

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

COMMENTARY NUMBER 415
Fourth-Quarter GDP, December Durable Goods and Home Sales

January 27, 2012

Net of Involuntary Inventory Build-Up, GDP Growth Was 0.8% Instead of 2.8%

Durable Goods Orders and New Home Sales Still Show Stagnation

Fed's New PCE Inflation Target Is Inconsistent with Plans for Ongoing Easing

PLEASE NOTE: The next regular Commentary is scheduled for Friday, February 3rd, covering the nonfarm payroll and unemployment data for January 2012. That release also will include the annual payroll benchmark revision for 2011, and changes in population estimates that will make the January 2012 unemployment numbers not directly comparable with the December 2011 data. The Commentary also will include detail on the PCE deflator inflation measure now formally being targeted by the Fed.

Best wishes to all — John Williams

Opening Comments and Executive Summary. Mr. Bernanke and friends keep changing the window dressings, but they can do little of substance to make the banking system solvent, to stimulate the economy or to contain inflation. The Fed has announced that it will target year-to-year inflation, as measured by change in the PCE deflator, at 2.0%. That is the heavily massaged and modeled inflation rate for personal consumption expenditure published on a monthly basis by the Bureau of Economic

Analysis (BEA), and quarterly as part of the GDP release. The series is heavily revised for at least a year or two. At subscriber request, we regularly will discuss the PCE deflator.

In theory the PCE deflator should run close to the chain-weighted C-CPI (C-CPI-U) (see [Commentary No. 413](#) for details of the C-CPI-U and other inflation measures). Yet, the last reported monthly PCE deflator (November 2011) showed 2.5% inflation. The C-CPI-U was 3.3% at the time, with the CPI-U at 3.4%, CPI-W at 3.8% and the SGS-Alternate (1980-Base) at 11.0%.

Annual inflation rates eased in December, however, with the C-CPI dropping by 0.3% to 3.0%. Accordingly, the PCE deflator for December should drop about 0.3% to around 2.1% to 2.2% (2.4% was suggested for December's monthly rate, by today's [January 27th] quarterly number and prior monthly reporting, where annual fourth-quarter PCE deflation was reported at 2.55%). The monthly and quarterly data here largely are meaningless, as is the GDP. The PCE number was the most-understated and worthless, regularly-followed inflation number the Fed could come up with, shy of the "core" PCE deflator, net of food and energy, which Mr. Bernanke traditionally has been fond of touting.

Instead of suggesting a boost in interest rates, which would be a normal response to inflation being above target, there were specific indications by the Fed of not raising rates, along suggestions of possible renewed purchasing of U.S. Treasury debt, actions that run counter to containing inflation.

The Economy. This week's economic releases were about as expected. For the GDP, the BEA reported its "advance" estimate of annualized real (inflation-adjusted) fourth-quarter 2011 GDP at 2.8%, slightly below the targeted economic consensus of 3.0%, and up from 1.8% in the third-quarter. The number was not statistically meaningful, as usual. Seventy-one percent of the purported growth was due to an involuntary inventory build-up, with final sales—GDP net of inventory shifts—showing annualized growth of just 0.8%. Big inventory build-ups often are followed by contractions in production.

Year-to-year GDP growth was 1.6% for the fourth-quarter, up a notch from 1.5% in the third quarter. For the year, though, annual growth slowed sharply to 1.7% from 3.0%. This most worthless of government economic series is subject to massive revisions through July.

There were no surprises in the monthly reporting of December new orders for durable goods, or for December new and existing home sales. The monthly movements all were in the range of regular series volatility and continued to show patterns of bottom-bouncing.

Hyperinflation Watch. Beyond the issues covered in today's *Commentary*, specifically comments from Mr. Bernanke on Wednesday, January 25th, and the "advance" fourth-quarter GDP estimate, the hyperinflation outlook just was updated fully in [Hyperinflation 2012](#).

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Fourth-Quarter 2011, “Advance” or First Estimate)

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.

