

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

COMMENTARY NUMBER 375
GDP Revision, May Durables Goods Orders and Home Sales

June 24, 2011

Bernanke Befuddled by Weak Economy?

**Major Downside Revisions to GDP Revisions Loom
As Economy Slowly Slides into a Double-Dip**

PLEASE NOTE: The next regular Commentary is scheduled for Friday, July 1st, with a general review of economic and liquidity conditions in an otherwise quiet week for major economic releases. June labor data are scheduled for release on July 8th.

—Best wishes to all, John Williams

Opening Comments and Executive Summary. “ ‘We don’t have a precise read on why this slower pace of growth is persisting,’ the Fed Chairman Ben S. Bernanke, said Wednesday [June 22nd] at a news conference. ‘Some of the headwinds that have been concerning us, like the weakness in the financial sector, problems in the housing sector, balance sheet and deleveraging issues, may be stronger and more persistent than we thought.’ ” [“Fed to Defer New Efforts for Growth,” *New York Times*, June 23, 2011.]

It is hard to believe that Mr. Bernanke, the presidents of the regional Federal Reserve Banks and the extensive staff of fine economists throughout the Federal Reserve System do not understand why the economic and systemic-liquidity crises persist. If indeed the problems really are not understood, Mr.

Bernanke should not be Fed Chairman. More likely, the problems are understood, but Bernanke's admitting that would entail his admitting that circumstances are beyond control, and that the Fed lacks the ability to address the issues effectively.

Such an admission likely would be destabilizing to the financial markets, although it is hard to see how the markets could take Mr. Bernanke's comments in a positive light. In either circumstance, Mr. Bernanke's remarks make a strong case for the Federal Reserve Chairman not to hold press conferences. There is the possibility, though, that the comments were deliberate, intended as a warning of things to come, as discussed in the *Hyperinflation Watch*.

My explanation as to why the various crises continue is detailed in the [*Hyperinflation Special Report \(2011\)*](#).

This Week's Data Held No Surprises. The second revision to first-quarter GDP was little more than statistical noise, with the revised 1.9% (previously 1.8%) annualized, inflation-adjusted first-quarter growth rate still largely accounted for (1.4%) by an involuntary build-up in inventories.

Benchmark revisions in GDP back to 2003 will be published on July 29th. The economic downturn, in revision, should be much more severe than currently is reported.

New orders for durable goods rose by 1.9% in May, failing to offset April's revised 2.7% decline. Reporting volatility was well within the normal range. May new- and existing-home sales both were lower, showing ongoing bottom-bouncing consistent with the downtrend in the bottom-bouncing in housing starts. There is no recovery in play here.

Hyperinflation Watch—Fed and Administration Preparing for More Trouble? Given Bernanke's unusual comments that the financial and economic systems have not improved as expected, he could have been giving a warning of intensified financial/economic problems ahead. Nonetheless, the just-published downside revisions to the Fed's economic forecasts, and the upside revisions to inflation forecasts, likely were no more than the usual overly-optimistic guesstimates. Further downside surprises in the systemic and economic performance are virtual certainties, and the Fed most likely will respond accordingly with some form of QE3, either overtly or covertly, irrespective of current official protestations to the contrary.

Key to what lies ahead remains the general commitment by the Fed and the U.S. federal government to prevent systemic collapse, as was seen in the crisis of September 2008. That commitment translates into creating and spending any amount of money or making any financial guaranty needed (whether domestic or foreign) in order to prevent a collapse of the financial system, so long as is possible. The Fed can act here, at present, even if the federal government gets tied up in a political impasse.

Tapping the U.S. Strategic Petroleum Reserve. A day after Mr. Bernanke's comments, the U.S. tapped its strategic petroleum reserve, in conjunction with the International Energy Agency, presumably to hit oil prices and to help reduce politically-sensitive gasoline prices in the United States. Dipping into the reserves at this point likely was pure politics. It also, however, could be front-running a pending crisis on the economic, financial or military front. Whatever is afoot, the impact of the U.S. and IEA's actions on oil and gasoline prices likely will be short-lived.

