

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

**COMMENTARY NUMBER 478**  
**Third-Quarter GDP, Durable Goods, Home Sales**

**October 26, 2012**

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**Nonsense GDP Growth Was Statistically Insignificant**  
**Corrected for Misleading Deflation, GDP Shows No Recovery**  
**M3 Velocity Continued to Rise**  
**Durable Goods Orders Contracted Quarter-to-Quarter and Year-to-Year**  
**Home Sales Remained Stagnant at Low Levels of Activity**  
**Upcoming October Jobs Report**

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*PLEASE NOTE: A Special Commentary reviewing economic, inflation and systemic conditions will be published next week, planned for Monday, October 29th. It will incorporate the latest September-economic and third-quarter-GDP reporting, as well as detail on fiscal-2012 operations of the federal government and monetary activities of the Federal Reserve. Any change in the scheduled release will be posted in the schedule box on [www.ShadowStats.com](http://www.ShadowStats.com).*

*The next regular Commentary is scheduled for Friday, November 2nd, covering October employment and unemployment reporting, and September construction spending and the PCE deflator.*

*Best wishes to all — John Williams*

**Opening Comments and Executive Summary.** As could be anticipated, the headline 2.0% growth in third-quarter 2012 GDP was little more than statistical noise, and it was meaningless in terms of reflecting underlying economic reality. It did, however, come in a bit stronger than consensus estimates, and it will provide some political solace to the Administration, which had seen two quarters of slowing growth before today's (October 26th) report. The level of reported growth likely reflected careful data adjustment by the Bureau of Economic Analysis (BEA). The BEA standardly targets the consensus GDP estimate, when it lacks hard data, as is the case with the "advance" estimate. What has happened here, however, is not noticeably more distorted than usual for this most-worthless, most-highly-politicized and most-heavily-massaged of government economic estimates.

Consider that the real (inflation-adjusted) annualized 2.01% second-quarter growth estimate comes with a 95% confidence interval of +/- 3.5%. The estimated gain simply is not statistically-significant. As discussed and graphed later in this section, corrected for roughly two-percentage points of understated inflation used in deflating the GDP estimate, the quarterly GDP change would have been zero. Beyond the inflation issues, there were problems or unusual conditions tied to estimates of consumer spending, of government spending and of salaries and wages. This GDP estimate very likely will face significant downside revisions in the year ahead, perhaps ultimately showing a quarterly contraction.

Here are some details of the heavily massaged data. The reported 2.01% growth rate was accounted for by the following items, which total slightly more than the headline growth, thanks to rounding:

- ***Consumer Spending Contributed 1.42%.*** While a gain in third-quarter real retail sales suggested a pick up in consumer spending, somehow, quarterly contractions in retail sales (such as seen in second-quarter 2012) generally do not end up triggering consumption contractions in the GDP.  
Within personal consumption, durable goods accounted for a contribution of 0.63%, or nearly one-third of the total GDP growth rate, despite three consecutive quarter-to-quarter contractions in new orders for durable goods, and despite third-quarter 2012 durable goods orders turning negative year-to-year, as discussed separately.  
Within durable goods, consumption of motor vehicles contributed 0.18% of the total growth, despite a 0.47% negative contribution from motor-vehicle production. Where industrial production contracted in the third-quarter, inventories still rose, suggesting here some overstatement of automobile sales.
- ***Government Spending Contributed 0.71% to Growth.*** Defense spending accounted for 0.64% of the 2.01% GDP growth rate. National defense spending increased at an annualized pace of 13.06%, the fastest growth since second-quarter 2009, which was the official last quarter of the recession. Accounting and spending here are under the control of the Administration.
- ***Housing Contributed 0.33% to Growth.*** Third-quarter housing starts showed a quarterly pick up due largely to an aberrant spike in initial September 2012 reporting that has not been supported in other housing or related-financing detail (see *Home Sales* in the *Reporting Detail* Section).
- ***Inventories Subtracted 0.12% from Growth.*** This number was dominated by a 0.42% negative contribution from farm inventories (crop-related problems), versus a 0.30% positive contribution from nonfarm inventories. Automobile inventories built up largely due to slack auto sales, somehow did not get reflected fully in the consumer spending numbers.

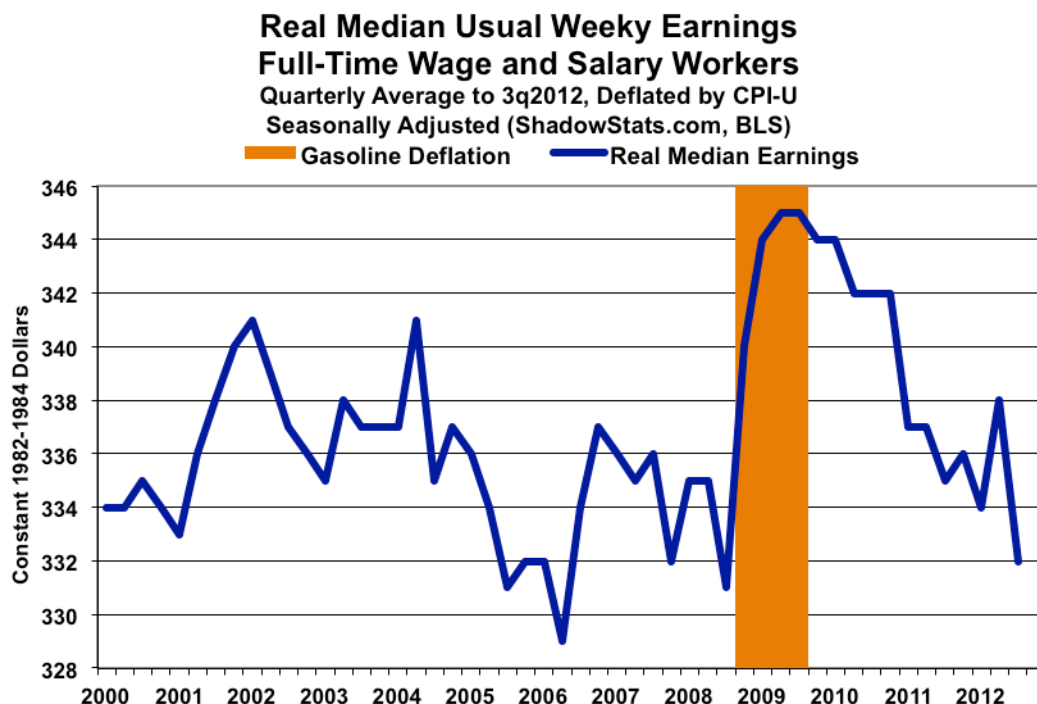
- **Business Investment Subtracted 0.13% from Growth.** Quarter-to-quarter contractions were seen in most categories.
- **Net Exports Subtracted 0.18% from Growth.** This generally was in line with the two months of data available for estimating the third-quarter trade deficit.

