John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 431
March Durable Goods Orders and Home Sales

April 25, 2012

Drop in March Durable Goods Orders Reflected Normal Volatility,
But Inflation-Adjusted Level Was 23.4% Below Pre-2007 Recession High

Protracted Low-Level Stagnation Continued for March Home Sales

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PLEASE NOTE: The next regular Commentary *is scheduled for Friday, April 27th, covering the first or "advance" estimate of first-quarter 2012 GDP. A subsequent* Commentary *on Monday, April 30th, will cover the March 2012 PCE deflator and the annual benchmark revisions to the retail sales series.*

PUBLIC COMMENT ON INFLATION MEASUREMENT. Within the next week, we will post a Public Comment on Inflation Measurement*, offering a review of the issues surrounding the U.S. government's estimates of inflation, and the rationale and methodology behind the SGS-Alternate CPI Measures. Details will include how academic theory was used by politicians as cover for changing the concept of the cost of living of maintaining a "constant standard of living" to a much different "constant level of satisfaction"—with resulting reductions in reported inflation—and how the SGS Alternate-CPI Measures are derived from the Bureau of Labor Statistics' own estimates of the effects on reported inflation of various methodological changes implemented in the last several decades.*

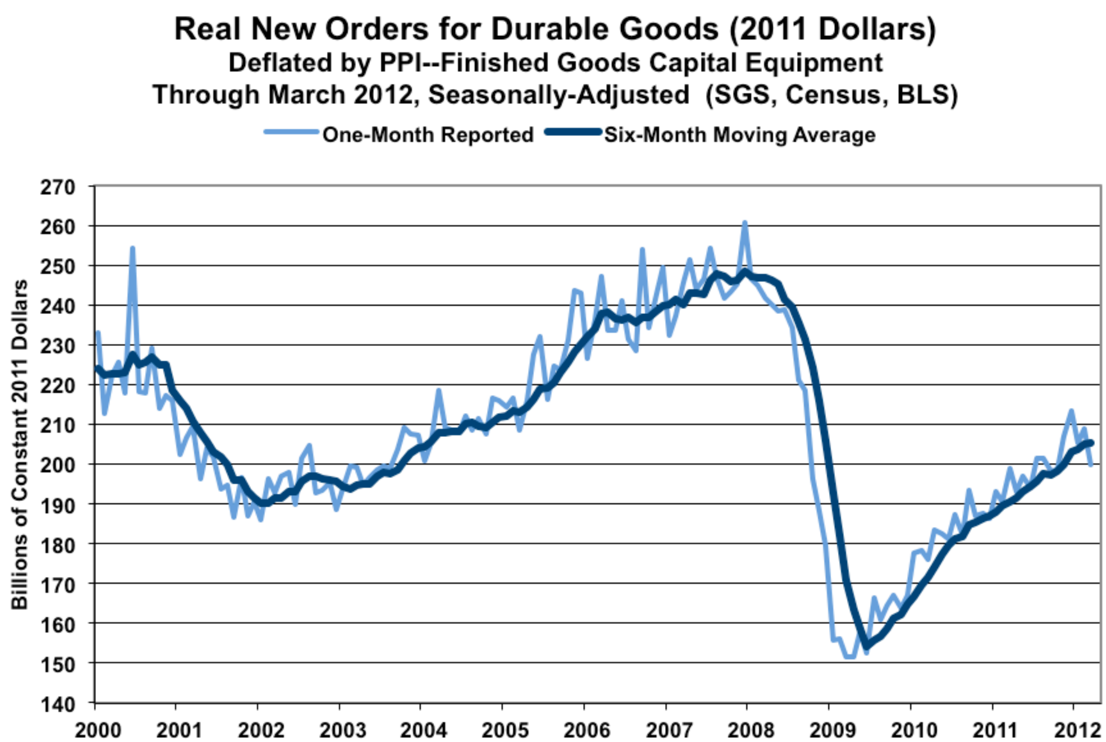
Best wishes to all — John Williams

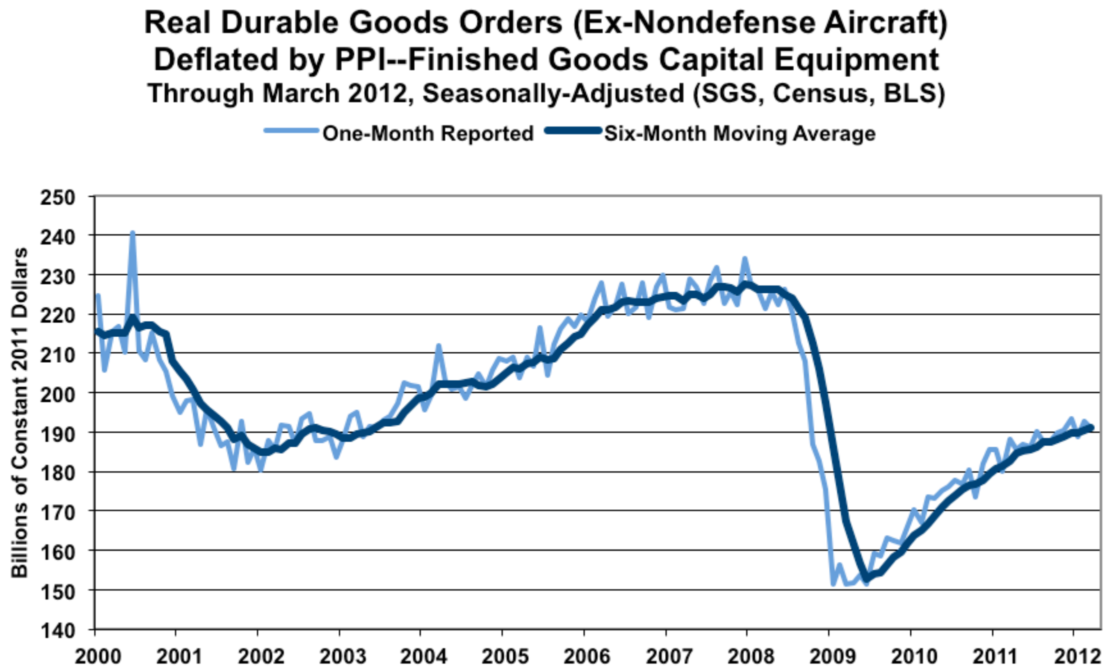
Opening Comments and Executive Summary. This *Commentary* updates new orders for durable goods and new home sales data in the context of recent *Special Commentaries* [*No. 426*] and [*No. 429*], on the economy and consumer liquidity. Developments in the SGS-Ongoing M3 Measure are discussed in the *Hyperinflation Watch* section. A broader review of economic conditions will be included with Friday's (April 27th) *Commentary* as part of the assessment of the "advance" estimate of first-quarter 2012 GDP.

