

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

**COMMENTARY NUMBER 370**  
**GDP Revision, Revised Durable Goods, Home Sales**

**May 26, 2011**

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**Major Downside Revisions to GDP Loom in Upcoming Benchmark**  
**Durable Goods Orders Revised Lower by 8% in Trough-Year 2009**  
**Housing Activity Disaster Exacerbates Systemic Solvency Issues**

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*PLEASE NOTE: The next regularly scheduled Commentary is for Friday, June 3rd. It will cover the unemployment rate and payroll employment reporting for May 2011.*

*—Best wishes to all, John Williams*

**Opening Comments and Executive Summary.** Most major economic reports in April disappointed consensus expectations and either were flat or negative for the month—including real retail sales, industrial production, housing starts and durable goods orders. Where first-quarter GDP growth slowed versus the fourth-quarter, the stage is set for the GDP to turn negative, again, sometime in the next two quarters, reflecting what would become an official double-dip recession. Unfortunately, though, key economic reporting such as retail sales and payroll employment remain so heavily distorted by seasonal-factor gimmicks as to be almost meaningless, at present. Still, with the July 29th GDP benchmark revisions (and second-quarter GDP “advance estimate”), heavy downside changes to historical data may help to lock-in a renewed downturn pattern for the GDP.

In terms of the latest on that most worthless of series, the small upside revision of 0.09 percentage point (not visible at the first decimal-point level) left reported annualized growth at 1.8%. Yet, consumer spending revised lower, while unwanted inventories increased. Net of the inventory build-up, which eventually should get worked off in reduced production, the GDP growth rate was at an annualized pace of just 0.6%.

April's new orders for durable goods fell by 3.6%, reflecting the high volatility of the series, but such was in the context of major downward historical revisions from the annual benchmarking process. The level of new orders in 2009—the purported cycle trough and the end of the recession—was reduced by 8.1%.

Similar patterns have been seen in revised payrolls, retail sales and industrial production, and all suggest pending hefty downside revisions to the GDP in the benchmark. These related revisions indicate that the recession has been much deeper than previously reported. The resulting likely shift in GDP levels should show a deeper trough, with current economic activity having not regained the levels seen before business activity began to plunge. Current GDP reporting shows that the earlier activity peak has been topped. Along with the pending shifts in reported GDP should be a shift to even slower growth, or outright contraction, coincident with “advance” second-quarter 2011 GDP estimate.

**Hyperinflation Watch—Housing Woes Impair Systemic-Solvency Resolution.** As shown in the accompanying table, housing activity peaked in 2005. The ensuing housing slowdown helped drive an economic downturn and systemic solvency crisis, both of which I contend are ongoing. It was the economy that triggered the mortgage crisis, not the other way around, although the credit and related financial crises certainly exacerbated what became the most severe and protracted economic downturn of the post-Great Depression era. If the banking system were adequately solvent, credit would be flowing much more easily. If the banking system were adequately solvent, Mr. Bernanke would not have put forth QE1 and QE2. There may be those at the Fed and/or in the Administration who hope that a recovery in real estate will resolve the systemic solvency crisis, but such a circumstance is not in the offing.

### Housing Activity--Annual Rate in Thousands of Units

	Peak			Avg	Last	Peak-
	2005	2009	2010	2011	Apr '11	to-
				YTD		Latest
Housing Starts (1)	2,064	554	587	566	523	-75%
New Home Sales (2)	1,283	375	323	303	323	-75%
Existing Home Sales (2)	7,076	5,156	4,907	5,115	5,050	-29%

(1) Trough in annual activity for current cycle was 2009. (2) Trough in annual activity for current cycle was 2010.

Monthly data are seasonally-adjusted. Sources: SGS, HUD, Census, NAR.

Consider that housing starts and new home sales are down 75% from the 2005 peak and are at levels that statistically are indistinguishable from historic lows. Consider that existing home sales are down 29%

from their 2005 peak; that 37% of the April 2011 sales volume was in foreclosure activity; where those buying often are doing so for cash and where mortgage availability is heavily restricted. Consider the broad economy, which is not recovering and seems to be stagnating at, or turning down anew from a relatively low level of activity. Consider the lack of consumer liquidity, with household income unable to keep up with rising inflation, and with debt expansion possibilities generally not available.

