

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

**COMMENTARY NUMBER 460**  
**FOMC, June Construction, Disposable Income, PCE Deflator**

**August 1, 2012**

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**Fed Action Appears to Be on Hold for Systemic-Solvency Crisis**

**Construction Spending Still Bottom-Bouncing**

**Disposable Income Flattens Out**

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*PLEASE NOTE: The next regular Commentary is scheduled for Friday, August 3rd, covering the July report on employment and unemployment reporting, and an initial estimate of July M3.*

*Best wishes to all — John Williams*

**Opening Comments and Executive Summary.** The Federal Open Market Committee (FOMC) took no meaningful action today (August 1st) to stimulate the domestic economy. In reality, there is little the Fed can do to help the economy, but it uses the economic woes as cover for actions aimed at propping up the banking system. The next round of Fed “accommodation” likely will be forced soon by the deepening systemic-solvency crisis. Official economic activity already is weak enough to provide cover for any Fed actions, and that cover only will increase in the months ahead. At such time as the Fed does act, that likely will lead to a massive dollar-selling crisis, which will begin the process of a rapid upturn in domestic consumer inflation, as discussed in [\*Special Report No. 445\*](#) and [\*Hyperinflation 2012\*](#).

Generally, reporting of the last month or so has shown a rapidly slowing economy that is headed into an official “double-dip,” and economic reporting of the last several days held few surprises. June construction spending continued its pattern of stagnation at a low level of activity, with a statistically-insignificant monthly gain of 0.4%. Although annual growth was a statistically-significant 7.0%, both the monthly and annual changes largely could be accounted for by inflation.

The June PCE deflator held at 1.5% for the second month, despite the annual revisions. That was the third consecutive month that the Fed’s chosen inflation series held below the targeted 2.0%. The downside revisions to this series in 2010, and the upside revisions to 2011, accounted for the bulk of the respective counter movements seen in the real (inflation-adjusted) GDP revisions, as discussed in [Commentary No. 459](#).

The annual revisions to disposable income at the monthly level are discussed below. Recent releases of private economic surveys tend to suggest some employment weakness ahead.

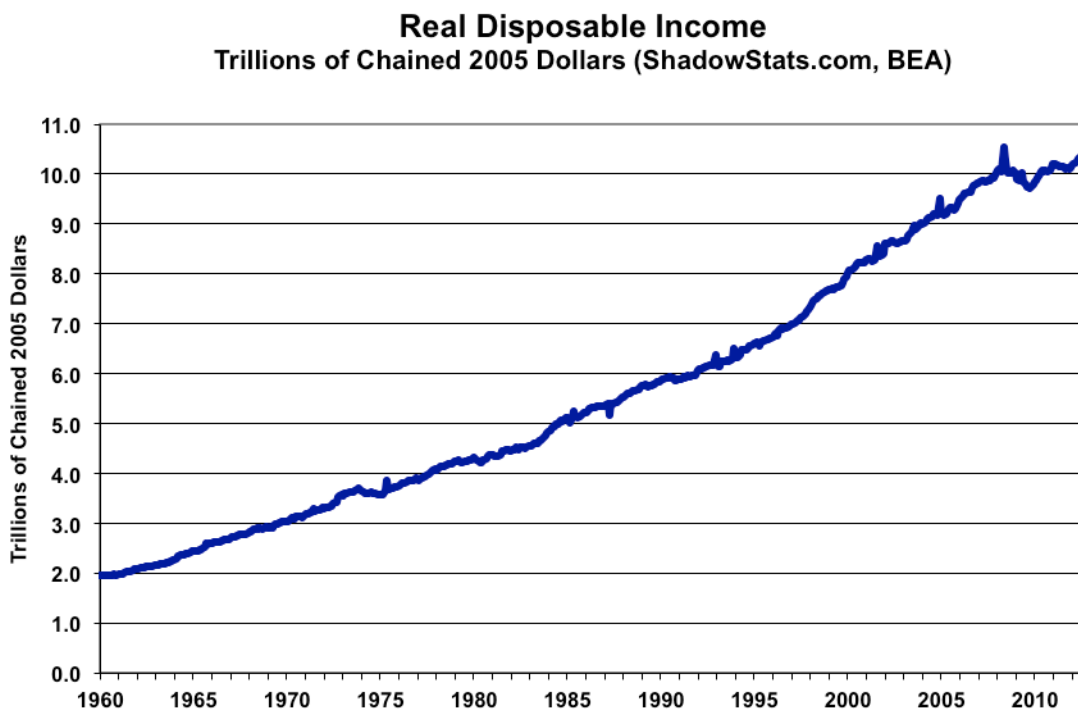
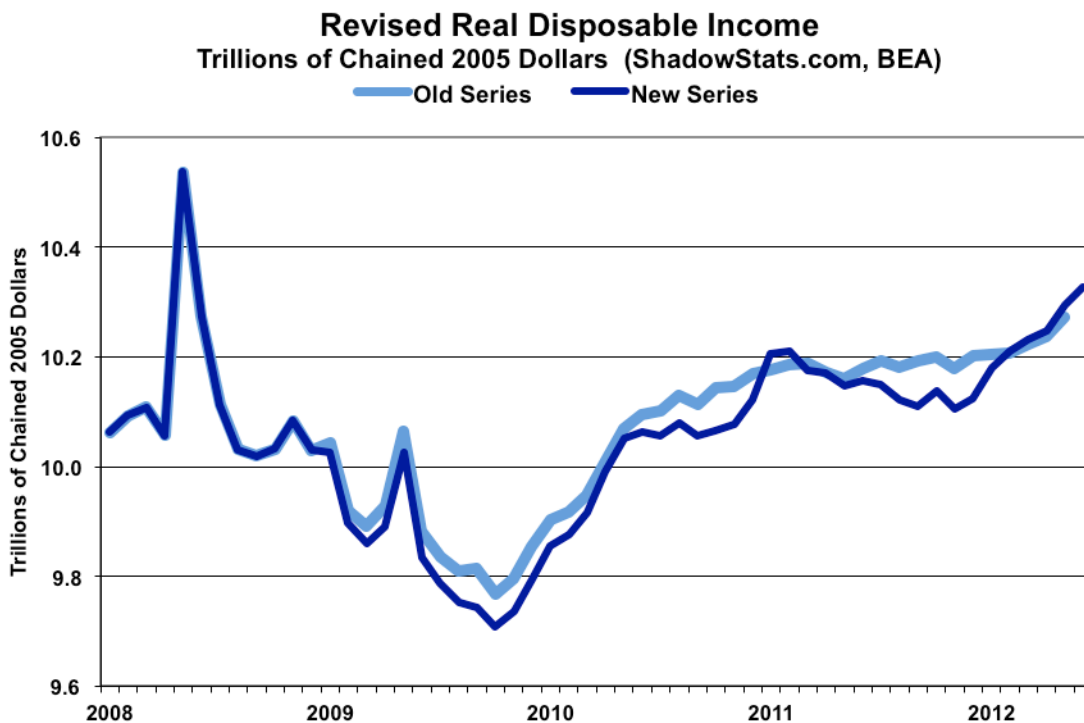
***Real Disposable Personal Income (DPI) and Annual Revisions to Monthly Data.*** The Bureau of Economic Analysis (BEA) released the monthly detail of its annual revisions to the national income accounts on July 31st. The graphs that follow in this section show the revisions to real (inflation-adjusted) disposable personal income (DPI), where revisions began with January 2009 (see [Commentary No. 459](#) for the quarterly detail and graphs of the DPI annual revisions).

