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

COMMENTARY NUMBER 392
Benchmark Payroll and GDP Revisions, August Durable Goods and Home Sales

September 29, 2011

GDP Revised Higher, GDI Revised Lower,
Growth Remained Statistically Indistinguishable from a Contraction

Average Monthly Understatement of 16,000 Jobs for
Year-Ended March 2011 (per BLS)

Home Sales Keep Bottom-Bouncing
Despite Having Covered Sales Lost to Stimulus Efforts

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, October 7th. It will cover the September employment and unemployment data. A* Special Commentary *likely will be included, if it has not been published earlier in response to escalating systemic instability.*

—Best wishes to all, John Williams

Opening Comments and Executive Summary. Economic reporting of the last week held few surprises with no change in the general economic outlook. As discussed in recent *Commentaries* and the *Hyperinflation Special Report (2011)*, the U.S. economy remains in its deepest and most-protracted downturn since the Great Depression, and chances for any meaningful improvement in broad economic activity remain nil for the foreseeable future. The systemic solvency crisis and the structural issues with

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consumer income and liquidity continue to constrain broad consumption patterns as well as the demand for housing.

Payroll Benchmark Revision. One surprise this week was today's (September 29th) Bureau of Labor Statistics' (BLS) preliminary upside benchmark revision to March 2011 unadjusted nonfarm payrolls. The estimated 192,000 positive revision means a monthly-average understatement of 16,000 jobs since the March 2010 count. I had expected a downside revision and will discuss that further in the *Commentary* of October 7th, which will cover the September 2011 payroll release. The final benchmark will be published in February 2012. The relatively small preliminary upside revision follows three consecutive larger downside annual revisions, and it should not affect current reporting (see *Week Ahead* section).

Online Help-Wanted Advertising. Sending out negative signals on the labor market is the Conference Board's online help-wanted advertising measure. The no-longer-published newspaper help-wanted advertising index was one of the best leading indicators to employment and general economic activity. The online measure still has a limited track record (since 2005) and may have some upside bias built into it from still-growing usage of the online medium for help-wanted ads.

That said, seasonally-adjusted total online help-wanted advertising fell for the fourth consecutive month in September, down by 11.2% or 524,000 job offerings since May. September's new ads, contracting in two of the last four months, were down 6.1% from May. While I consider the new ads to be the better economic indicator, the pattern here is a negative one, in any event, for upcoming payroll reporting.

Initial Claims for Unemployment Insurance. Despite repeated writings on the worthlessness of the individual weekly claims numbers (except for creating stock-market gyrations and financial-media frenzies), I constantly get queries as to what a big gain or loss in weekly jobless claims means. Big weekly movements usually have no significance, because they most often are tied to the Department of Labor's inability to make meaningful weekly seasonal adjustments, particularly around holidays, etc.

To make sense of the numbers, one has to look at some type of smoothing, such as a moving average, and the four-week moving average is the popular measure. Based on today's reporting (with a market-spiking sharp weekly decline), the four-week moving average was 417,000. Going back to the beginning of the year, the first weekly reporting of January 2011 showed the four-week moving average at 418,000.

Further, in a depressed labor market, where payrolls stand below where they were 10 years ago, one cannot expect "benchmarks" from less-severe economic circumstances to be meaningful in the current environment. Some analysts, for example, tout as a "rule of thumb" that weekly new claims below 400,000 signal growing employment. That is simplistic at best, given the extraordinary magnitude of jobs already lost and in the context of underlying labor conditions such demand for new hires.

One needs to consider the balancing factor to new claims for unemployment insurance (basically layoffs): hiring. The best indicator of current demand for labor is help-wanted advertising (see previous section), which has been in contraction for the last four months.

GDP. With second-quarter growth still statistically indistinguishable from a quarterly contraction, the latest revision to second-quarter gross domestic product (GDP) took the headline growth rate back to the initial reporting of 1.3%, versus 1.0% in the first revision. That was against 0.4% growth in the first-quarter. Year-to-year growth slowed in the second-quarter to 1.6% from 2.2% in the first-quarter.