There also are some significant problems with income reporting, although the initial estimate of gross domestic income (GDI) will not be published until the next release on November 29th. GDI is the income-side equivalent of the consumption-side gross domestic product (GDP).

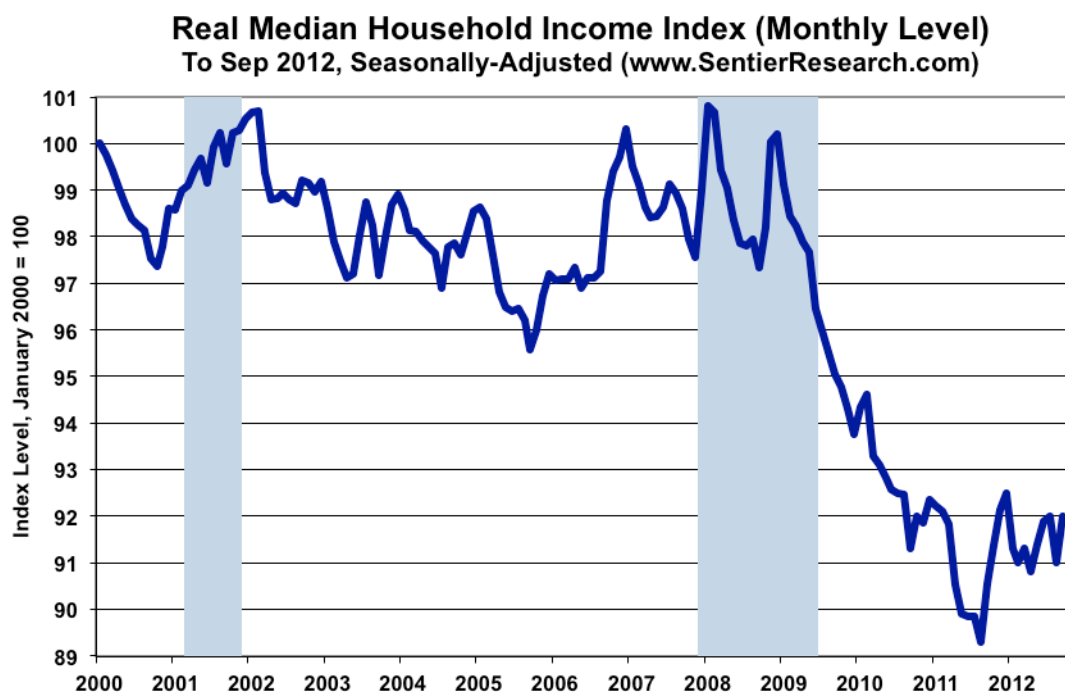
Nonetheless, certain income components of the GDI are published along with the “advance” estimate of GDP, and the third-quarter wage and salary estimates run counter to related reporting. Keep in mind that the BEA’s estimates of GDP and GDI largely are a judgmental compendium of other reporting, some out of the government and some out of the private sector.

At issue here is a purported 2.5% annualized nominal (not-adjusted-for-inflation) growth rate in third-quarter wages and salaries. The following graph shows the level of quarterly median usual weekly earnings of full-time wage and salary workers, adjusted for CPI-U inflation. On that basis, real earnings contracted at an annualized pace of 6.9% in third-quarter 2012. Removing the effects of inflation adjustment and allowing for an increase in the number of workers, earnings still contracted at an annualized pace of 3.9%.

While the median level is the middle measure—as opposed to an average or mean—the indications here certainly are suggestive of a quarterly contraction, not expansion, in both nominal and real wages and salaries, as well as in real disposable income. Overstated income estimates also would tend to be reflected in overstated estimates of growth in consumer-related GDP components.