As noted last week, the crises facing the United States and the U.S. dollar dwarf those in the euro system, and should tend to dominate the financial markets, as the issues with Greece, and any other troubled states that could threaten systemic collapse, are stabilized. The broad inflation and economic outlooks discussed in [Hyperinflation Special Report \(2011\)](#) continue unabated.

REPORTING DETAIL

GROSS DOMESTIC PRODUCT (FIRST-QUARTER 2011, SECOND REVISION)

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.

Major Downside Revisions Ahead for GDP. The first-quarter 2011 GDP second revision was minimal, with annualized real growth at 1.9% versus the 1.8% in both the first and second estimates. On July 29th, however, annual revisions will be reported for the GDP for 2008 through first-quarter 2011, with some special revisions in GDP back through 2003, along with the “advance” estimate of second-quarter 2011 GDP. Based on benchmark revisions already published for nonfarm payrolls, retail sales, new orders for durable goods, industrial production and the trade deficit, the revised GDP growth should show the economic downturn to have been more severe than currently is reported. More detailed comments on the upcoming benchmarking will follow in a later *Commentary*.

GDP. Published today, June 24th, by the Bureau of Economic Analysis (BEA), the third estimate of, or second revision to, first-quarter 2011 gross domestic product (GDP) showed annualized quarterly growth of 1.91% +/- 3% (95% confidence interval) versus a first estimate of 1.84%, and an initial estimate of 1.75%. As with the first revision, today’s changes to this most worthless of major economic series were little more than statistical noise. First-quarter growth was down from 3.11% in fourth-quarter 2010.

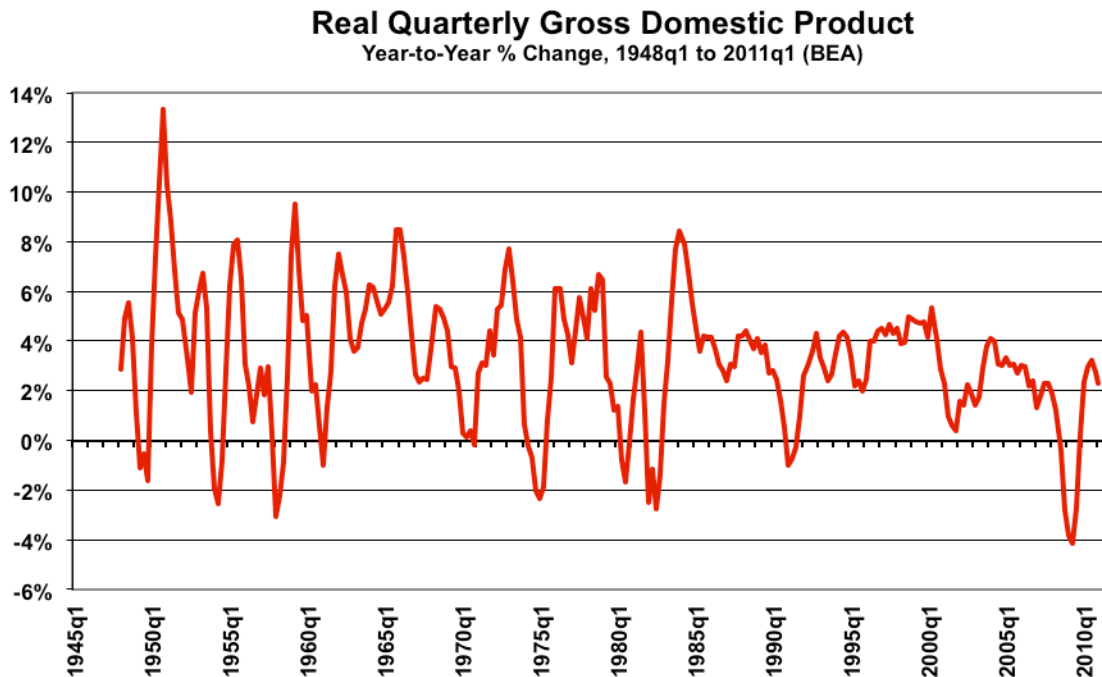
Of the reported annualized 1.91% GDP growth, 1.40% was due to an involuntary build-up in inventories. Also, the patterns of net exports in first-quarter GDP still show no obvious relationship to the sharp deterioration otherwise reported in the first-quarter trade deficit (an otherwise uncounted reduction in GDP level).