New and Existing Home Sales. The 7.1% monthly decline in March new home sales and the 2.6% decline in March existing home sales were not meaningful, when considered against the highly volatile and poor-quality reporting of the two series. Both series continued their patterns of bottom-bouncing, following the plunge in activity that began in 2006 (see graphs in the *Home Sales* section). The post-plunge gyrations seen in existing home sales reflect various home-buyer tax incentives that had the effect of shifting sales into earlier months from later months.

New Orders for Durable Goods. The reported 4.2% monthly decline in March new orders for durable goods was due almost entirely to a sharp decline in the regularly volatile nondefense aircraft orders. Aircraft orders generally are placed years in advance of expected delivery, so they generally do not have immediate impact on near-term economic activity.

Total new orders and the orders net of nondefense aircraft are shown in the two graphs following. The series are adjusted for inflation and are shown smoothed with a six-month moving average, as well as with the reported monthly detail.





Both durable goods orders series remain sharply below levels seen going into the 2001 recession, as well as into the 2007 recession. There has been no recovery here. If the PPI finished goods capital equipment deflator were adjusted for distortions from hedonic adjustments, the uptrend in orders seen in the last three years likely would be flat, consistent with the bottom-bouncing of other series.

Hyperinflation Watch—M3 Slowing Further? March durable goods orders and new and existing home sales joined March payroll employment, housing starts and industrial production in disappointing consensus expectations. Again, as discussed in the prior *Commentary*, while the headline retail sales number was stronger than expected, the March monthly gain was statistically-insignificant, net of inflation effects. The economy has not recovered from its multi-year plunge in activity from 2006/2007 into late-2008/mid-2009. Reported economic gains largely have been illusions, tied to the effects of underestimated inflation. A much worse-than-expected underlying economic reality means much-worse-than-anticipated federal budget deficits, U.S. Treasury funding needs and banking-system solvency issues.