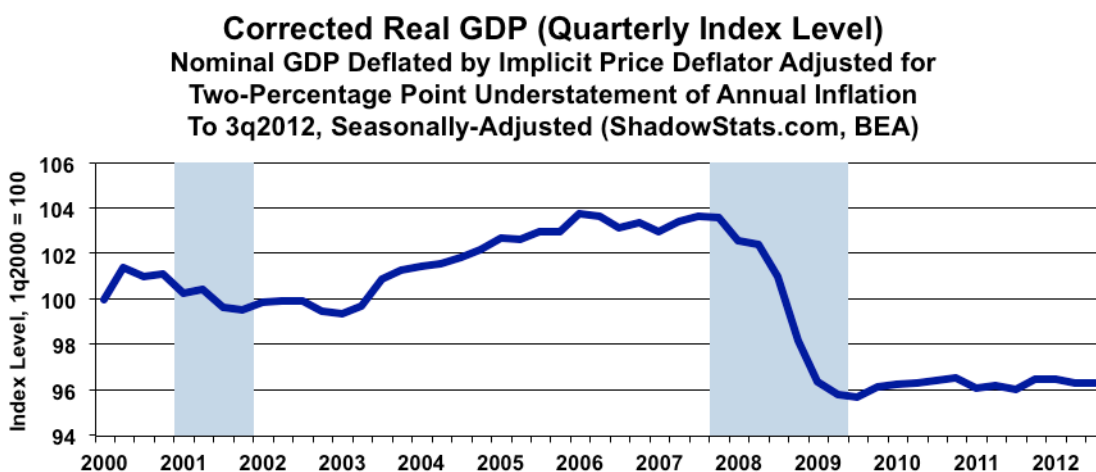
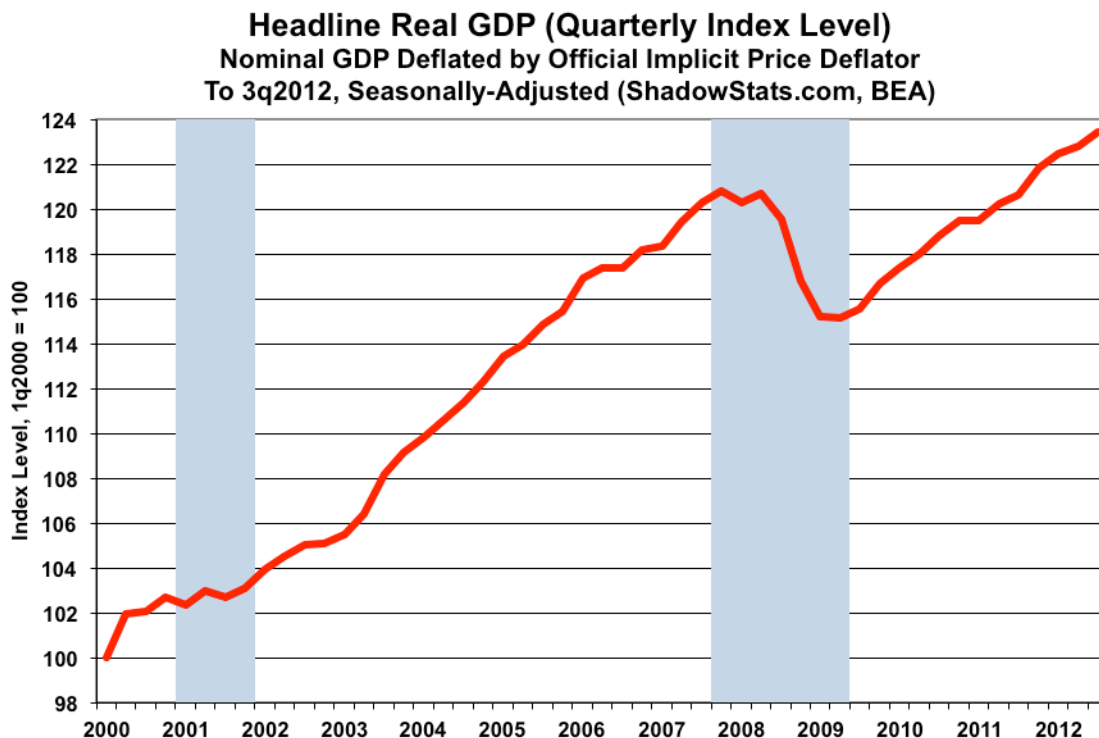


There is some similarity to the patterns in the preceding graph of median usual weekly earnings (on an individual basis) and the patterns shown in the following graph of the latest Sentier Research ([www.SentierResearch.com](http://www.SentierResearch.com)) estimates of real median household income. As seen in the preceding graph, real income can be spiked by low inflation, or deflation, as was the case in 2009 period of shallow CPI-U deflation that resulted from collapsing energy and gasoline prices. Use of either of SGS-Alternate Inflation Measures, however, would show higher inflation in that same period, with no outright deflation and with resulting weaker real income performance. Consumer liquidity remains structurally impaired, with consumer and household income unable to stay ahead of inflation, and with consumer debt unable to make up the difference. Consumer liquidity and inflation issues will be discussed in greater detail in the pending *Special Commentary*.



***Corrected Gross Domestic Product.*** The full economic recovery reported in the official real GDP is an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. As has become standard reporting in these *GDP Commentaries*, the following two graphs help to tell that story.

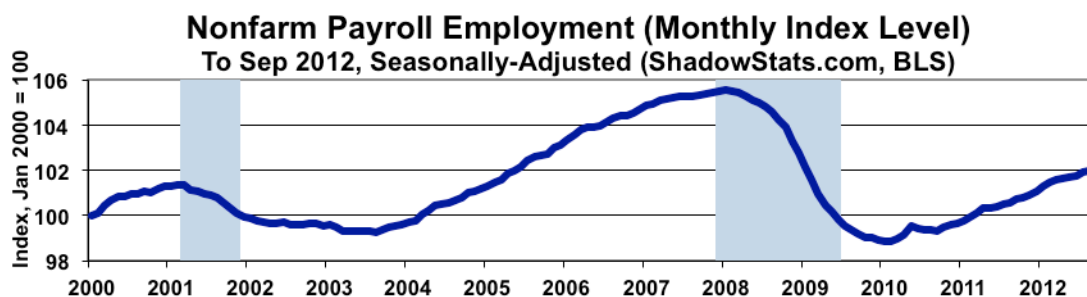
Shown in the first graph, the official level of real GDP activity has been reported at above pre-2007 recession levels—in full recovery—since fourth-quarter 2011. As previously discussed, no other major economic series has shown a parallel pattern of full economic recovery. Either GDP reporting is wrong, or all other major economic series are wrong. While the GDP is heavily modeled, imputed, theorized and gimmicked, it also encompasses reporting from those various major economic series and private surveys, which attempt to survey real-world activity. Flaws in the GDP inflation methodologies have created the “recovery.”



The second graph shows the GDP corrected for the understatement inherent in official inflation estimates. It plots the GDP with the deflation by the implicit price deflator (IPD) corrected for understatement of roughly two-percentage points of annual inflation in the IPD. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in [Hyperinflation 2012](#), [Special Report No. 445](#) and [Public Comment on Inflation](#).

Both graphs are indexed to first-quarter 2000 = 100, with the plots to consistent scales, as is the case for following graph of payroll employment. Employment patterns remain more consistent with the corrected

GDP series than with the headline GDP series. Among other features, the payroll employment and corrected GDP series both still reflect the 2001 recession (and its unofficial duration into 2003). The 2001 recession, however, simply has disappeared from the headline series, thanks to distortions from poor-quality inflation adjustments.