While the dollar level of first-quarter GDP should revise sharply lower in the upcoming benchmark revisions, the 1.9% annualized quarterly real growth rate likely will be little changed. The BEA usually tries to keep the annualized quarterly growth rate of the last quarter before the revisions (first-quarter 2011 GDP in this case) as close to the prior reporting as possible. Such helps divert media attention from earlier downside changes, and the reduced level of overall activity.

Year-to-year change in first-quarter 2011 over first-quarter 2010 still continued the slowing trend in annual growth, revising to 2.33%, from 2.31% (initially 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 revised up a notch at an annualized 2.05% from the prior estimate of 1.91% (initially 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 revised estimate of annualized real quarterly growth for first-quarter 2011 gross national product (GNP) was 3.44%, up from the initial estimate of 3.10%, and up from 2.75% in the fourth-quarter. Year-to-year growth, however, revised to 2.57% from 2.49% in the first-quarter, still lower than the 2.82% of the fourth-quarter.

GDI. Gross domestic income (GDI), the income-side equivalent to the consumption-side GDP, showed revised annualized real quarterly growth of 1.89% (initially 1.23%) for first-quarter 2011, versus 3.85% in the fourth-quarter. Year-to-year growth revised to 2.41% (initially 2.24%) in the first-quarter, versus 2.96% in the fourth-quarter.

NEW ORDERS FOR DURABLE GOODS (MAY 2011)

May Durable Goods Orders Gain Was Within Normal Month-to-Month Volatility. The Census Bureau reported today (June 24th) that the regularly-volatile, seasonally-adjusted May 2011 new orders for durable goods increased by 1.9% (up by 3.0% before prior-period revisions) month-to-month, after a revised 2.7% (previously a 3.6%) decline in April. The monthly increase reflected a 36.5% surge in

irregular, long-term aircraft orders, a category that showed a revised 29.0% (previously 30.0%) monthly plunge in April. June orders likely will show highly volatility, as well, as orders from the Paris air show are booked.

Unadjusted, year-to-year change in total May 2011 new orders was a gain of 10.8%, which was up from the revised annual 4.8% (previously 3.4%) gain in April. Current durable goods reporting remains subject to many of the same sampling and adjustment problems that are seen with retail sales and payroll reporting.

The widely followed nondefense capital goods orders rose by 5.8% (up by 7.7% before prior-period revisions) in May, versus a revised month-to-month 5.6% (previously 7.3%) decline in April. For May, the unadjusted year-to-year growth in the series was 16.4%, up sharply from the 4.9% (previously 3.5%) annual growth estimated for April.

EXISTING AND NEW HOME SALES (MAY 2011)

Home Sales Continued Bottom-Bouncing. May home sales continued to show no recovery, generally consistent with the still down-trending bottom-bouncing of May housing starts (see [Commentary No. 374](#)). Existing- and new-home sales both declined in May 2011, although the movement in new home sales was not statistically significant on either a monthly or an annual basis. The pattern of bottom-bouncing in industry sales continued, with the distressed or foreclosed portion of existing-home sales declining further. The downtrend in foreclosure sales, though, appeared to be due to factors other than improving consumer or homeowner conditions.