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At the same time, gross domestic income (GDI)—the GDP's theoretical equivalent—was revised lower. The boost in GDP came from an upward revision estimated for vacation spending. Only in the national income accounts (GDP, GDI, etc.) is that likely to happen alongside a downward revision in income.

New Orders for Durable Goods. The 0.1% decline reported for August new orders for durable goods was no more than statistical noise, well within the scope of regular volatility for this series.

New Home Sales. Enough time has passed for the short-lived gains from the housing stimulus measures—home sales borrowed from future activity—to have run their course, and the cost to future activity appears largely to have been paid. Although such should be relatively positive for home sales, sales numbers continued bottom-bouncing in August, with new home sales in a new downtrend. The housing issues remain tied to the systemic solvency crisis and to the structural liquidity issues hampering consumers and homeowners.

Combined existing and new home sales in August 2011 are now basically at the same level they were in August 2008 (the first month following the initial housing-stimulus enactment), and also as averaged over the intervening period. The ensuing stimulated sales boosts and countervailing stimulus-expiration losses have averaged out to what otherwise would have been three-years of bottom bouncing (as seen in housing starts, *Commentary No. 391*).

In August 2008, the first full month following enactment of the initial stimulus, total monthly (not the annualized pace used in the headline data), seasonally-adjusted home sales were 447.1 thousand (410.8 thousand existing homes, 36.3 thousand new homes). The August 2011 number was 443.8 thousand (419.2 thousand existing homes, 24.6 thousand new homes), while the intervening average through all the sales gyrations was 444.9 thousand (416.1 thousand existing homes, 28.8 thousand new homes). The greater relative weakness has been with the new home sales and related construction, which impact GDP directly.

As was widely recognized at the time, stimulus efforts to encourage home buying through tax breaks did little more than borrow activity from the future, moving it into the period of the stimulus. Since August of 2008, following enactment of the first new homebuyer tax credit, home sales repeatedly surged and sank along with various stimulus efforts and expirations of same. That volatility, perhaps, is most visible in the existing home sales graph among the three charts that follow.

Note in the two graphs of home sales that the downturns start in 2005, while the downturn in housing starts began to reflect the underlying market in early-2006, nearly two years before the official onset of the recession. It is this weakness that led to the debt crisis in 2007, which, in turn, exacerbated the downturn. It was not the debt crisis that triggered the recession.