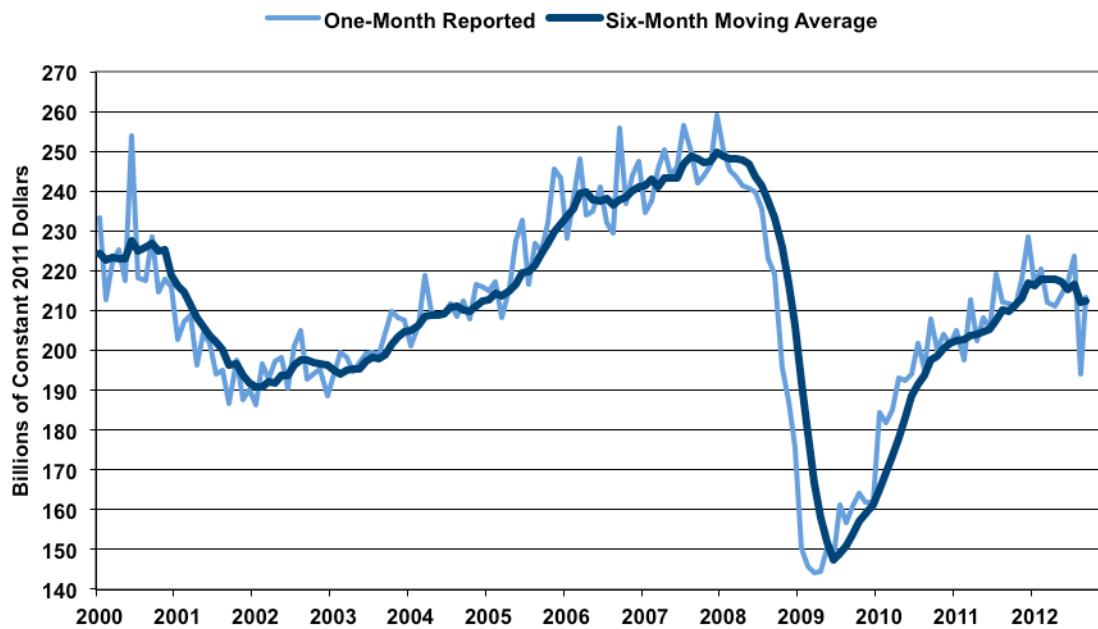
Again, as will be discussed in the *Special Commentary*, when good-quality current economic reporting is not available—as is the present circumstance—consideration of the underlying fundamentals is of some value. If the underlying fundamentals are not improving (as shown in the earlier graphs on real median earnings and household income), it is likely that the broad economy also is not improving.

**New Orders for Durable Goods.** Contrary to the results of today’s third-quarter GDP estimate, new orders for durable goods have been declining. They fell at an annualized quarterly pace of 5.1% (6.9% after PPI finished capital goods deflation) in third-quarter 2012, which was the third consecutive quarter-to-quarter contraction for this series. Orders lead both consumption and production activity. Further, in September 2012, both nominal and real (unadjusted- and adjusted-for-inflation) not-seasonally-adjusted aggregate orders fell year-to-year for the second-straight month, with third-quarter 2012 new orders down from the year before.

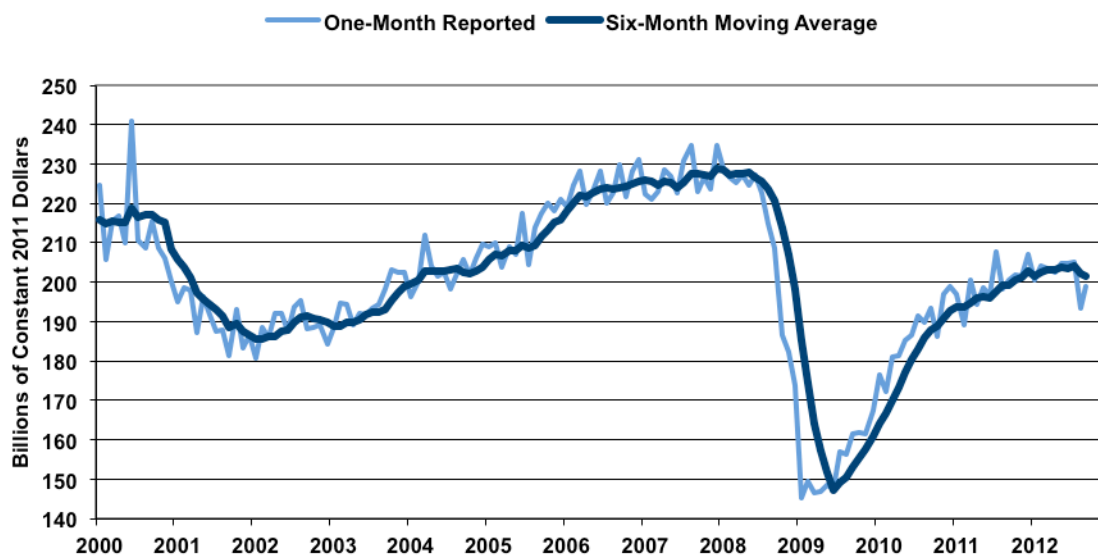
Still, aggregate September orders jumped by 9.9% for the month, the bulk of which was accounted for by a 2,640.7% surge in commercial aircraft orders. The remainder of September’s new orders, however, remained below the levels seen in July 2012, with major sectors such as motor vehicles and computers showing the second-straight monthly decline in orders. The difference in terms of economic implications is that aircraft orders usually are booked years in advance, affecting more the longer-range economic outlook, while automobile and computer orders tend to affect more the outlook for near-term production and economic activity.

The pattern of decline developing in new orders is one that usually precedes or indicates a recession, as suggested in the following historical graphs of the real (inflation-adjusted) series, both aggregate and net of nondefense aircraft. The data here are smoothed and adjusted for inflation. The level of real new orders in September 2012 for the two shown series remained below the both the pre-2001 and pre-2007 recession highs for the series.