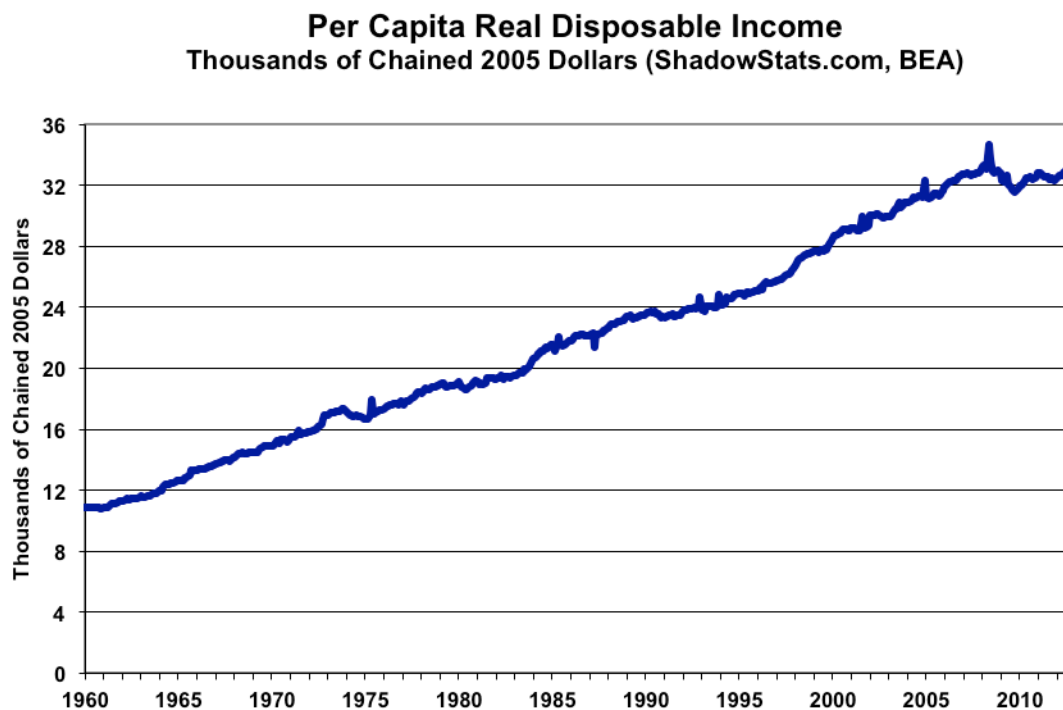
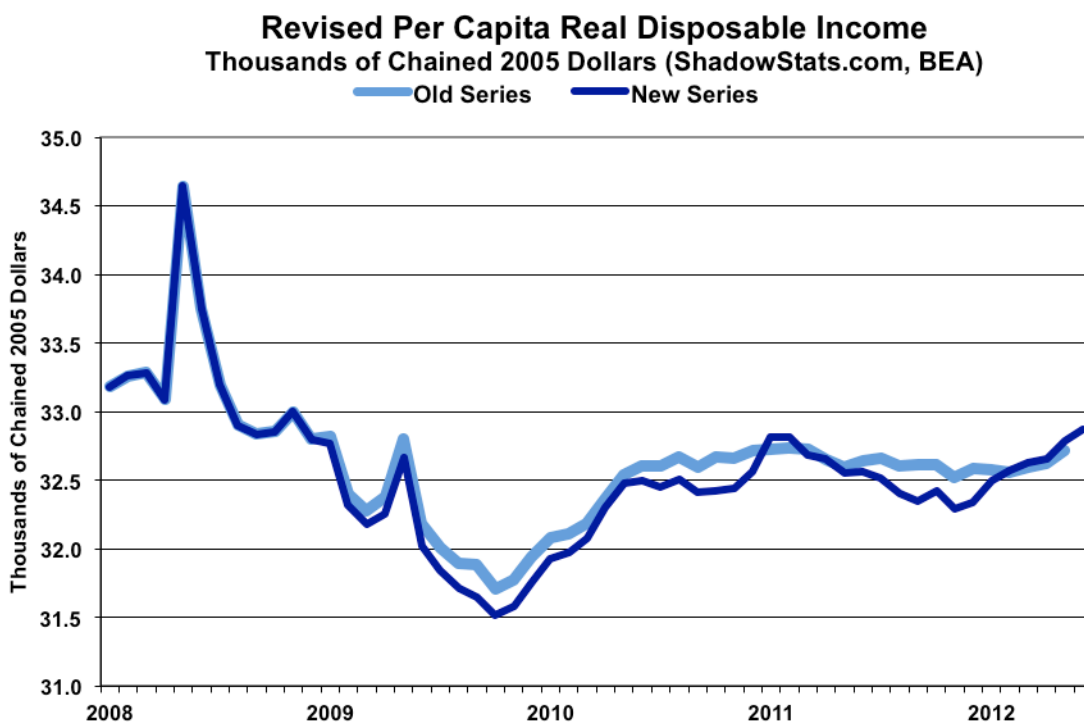
The government’s estimate of DPI—effectively take-home pay—is not particularly meaningful in terms of reflecting common experience, but it is an important factor in the construction of the government’s national income accounts, including gross domestic product (GDP). Outside of real-world considerations, the DPI includes significant earnings imputed by the government, such as the theoretical rents that homeowners pay themselves to live in their own homes, or the “interest income” that individuals are earning, in theory, when they are not charged fees on their checking accounts.

