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

COMMENTARY NUMBER 380
June Housing Starts and Existing Home Sales, Liquidity, GDP Outlook

July 20, 2011

Housing Starts Boosted by Apartment Starts

Existing Home Sales Suffer From Liquidity Crunch

Solvency Crisis: Banks Are Not Increasing Aggregate Lending

Downside GDP Revisions Loom

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, July 29th. It will cover the "advance" estimate of second-quarter GDP and benchmark revisions, June new orders for durable goods and June new home sales.*

—Best to all, John Williams

Opening Comments and Executive Summary. June housing-industry data dominated this week's otherwise light economic calendar, and the outlook for residential real estate activity remains bleak. Consumer liquidity issues and lack of growth in aggregate bank lending remain at least partially at fault for the continuing housing woes. The liquidity issues are addressed in the *Hyperinflation Watch* section.

Underlying economic fundamentals generally are weaker than as assessed by consensus forecasters. The consensus viewpoint, however, may soften a little following likely downside GDP benchmark revisions that will be published next week.

June Housing Starts and Existing Home Sales. The regularly-volatile housing starts series showed a statistically-significant 14.6% seasonally-adjusted monthly gain in June, thanks to prior-period revisions and to a 31.8% surge in the erratic and extremely volatile starts for apartment buildings. May starts were unchanged in revision (previously up by 3.5%). Nonetheless, the changes were well within normal volatility for this still-bottom-bouncing series.

Seasonally-adjusted existing home sales declined for the third straight month, falling 0.8% in June after a 3.8% drop in May, hitting a seven-month low. The National Association of Realtors (NAR) press release, accompanying the data, cited an "unusual" surge in sales contract cancellations that likely was due to too-tight credit and to appraisals coming in too low to support needed mortgages.

GDP Revisions. Both the "advance" estimate of second-quarter 2011 GDP and the annual benchmark revisions to the GDP series are due for release on Friday, July 29th. With a flattening of quarterly growth in second-quarter 2011 relative to first-quarter reporting of industrial production and real (inflation-adjusted) retail sales (see *Commentary No. 379*), second-quarter GDP growth—net of a reported trade-deficit improvement and a possible further involuntary buildup in inventories—should have been weaker than growth currently estimated for the first-quarter. Consensus estimates should be reasonably soft. Although the Bureau of Economic Analysis (BEA) usually targets its "advance" estimate at the consensus, a downside surprise is a fair shot here, given the also-pending downside historical revisions.

Although some methodological revisions will go back to first-quarter 2003, and GDP levels likely will be revised higher back to 1929, the revisions to standard reporting should have their biggest impact in 2008 and 2009. Benchmark revisions this year to the trade data, payroll employment, retail sales, industrial production all indicated that recent GDP history has overstated economic growth. Offsetting these fundamental revisions to key underlying data will be upside revisions to gimmicked capitalization of software, and use of the Fed's new hedonic price adjustments (as in lower inflation, higher real growth) to communication equipment.

The net effect of the revisions should be to show that the 2007 recession was longer and deeper than previously reported, and that GDP levels—contrary to current reporting—have not recovered their pre-recession highs.

Hyperinflation Watch—Systemic Liquidity Problems Continue. The broad inflation and economic outlooks discussed in the *Hyperinflation Special Report (2011)* continue to unfold and are unchanged. The following updates several measures related to the ongoing systemic-liquidity crisis.

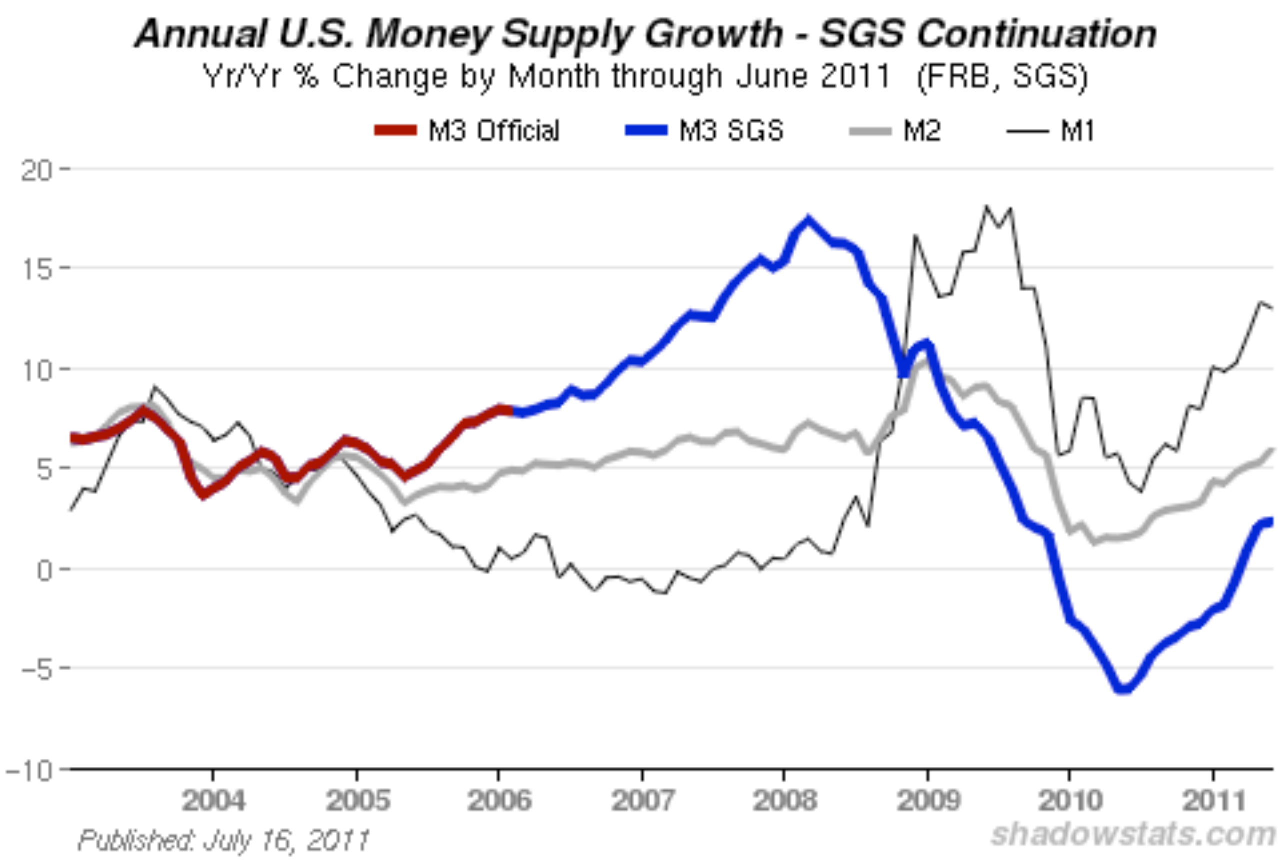
Systemic Liquidity. Despite the extreme level of liquidity pumped into the U.S. financial system by the Federal Reserve, aggregate bank lending has not picked up since the banking system was pushed to the brink of collapse in 2008.