**Real New Orders for Durable Goods**  
Deflated by PPI--Finished Goods Capital Equipment  
To Sep 2012, Seasonally-Adjusted (ShadowStats.com, Census, BLS)



**Real Durable Goods Orders (Ex-Nondefense Aircraft)**  
Deflated by PPI--Finished Goods Capital Equipment  
To Sep 2012, Seasonally-Adjusted (ShadowStats.com, Census, BLS)



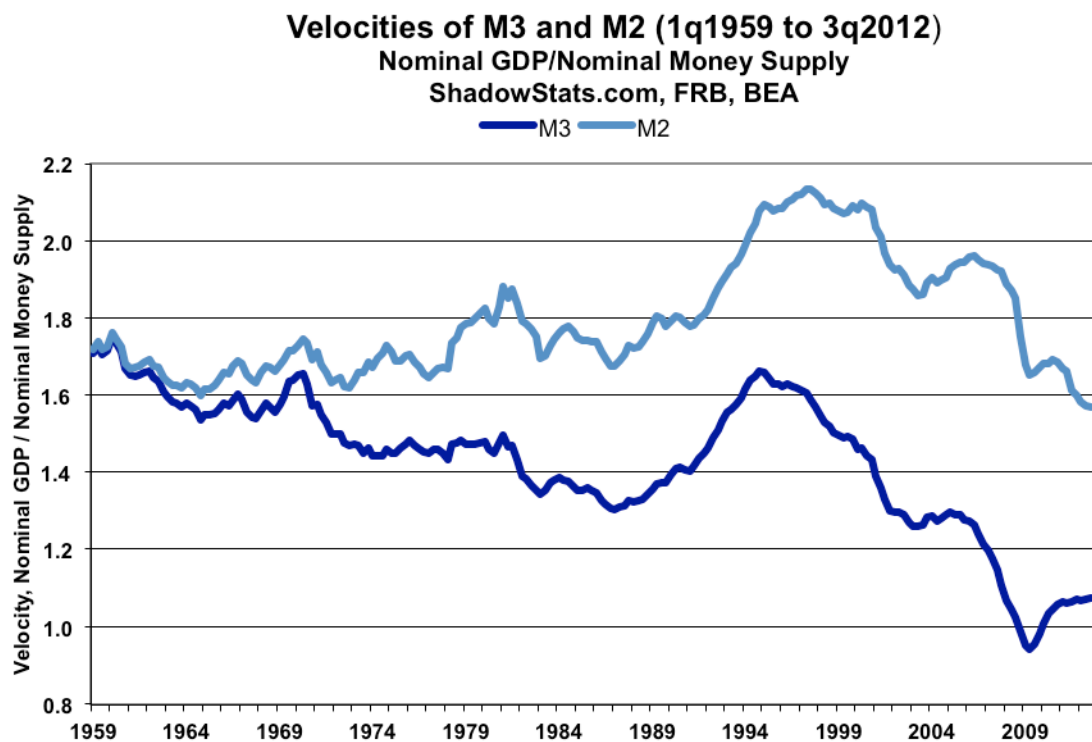


If the deflation measure here (PPI finished capital goods) were corrected meaningfully for hedonic-adjusted understatement of inflation, the post-2009 uptrend in real orders likely would be little more than a flat line, reflecting ongoing bottom-bouncing along a low-level plateau of economic activity, with the most recent reporting turning increasingly negative.

***[More complete information on third-quarter GDP reporting, September new orders for durable goods and home sales is found in the Reporting Detail section. The outlook for the upcoming report on October employment and unemployment is covered in the Week Ahead section.]***

**Hyperinflation Watch—Updated Money Velocity Numbers.** Incorporating today's nominal data on third-quarter GDP, as well as recent regular revisions to underlying money data published by the Federal Reserve, updated estimates of money velocity for money supply M2 and M3 are graphed below. Velocity continues to fall for M2, but M3 velocity has been rising for the last three years.

As a separate issue, the broad outlook on the economy and financial system has not changed, but it will be updated fully in the pending *Special Commentary*.



***M3 Velocity Continues to Rise.*** Subscribers frequently ask for specifics on the velocity of money, with the result that this section has become a standard feature for *Commentaries* covering the first GDP



reporting of a quarter. The nature of velocity is discussed in some detail in the 2008 [Money Supply Special Report](#). Velocity simply is the number of times the money supply turns over in the economy in a given year, or the ratio in nominal terms (not adjusted for inflation) of GDP to the money supply. At present, the velocity of M2 is falling, but the velocity of M3 (using the SGS Ongoing-M3 Measure) is rising, as shown in the accompanying graph.

Velocity has theoretical significance, where, in combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is ratio of two numbers that are not particularly well or realistically measured, I do not put much weight in its actual estimate. As an inflation predictor, it has to be viewed in the context of accompanying money-supply growth.

M3 velocity hit its near-term peak in first-quarter 2005, bottomed in second-quarter 2009 and generally has been flat or rising since. M2 velocity hit its near-term peak in second-quarter 2006, and—other than for a brief bump—it has been declining since.

M3 and M2 currently are showing opposite patterns, because growth in M3 has been much weaker than growth in M2. The reason behind the difference largely is that much of the relatively stronger M2 growth has reflected cash moving out of M3 categories—such as large time deposits and institutional money funds—into M2 or M1 accounts. M3 contains M2, and M2 contains M1. The effect of the funds shift has no impact on M3, but it spikes M2 growth. The clarity of what is happening here is why I like to follow the broadest money measure available. Again, full definitions can be found in the [Money Supply Special Report](#), which I expect to update in the months ahead, as to data used; the principles are unchanged.

***Economic, Systemic and Inflation Outlooks to to Be Updated in Pending Special Commentary.*** The following summary of the broad outlook has not changed since the prior *Commentary*, but it is included here for those who may not be familiar with it, including new subscribers. The nature and implications of QE3—announced recently by the FOMC of the Federal Reserve Board—were discussed in the *Opening Comments* of [Commentary No. 470](#). Specifically, while general circumstances have continued to advance towards the ultimate demise of the dollar, the general outlook is unchanged. While QE3 is an enabling action for the onset of massive inflation, the outside timing of 2014 for the ShadowStats.com hyperinflation forecast remains in place. The hyperinflation outlook will be reviewed and updated fully in the *Special Commentary* scheduled for Monday, October 29th.