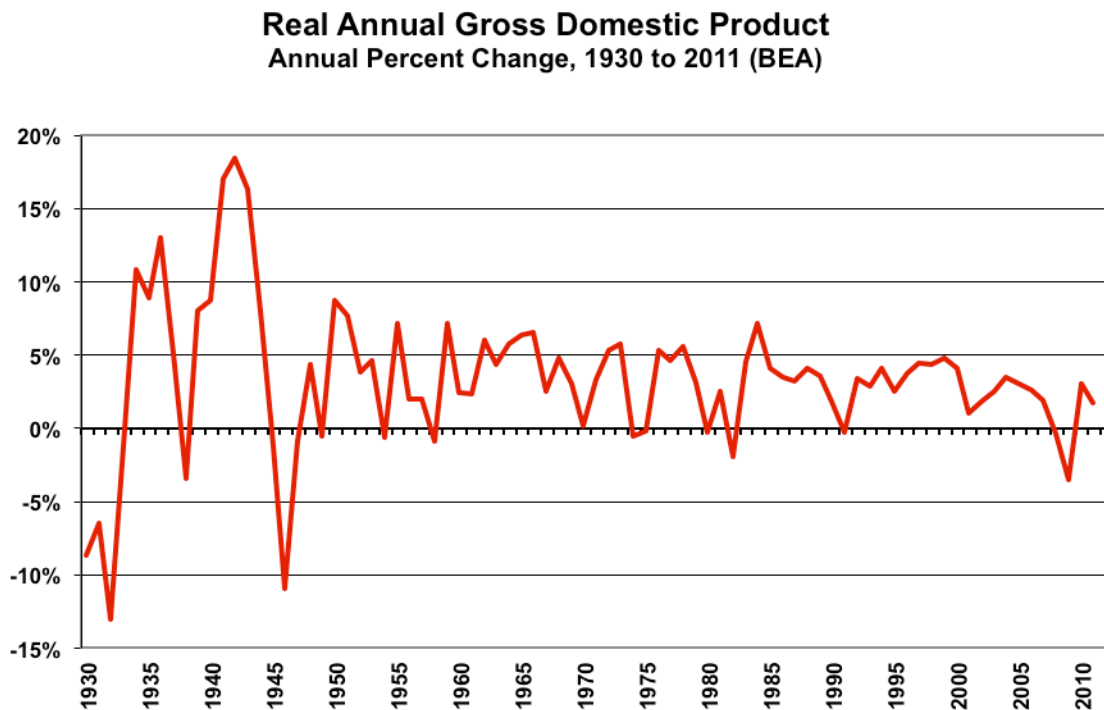
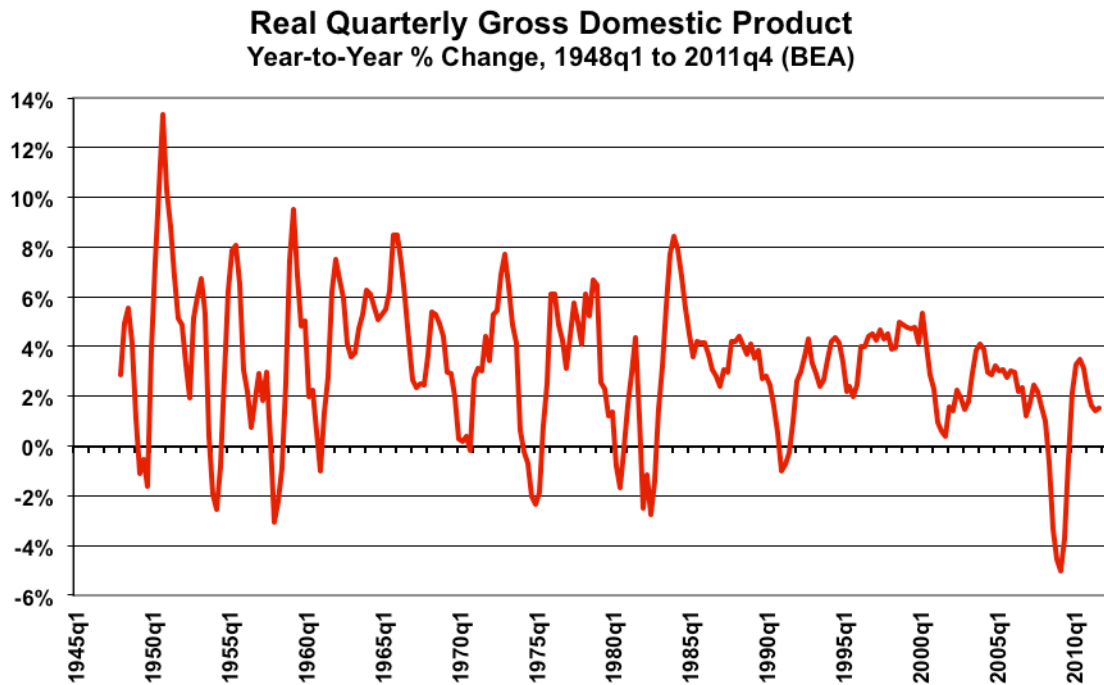
Nominal (or Current Dollars) means growth or level has not been adjusted for inflation. This is the way a business normally records revenues or an individual views day-to-day income and expenses.