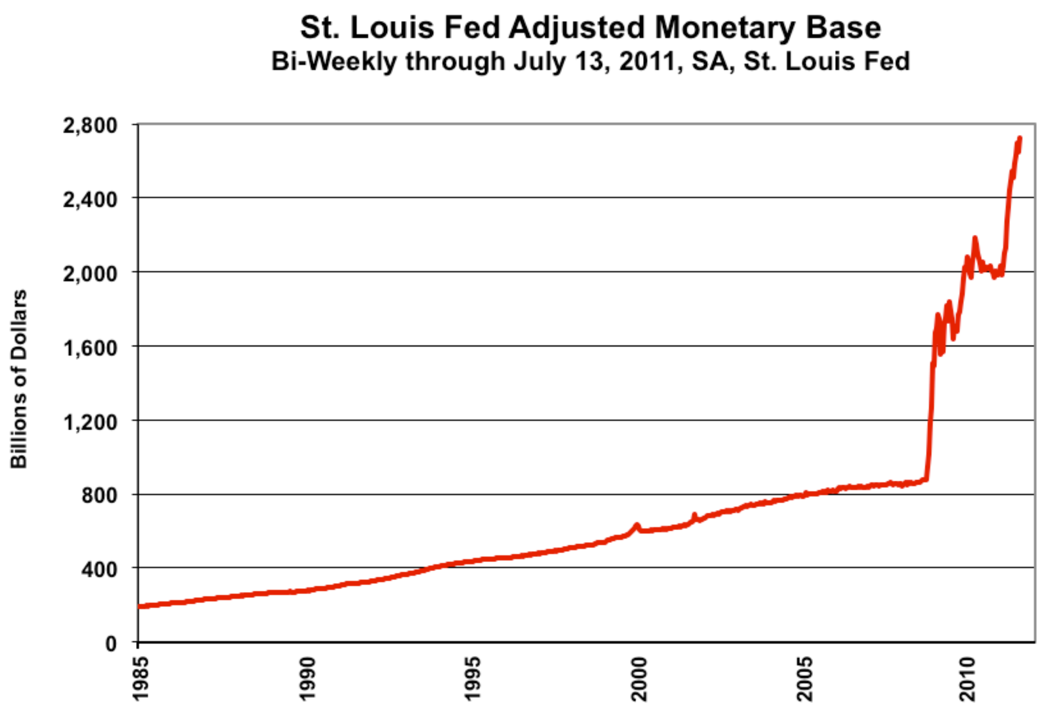
As noted in the minutes of the last FOMC meeting in June 2011: "Bank credit was flat, on balance, in April and May. Core loans—the sum of C&I [commercial and industrial], real estate, and consumer loans—continued to contract modestly, pulled down by the ongoing decline in commercial and residential real estate loans. In contrast, C&I loans increased at a brisk pace in April and May."