In the context of the updated economic background published in *Special Commentary No. 426* and *Special Commentary No. 429* on consumer liquidity, and with full consideration to other intervening economic, inflation and financial-market developments since the January 25, 2012 publication of the hyperinflation report, the broad economic, inflation and hyperinflation outlooks discussed in *Hyperinflation 2012* have not changed.

M3 Growth Continues to Slow. With less than two weeks of reporting in hand, early indications are for further slowing of the SGS-Ongoing M3 Measure. If current weekly reporting holds as is, April M3 would show a month-to-month contraction, with annual growth slowing to perhaps 2.9% from 3.7% in March. This, again, could be reflective of a renewed intensification of the systemic-solvency crisis.

As an aside, the latest money numbers reflect not only an annual benchmark revision to underlying data by the Fed, but also a large shift of funds from the reported M2 component of retail money funds to the memorandum item (and M3 component) institutional money funds. The shift appears to have been definitional, with revisions pushing back to before the Fed ceased M3 reporting in 2006.

REPORTING DETAIL

NEW ORDERS FOR DURABLE GOODS (March 2012)

Real Durable Goods Orders Remained Below Pre-2001 Recession Levels. The sharp monthly decline in March new orders for durable goods was within the scope of regular monthly volatility and was explained largely by declining nondefense aircraft orders. Historical graphs of the series, both aggregate and net of nondefense aircraft, are shown in the *Opening Comments and Executive Summary*. The data there are smoothed and adjusted for inflation.

As described in *Commentary No. 426*, there is no fully appropriate inflation measure available for deflation of the durable goods series. The one used here is the PPI's inflation measure for finished goods capital equipment, an official inflation measure. The problem with that measure is in the hedonic quality adjustments to prices, where nebulous "quality improvements," which cannot be measured directly and are not consistently applied to all products, are modeled in incredibly imprecise efforts by the government to reduce reported inflation versus real-world experience. The same issues are part of the methodological problems that significantly understate the CPI and the GDP implicit price deflator inflation measures.

In terms of smoothing, the graphs reflect a six-month moving average, as well as the raw monthly data. The detail also is graphed net of nondefense aircraft orders, a significant cause of month-to-month volatility in the series.

Official Reporting. The Census Bureau reported today, April 25th, that the regularly-volatile, seasonally-adjusted nominal (not adjusted for inflation) new orders for durable goods in March 2012 fell by 4.2% (down by 4.3% before prior-period revisions), after a revised 1.9% (previously 2.2%) gain in February. Net of the effects of plunging nondefense aircraft orders, orders were down by 0.6% for the month.

The irregular and highly volatile long-term nondefense aircraft orders fell by 47.6% in the month of March, following a revised 2.1% monthly decline (previously a 6.0% gain) in February. 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 annual benchmark revision is scheduled for release on May 18th and downside revisions to history of the series in the last couple of years are likely.

Unadjusted, year-to-year growth in total March 2012 new orders narrowed sharply to 1.0%, from a revised 18.9% (previously 17.7%) pace of annual growth in February.

The popularly followed nondefense capital goods orders also fell in March, down by 10.5% (down by 10.8% before prior-period revisions). Again, the bulk of the downturn was accounted for by the fall in aircraft orders. February orders here reflected a revised monthly gain of 1.0% (previously 1.5%).

For March 2012, the unadjusted year-to-year change in the series showed a 1.9% contraction, swinging into negative territory against a revised 26.2% (previously 23.7%) gain in February.