The Federal Reserve is a private corporation owned by commercial banks or banking interests. The Fed's primary job is not to generate sustainable economic growth, nor to contain inflation, but rather to keep the banking system sound and healthy. Accordingly QE1 and QE2 likely were targeted primarily at addressing systemic solvency issues, with the Fed using the weak economy as cover.

As the systemic solvency crisis continues and/or intensifies, an overt or covert QE3 likely will be in place by third-quarter 2011, under the cover of a deteriorating economy. The broad inflation and economic outlooks discussed in [Hyperinflation Special Report \(2011\)](#) continue unabated.

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## REPORTING DETAIL

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### ***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  $1.01 \times 1.01 \times 1.01 \times 1.01 = 1.0406$  or 4.1%, instead of  $4 \times 1\% = 4\%$ .

**Annual** growth refers to the year-to-year change of the referenced period versus the same period the year before.

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**Though Aggregate Growth Appeared Unchanged, Underlying First-Quarter GDP Trends Shifted to the Negative in Revision.** The first-quarter 2011 GDP revision was minimal, with annualized 1.8% real growth unchanged at the first decimal point. The updated reporting to this most worthless of major economic series, however, reflected weaker personal consumption than initially estimated, offset by a greater, involuntary build-up in inventories. Net of the increased nonfarm inventories, growth was a revised annualized 0.56% (previously 0.75%); on a straight quarter-to-quarter basis that was a non-annualized quarterly gain of 0.14%. Further, the sharp deterioration reported in the inflation-adjusted first-quarter 2011 trade deficit still did not surface in the first-quarter GDP estimate. Although the reported growth rate for first-quarter 2011 continued to be slower than that currently estimated for fourth-quarter 2010, the first-quarter number remained not statistically meaningful, either as to the slowing pace or as to being even in positive territory.

Nonetheless the growth pattern likely is being set for the “broadest” measure of U.S. economic activity to slip slowly into double-dip recession status. That pattern should be exacerbated in the months ahead as key underlying series continue to slow, and as the July 29th annual GDP revisions show recent economic history to have been weaker than currently assumed by the markets (see *Opening Comments*).

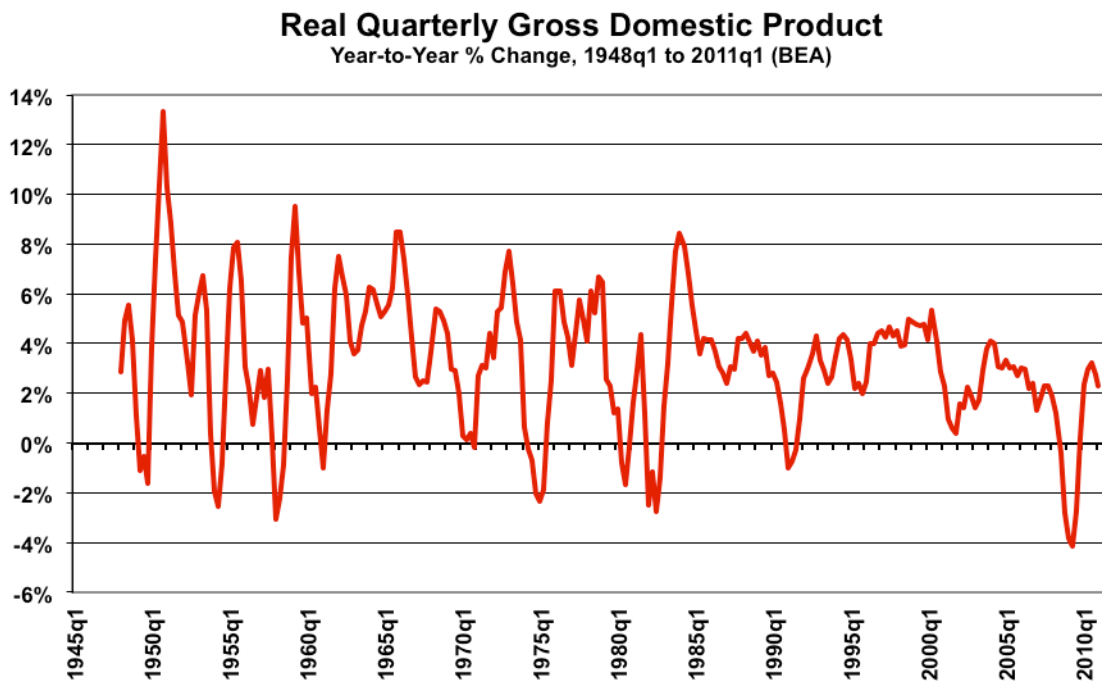
**GDP.** Published today, May 26th, by the Bureau of Economic Analysis (BEA), the second estimate of, or first revision to, first-quarter 2011 Gross Domestic Product (GDP) showed annualized quarterly growth of 1.84% +/- 3% (95% confidence interval) versus an initial estimate of 1.75%. Due to rounding, the annualized growth rate increased by nearly 0.1-percentage point, but it remained unchanged at the first decimal point level of 1.8%. First-quarter growth was down from 3.11% in fourth-quarter 2010.