DPI also is deflated by the PCE deflator (see the *Reporting Detail* section), which understates inflation and overstates DPI growth. Real DPI will be examined in the next review of consumer liquidity, deflated using the CPI-U and the SGS-Alternate CPI measures. The difference is that the official 1.7% annual real growth in June DPI likely is closer to a five-percent contraction in terms of common experience

There are two series of graphs that follow, where the first reflects aggregate national DPI, and the second reflects DPI on a per capita basis. The first graph in each series shows the near-term detail, where general downside revisions have been seen in the earlier periods, where more-complete data now are available. The most recent reporting, based on heavy guesstimation, shows an upturn in DPI that is relatively minor and that likely will revise away as well.

The second graph in each series reflects the history since 1960, showing that the disruption to DPI in recent years is the most extreme in modern reporting. In both the DPI and per capita DPI series, present reporting shows levels have tended to flatten out, particularly on a per capita basis, as would be expected. Again, these series will be revisited shortly with more realistic deflation, which should show patterns of activity closer to the median real household income measure (see [Commentary No. 458](#)).





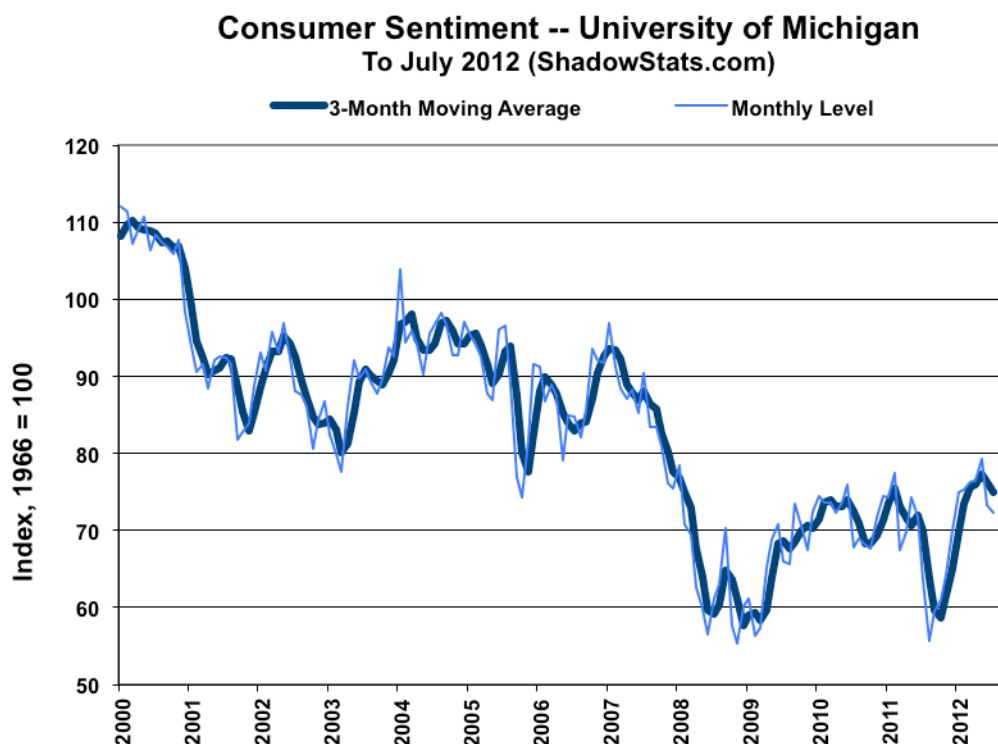
**Other Economic Releases.** There have been a number of private economic releases within the last week and today (August 1st).

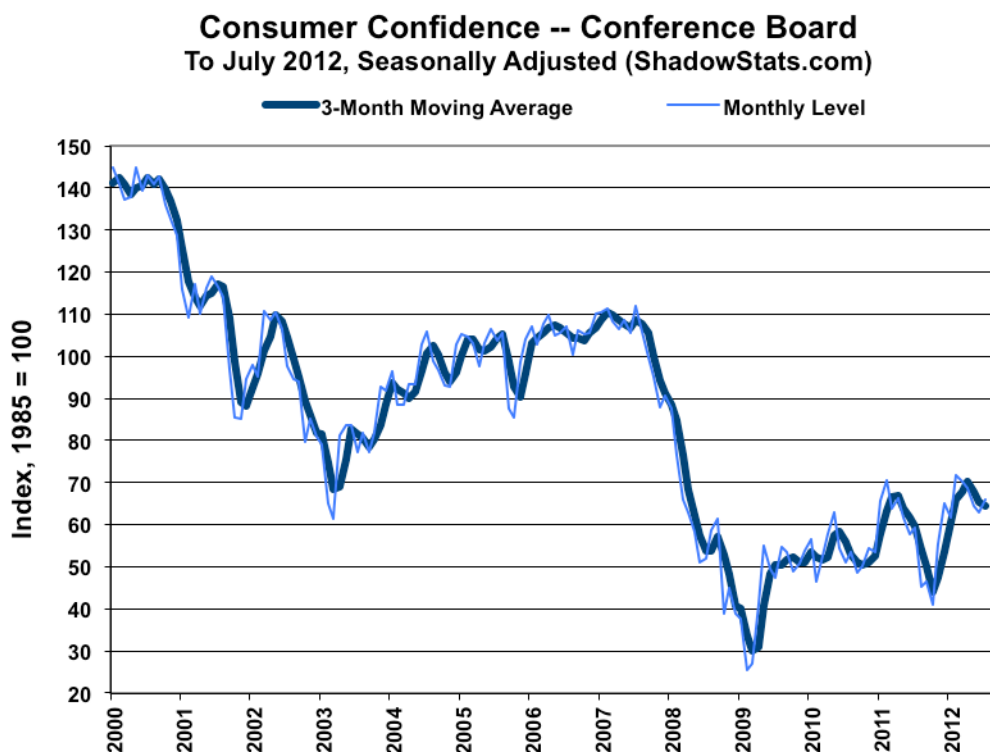
Employment Related. The Conference Board's July online help-wanted index (new advertising) showed a 7.3% month-to-month decline, following an 8.9% increase in June. That suggests some possible downside pressure on the July employment numbers.