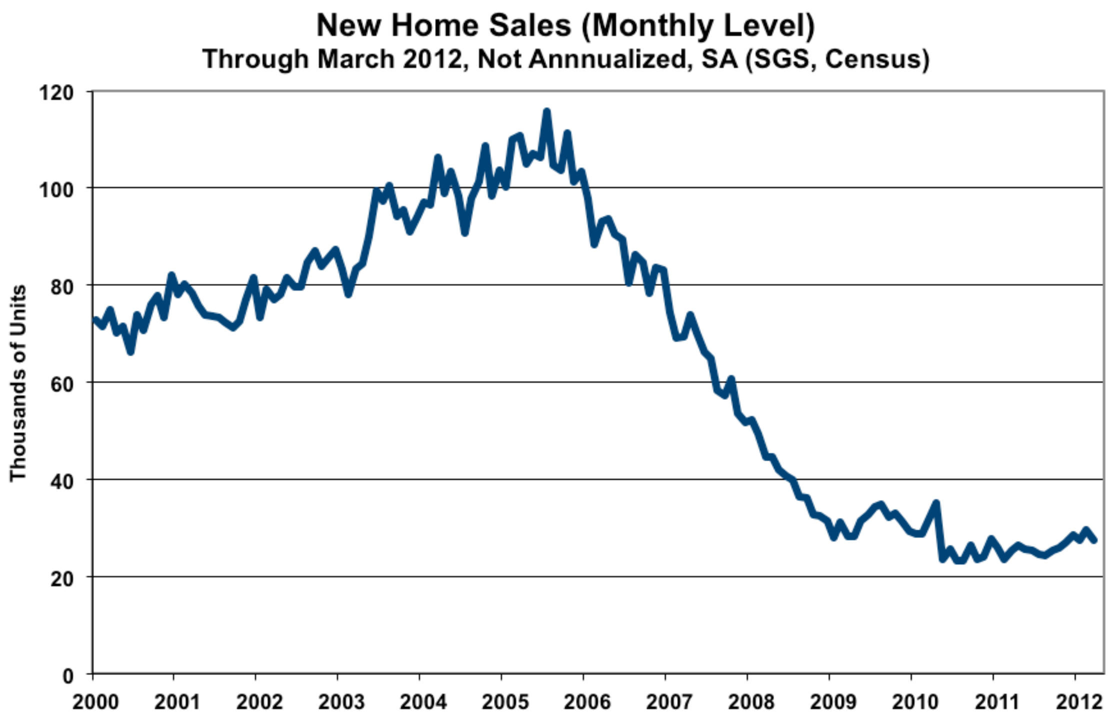
Inflation-Adjusted and Smoothed. The official 4.2% monthly contraction in March was a drop of 4.3% after inflation, and was a 0.1% gain after inflation for the six-month moving average, as of March. That was against the official February monthly gain of 1.9%, which was a gain of 1.8% after inflation, and a gain of 0.6% after inflation for the six-month moving average, as of February. These series have shown a slow uptrend in the last two-to-three years, but clearly no recovery as shown in the official GDP reporting. The real (inflation-adjusted) level of orders in March 2012 remained below the pre-2001 recession high and was 23.4% below the pre-2007 recession high.

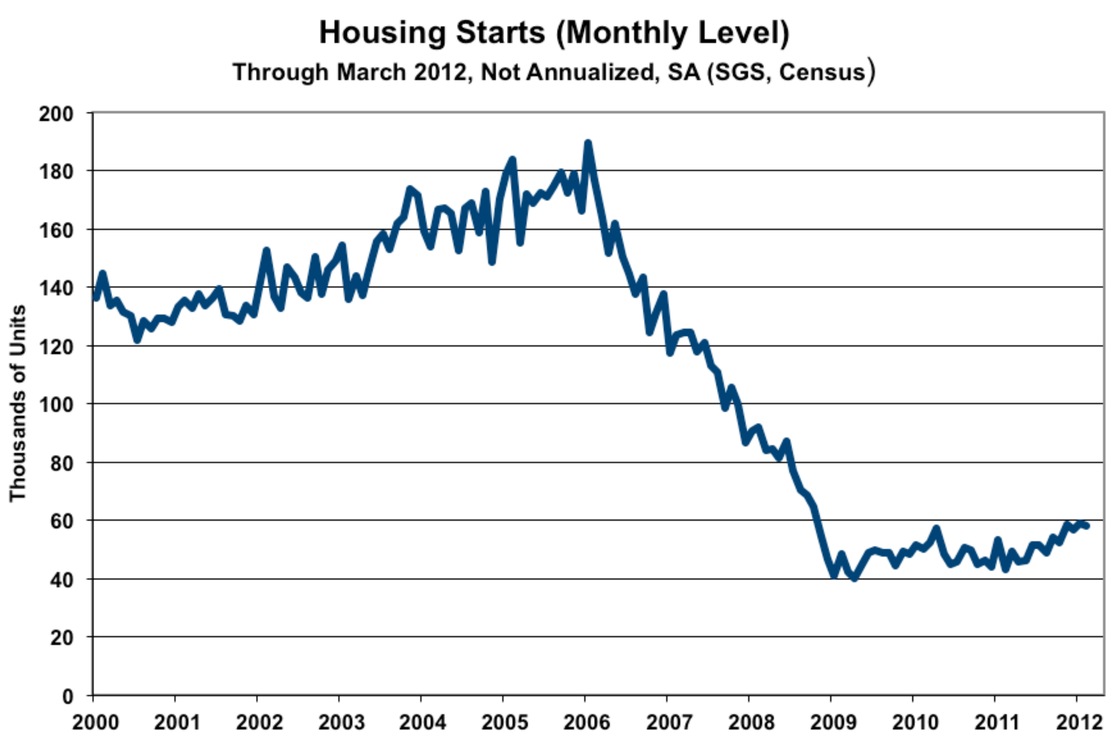
If the deflation measure here could be corrected meaningfully for its hedonic-adjusted understatement, the uptrend in real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity (see *Commentary No. 426*).