Year-to-year change in first-quarter 2011 over first-quarter 2010 still continued the slowing trend in annual growth, revising to 2.31% (previously 2.28%), down from 2.78% in the fourth-quarter, and well off the peak reported growth of 3.25% purportedly seen in third-quarter 2010.

The first-quarter GDP implicit price deflator estimate was little changed at an annualized pace of 1.91% (previously 1.90%), versus 0.35% in the fourth-quarter. In contrast, annualized seasonally-adjusted quarterly inflation for the CPI-U in the first-quarter spiked to a seasonally-adjusted 5.22%, from 2.62% annualized inflation in the fourth-quarter (see [Commentary No. 363](#)). The lower the inflation rate that is used in deflating the GDP, the stronger is the resulting inflation-adjusted number and vice versa. A slightly more realistic inflation number would have pushed the “advance” quarterly growth rate into negative territory.

The SGS Alternate-GDP estimate for first-quarter 2011 remains an approximate annual contraction of 2.6% versus the official estimate of a 2.3% gain. Such is more negative than the alternate 2.1% annual

contraction (2.8% official gain) in the fourth-quarter (see the [Alternate Data](#) tab). While annualized real quarterly growth is not estimated formally on an alternative basis, a meaningful quarter-to-quarter contraction appears to have been realistic for the first-quarter, in what generally has been a protracted period of business bottom-bouncing.



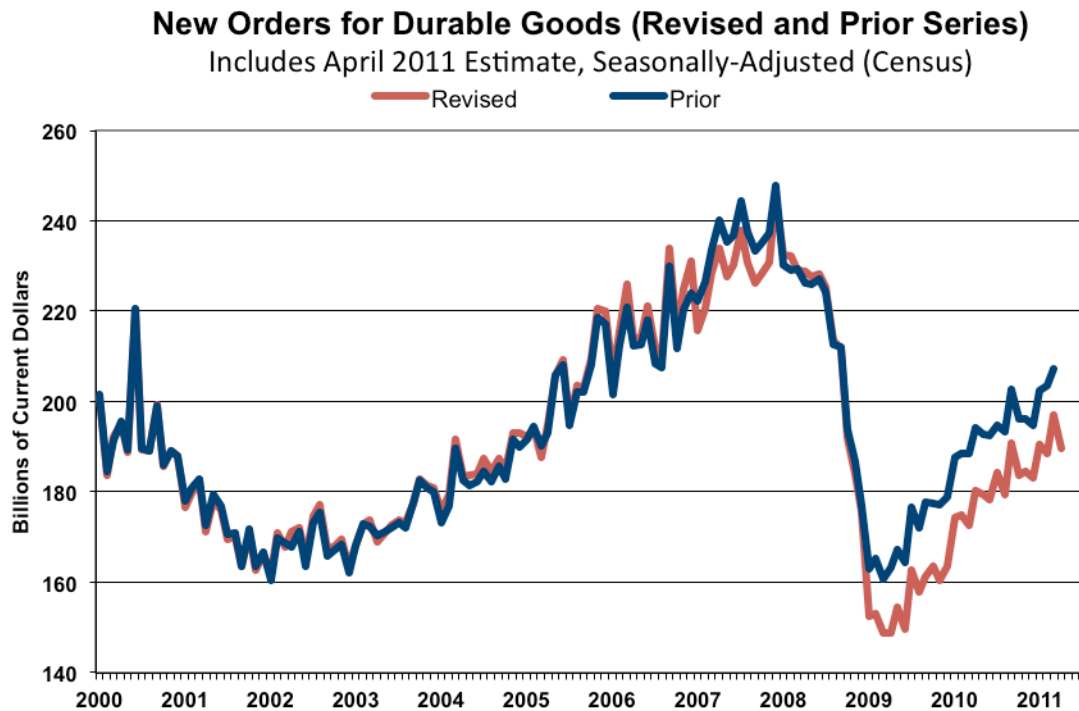
Reflecting the latest reporting, the preceding graph shows year-to-year percent change in the official inflation-adjusted quarterly GDP for the history of the series. The record annual contraction for the series was 4.11%, seen in second-quarter 2009. When the GDP and related series go through their annual benchmark revisions on July 29, 2011, that record contraction likely will deepen in revision.