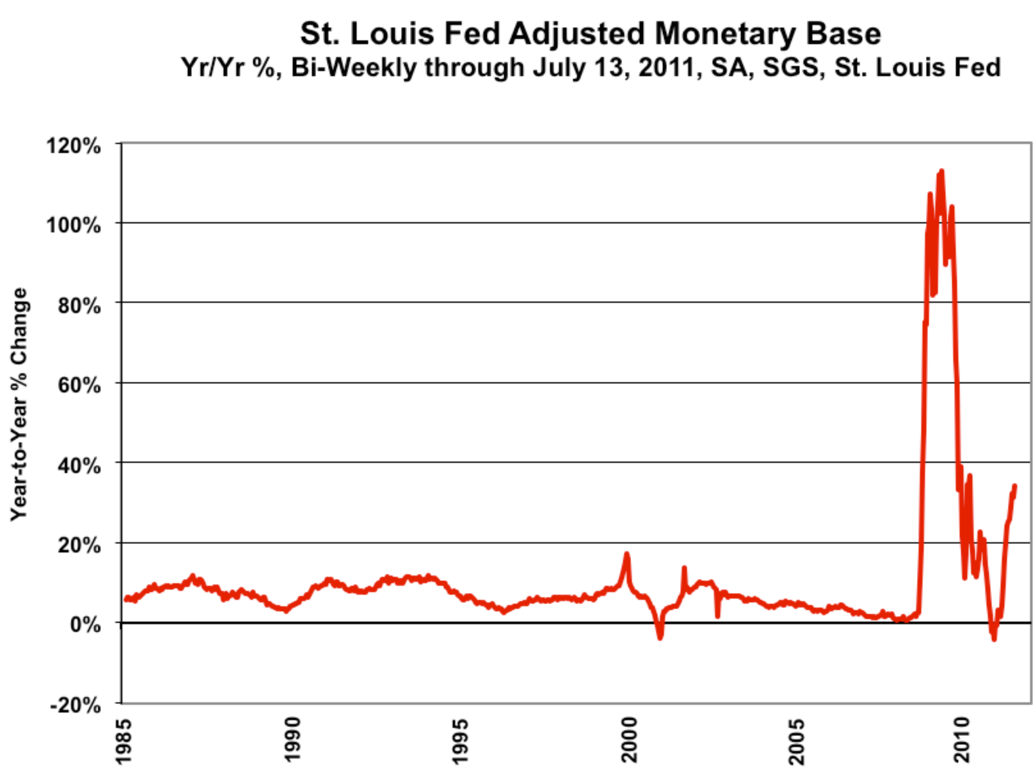
In the series of graphs that follow, growth in the broad money supply (SGS-Ongoing M3 Estimate) began to show some pick-up in May, but that faltered in June. This was despite the record level of the monetary base (cash in circulation, which is part of M1, plus the now-dominant component of bank reserves, largely excess reserves, which is not part of the money supply). The monetary base has continued to increase despite the recent official end of QE2.

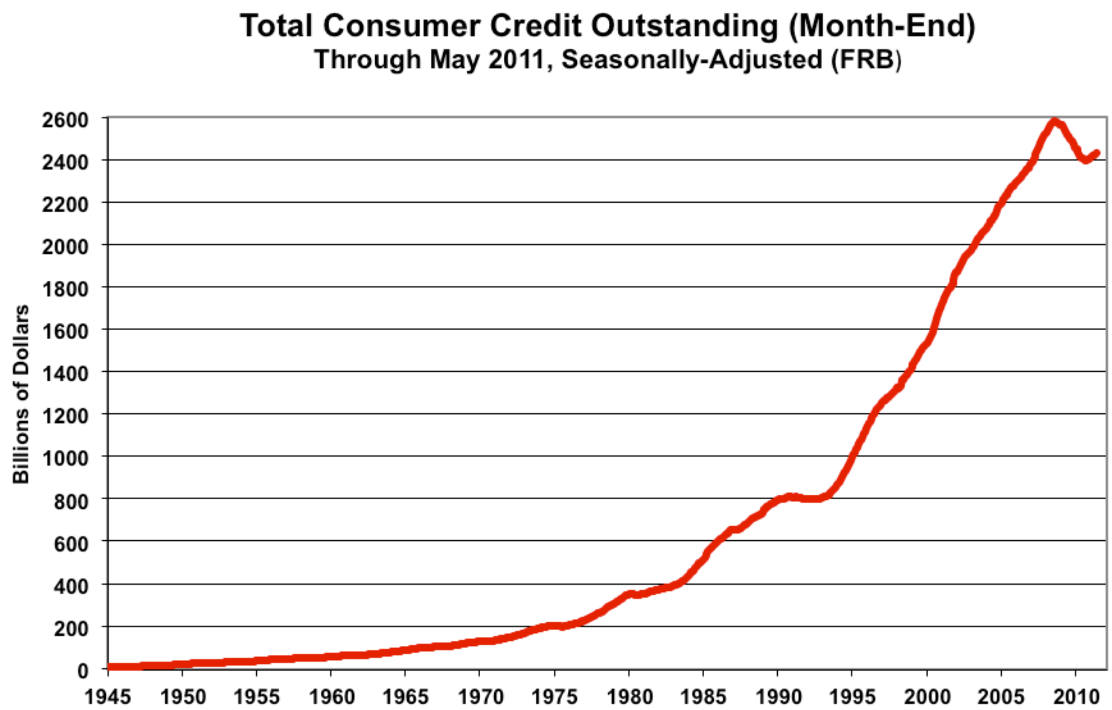
Consumer debt outstanding (the monthly level is plotted in historical perspective since World War II, and also in finer detail in the last decade or so) has shown some increase in recent months, but that increase is due entirely to federal government lending of student loans, not to bank lending. Commercial and industrial loans (the monthly level also is plotted in historical perspective since World War II, and also in finer detail in the last decade or so) did jump as advertised by the FOMC, but new lending has faltered in June and early July.