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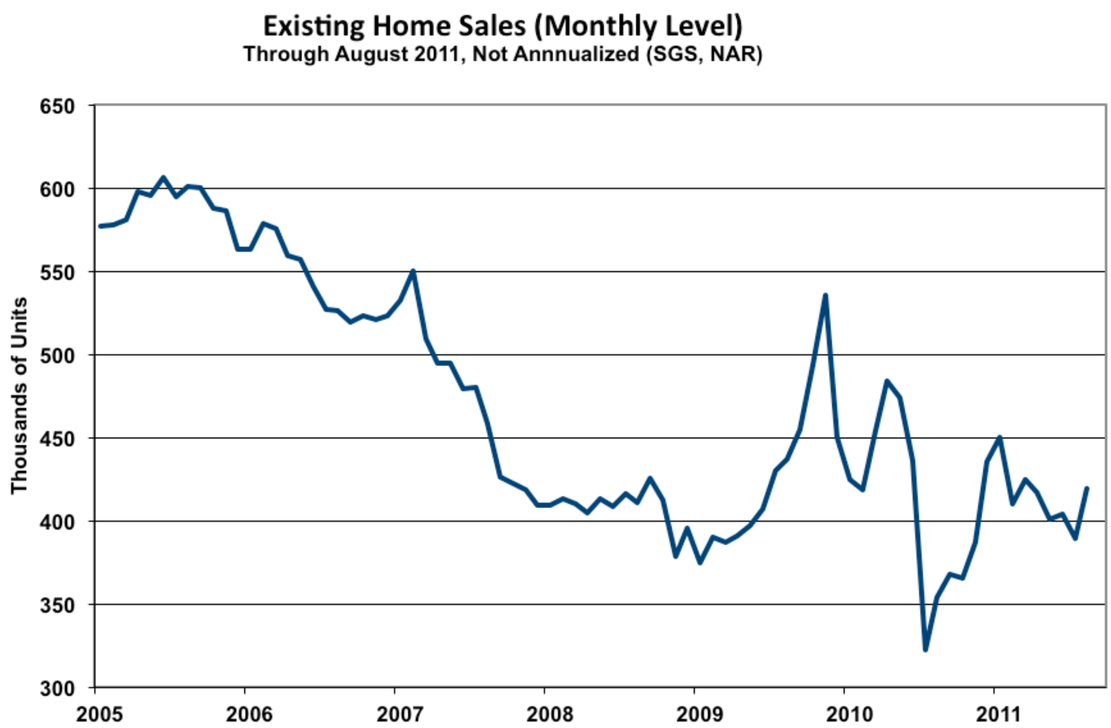
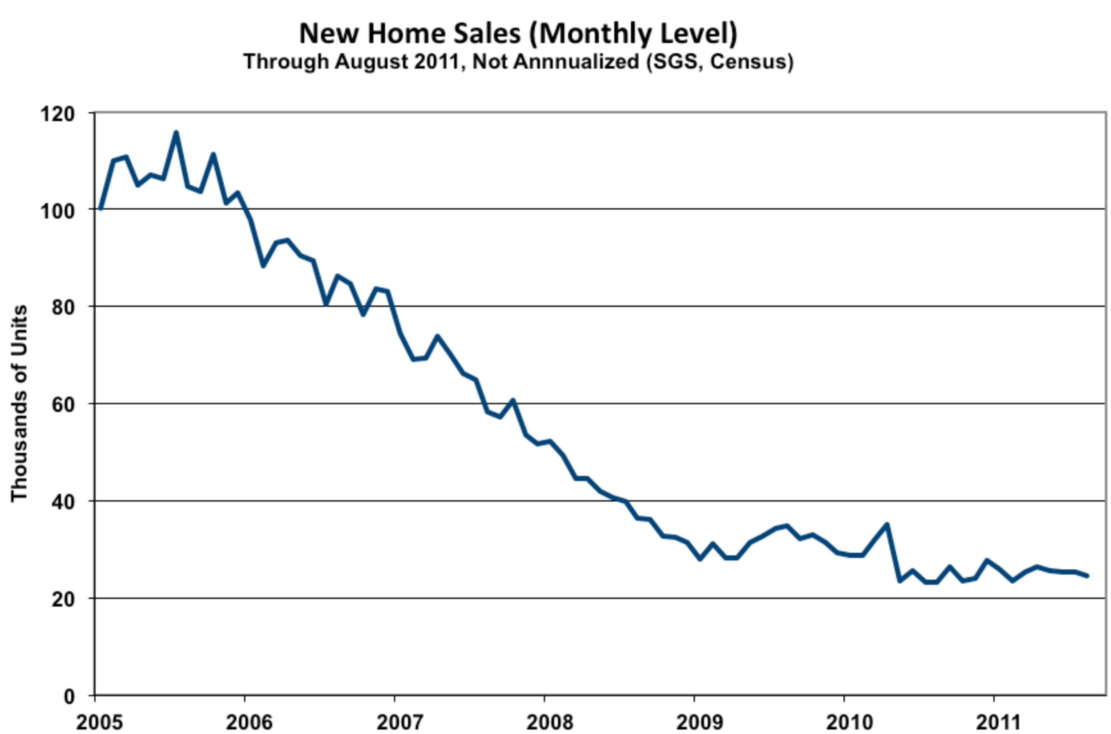

Existing Home Sales (Monthly Level)
Through August 2011, Not Annnualized (SGS, NAR)
Thousands of Units
650
600
550
500
450
400
350
300
2005
2006
2007
2008
2009
2010
2011


New Home Sales (Monthly Level)
Through August 2011, Not Annnualized (SGS, Census)
Thousands of Units
120
100
80
60
40
20
0
2005
2006
2007
2008
2009
2010
2011

Hyperinflation Watch—Financial System Instabilities Continue. The financial markets and systemic conditions remain in turmoil and are extremely dangerous. Various heads of state, finance ministers, central bankers, Treasury Secretary Geithner and Fed Chairman Bernanke continue to behave and talk as though the system is at risk. It well may be, although Mr. Bernanke took no meaningful overt action last week to create new systemic liquidity. A *Special Commentary* on the systemic liquidity crisis will be published before or with the October 7th *Commentary* on September labor conditions.