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.

Poor-Quality GDP Reporting Continues. Running counter to common experience, the 2.8% headline growth in fourth-quarter GDP was statistically insignificant, but it was consistent with the regular overstatement of broad economic activity by the Bureau of Economic Analysis (BEA). The GDP series remains the most heavily politicized of the government’s popularly followed economic reports. Related issues generally were explored in [Hyperinflation 2012](#).



GDP. Published this morning, January 27th, by the BEA, the “advance” or first estimate of fourth-quarter 2011 gross domestic product (GDP) showed real (inflation-adjusted) quarterly growth estimated at a

statistically insignificant 2.75% +/- 3% (95% confidence interval), versus an estimated annualized gain of 1.81% for third-quarter 2011. For each of the four quarters in 2011, purported growth rates have been little more than statistical noise around the unchanged level, and they possibly have been massaged to keep the quarterly growth rates in minimally-positive, as opposed to minimally-negative territory.

The relative gain in the fourth-quarter versus the third-quarter GDP was attributable primarily to an involuntary surge in inventories. Net of inventory changes, the final sales category showed annualized real growth of just 0.81%.

As shown in the preceding graphs, year-to-year real change in fourth-quarter 2011 GDP notched higher to 1.56% from 1.46% annual growth in the third-quarter. Current annual growth continued well off the near-term peak in reported growth of 3.51% during third-quarter 2010. For the year, real GDP slowed sharply to 1.72% in 2011 from 3.03% in 2010.

Implicit Price Deflator. The estimate of the fourth-quarter GDP implicit price deflator (IPD) was 0.39%, well below the 2.56% of the third-quarter. For comparison purposes, annualized seasonally-adjusted quarterly inflation for the CPI-U in the fourth-quarter slowed to 0.94% from 3.07% in the third-quarter. On a year-to-year basis, the fourth-quarter IPD was up by 2.00%, down from 2.41% in the third-quarter. Annual inflation in fourth-quarter CPI-U eased to 3.29%, versus 3.76 % in the third-quarter. The lower the inflation rate used in deflating the GDP, the stronger is the resulting inflation-adjusted number and vice versa.

SGS-Alternate GDP. The SGS-Alternate GDP estimate for fourth-quarter 2011 is an approximate annual contraction of 2.7% versus the official estimate of a 1.6% gain. Such is slightly less-negative than the alternate 2.9% annual contraction (1.5% official gain) estimate for the third-quarter (see the [Alternate Data](#) tab). While annualized real quarterly growth is not estimated formally on an alternative basis, a quarter-to-quarter contraction once again appears to have been a realistic possibility for the fourth-quarter, as it was in the earlier quarters of 2011, in what generally has been a protracted period of business bottom-bouncing.

Adjusted for gimmicked inflation and other methodological changes, the business downturn that began in 2006/2007 is ongoing; there has been no meaningful economic rebound.

GDI and GDP. Due to the poor quality and incompleteness of early survey data and guesstimate, the BEA will not publish estimates on fourth-quarter 2011 gross domestic income (GDI) or gross national product (GNP), for another two months. The BEA would do well to delay its GDP estimate, too, rather than to mislead the public with particularly poor-quality early reporting. GDI is the income-side reporting equivalent of the consumption-side GDP. GNP is the broadest measure of U.S. economic activity, where GDP is GNP net of trade in factor-income, or interest and dividend payments.

NEW ORDERS FOR DURABLE GOODS (December 2011)

December Durable Goods Orders Again Boosted by Irregular Strength in Aircraft Orders. The Census Bureau reported yesterday, January 26th, that the regularly-volatile, seasonally-adjusted new

orders for durable goods in December 2011 increased by 3.0% (up by 3.8% before prior-period revisions), following a revised monthly gain of 4.3% (previously 3.8%) in November.