NEW AND EXISTING HOME SALES (March 2012)

Multi-Year Crash in New Homes Sales Showed No Signs of Relief. March 2012 new home sales continued in a state of depressed stagnation, in parallel with March housing starts, as shown in the following two graphs (see *Commentary No. 430* for housing starts reporting details). There remains no indication—in underlying fundamentals that drive the housing industry—of any pending industry turnaround or of a developing economic recovery.

Yesterday's (April 24th) release of March new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of volatile bottom-bouncing, with month-to-month changes far from being statistically significant. The March 2012 monthly contraction of 7.1% (a gain of 4.8% before prior-period revisions) +/- 24.2% (all confidence intervals are at the 95% level) was statistically insignificant. In turn, the February monthly change was revised to a gain of 7.3% (previously a decline of 1.6%). The year-to-year change in March 2012 new-home sales, a gain of 7.5% +/- 22.9%, also was statistically-insignificant. February's annual gain was revised to a 25.6% (previously 11.4%) increase. Recent volatility in annual change reflects partially the effects of lapsing housing stimulus efforts a year ago.

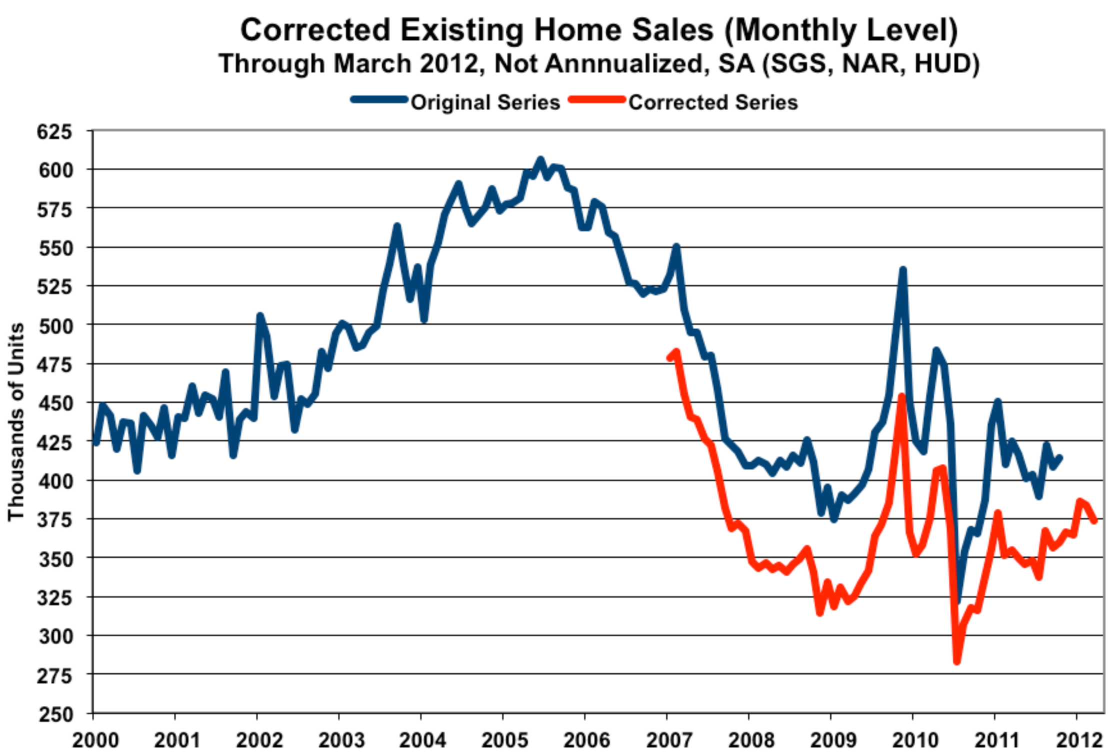

New Home Sales (Monthly Level)
Through March 2012, Not Annnualized, SA (SGS, Census)
Thousands of Units
0
20
40
60
80
100
120
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012