Repeated from the prior *Commentary*, there are no happy solutions available here, only tools—devil's choices—for buying a little extra time. From the Fed's standpoint, keeping the banking system afloat remains its primary concern, although needs for economic growth and contained inflation will be given as the rationale behind any overt change in policy. The ultimate cost in propping the system, however, remains inflation. The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the *Hyperinflation Special Report (2011)* and recent *Commentaries*, continue to unfold with outlooks that remain unchanged.

The root source of current global systemic instabilities largely has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent a euro-area crisis from triggering a systemic collapse in the United States. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

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The financial markets still are roiled by deepening crises of confidence in the U.S. dollar and in the long-term outlook for U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of further near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold, the stronger currencies and precious metals remain the fundamental hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets could start at anytime, with little or no further warning. With a U.S. government unwilling to balance or even to address its uncontainable fiscal condition; with the federal government and Federal Reserve standing ready to prevent a systemic collapse, so long as it is possible to print and spend whatever money is needed; and with the U.S. dollar at risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.

REPORTING DETAIL

NONFARM PAYROLLS (March 2011 Benchmark Revision, Preliminary Estimate)

BLS Estimated Average Understatement of 16,000 Jobs per Month for Year-Ended March 2011. The Bureau of Labor Statistics (BLS) published its preliminary estimate of the 2011 nonfarm payroll benchmark revision this morning (September 29th). The initial not-seasonally-adjusted benchmarking for March 2011 indicated that payrolls had been understated by 192,000 (an average of 16,000 per month) since the prior benchmarking of March 2010. The latest revision follows three years of larger downside benchmark revisions.

Final benchmarking detail will be published on February 3, 2012 (the January 2012 employment release). The benchmarking should have no impact on monthly payroll reporting, prior to the January 2012 release, assuming traditional reporting patterns are followed.

GROSS DOMESTIC PRODUCT—GDP (Second-Quarter 2011, Third Estimate, 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.*

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***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.*

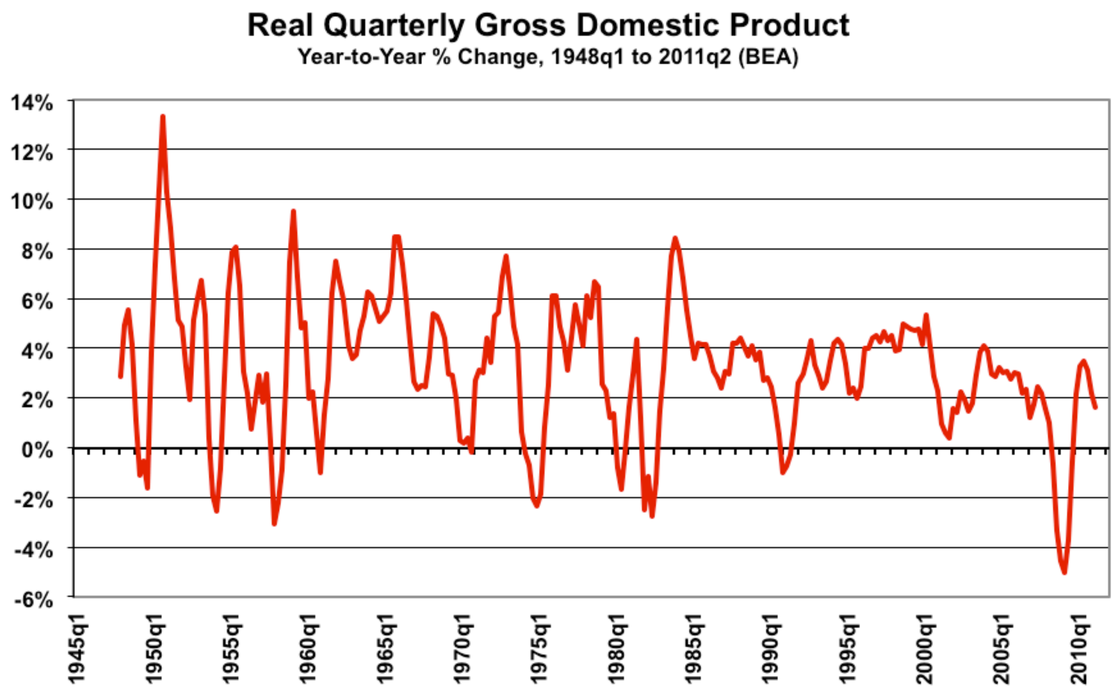
***Quarterly** growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by 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.*