The ISM's July purchasing managers (manufacturing) survey held at a contraction level, below 50.0, at 49.8 versus 49.7 in June. The employment index dropped to 52.0 in July from 56.6 in June. Normally, that would be a negative signal for July jobs, but this monthly series has been disrupted meaningfully in the last several years by seasonal-adjustment distortions, as discussed in [Hyperinflation 2012](#).

The ADP estimate on July private payrolls was out this morning (up by 163,000 for July versus a revised June gain of 172,000), but I have seen little relationship between the reporting there and what follows two days later with Bureau of Labor Statistics (BLS) estimates.

Consumer Confidence/Sentiment. The July estimates of the University of Michigan's consumer sentiment and the Conference Board's consumer confidence surveys were mixed in month-to-month direction, as shown in the accompanying graphs. The general outlook here has not changed. Both series are trending lower, and current reporting remains at levels that have been seen historically only at the depths of the worst recessions.





**Hyperinflation Watch—General Outlook Unchanged.** *General circumstances have not changed, with the detail discussed in [Special Report No. 445](#) (June 12th) having updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That Special Report supplemented [Hyperinflation 2012](#) (January 25th), which remains the primary Commentary detailing the hyperinflation story. With minor change to revision references and possible pending action by the Federal Reserve, the following text is the same as provided in the prior Commentary.*

Official GDP reporting shows plunging economic activity from fourth-quarter 2007 to second-quarter 2009, with an ensuing upturn in activity that led to a full recovery as of fourth-quarter 2011, and that “recovery” has continued through initial second-quarter 2012 reporting.

In contrast to GDP reporting—and in line with patterns seen in better-quality economic series—I still contend that the economy began turning down in 2006, plunging in 2008 into 2009 and subsequently stagnating—bottom-bouncing—at a low level of activity, ever since. There has been no recovery since mid-2009, and the economic downturn now is intensifying once again. The renewed slowdown is evident in the current reporting of nearly all major economic series. Not one of those series shows a pattern of activity that confirms the recovery evident in the GDP series.

As shown in [Commentary No. 459](#), the official recovery simply is a statistical illusion created by the government’s use of understated inflation in deflating the GDP, which has the result of overstating economic growth (see also [Special Report No. 445](#)).

The long-term fiscal solvency issues of the United States—where GAAP-based accounting shows annual deficits running in the \$5 trillion range—are not being addressed, and the politicians currently running the government lack the political will to address those issues. That circumstance initially suggested a hyperinflation crisis by the end of this decade, but federal government and Federal Reserve actions—in response to the systemic-solvency crisis of 2008—accelerated the process, indicating a hyperinflation problem by no later than the end of 2014. The continuing economic downturn is intensifying the fiscal- and systemic-solvency problems.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions. With the economy weak enough to provide cover for further Fed accommodation to the still-struggling banking system, the next easing by the Fed—and it should follow as needed to support the banking system—likely will lead to a massive dollar-selling crisis and that will begin the process of a rapid upturn in domestic consumer inflation.

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## REPORTING DETAIL

### CONSTRUCTION SPENDING (June 2012)

#### Construction Spending Kept Bottom-Bouncing in June.

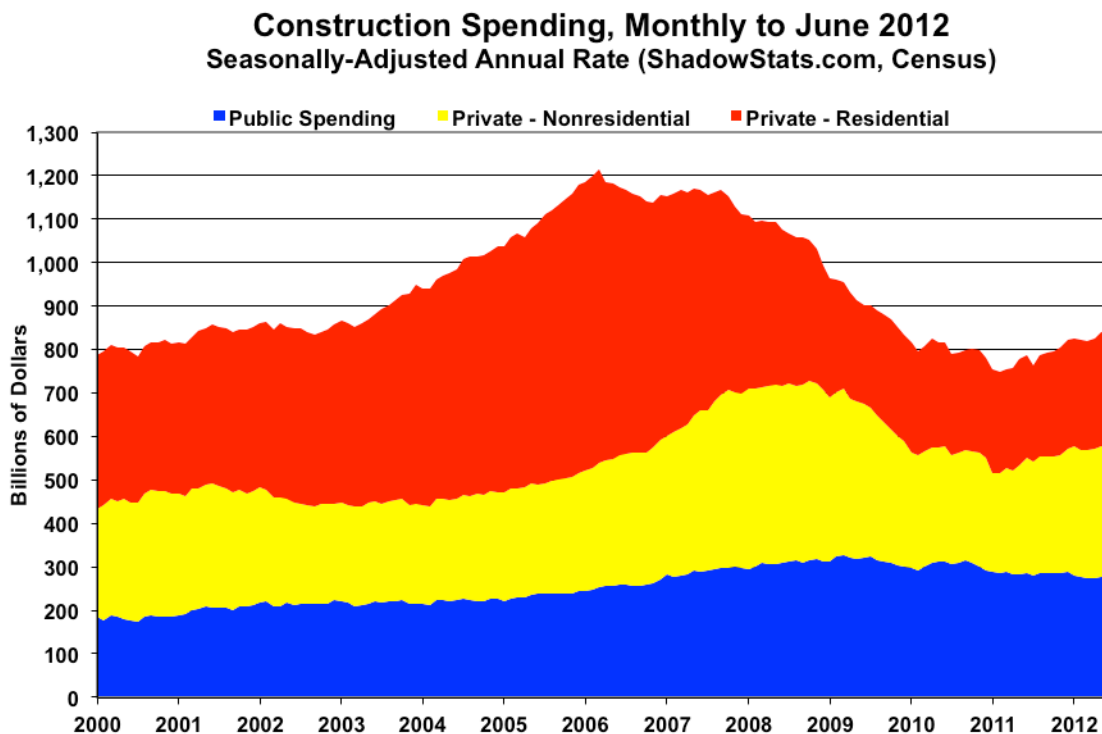
The trend of stagnation in construction activity at low levels of activity continued in July. The Census Bureau reported today, August 1st, that the total value of construction put in place in the United States during June 2012 was \$842.1 billion, on a seasonally-adjusted—but not inflation-adjusted—annual-rate basis. That estimate was up by a statistically-insignificant 0.4% +/- 2.1% (all confidence intervals are at a 95% level) from an upwardly \$838.3 billion (previously (\$830.0 billion) in May. As revised, the monthly gain for May was 1.6% (previously 0.9%).

Although total construction was up year-to-year by a statistically-significant 7.0% +/- 2.3% in June, the gain likely was more than covered by increases in construction costs. The Bureau of Economic Analysis (BEA) underestimates the year-to-year inflation in “structures” at 3.9% for second-quarter 2012. Year-to-year, May construction was up by a revised 8.1% (previously 7.0%).