Housing Starts (Monthly Level)
Through March 2012, Not Annualized, SA (SGS, Census)
Thousands of Units
0
20
40
60
80
100
120
140
160
180
200
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

Existing-Home Sales Decline Also Was Within Normal Bounds of Volatility. As noted last month (*Commentary No. 425*), the recently corrected and revised existing-home sales series likely remains subject to significant seasonal-factor instabilities, as has been seen recently in a number of government series. Those seasonal-factor distortions are a result of the severe depth and length of the economic contraction, a circumstance that post-World War II (or modern) economic reporting never was designed to handle. Further, as shown in the accompanying graph, the old (pre-November 2011) and corrected series do not appear to be consistent or comparable. For those interested in the latest detail, however, we continue to look at the regular reporting of the new series, although a heavy caution is offered on the quality of what is being published.

The April 19th release of March 2012 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly drop of 2.6% (a decline of 2.4% before prior-period revisions). The NAR does not publish estimates of statistical significance for changes in its series. As revised, February showed a 0.6% monthly decline, which initially had been reported as a decline of 0.9%.

On a year-to-year basis, March 2012 sales rose by 5.2%, a somewhat slower pace than the revised 9.0% (previously 8.8%) annual gain reported in February. Distressed properties remained a significant portion of existing home sales activity. The NAR reported "distressed" sales in March at 29% (18% foreclosures, 11% short sales), down from 34% (20% foreclosures, 14% short sales) in February. While foreclosures also 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 remains sporadic. The political system would like to see the issues disappear until after the 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.

Gross Domestic Product—GDP (First-Quarter 2012, First or "Advance" Estimate). The Bureau of Economic Analysis (BEA) usually targets the consensus estimate, when making its initial guess at economic activity for a new quarter, as reflected in the GDP. The "advance" estimate of first-quarter 2012 GDP is due for release on Friday, April 27th, with the consensus outlook for headline-GDP growth climbing higher (annualized and inflation-adjusted) at 2.7% (MarketWatch.com). The early consensus was at 2.3%. All of that is down from the last fourth-quarter 2011 headline GDP growth of 3.0%.

Underlying economic reality would suggest a downside reporting surprise for this most worthless of government statistics. The actual estimate most certainly will not be statistically significant. Separately, the hard data—on which the estimate will be based—are so sparse that the BEA will not publish an initial guess at first-quarter gross domestic income (GDI) or gross national product (GNP) until next month.

Personal Consumption Expenditure (PCE) Deflator (March 2012). The initial guesstimate for the March PCE deflator is scheduled for release on Monday, April 30th. Once again, the Federal Reserve's newly targeted inflation measure likely will exceed the 2.0% annual growth target. As discussed previously, the current concept of an inflation target serves only as pabulum for the financial markets, not as a defining priority that drives Fed policy.

Retail Sales (Annual Benchmark Revision). Due for release on Monday, April 30th, the annual benchmark revision to retail sales likely will show weaker growth in recent years, particularly in 2010, the year for which new hard data will be available.

Construction Spending (March 2012). Due for release on Tuesday, May 1st, March construction spending likely will show ongoing patterns of bottom-bouncing at low levels of activity for the series, particularly after inflation-adjustment. Monthly changes should not be statistically significant.

Employment and Unemployment (April 2012). April labor data are due for release on Friday, May 4th. The early expectation for April payroll employment is a gain of 193,000, up from the initial reporting of a 120,000 gain in March, with the headline unemployment rate for April expected to hold at 8.2%, the same level as reported for March, per MarketWatch.com.

April data likely will disappoint expectations. Aside from ongoing underlying weakness in related economic fundamentals, these series also are due for further catch up from what appears to have been unusually positive spin given to the numbers in recent months by questionable seasonal factors.