Reported GDP Growth Still Is Statistically Indistinguishable from Contraction. As discussed in the *Opening Comments and Executive Summary*, the revised second-quarter GDP growth estimate remained statistically insignificant, while the revision itself was little more than statistical noise. The consumption-side GDP revised higher by 0.3%, thanks largely to stronger personal consumption (recreation services—vacations), but the income-side-equivalent GDI revised lower by 0.2%. Revisions at the same time for stronger consumption and weaker income are suggestive of possible internal discrepancies in the GDP model.

GDP. Published today, September 29th, by the Bureau of Economic Analysis (BEA), the third-estimate or second-revision of second-quarter 2011 gross domestic product (GDP) showed annualized real quarterly growth of 1.33% (versus the second estimate of 0.99% and initial reporting of 1.28%) +/- 3% (95% confidence interval), versus an estimated annualized gain of 0.36% for first-quarter 2011. Not annualized, second-quarter GDP growth revised to 0.33%, against a second estimate of 0.25% and initial reporting of 0.32%, and up from 0.09% in the first-quarter. In this most worthless of major economic series, the reported annualized growth rates for the last two quarters are little more than statistical noise around the unchanged level. They possibly have been massaged to keep the quarterly growth rates in minimally-positive as opposed to minimally-negative territory.

Year-to-year real change in second-quarter 2011 GDP retained its slowing trend, up by a revised 1.63%, versus a second estimate of 1.55% (that rounds to 1.5%) and initial reporting of 1.62%, and versus 2.24% in the first-quarter. Such remained well off the near-term peak in reported growth of 3.51% in third-quarter 2010.



The estimate of the second-quarter GDP implicit price deflator (IPD) was revised to 2.59%, up from the second-estimate of 2.50% and initial reporting of 2.39%, versus 2.73% in the first-quarter. In contrast, annualized seasonally-adjusted quarterly inflation for the CPI-U in the second-quarter eased to 4.09% from a seasonally-adjusted 5.22% in the first-quarter. On a year-to-year basis, the second-quarter IPD was up by 0.64%, versus 0.67% in the first-quarter. In contrast, second-quarter CPI-U surged to 3.43%, versus 2.14% in the first-quarter.

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 second-quarter GDP quarterly growth rate into negative territory.

The SGS Alternate-GDP estimate for second-quarter 2011 remains an approximate annual contraction of 2.8% versus the official revised estimate of a 1.6% gain. Such is more negative than the alternate 2.6% annual contraction (2.2% official gain) in the first-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 second-quarter, in what generally has been a protracted period of business bottom-bouncing.

GNP. GDP is Gross national product (GNP) net of international flows in factor income (dividend and interest payments). Although boosted by money-flow distortions from the ongoing systemic-solvency crisis, GNP growth still is statistically insignificant, with annualized real quarterly growth reported at a revised 2.16% (initially 1.70%) in the second-quarter, versus 1.45% in the first-quarter (0.54% [initially 0.42%] versus 0.36%, not annualized). Year-to-year growth revised to 2.01% (initially 1.89%), versus 2.59% in the first-quarter.

GDI. Gross domestic income (GDI) is the theoretical income-side equivalent to the GDP's consumption-side. Reflecting revised income reporting, the statistically-insignificant, annualized real quarterly growth in GDI revised lower to 1.34% (initially 1.55%) in the second-quarter, versus 2.45% in the first. Year-to-year change revised to 1.94% (initially 2.00%) in the second-quarter, versus 2.55% in the first-quarter.