The insignificant gain in monthly construction spending included an unchanged monthly level in public construction spending, which was revised to a 0.5% gain (previously a 0.4% contraction) in May,

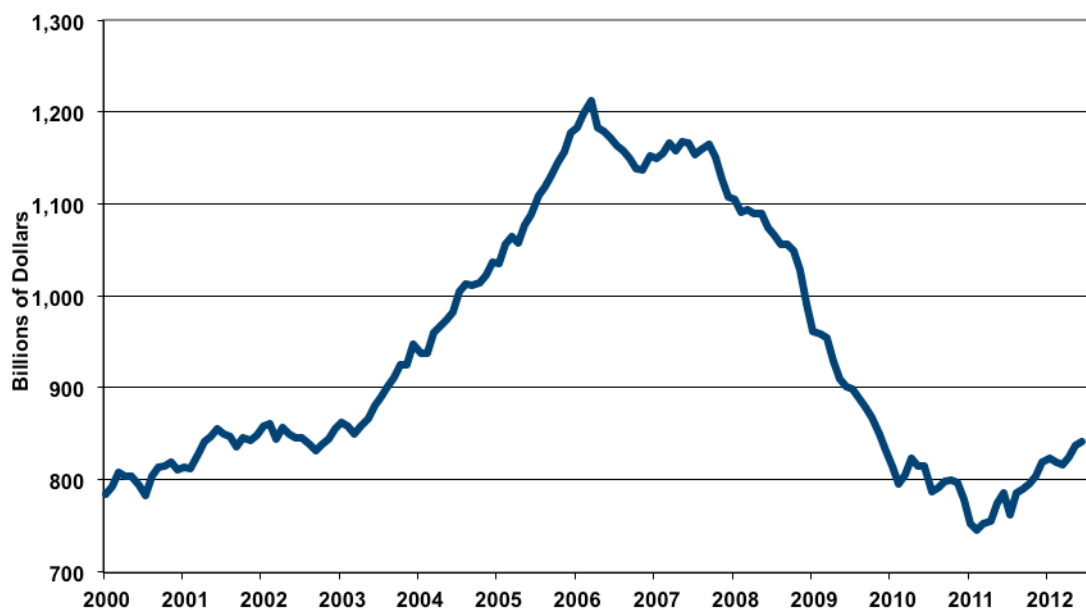
breaking a string of month-to-month declines. June private construction rose by 0.7% in the month, versus a revised monthly gain in May of 2.1% (previously 1.6%).

As reflected in the accompanying graphs, June total construction rose by 0.4% for the month, with private residential construction up by 1.3%, private nonresidential construction up by 0.1% and public construction unchanged for the month.

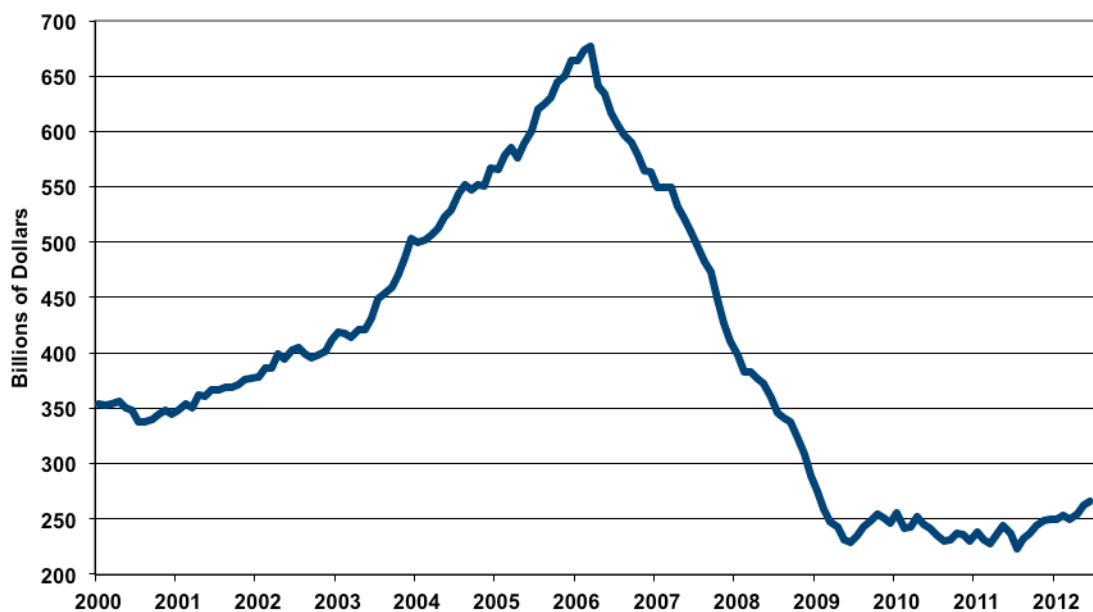




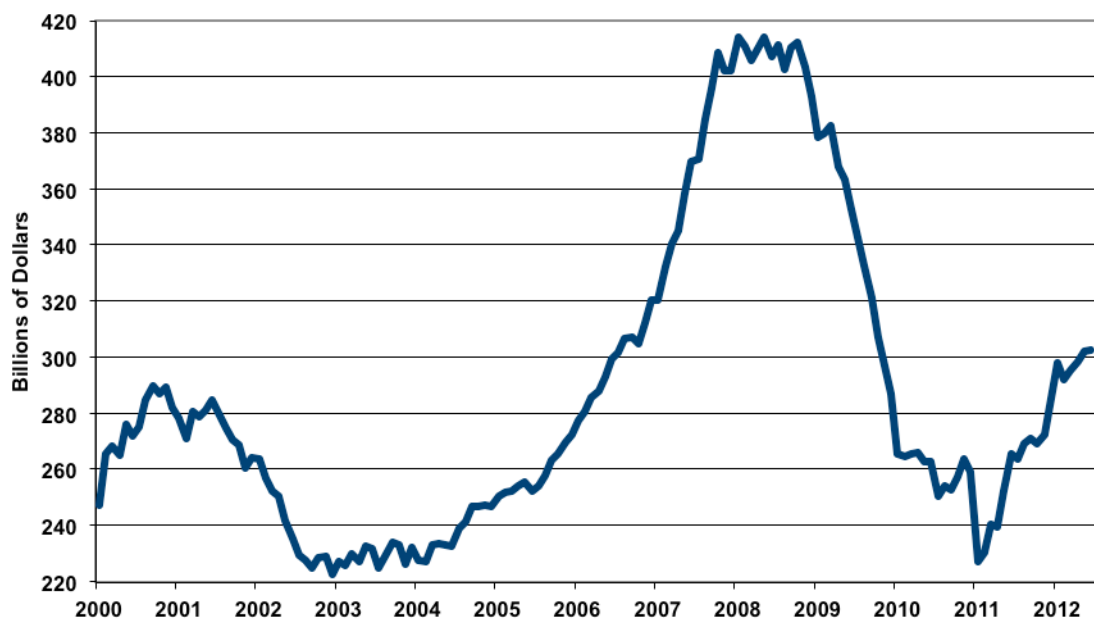
**Total Construction Spending, Monthly to June 2012**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)