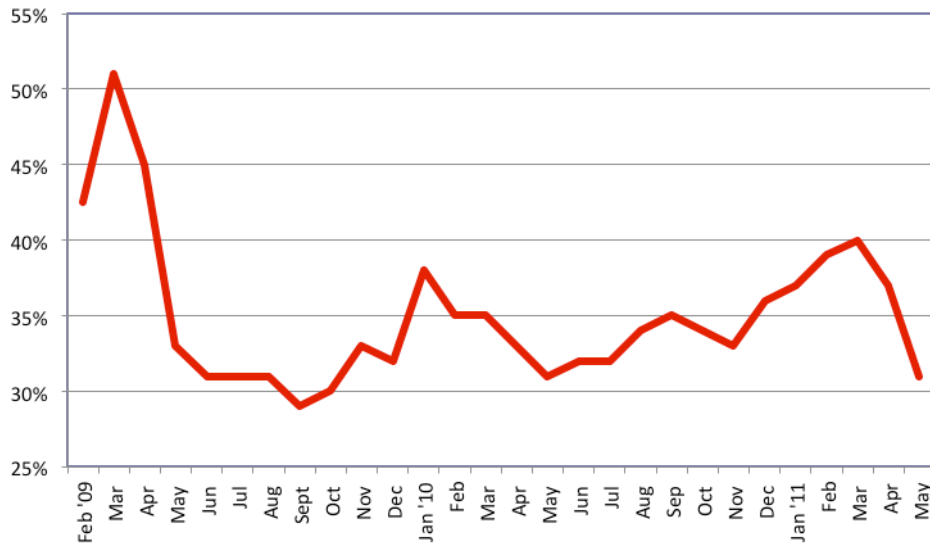
Thursday's (June 23rd) reporting of May new-home sales (counted based on contract signings, Census Bureau) showed a statistically-insignificant monthly decline of 2.1% (down 1.2% before prior-period revisions) +/- 15.8% (95% confidence interval) from April. April's gain was revised to 6.5% (previously up by 7.3%) versus March. The year-to-year gain in May 2011 new-home sales was a statistically-insignificant 13.5% +/- 15.9% (95% confidence interval), versus a revised 22.6% (previously 23.1%) April decline. The high volatility in annual change is due to the lapsing of stimulus effects a year ago.

The June 21st release of May existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a monthly drop of 3.8% (down by 4.8% net of prior-period revisions), versus April's revised 1.8% (previously 0.8%) monthly decline. On a year-to-year basis, May sales were down by 15.3%, versus a 13.8% (previously 12.7%) annual decline in April.

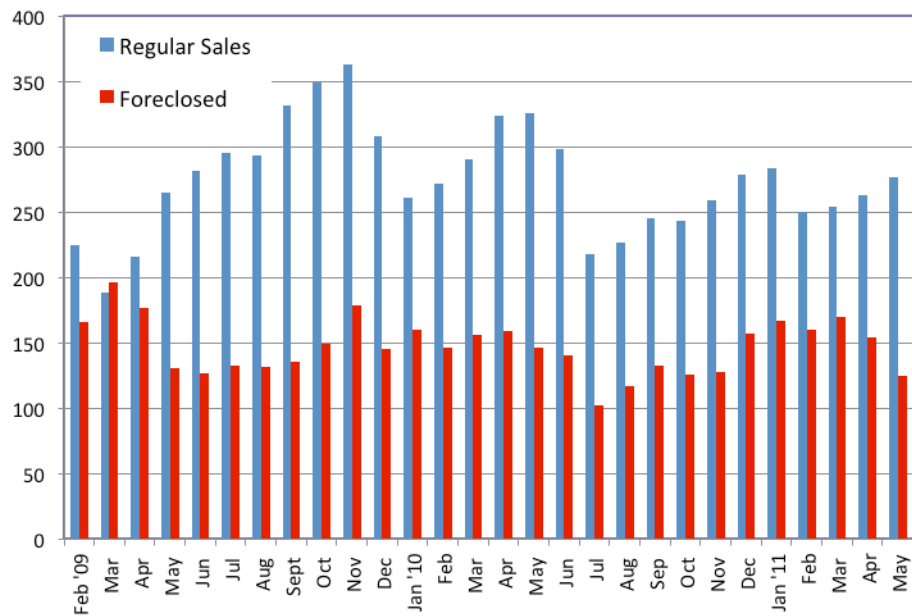
Foreclosure activity remained a major distorting factor for home sales, with "distressed" activity accounting for an estimated 31% of existing sales in the NAR's May reporting, down from the 37% estimated for April.