**GNP.** Reflecting distorted positive flows in global interest and dividend payments—induced partially by the ongoing systemic crises—the initial estimate of first-quarter 2011 gross national product (GNP) was for annualized real quarterly growth of 3.10%, up from 2.75% in the fourth-quarter. Year-to-year growth, however, slowed to 2.49% in the first-quarter, from 2.82% in the fourth-quarter.

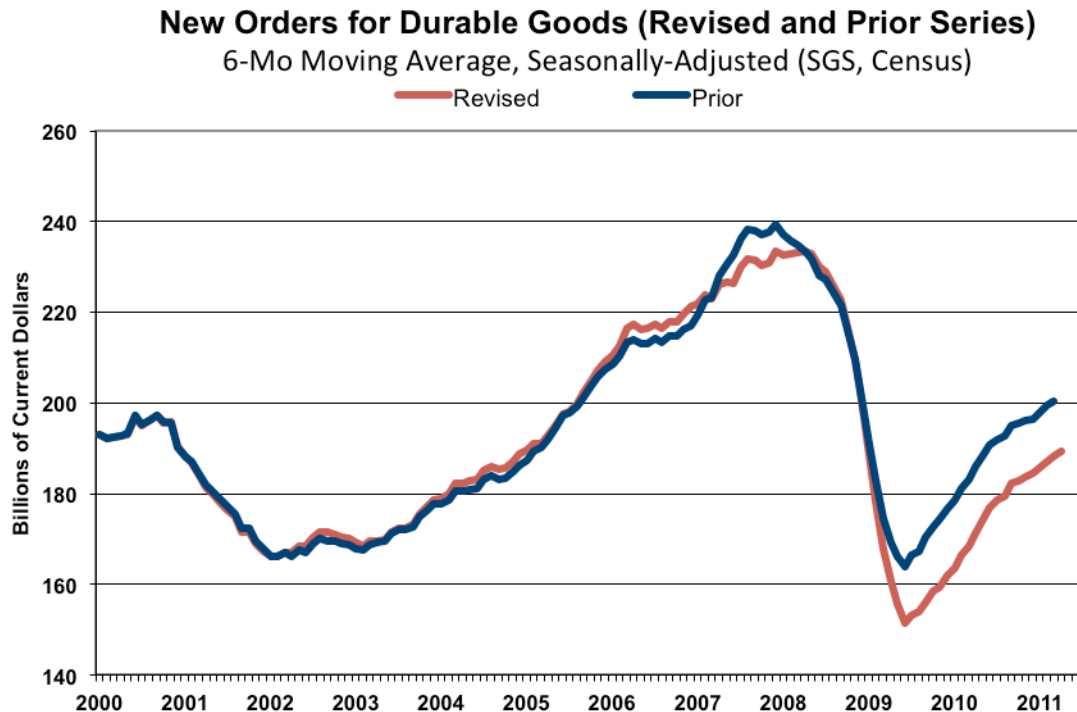
**GDI.** Gross domestic income (GDI), the income-side equivalent to the consumption-side GDP, showed annualized real quarterly growth of 1.23% (0.51% before prior-period revisions) in initial first-quarter reporting, versus 3.85% in the fourth-quarter. Year-to-year growth slowed to 2.24% in the first-quarter, from 2.96% in the fourth-quarter.