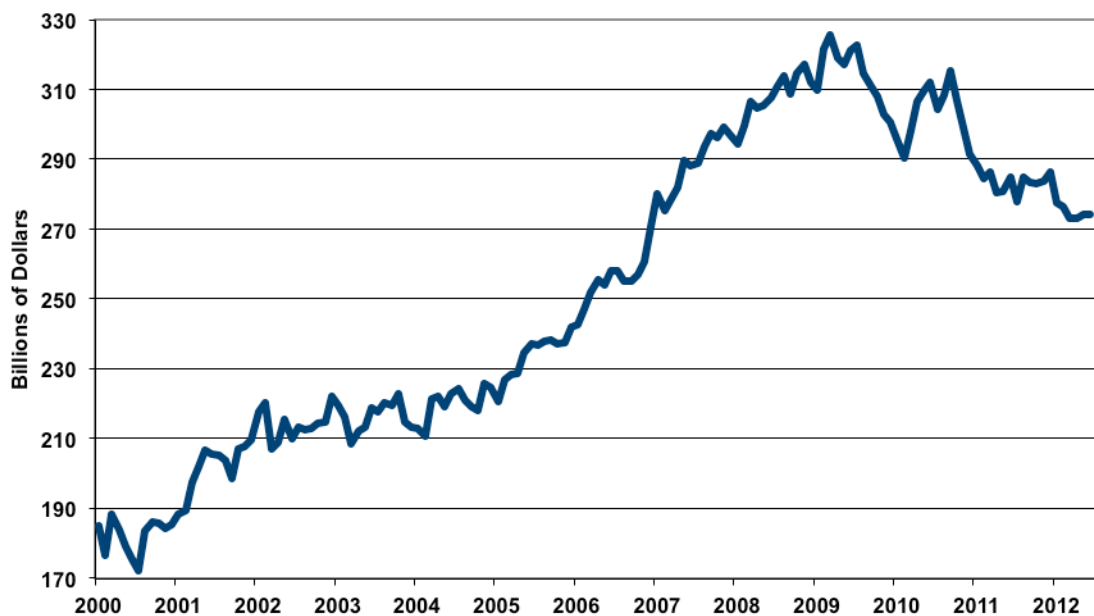
**Private Residential Construction to June 2012**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)

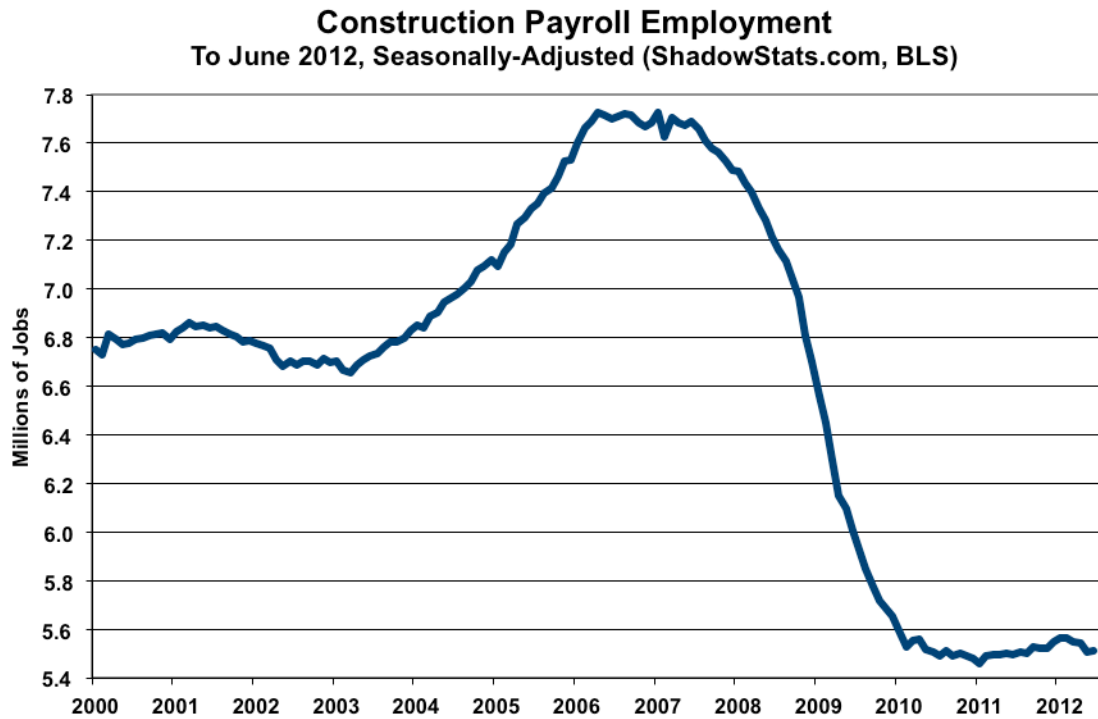


**Private Nonresidential Construction to June 2012**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)



**Public Construction, Monthly to June 2012**  
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)





As shown in the preceding graph, and in line with the ongoing bottom-bouncing reported through June 2012 in construction spending, seasonally-adjusted June construction employment was virtually flat. June construction jobs reportedly inched higher by 2,000 (down by 7,000 before prior period revisions) for the month, to a level of 5.509 million, from a revised 5.507 (previously 5.516) million in May, per the June payroll survey as published by the Bureau of Labor Statistics.