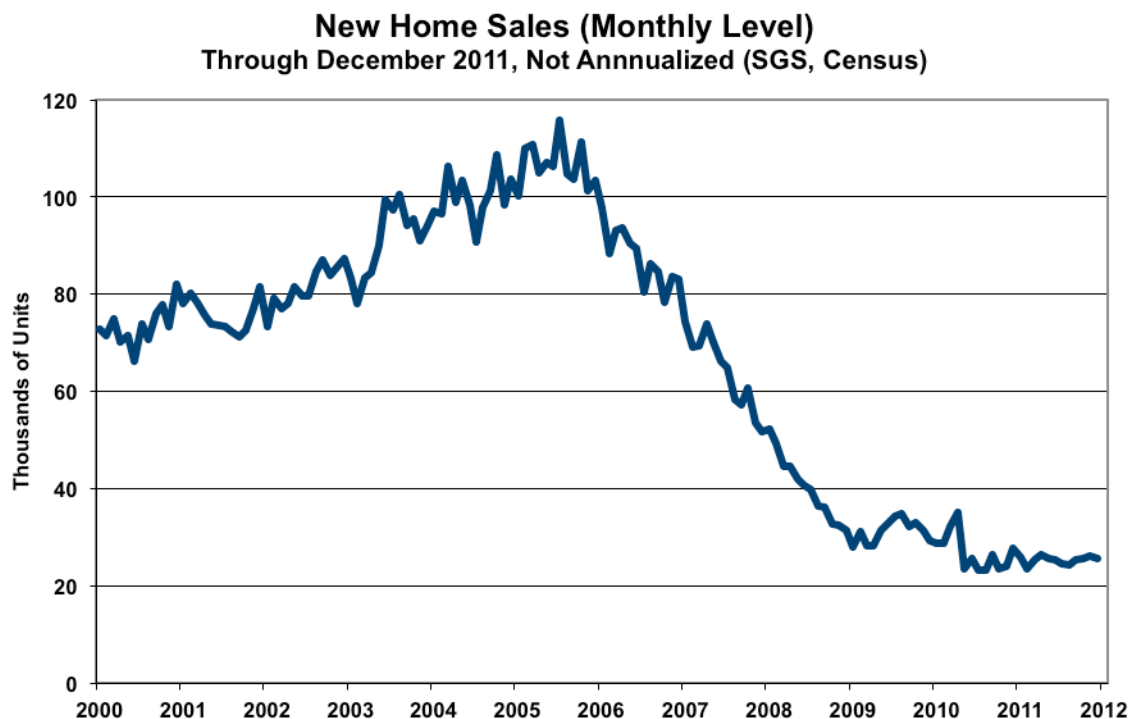
As often is the case, the monthly change was affected by irregular and highly volatile long-term nondefense aircraft orders. December's aircraft orders jumped by 18.9%, following a revised monthly surge in November of 88.1% (previously 73.3%). Airplane orders usually are placed years in advance of delivery and rarely impact near-term economic activity.

Current durable goods reporting remains subject to many of the same sampling and concurrent-seasonal-adjustment problems that are seen with retail sales and payroll reporting. Unusual seasonal-factor volatility raises issues as to the significance of the latest adjusted monthly changes. The numbers here are not adjusted for inflation.

Unadjusted, year-to-year growth in total December 2011 new orders was 14.4%, versus a revised 12.5% (previously 12.2%) annual gain in November.

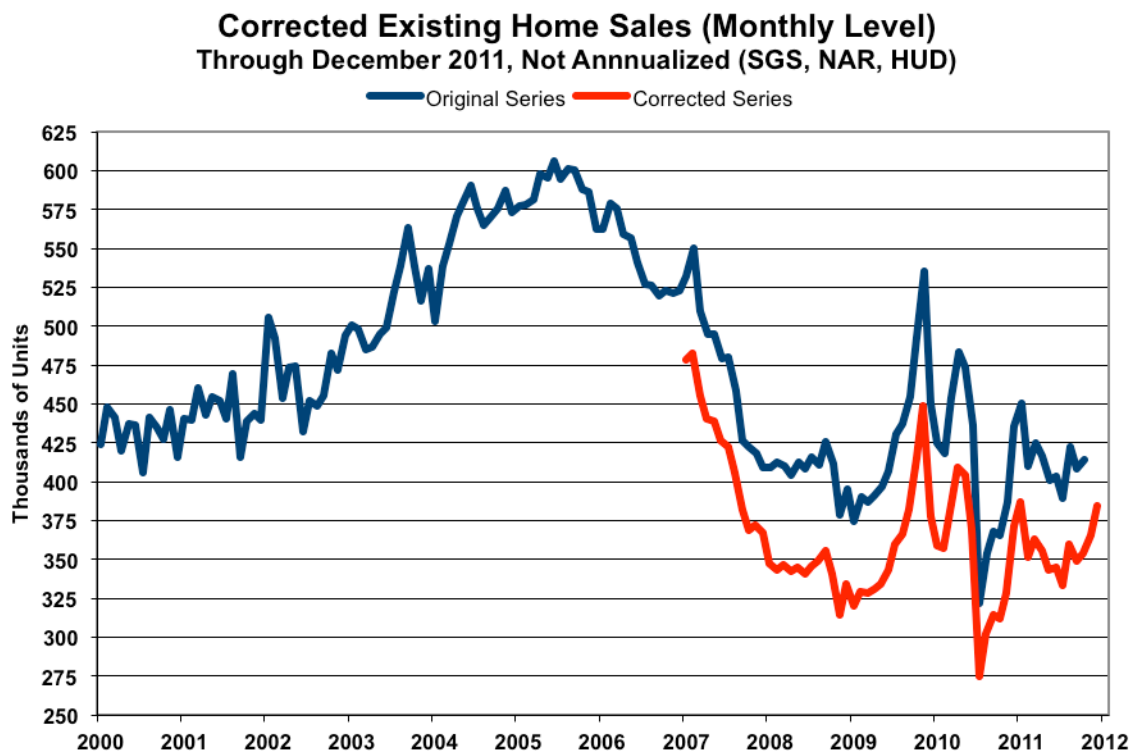
The widely followed nondefense capital goods orders also rose in December, up 5.8% (up by 7.2% before prior-period revisions) for the month, versus a revised monthly 9.6% (previously 8.1%) jump in November orders. The December gain also was impacted by the strong aircraft sales. For December, the unadjusted year-to-year growth in the series rose to 30.4%, against an unrevised 21.3% in November.