NEW ORDERS FOR DURABLE GOODS (August 2011)

August Durable Goods Orders Decline Still Included Strong Airplane Orders. The Census Bureau reported September 28th that the regularly-volatile, seasonally-adjusted new orders for durable goods fell for the month by 0.1% (rose by 0.2% before prior-period revisions) in August 2011, following a revised 4.1% (previously 4.0%) gain reported for July. August's monthly contraction was despite a 23.5% jump in irregular, long-term nondefense aircraft orders, a category that showed a revised 49.9% (previously 43.4%) surge in July. Airplane orders usually are placed years in advance of delivery and rarely impact near-term economic activity.

Unadjusted, year-to-year growth in total August 2011 new orders was 14.1%, versus a revised 9.5% (previously 9.2%) annual gain in July. Current durable goods reporting remains subject to many of the same sampling and seasonal-adjustment problems that are seen with retail sales and payroll reporting.

The widely followed nondefense capital goods orders increased in August by 5.2% (up by 7.4% before prior-period revisions), versus a revised monthly 4.3% (previously 2.4%) increase in July. For August, the unadjusted year-to-year growth in the series was 25.4%, up from July's revised 13.8% (previously 12.5%) annual growth estimate.

EXISTING AND NEW HOME SALES (August 2011)

Three Years Later, All Housing Stimulus Gains Having Evaporated in Offsets. Combined existing and new home sales in August 2011 are basically the same level they were in August 2008 (first month following the initial housing-stimulus enactment), and also as averaged over the intervening period. The ensuing stimulated sales boosts and countervailing stimulus-expiration losses have averaged out to what otherwise would have been three-years of bottom bouncing. Enough time has passed that paying for the "borrowed" sales has run its course. While that could be a positive for home sales, ongoing weakness continues, reflecting the residential market still taking a full hit from the fundamental and ongoing consumer structural income problems and illiquidity (see discussion and graphs in *Opening Comments and Executive Summary*.

Existing Home Sales Bounce A Little Higher. The September 21st release of August existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly gain of 7.7%, versus July's unrevised decline of 3.5%. On a year-to-year basis, August

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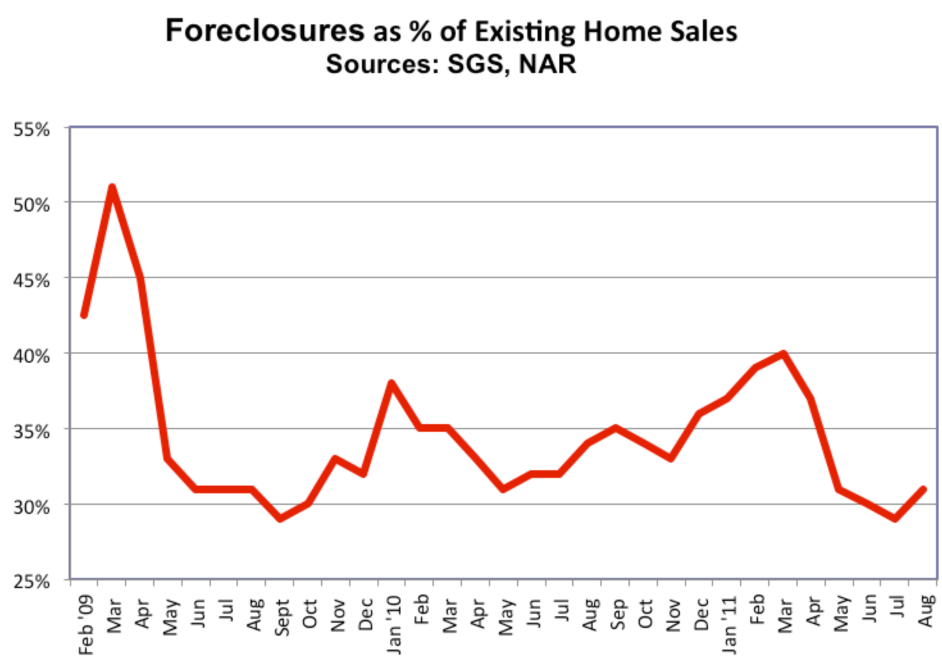
sales jumped by 18.6%, versus an unrevised 21.0% in July. The relatively strong annual growth still reflects the lapsing of year-ago end-of-stimulus effects.