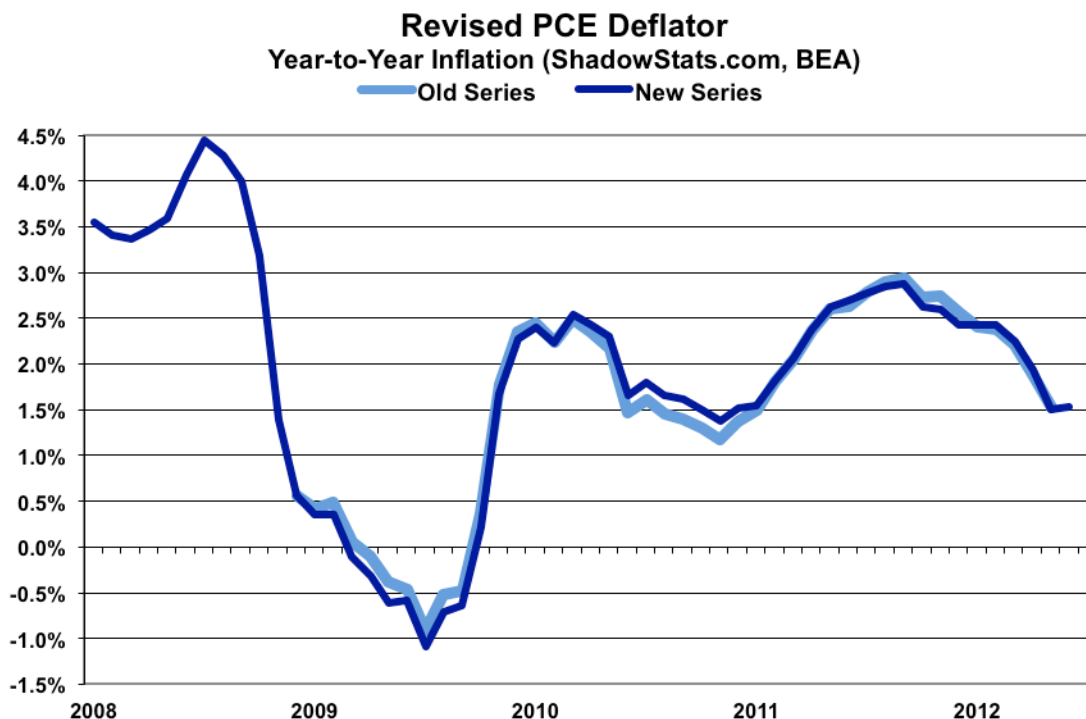
### PERSONAL CONSUMPTION EXPENDITURE (PCE) DEFLATOR (June 2012, and Benchmark)

**June PCE Deflator Rose by 0.1% for the Month, with Year-to-Year Inflation at 1.5%.** Published on July 31st, in the context of the annual revisions by the Bureau of Economic Analysis (BEA), the seasonally-adjusted June PCE deflator rose by 0.11% (virtually unchanged—up by 0.01%—before prior-period revisions), versus an unrevised 0.19% month-to-month decline in May.

Year-to-year PCE deflator growth basically held steady, at 1.52% in June, versus a revised 1.50% (was 1.52%) in May. Annual PCE inflation held below the Fed's 2.0% target for a third straight month. Nonetheless, below-target PCE inflation reporting should not become a protracted pattern here.

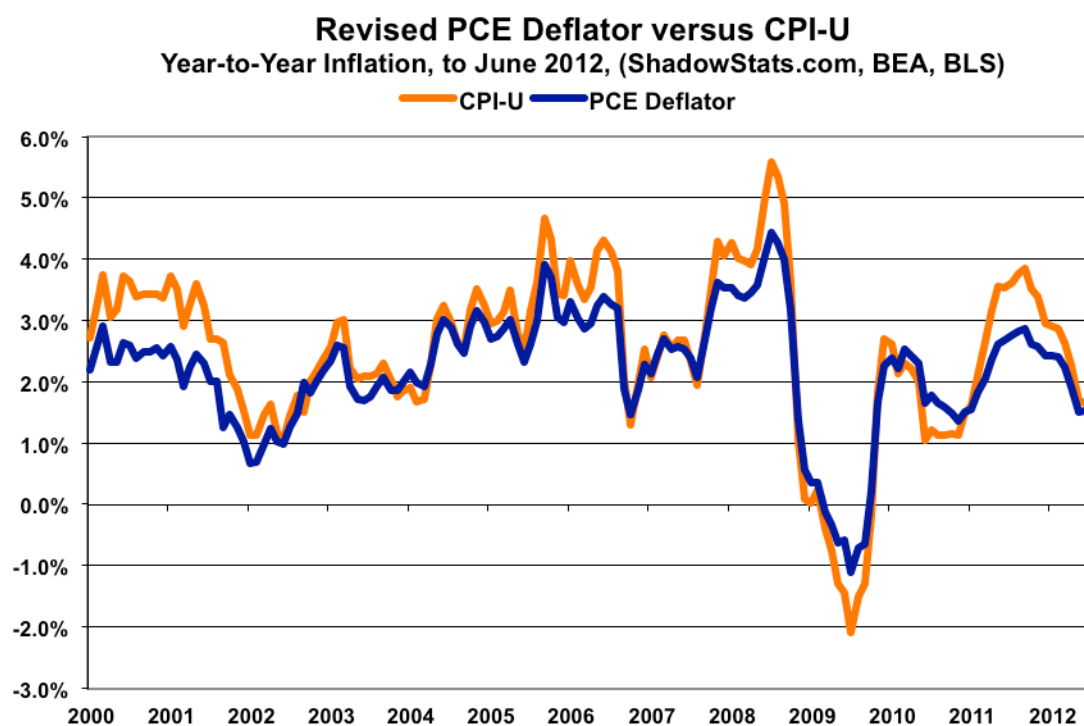
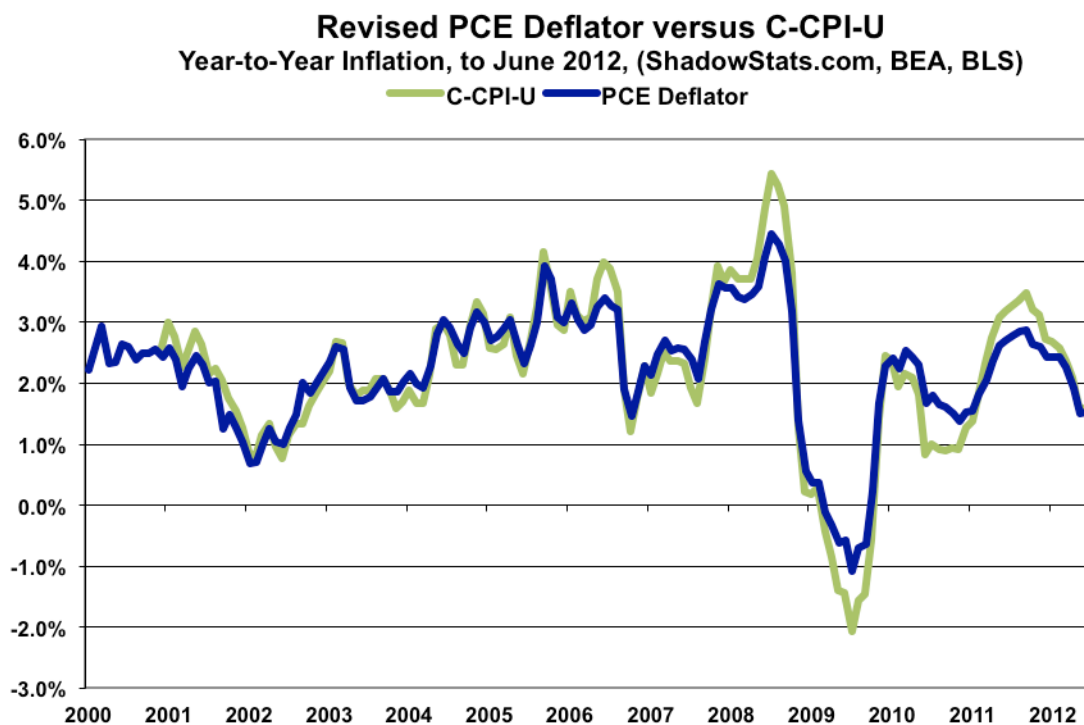
As discussed in [Commentary No. 459](#), year-to-year change in the second-quarter personal consumption expenditures (PCE) deflator was 1.65%, versus a revised 2.36% (previously 2.00%) in the first quarter.