NEW AND EXISTING HOME SALES (December 2011)



December New-Home Sales Still Bottom-Bouncing. December 2011 new home sales continued bottom-bouncing, as shown in the above graph, in line with December housing starts. See [Commentary No. 413](#) for details on the latest housing starts reporting.

Yesterday's (January 26th) release of December new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of stagnation at an historically-low level of activity. December's 2.2% monthly contraction (a decline of 2.5% before prior-period revisions) +/- 15.4% (95% confidence interval) versus November was statistically meaningless. In turn, November's monthly gain was a revised 2.3% (previously 1.6%). The year-to-year change in December 2011 new-home sales was a statistically-insignificant decline of 7.3% +/- 19.4% (95% confidence interval). November's annual gain was revised to 9.4% (previously 9.8%). Recent volatility in annual change still reflects the effects of lapsing housing stimulus efforts a year ago.



December Existing-Home Sales Gain Remains Meaningless. The December 2011 existing home sales estimate was the first such report since the series was corrected for significant errors, last month. As graphed above, the old and corrected series do not appear to be consistent or comparable. For those interested in the latest detail, however, we continue to look at current reporting of the new series.

The January 20th release of December existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly gain of 5.0% (up 4.3% net of prior period revisions), versus a revised 3.3% (previously 4.0%) gain in November.

On a year-to-year basis, December 2011 sales rose by 3.6%, versus a revised 11.4% (previously 12.2%) annual gain in November. Foreclosures remain a factor in both new and existing home sales. The NAR

reported “distressed” sales in December at 32% (19% foreclosures, 13% short sales), up from November’s 29% (19% foreclosures, 10% short sales). While foreclosures remain a factor in new home sales, the Census Bureau does not provide an estimate of foreclosure volume.

Week Ahead. Recognition of an intensifying double-dip recession as well as an escalating inflation problem still is sporadic. The political system would like to see the issues disappear until after the 2012 election; the media does its best to avoid publicizing unhappy economic news; and the financial markets will do their best to avoid recognition of the problems for as long as possible, problems that have horrendous implications for the markets and for systemic stability.

Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

PCE Deflator (December 2011). Due for release on Monday, January 30th, the December PCE deflator’s year-to-year inflation rate should drop at least several tenths of a percent versus November’s 2.5% rate, net of likely revisions in this series, which is unstable and otherwise worthless, except for market attention to the Fed’s targeting.

Unemployment, Payroll Employment and Benchmark Revisions (January 2012). Data on January labor conditions are due for release on February 3, 2011. Given pending benchmark revisions, monthly reporting results are unusually vulnerable to any reporting needs of the political establishment. Underlying economic reality suggests payroll employment and unemployment reporting should be worse than likely strong consensus estimates. The initial benchmark estimate promised a 192,000 upside revision to not-seasonally-adjusted March 2011 payrolls, which will be modeled and extended both back and forward in time. The changes in population guesstimates for the household survey will provide a break in all related series, but it should not make too much of a difference in the January unemployment rate.