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 August's reporting, up from the 29% estimated for July.

August New Home Sales Showed a Further, Downtrending Bottom-Bounce. Consistent with the long-term negative trends in housing starts (see the prior *Commentary No. 391* for August details), the September 26th release of August new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of a bottom-bounce at a slowing pace, nearing last year's historic low. August's decline of 2.3% (down 1.0% before prior-period revisions) +/- 16.2% (95% confidence interval) from July was statistically insignificant. In turn, July's decline was revised to a 0.3% drop (previously down by 0.7%) versus June. The year-to-year gain in August 2011 new-home sales was a statistically-insignificant 6.1% +/- 22.0% (95% confidence interval). July's annual gain was revised to 8.2% (previously 6.8%).

As with existing homes sales, the positive annual change is due to the effects of the lapsing of housing stimulus efforts a year ago. Also, part of the new sales volume is due to foreclosure activity, but the Census Bureau does not provide an estimate of foreclosure volume.

The following graphs reflect a level of finer monthly detail than seen in the charts of the *Opening Comments and Executive Summary*.



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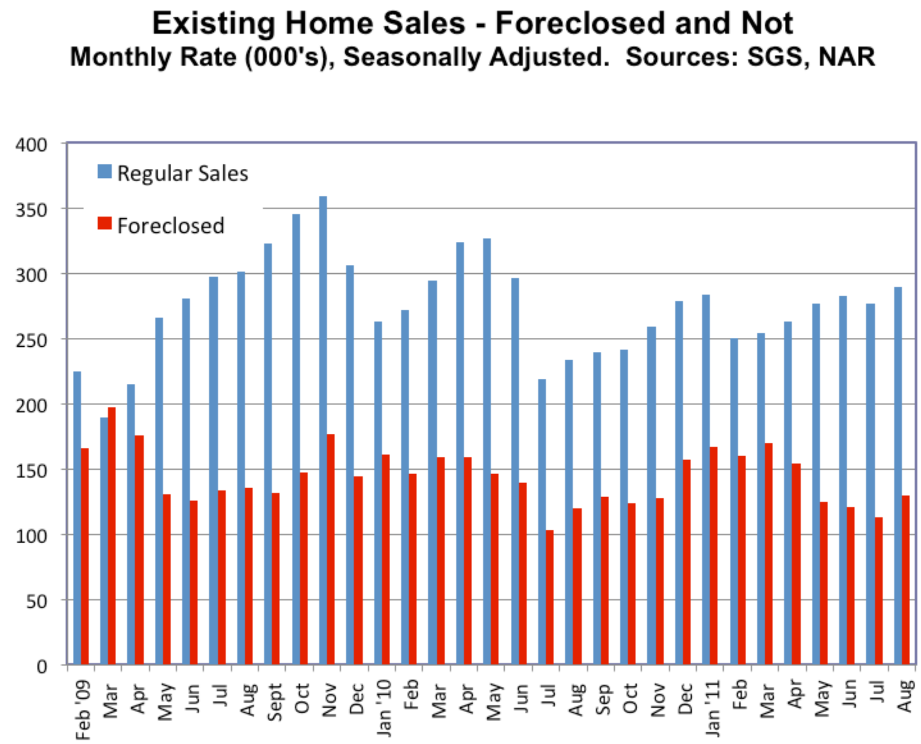