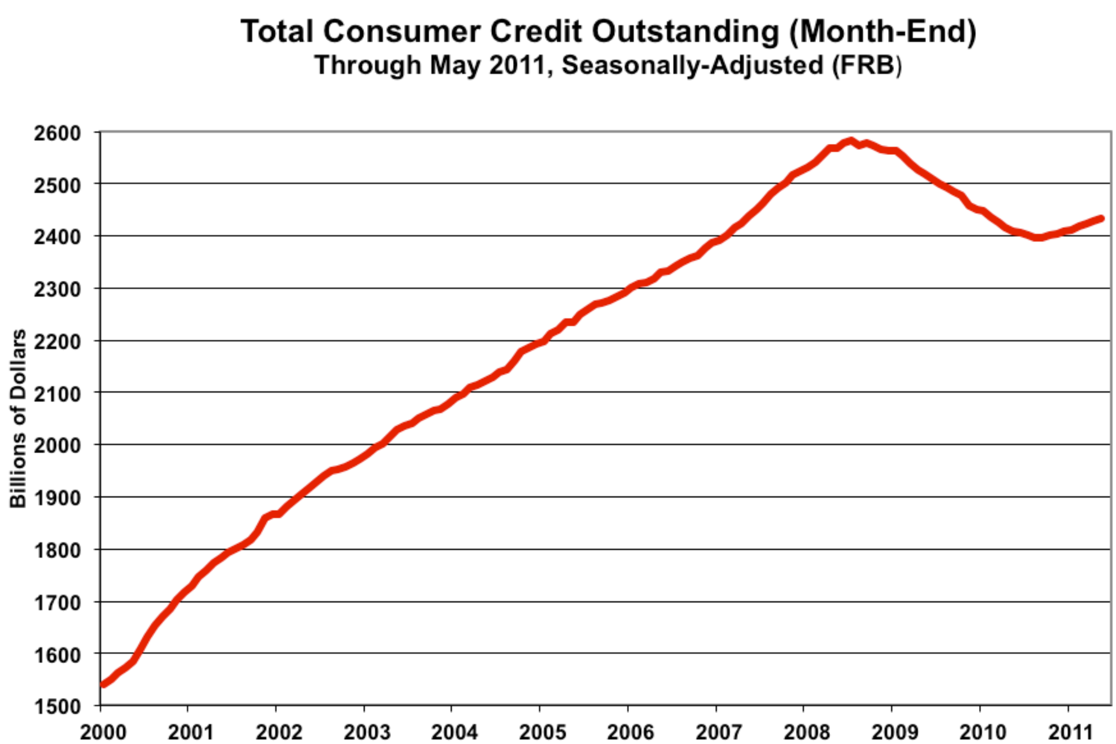
Where some bank lending may be limited by borrower credit worthiness, the bulk of the problem still appears to be ongoing bank balance sheet issues. Despite the systemic salvation in 2008, the systemic-solvency and economic crises continue. As a result, some form of QE3 remains likely soon, and, despite protestations to the contrary, some further form of attempted economic stimulus remains likely before the 2012 election.