**Durable Goods Orders Revised Sharply Lower.** Continuing the patterns seen in benchmark revisions to payroll employment, retail sales and industrial production, the May 13th benchmark revisions to new orders for durable goods showed sharp downside revisions to 2009 levels, with the monthly patterns following the 2009 reductions largely continuing as previously reported, but at reduced levels. The big hits in the various series' revisions to 2008 and 2009 are based on new and improved information, such as the 2009 Annual Survey of Manufactures as it relates to durable goods. Where the post-2009 data have no new information available, other than some paperwork catch-up in late reporting, the underlying assumptions that boosted relative activity in 2010 remain in place, with significant downside revisions likely for 2010 in next year's benchmark.

Following are the revised data graphed against prior reporting. The first graph shows seasonally-adjusted monthly data, which can be highly volatile. The second graph smooths out some of that volatility, using a six-month moving average. As reported by the Census Bureau, the net revisions to annual levels of new orders for durable goods were as follows: 2007 down by 2.6%; 2008 up by 0.3%; 2009 down by 8.1%; 2010 down by 6.7% (dollar amounts of 2009 and 2010 revisions were the same; percentage changes were against different bases).







**Monthly Durable Goods Orders Take a Hit.** The Census Bureau reported yesterday (May 25th) that the regularly-volatile, seasonally-adjusted April 2011 new orders for durable goods fell by 3.6% (down by 8.9% before prior-period and benchmark revisions) month-to-month, after a revised 4.4% (previously a 2.5%) gain in March. The monthly decline reflected a 30.0% plunge in irregular, long-term aircraft orders, a category that showed a revised 2.3% (previously 0.9%) monthly increase in March. Unadjusted, year-to-year change in total April 2011 new orders was a gain of 3.4%, which was sharply lower than the revised annual gain in March of 14.4% (previously 12.2%). Despite the new 2008 and 2009 numbers, current durable goods reporting remains subject to many of the same sampling and adjustment problems seen with retail sales and payroll reporting.

The widely followed nondefense capital goods orders fell by 7.3% (down by 7.7% before prior-period and benchmark revisions) in April, versus a revised month-to-month gain of 5.0% (previously up by 3.2%) in March. For April, the unadjusted year-to-year growth in the series was 3.5%, down sharply from the 20.7% annual growth estimated initially for March.

**Home Sales Reflect Ongoing Housing-Industry Disaster.** Generally consistent with the down-trending bottom-bounce seen in April housing starts (see [Commentary No. 369](#)), April home sales showed no meaningful movement towards recovery. As discussed in the *Opening Comments*, the ongoing crises in the real estate markets remain unhappy underpinnings to the still-evolving systemic solvency crisis, with housing starts and new home sales (including related foreclosures) down 75% from their 2005 peak. The

29% decline in existing home sales from 2005 includes an April 2011 sales level encompassing 37% foreclosures.

Existing- and new-home sales moved in different directions in April 2011, but the reported monthly gain in new homes was not statistically significant, although the reported year-to-year decline continued to be meaningful. The pattern of bottom-bouncing in industry sales continued, with the distressed or foreclosed portion of existing-home sales shy of March's 40%. At the same time, housing starts or new construction (as eventually reflected in the GDP) broadly have turned to a pattern of renewed aggregate decline.