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.

Foreclosures as % of Existing Home Sales
Sources: SGS, NAR

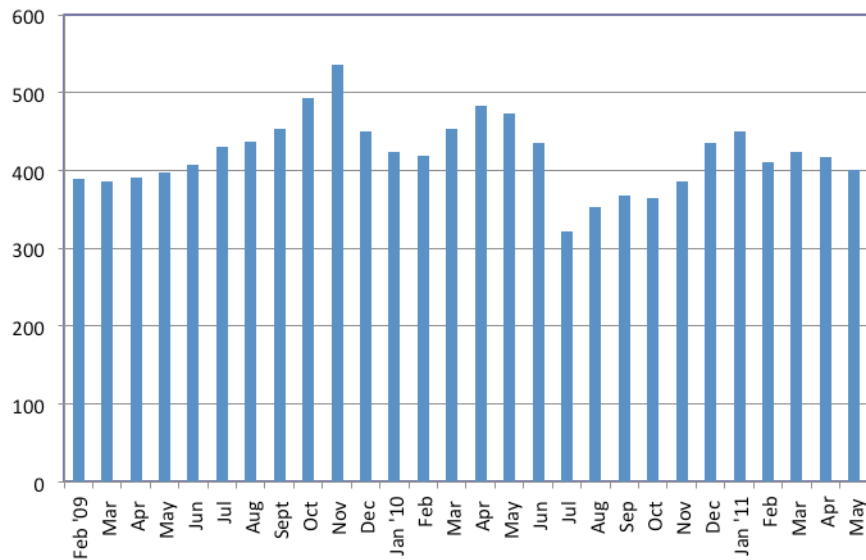


Existing Home Sales - Foreclosed and Not
Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR



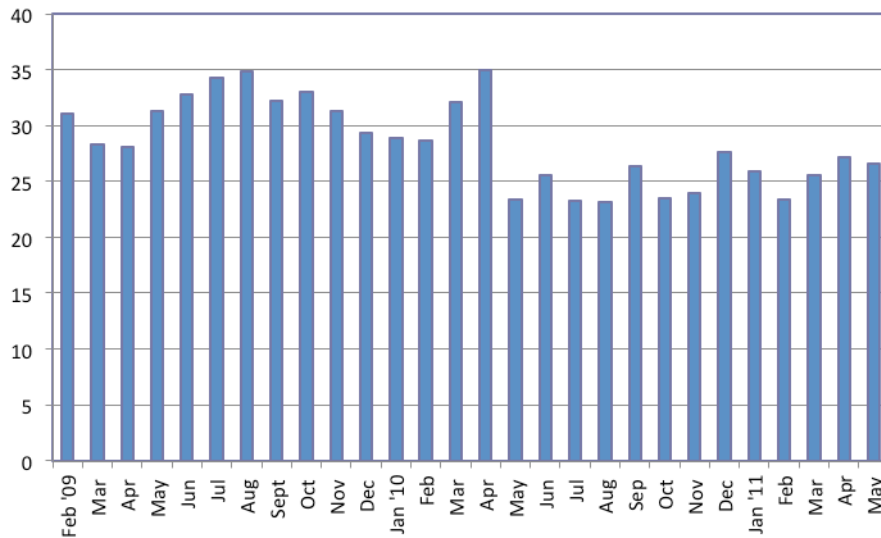
Existing Home Sales - Total

Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR



New Home Sales

Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, Census



Week Ahead. Though still not widely acknowledged, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations fully 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.

There are no major economic releases in the week ahead. Any unusual results in consumer confidence reporting or in the purchasing managers surveys will be discussed in the next Commentary.