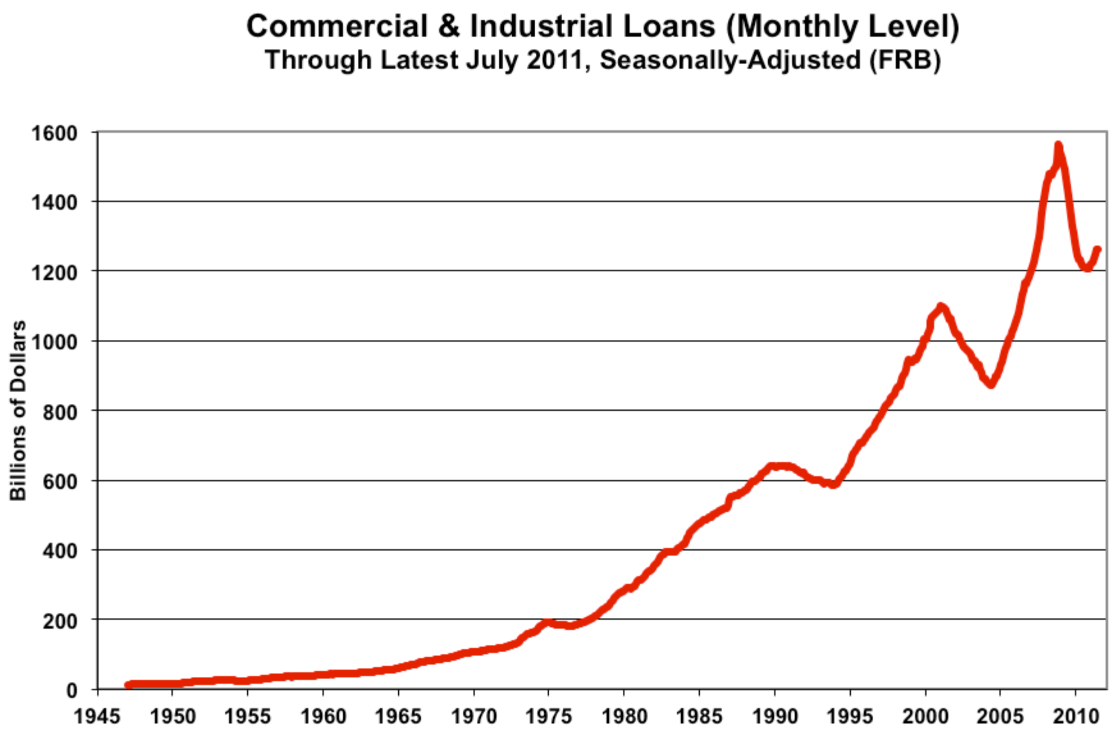


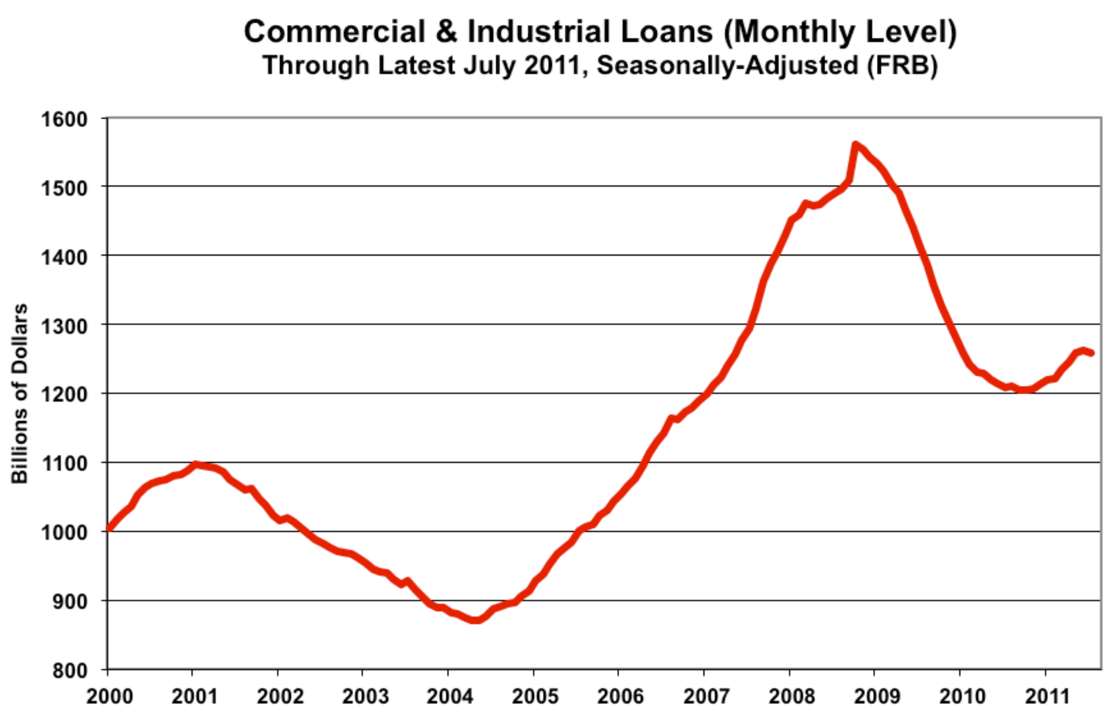

St. Louis Fed Adjusted Monetary Base
Bi-Weekly through July 13, 2011, SA, St. Louis Fed
Billions of Dollars
2,800
2,400
2,000
1,600
1,200
800
400
0
1985
1990
1995
2000
2005
2010


St. Louis Fed Adjusted Monetary Base
Yr/Yr %, Bi-Weekly through July 13, 2011, SA, SGS, St. Louis Fed
Year-to-Year % Change
120%
100%
80%
60%
40%
20%
0%
-20%
1985
1990
1995
2000
2005
2010


Total Consumer Credit Outstanding (Month-End)
Through May 2011, Seasonally-Adjusted (FRB)
Billions of Dollars
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


Total Consumer Credit Outstanding (Month-End)
Through May 2011, Seasonally-Adjusted (FRB)
Billions of Dollars
2600
2500
2400
2300
2200
2100
2000
1900
1800
1700
1600
1500
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011


Commercial & Industrial Loans (Monthly Level)
Through Latest July 2011, Seasonally-Adjusted (FRB)
Billions of Dollars
0
200
400
600
800
1000
1200
1400
1600
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


Commercial & Industrial Loans (Monthly Level)
Through Latest July 2011, Seasonally-Adjusted (FRB)
Billions of Dollars
800
900
1000
1100
1200
1300
1400
1500
1600
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011

REPORTING DETAIL

HOUSING STARTS (JUNE 2011)