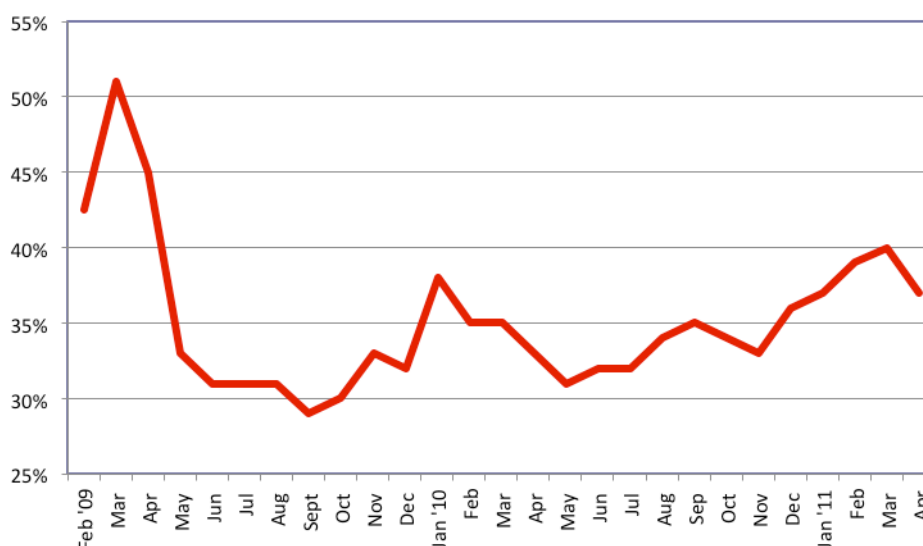
Wednesday's (May 24th) reporting of April new-home sales (counted based on contract signings, Census Bureau) showed a statistically-insignificant monthly gain of 7.3% (up 7.7% before prior-period revisions) +/- 19.4% (95% confidence interval) from March. March's revised level was up by 8.3% (previously up by 11.1%) from February. The year-to-year decline in April 2011 new-home sales was a statistically-significant 23.1% +/- 11.3% (95% confidence interval), versus a revised 21.6% (previously 21.9%) decline in March. The April release included minimal annual revisions to the seasonally-adjusted series.

The May 19th release of April existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a 0.8% monthly decline (down by 1.0% net of prior-period revisions), versus March's revised 3.5% (previously 3.7%) monthly increase. On a year-to-year basis, April sales were down by 5.0%, versus a 6.1% (previously 5.9%) annual decline in March.

Foreclosure activity remained a major distorting factor for home sales, with "distressed" activity accounting for an estimated 37% of existing sales in the NAR's April reporting, down from the 40% estimated for March (that was the highest portion seen since Spring 2009).

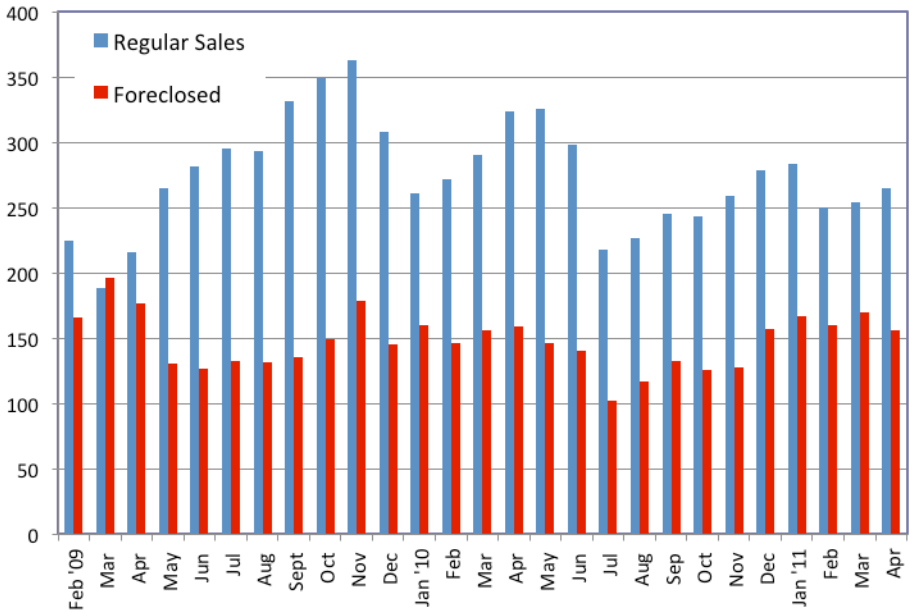
### Foreclosures as % of Existing Home Sales