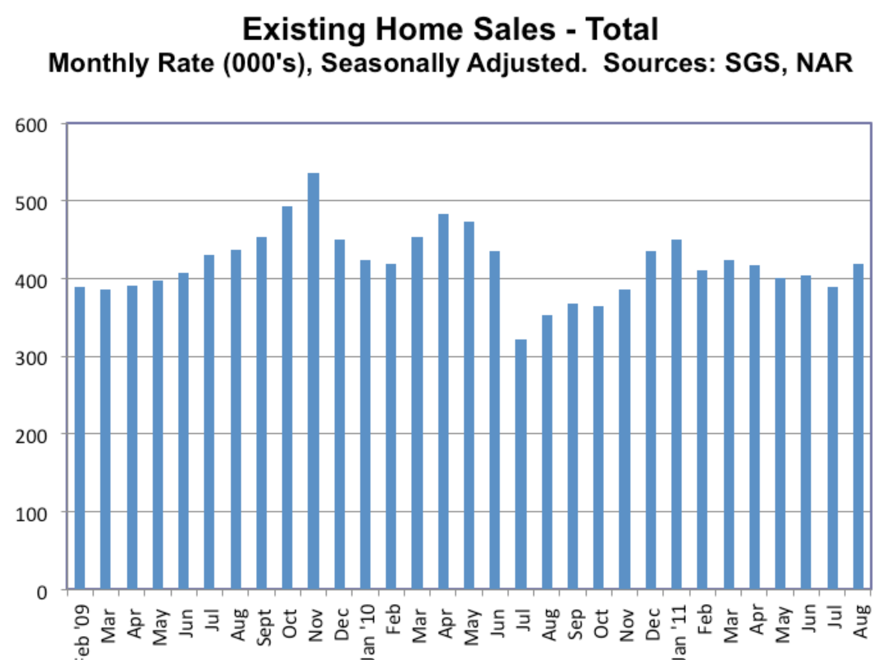

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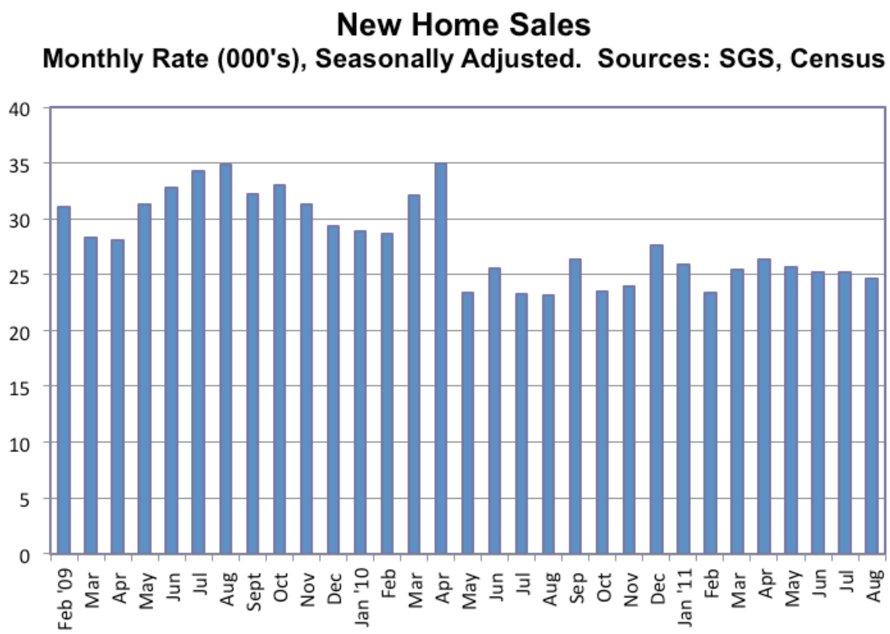

Week Ahead. Although still not fully acknowledged, there is both an intensifying double-dip recession and an escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected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

Unemployment Rate and Payroll Employment (September 2011). Nonfarm payrolls and the unemployment rate for September 2011 are due for release on Friday, October 7th. This first major indicator of September economic activity likely will show continued deterioration in broad economic conditions. A pattern of weaker-than-expected reporting, against likely soft consensus expectations for the labor market, is a fair bet to be seen with the September numbers.

Payrolls remain at risk of showing an outright monthly contraction, with the unemployment rate notching higher. Yet, as seen with last month's (August) zero monthly change in headline payrolls and unemployment rate, whatever is reported likely will include a payroll contraction and higher unemployment rate within the 95% statistical reporting confidence intervals (+/- 129,000 for payroll change, +/- 0.2% for the unemployment rate). As has been the case for some time, unstable seasonal adjustments can distort the reported monthly changes in these series meaningfully.

The preliminary estimate of the 2011 payroll benchmark revision should have no bearing on near-term reporting. The weakness in online help-wanted advertising (see *Opening Comments and Executive Summary*), though, is suggestive of outright monthly payroll contractions in near-term payroll reporting.