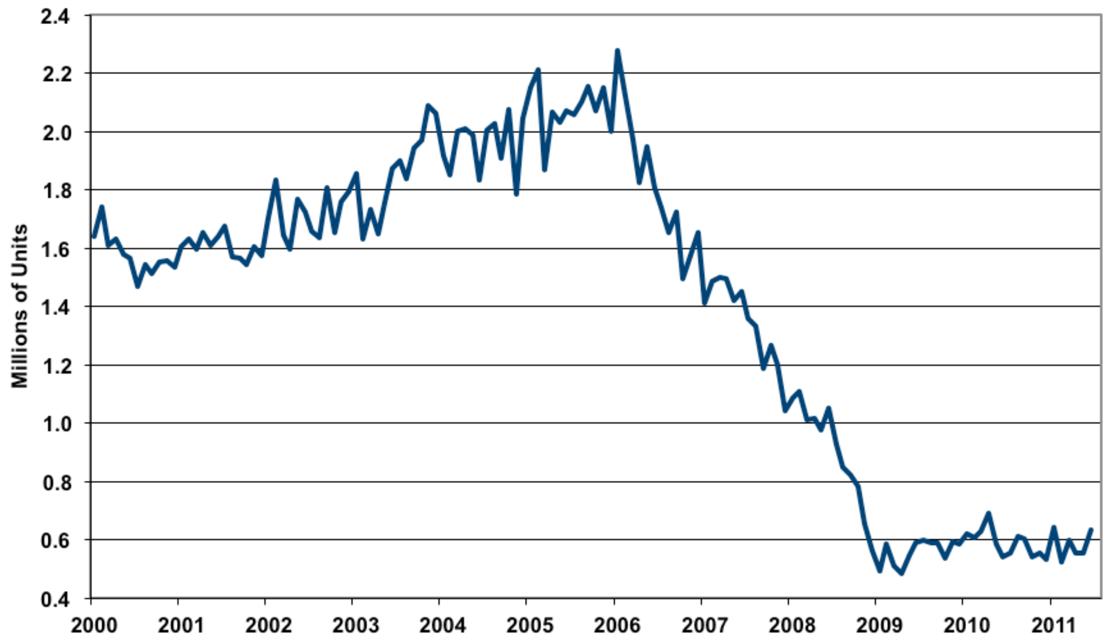
June Housing-Starts Gain Reflected Prior-Month Revisions and a Jump in Extremely Volatile Apartment Structures Category. The regularly volatile housing starts series continued bottom-bouncing in June, albeit with a monthly gain that was enhanced by erratic and extreme volatility common to the "5-units or more" category (apartment buildings). The Census Bureau reported yesterday, July 19th, a statistically-significant monthly increase in seasonally-adjusted June 2011 aggregate housing starts of 14.6% +/- 12.7% (all confidence intervals are at the 95% level); the June gain was 12.3% before prior-period revisions. May starts were revised to unchanged from a previously-indicated 3.5% monthly gain.

None of the gains in the June series' components was statistically meaningful (month-to-month or year-to-year), but, as aggregated by the Census Bureau, the total gain for the series was determined to be statistically meaningful. Broken out by type of structure, the seasonally-adjusted "1-unit" starts (72.0% of the volume) were up a statistically-insignificant 9.4% +/- 13.0% for the month, up 0.4% +/- 9.7% for the year; the seasonally-adjusted numbers for "2-to-4 units" starts were so limited in scope as to be deemed "unreliable" (but implied at 1% of the volume); the seasonally-adjusted "5-units or more" starts (27.0% of the volume) were up a statistically-insignificant 31.8% +/- 38.8% for the month, up 104.8% +/- 111.3% for the year.

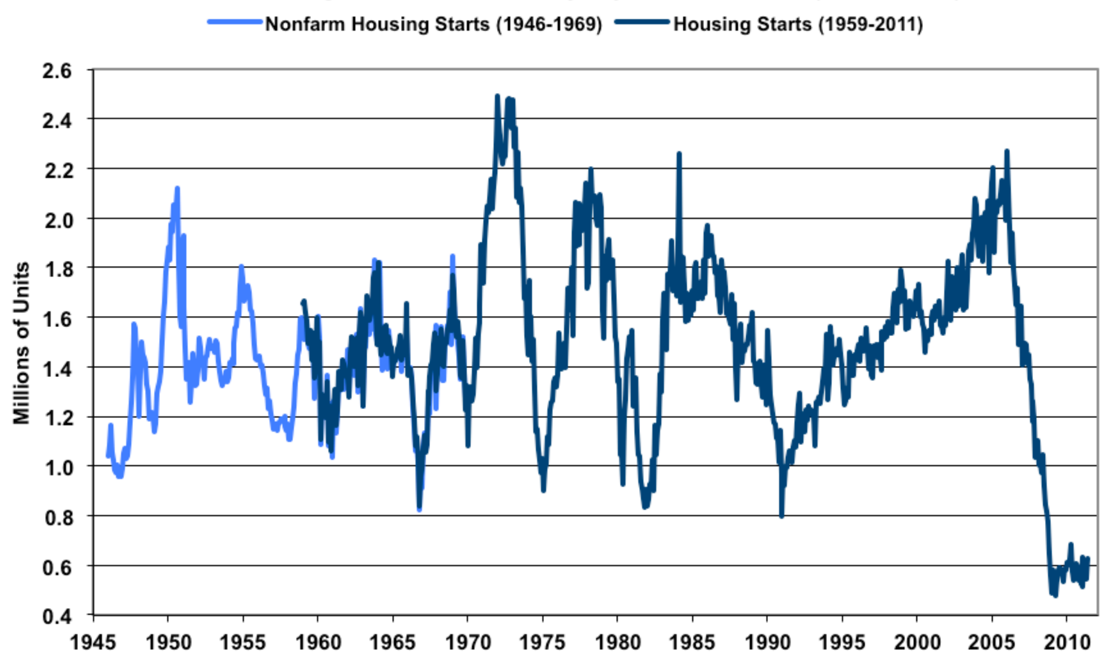
Still, the year-to-year change in aggregate June housing starts was a statistically-significant increase of 16.7% +/- 13.8% (95% confidence interval), following a revised annual 5.3% (previously 3.4%) decline in May. The swing to annual gain reflected both the surging apartment starts, the continued year-ago drop-off in post-stimulus activity, and the continuation of a generally downwardly-sloped trend of bottom-bouncing since.