*The detail in [Special Commentary No. 445](#) (June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That Special Commentary supplemented [Hyperinflation 2012](#) (January 25th), which remains the primary missive detailing the hyperinflation story. Those reports are suggested as background reading for new subscribers.*

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

In contrast to the GDP reporting—and in line with patterns seen in better-quality economic series—I 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 full recovery shown in the GDP series.

Federal Reserve Chairman Ben Bernanke has observed that broad aggregate measures of the U.S. economy, such as GDP, do not appear to be reflecting the common experience of the general public. Indeed, common experience suggests that the economy has not recovered. The official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP, which overstates deflated economic growth, as discussed in [Commentary No. 467](#), [Special Commentary No. 445](#), and [Public Comment on Inflation](#).

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, suggesting a hyperinflation problem by no later than the end of 2014. The continuing economic downturn is intensifying the fiscal- and systemic-solvency problems, and public awareness of this should grow rapidly in the months ahead.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions, and the most recent readings on income variance suggest that the worst is yet to be seen, as discussed in [Commentary No. 469](#).

With the economy weak enough to provide political cover for further Federal Reserve accommodation to the still-struggling banking system, QE3 was introduced on September 13th. That action effectively provided for open-ended monetization of U.S. Treasury debt at the Fed's discretion. The mechanism for eventual full debasement of the dollar now is in place, and it likely will come into full play, as needed to support the banking system and as needed to assure “successful” auctions of Treasury debt.

QE3 likely will lead to a massive dollar-selling crisis, and that will begin the process of a rapid upturn in domestic consumer inflation. A near-term dollar-selling crisis is now of a much greater risk, post-QE3. Separately, though, a dollar-selling crisis could begin at any time, triggered by various economic, sovereign-solvency or political issues. With the guidelines set for QE3, even negative employment reports could trigger massive dollar selling.

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## REPORTING DETAIL

### GROSS DOMESTIC PRODUCT—GDP (Third-Quarter 2012, First or “Advance” Estimate)

**Third-Quarter Headline Growth of 2.01% Was Little More than Statistical Noise.** The first estimate of third-quarter 2012 GDP was meaningless—as usual—in terms of having any relationship to underlying real-world economic activity. The headline growth rate was well within the 95% reporting confidence interval of +/- 3.5%. This most-worthless and most-heavily-politicized of government economic series likely was massaged carefully so that the headline guesstimate of growth, published by Bureau of Economic Analysis (BEA), topped consensus forecasts. The BEA actually sees value in consensus guesses, particularly where the BEA lacks hard data, as is the case with early GDP reporting.

Details on major GDP components are discussed in the *Opening Comments and Executive Summary* section. The GDP remains the only major economic series to show a full economic recovery, but the GDP’s upswing since mid-2009 has been no more than a statistical illusion resulting from the use of bad-quality inflation data. Details there also are discussed and graphed in the *Opening Comments*.

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### 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

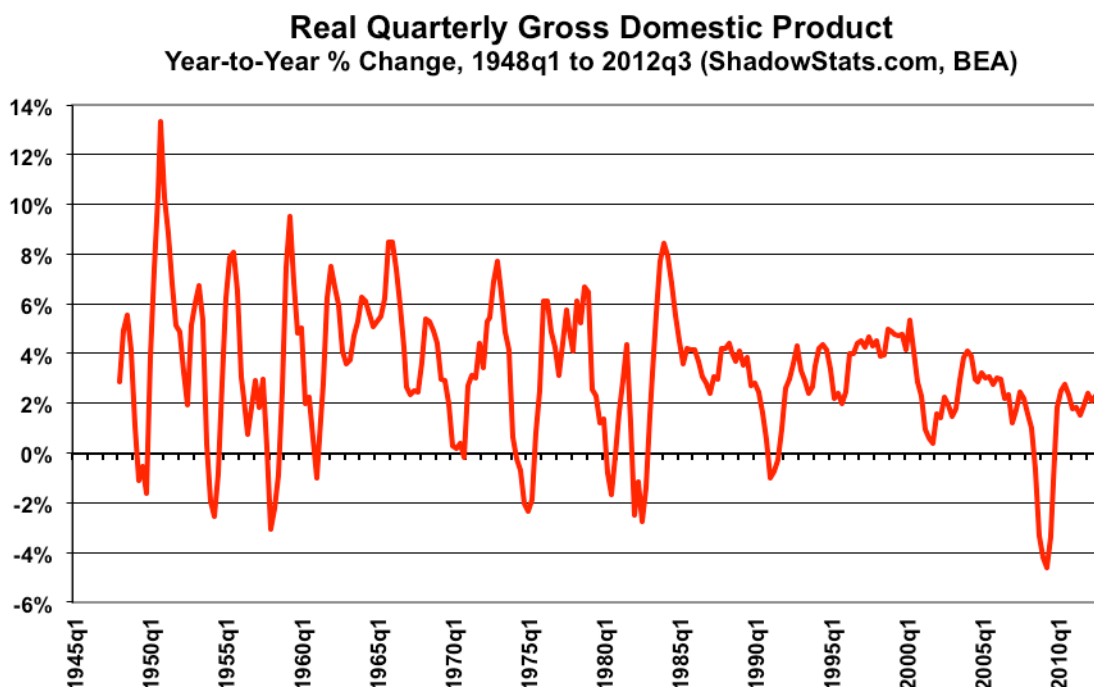
*the deflated GDP sub-series misses the total of the deflated total GDP series by nearly \$107 billion in “residual” as of fourth-quarter 2011.*

**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.

**GDP.** Published this morning, October 26th, by the Bureau of Economic BEA, the first or “advance” estimate of third-quarter 2012 gross domestic product (GDP) showed real (inflation-adjusted) quarterly growth at a statistically-insignificant 2.01% +/- 3.5% (95% confidence interval), versus a 1.25% headline gain in the second-quarter and 1.96% growth reported in the first-quarter.

