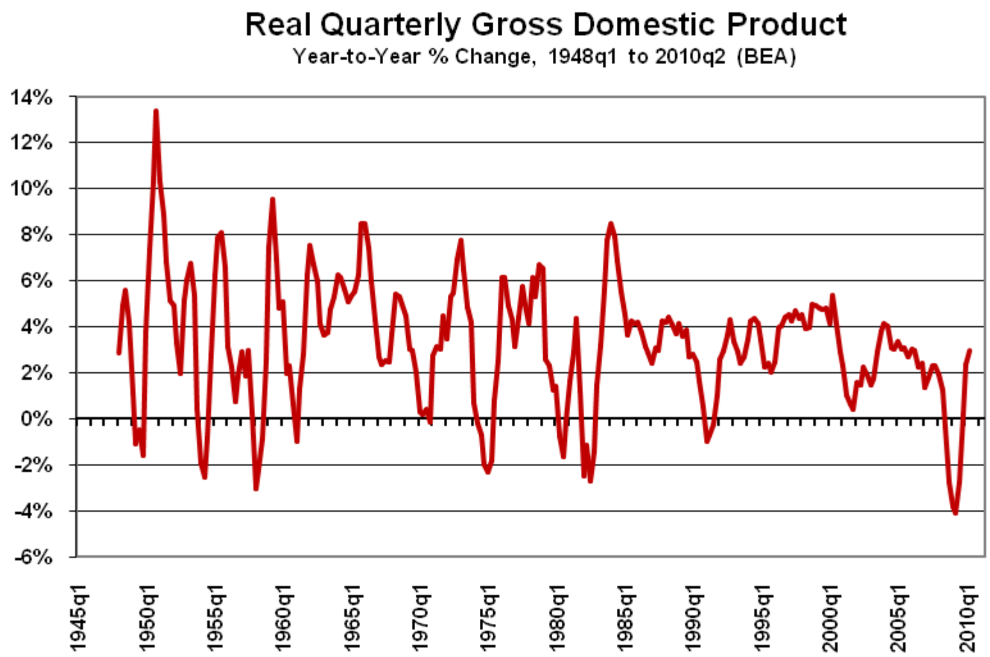
The SGS Alternate-GDP estimate for second-quarter 2010 remained an approximate annual contraction of 1.3% versus the official estimate of a 3.0% gain, less-negative than the annual 1.5% contraction (2.4% official gain) estimated in the first-quarter (see the Alternate Data tab). While annualized real quarterly growth is not formally estimated on an alternative basis, a flat-to-minus quarter-to-quarter gain likely would have been realistic for the second-quarter. The relative upturn in annual change reflects the bottom-bouncing at low levels of activity seen for much of the last year in key underlying economic series, not an economic recovery. As discussed in *Commentary No. 326*, an intensified downturn, now in the form of a double-dip recession, continues to unfold.

GNP and GDI (see Notes on GDP-Related Nomenclature and Definitions Sidebar). Second estimates of Gross National Product (GNP) and Gross Domestic Income (GDI) for second-quarter 2010 GDP also were published with today's release.

The first revision to annualized second-quarter 2010 real GNP growth notched growth higher to 1.81% from initial reporting of 1.65%. The second-quarter growth rate was down from 4.41% in the first-quarter. Year-to-year change in the second-quarter was reported at a revised 3.43% (previously 3.39%), up from 2.84% in the first-quarter.

The first revision to annualized second-quarter 2010 real GDI growth was estimated at 1.30%, down sharply from the initial 2.31% estimate, and down from 4.11% in the first-quarter. Year-to-year growth in the second-quarter was revised to 2.99% (previously 3.25%), and up from 2.24% in the first-quarter.

The following graph shows the annual percent change in quarterly GDP for the history of the series. The record annual contraction for the series was 4.11%, seen in last year's (2009's) second-quarter.



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.

Employment and Unemployment (September 2010). Due for release on Friday, October 8th, reporting of both the September payroll employment change and unemployment rate likely will disappoint market expectations. Further, the preliminary estimate of the benchmark revision as of March 2010 will be published, and odds favor a meaningful downside revision.

The Census Bureau reported yesterday (September 29th) that its temporary and intermittent hires for the 2010 census were reduced by roughly 78,000 in September, based on the payroll-survey weeks, with only 6,000 census hires left to be discharged. Where Briefing.com shows a consensus estimate of a 15,000 decline in September payroll employment, versus a 54,000 decline in August, such suggests that the consensus is looking for a gain in payrolls -- net of temporary census hiring -- of about 63,000.

The "public sector" employment estimates are not the same thing as payrolls ex-census workers, since regular changes in federal, state and local employment are excluded from the public sector count. At the state and local level, government employment trends have been negative.

I expect the September ex-census number to show outright contraction (at least net of prior-period revisions), and for the headline U.3 unemployment number to rise above the consensus (Briefing.com) 9.7%, versus 9.6% in August.

Importantly, though, these expectations are against an environment where statistical significance at the 95% level is +/- 129,000 for the monthly payroll change, and +/- 0.2% in the monthly headline unemployment rate change. On that basis, my estimates are within the scope of consensus estimates, but the markets ignore the relative meaninglessness of the initial reporting.

The outlook for the labor report will be updated next week, as needed, if detail from related series alters the outlook. The Conference Board's August help-wanted advertising index (newspapers), which leads September employment reporting, was reported, again, at 10 -- unchanged for a number of months -- and one point above its historic low. The Conference Board's help-wanted advertising index (online) for September, however, rose by 1.4% for the month for total ads, but it fell by 2.6% for new ads, reversing a rising trend. I view the "new ads" series here to be the more significant one.