There still are no indications of a reprieve for the housing industry or the otherwise deteriorating broader economy. Indeed, the pattern of housing starts has remained one of stagnation at an historically low-level plateau of activity, over the last 31 months. The six-month moving-average of seasonally-adjusted housing starts was 579,000 in June, 10.0% above the historic low six-month moving-average seen in May 2009. Significantly weaker monthly numbers remain likely in the months ahead. Since December 2008, housing starts have averaged a seasonally-adjusted annual rate of 571,000. In that period, all monthly readings have been within the normal range of monthly volatility for the aggregate series around that average, with the 629,000 June 2011 monthly reading at 10.2% above average. Again, such is within the normal volatility of the series.

Housing Starts (Monthly Level)
Through June 2011, Seasonally-Adjusted Annual Rate (SGS, Census)



Housing Starts (Monthly Level)
Through June 2011, Seasonally-Adjusted Annual Rate (SGS, Census)



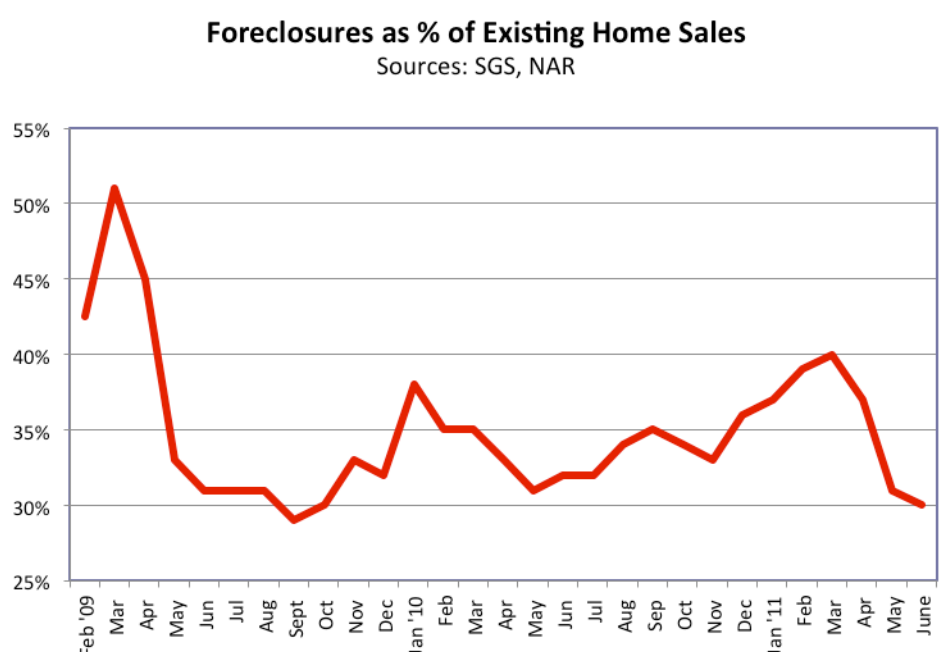
As shown in the preceding graphs, current monthly housing starts activity remains near the record monthly low seen for the present series in April 2009. The current number also is well below any level reported in the predecessor nonfarm housing starts series, which was introduced in 1946. The first graph shows recent detail for current housing starts activity, the second graph shows the same data within the historical context of the post-World War II period.

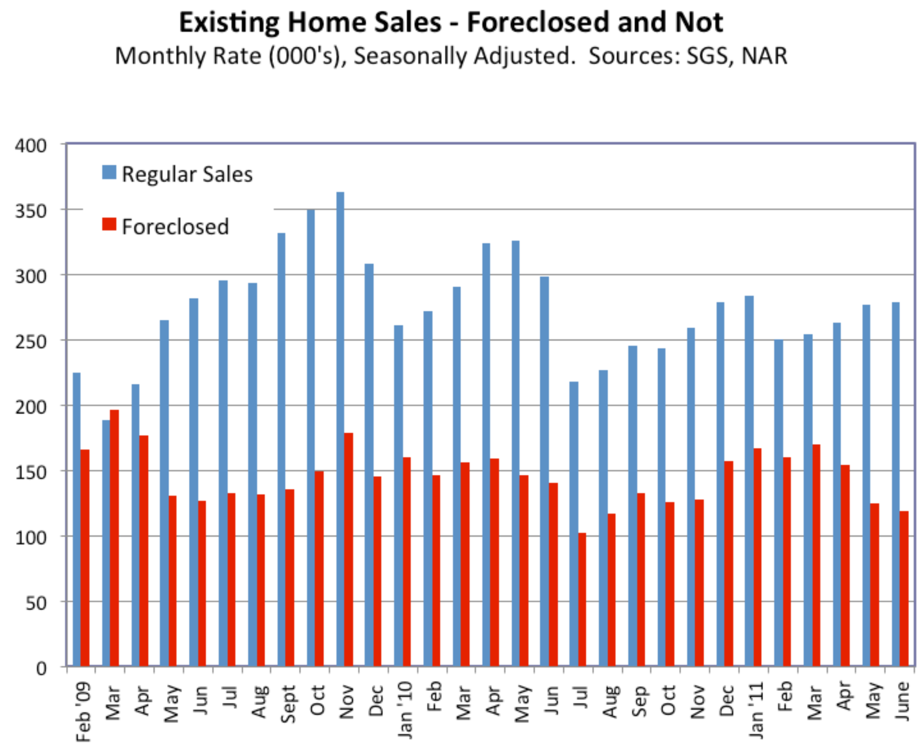
EXISTING HOME SALES (JUNE 2011)