For six of the seven quarters since first-quarter 2011 (fourth-quarter 2011 excepted), estimated growth rates have been little more than statistical noise around the unchanged level, and these heavily guessed-at numbers possibly have been massaged to keep the quarterly growth rates in minimally-positive, as opposed to minimally-negative territory.



Reflected in the preceding graph, the “advance” estimate of year-to-year real change in third-quarter 2012 GDP was 2.32%, versus 2.14% in the second-quarter and 2.45% in first-quarter 2012. The latest annual growth remains off the near-term peak growth of 2.80% reported during third-quarter 2010. The current cycle trough was in second-quarter 2009 at a 4.58% year-to-year decline, the deepest annual contraction seen for any quarterly GDP in the history of the series, which began with first-quarter 1947.

***Implicit Price Deflator (IPD) and PCE Deflator.*** The third-quarter 2012 GDP implicit price deflator (IPD) reflected an annualized quarterly inflation rate of 2.90%, versus 1.53% in the second-quarter and 2.17% in the first-quarter. Third-quarter year-to-year inflation was estimated at 1.68%, little changed from 1.70% in the third-quarter, but down from 1.98% in the first-quarter.

For comparison purposes, annualized seasonally-adjusted quarterly inflation for the CPI-U in third-quarter 2012 was 2.30%, versus 0.75% in the second-quarter and 2.48% in the first-quarter, with year-to-year CPI-U at 1.70%, versus 1.89% in the second-quarter and 2.82% 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.

Year-to-year change in the third-quarter personal consumption expenditures (PCE) deflator was 1.50%, versus 1.64% in the second-quarter and 2.36% in the first-quarter. The PCE deflator detail will be updated in the November 2nd *Commentary*, which will cover the October 29th release of the September monthly data.

***SGS-Alternate GDP.*** The SGS-Alternate GDP estimate for third-quarter 2012 is a 2.1% year-to-year contraction versus the official estimate of a 2.3% gain. The SGS third-quarter estimate is a narrower contraction than the 2.2% estimated for second-quarter 2012, versus the official estimate of 2.2% year-to-year growth (see the [Alternate Data](#) tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, a quarter-to-quarter contraction once again appears to have been a realistic possibility for the third-quarter, as it has been for six of the last seven quarters, a period of protracted business bottom-bouncing in the real world.

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. The inflation-corrected GDP graph (see the *Opening Comments and Executive Summary* section and [Hyperinflation 2012](#) and [Special Report No. 445](#)) is based on the removal of the impact of hedonic quality adjustments that have reduced the reporting of official annual GDP inflation by roughly two-percentage points. It is not the same measure as the SGS-Alternate GDP, which reflects the impact of reversing additional methodological distortions of recent decades.

***GNP and GDI.*** Gross national product (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, while gross domestic income (GDI) is the income-side reporting equivalent of the consumption-side GDP. Given lack of availability of significant underlying data for these series, the BEA will follow its standard delays and not publish estimates on the GDP or the GDI until the next monthly report on November 29th. The data supporting today’s GDP estimate are equally incomplete, and the BEA would do well to delay release of its “advance” GDP estimates for at least one month, as well.



## NEW ORDERS FOR DURABLE GOODS (September 2012)

**Durable Goods Remained Down Year-to-Year, Despite September's Monthly Jump.** Running in a direction opposite from the third-quarter GDP gain, aggregate new orders for durable goods have been in general decline during third-quarter 2012, falling at an annualized quarterly pace of 5.1% (6.9% after PPI finished capital goods deflation). That was the third consecutive quarter-to-quarter contraction for the durable goods series; reflecting a pattern that already should have surfaced in GDP reporting. In terms of annual growth, September 2012 new orders (not seasonally adjusted) remained in contraction year-to-year for the second-straight month, with an annual contraction also seen for the full third-quarter 2012.

Still, total orders for September jumped by 9.9% month-to-month, a gain that was dominated by a 2,640.7% surge in commercial aircraft orders, versus negligible net aircraft orders in August. The remainder of September's new orders remained below the levels seen in July, with major sectors such as motor vehicles and computers showing the second straight decline in monthly orders. Aircraft orders usually are booked years in advance, affecting more the longer-range economic outlook, while automobile and other orders tend to affect more the outlook for near-term production and economic activity.

The pattern of decline developing in new orders is one that usually precedes or indicates a recession, as suggested in the historical graphs of the real (inflation-adjusted) series, both aggregate and net of nondefense aircraft, in the *Opening Comments and Executive Summary*. The level of real new orders in September 2012 remained below the both the pre-2001 and pre-2007 recession highs for the series.

*Note on Deflating New Orders for Durable Goods: As described in [Special Commentary No. 426](#), there is no fully appropriate inflation measure available for deflating durable goods. The one used in the "real" graphs is the PPI's inflation measure for finished goods capital equipment (PPI-FGCE), 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 in the Opening Comments and Executive Summary section 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, Nominal September Reporting.** The Census Bureau reported yesterday, October 25th, that the regularly-volatile, seasonally-adjusted nominal (not adjusted for inflation) new orders for durable goods in September 2012 jumped by 9.9%, following a revised 13.1% (initially a 13.2%) monthly drop in August.

The irregular and highly volatile long-term nondefense aircraft orders rebounded in September by 2,640.7%, following a revised decline in August of 97.2%, which at least left orders in positive territory. Initially, August orders had been reported down by 101.8%, including cancellations. Aircraft orders usually are placed years in advance of delivery and rarely impact near-term economic activity.

Unadjusted, year-to-year change in total September 2012 new orders remained negative, down 0.3% (2.0% after inflation) from the year before, following an unrevised annual contraction of 7.2% (9.9% after inflation adjustment).

Also massively affected by the extreme volatility in nondefense aircraft orders, seasonally-adjusted new orders for nondefense capital goods rebounded by 23.7% in September, following a revised 24.0% (previously 24.3%) decline in August. For September 2012, the unadjusted year-to-year change in the series remained negative, down by 3.4% from the year before, versus a revised annual decline in August of 24.3% (previously by 24.0%), which coincidentally matched the monthly change.