Sources: SGS, NAR

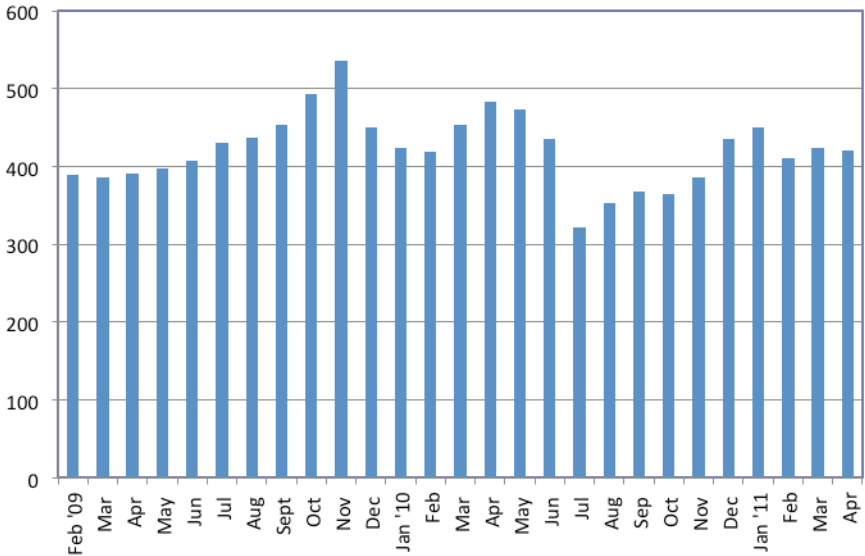


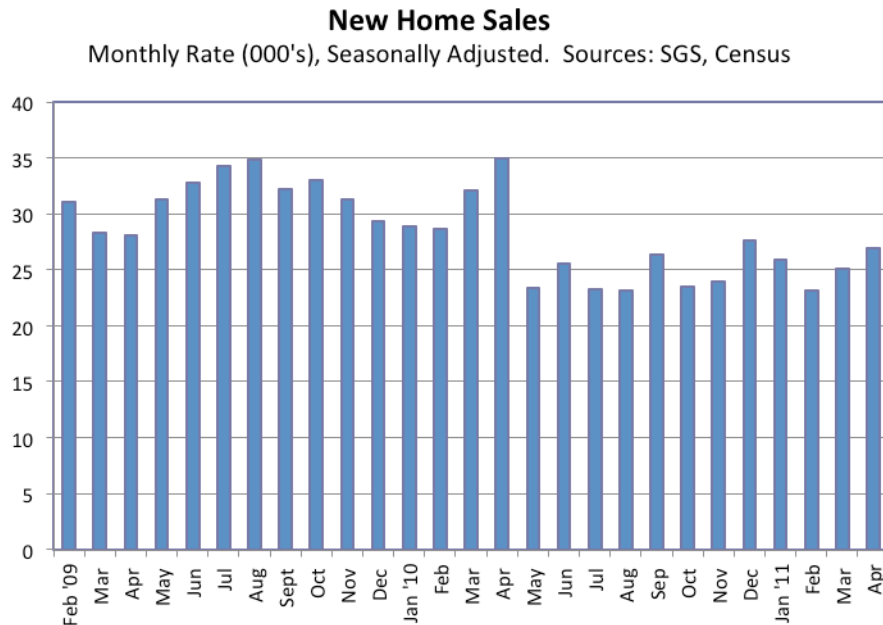


Existing Home Sales - Foreclosed and Not  
Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR



Existing Home Sales - Total  
Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR





Separately, the Census Bureau acknowledges that a portion of new home sales also is from foreclosure activity but offers no estimate 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.

**Week Ahead.** Though not yet commonly recognized, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

**Employment and Unemployment (May 2011).** The first major economic release for May is the report on labor market conditions, scheduled for publication on Friday, June 3rd. With most major economic reporting having come in on the downside of expectations in April, odds are increased for negative surprises to what likely will be relatively positive consensus forecasts for payrolls and unemployment. Given the ongoing monthly concurrent-seasonal-factor distortions in payroll reporting, an outright payroll contraction could be reported any time, although most reporting here likely will be without significance. The headline unemployment rate is due for further upside movement.