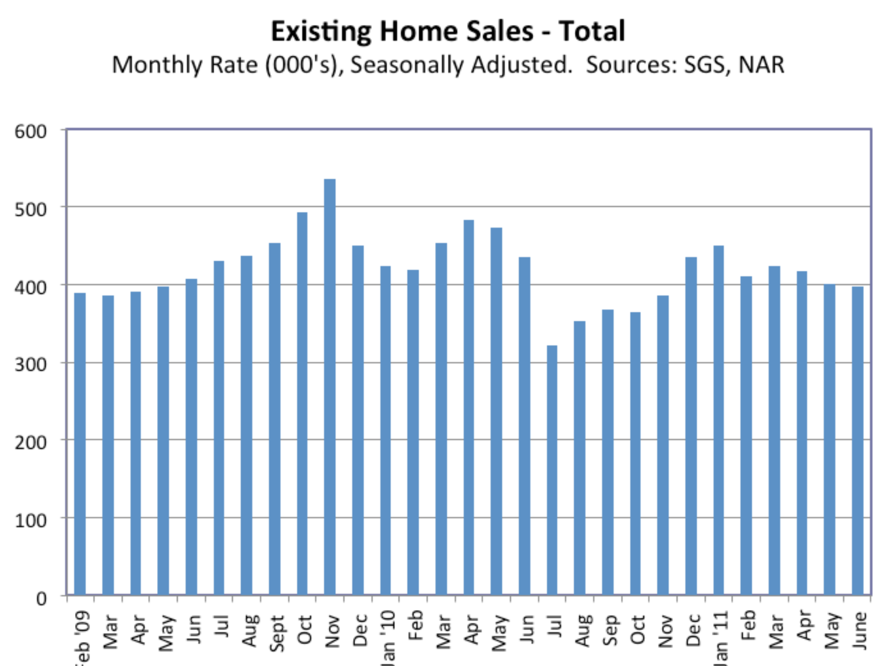
"Unusual Spike" in Sales Contract Cancellations Hits Existing Home Sales. Today's (July 20th) release of June existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly decline of 0.8%, versus May's unrevised 3.8% monthly decline. On a year-to-year basis, June sales were down by 8.8%, versus a 15.3% annual decline in May. The narrowing of the pace of annual reflects the year-ago diminution of stimulus effects.

Foreclosure activity remained a major distorting factor for home sales, with "distressed" activity accounting for an estimated 30% of existing sales in the NAR's June reporting, down from the 31% estimated for May.

The NAR's press release on the June data suggested that the "unusual" surge in contract cancellations could be due to too-tight credit and to low appraisals that were hurting the ability to support needed mortgages.




Existing Home Sales - Foreclosed and Not
Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR
Regular Sales
Foreclosed
400
350
300
250
200
150
100
50
0
Feb '09
Mar
Apr
May
Jun
Jul
Aug
Sept
Oct
Nov
Dec
Jan '10
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan '11
Feb
Mar
Apr
May
June


Existing Home Sales - Total
Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR
600
500
400
300
200
100
0
Feb '09
Mar
Apr
May
Jun
Jul
Aug
Sept
Oct
Nov
Dec
Jan '10
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan '11
Feb
Mar
Apr
May
June

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.

New Home Sales (June 2011). June existing home sales (National Association of Realtors) were released today, July 20th, and are covered above. New home sales (Census Bureau) are due for release on Tuesday, July 26th. As with the ongoing historic weakness in housing starts and existing sales, the volatile new home sales series should remain extremely weak, with any positive monthly change again lacking statistical significance. Also, as usual, given the extreme volatility, reporting error and revisions in both these series, given the poor-quality seasonal adjustments, given continuing negative anecdotal evidence, and given ongoing massive distortions from irregularly volatile foreclosure activity, the monthly movements in these numbers (particularly to the upside) remain meaningless.

New Orders for Durable Goods (June 2011). Due for release on Wednesday, July 27th, June's new orders for durable goods could show a spike from Paris Air Show orders, but it likely will not show a meaningful monthly change otherwise, with odds slightly favoring a decline in in non-aircraft orders in this irregularly volatile series.

Gross Domestic Product—GDP (Second-Quarter 2011—"Advance" Estimate, Benchmark Revision). The "advance" estimate of second-quarter GDP is due for release from the Bureau of Economic Analysis (BEA) on Friday, July 29th. Benchmark revisions to the data will be released at the same time, with some of the numbers to be restated back to 1929.

The second-quarter GDP headline, annualized quarterly real growth rate should come in somewhat below a likely soft consensus expectation, although the BEA tries to target its initial quarterly guesstimate at the consensus growth estimate. GDP growth of the last several years should be revised lower, in line with earlier benchmark revisions to trade, payroll employment, real retail sales, industrial production and new orders for durable goods. See the *Opening Comments and Executive Summary* for more detail.