**PCE Deflator Annual Revisions.** Shown in the following graph is the monthly detail of the revised year-to-year change in the PCE-deflator, where the period of revision was limited to January 2009 through May 2012. The downside revisions to inflation in 2009 and upside revisions in 2010 corresponded with the GDP's upside revisions in 2009 and downside revisions in 2010. As discussed in [Commentary No. 459](#), the lower the inflation rate that is used in deflating the GDP, the stronger is the resulting inflation-adjusted number and vice versa.



Following in the gimmicked reporting of its quarterly GDP parent series, the monthly PCE deflator can vary widely month-to-month and year-to-year, with prior-period revisions. The 2012 annual revisions changed year-to-year growth by at least 0.2 percentage point in 16 of the 41 months of revisions. How could this series (or the related C-CPI-U series) be used as a replacement for the CPI-U, where settled inflation-adjusted contracts likely would have to be resettled after each annual revision?

Unlike the CPI-U series—which never is revised on a not-seasonally-adjusted basis so that the reported year-to-year inflation always remains fixed—the PCE deflator always is seasonally adjusted. The PCE deflator is not even estimated on an unadjusted basis.



***PCE Deflator versus Other Inflation Measures.*** In theory the PCE deflator measure should be virtually identical to the chain-weighted-CPI (C-CPI-U) (see [Commentary No. 456](#) for details of the latest C-CPI-U and other inflation measures), and indeed it has been closing in on the C-CPI-U in recent reporting, as shown in the preceding graphs. The fully-revised June 2012 PCE deflator showed 1.5% year-to-year inflation, versus an unrevised 1.5% in May; such compared with annual inflation in the June C-CPI-U at 1.6%, versus 1.6% in May; June CPI-U at 1.7%, versus 1.7% in May; June CPI-W at 1.6%, versus 1.6% in May; and the June SGS-Alternate (1980-Base) at 9.3%, versus 9.3% in May.

This “inflation targeting” effort by the Federal Reserve primarily is window-dressing for those in the markets who think the Fed really would move to contain inflation at the cost of impairing already-fragile banking-system solvency. The Fed’s primary function remains keeping the banking system afloat, at any cost.

*NOTE: The PCE deflator 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 monthly series, which is a surrogate measure of consumer inflation—fully substitution and hedonic-based—currently is yielding the lowest annual consumer inflation rate of the major series (see the preceding graphs of the PCE deflator versus the CPI-U and the C-CPI-U. Unlike the more widely followed CPI-U measure, which never is revised and is published on a seasonally unadjusted-basis, the PCE deflator is heavily revised for many years following initial reporting, and it is available only on a heavily-massaged, seasonally-adjusted basis.*

***Week Ahead.*** Market recognition of an intensifying double-dip recession is taking a somewhat stronger hold, at the moment, while recognition of a mounting inflation threat remains sparse. 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 or to put a happy spin on the numbers; 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 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.*

***Employment and Unemployment (July 2012)—UPDATE.*** See the *Opening Comments and Executive Summary* for comments on recently released related series in *Other Economic Releases*. The rest of the text here is unchanged and stands as it was written in the prior *Commentary*.

July labor data are due for release by the Bureau of Labor Statistics (BLS) on Friday, August 3rd. As often is the case, the consensus jobs estimate appears to be settling around the trend estimate that comes out of the BLS seasonal-adjustment models. The payroll trend number for July is 108,000 as discussed in [Commentary No. 453](#).

Nonetheless, the July numbers, once again, should disappoint market expectations, given intensifying underlying weakness in related fundamentals. Payroll growth could be well below 100,000. While an upside tick in the actual U.3 unemployment rate—to 8.3%—is likely, the headline number could come in

anywhere. Inconsistent concurrent-seasonal-factor reporting makes reported month-to-month changes in the headline unemployment rate absolutely meaningless (see the unemployment concurrent-seasonal-factor discussion in [Commentary No. 453](#)).

Simply put, the headline July unemployment rate will be calculated in the context of a set of seasonal factors unique to July's reporting. That same calculation also will generate revised unemployment rates for June, and earlier, which would be consistent with the new July estimate. Still, the BLS will not publish the revised, consistent June number, so as "to avoid confusing data users."

As a result, that uniquely calculated July unemployment rate will be published and compared with the unrevised and June unemployment rate that was uniquely calculated and published one month ago. The headline July and June numbers put before the public will be inconsistent and, accordingly, not comparable.

This all is despite the BLS knowing what actually is the consistent June number. If used, the consistent number could affect the headline monthly change in the unemployment rate by several tenths of a percentage point, in either direction, versus what the mainstream media will be touting, and around which the financial markets will be gyrating nonsensically.

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