*Caution: 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 reported seasonally-adjusted monthly changes.*

***Inflation-Adjusted and Smoothed.*** The nominal 9.9% monthly gain in September aggregate orders effectively was an increase of 10.0%, after inflation adjustment, while the revised nominal monthly decline of 13.2% in August was a drop of 13.3%, after inflation adjustment.

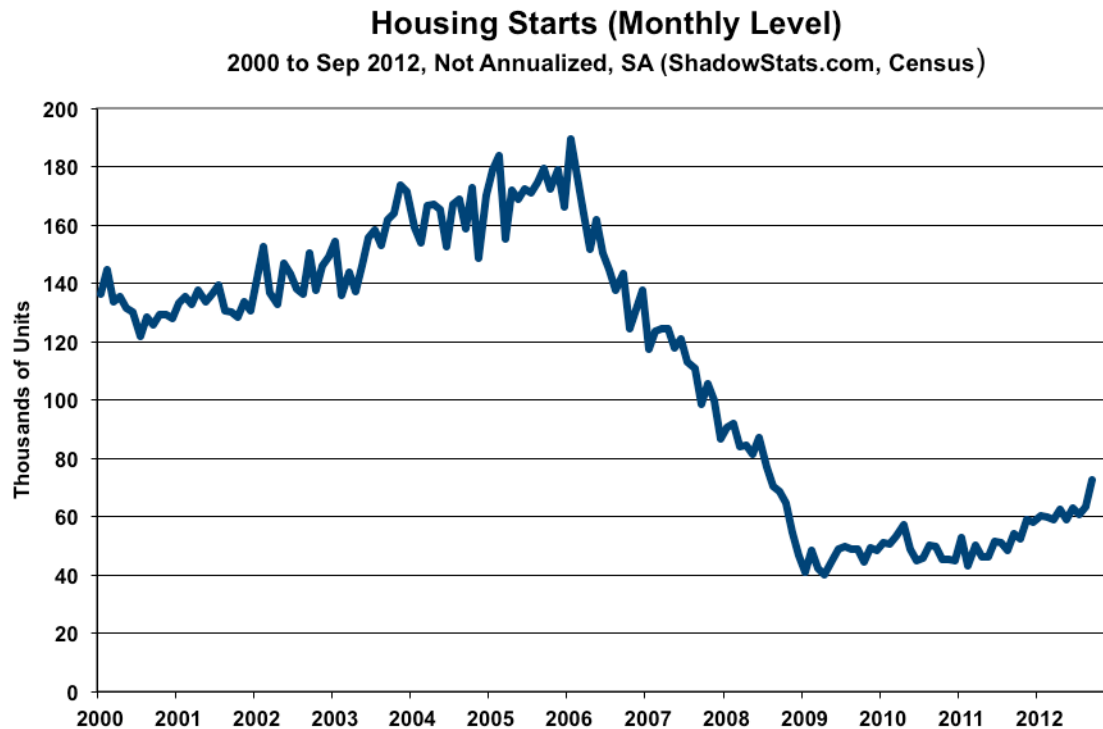
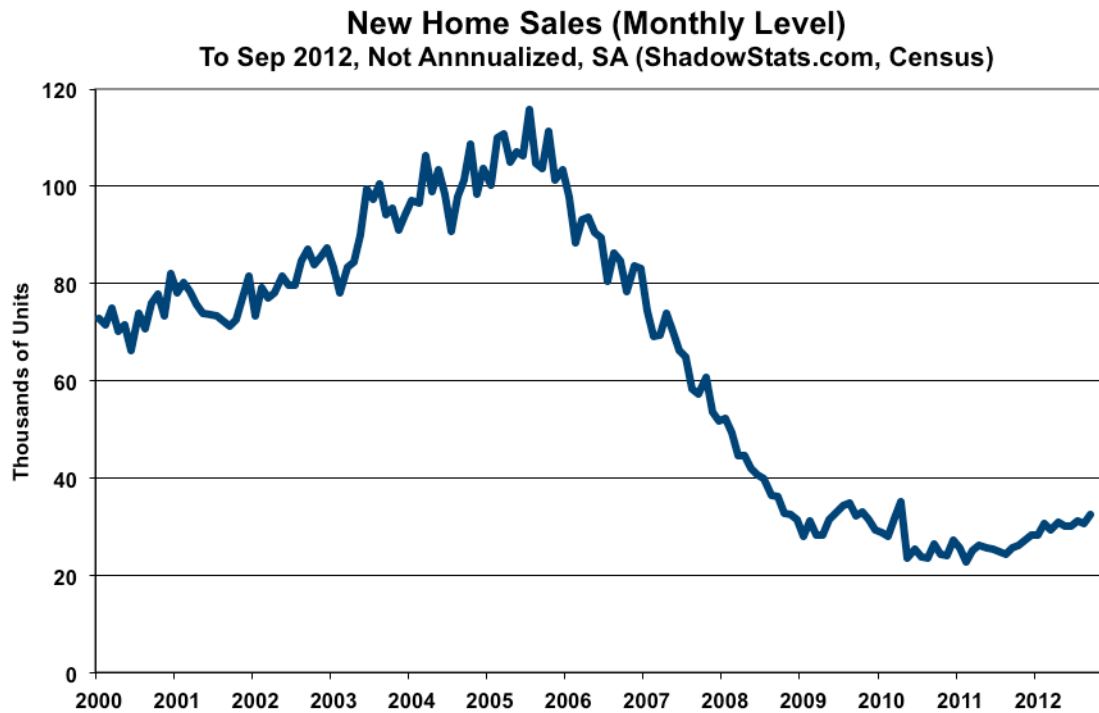
As indicated in the graphs in the *Opening Comments and Executive Summary*, these series have shown a slowing uptrend and flattening-out in the last two-to-three years—now turning to a pattern of downturn—clearly not the recovery that is seen in official GDP reporting. As was discussed above, the real (inflation-adjusted) level of orders in September 2012 remained below both the pre-2001 and pre-2007 recession highs.

If the deflation measure here were 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, with a recent pattern of downturn now well entrenched (see [Special Report No. 445](#)).

## **NEW HOME SALES (September 2012)**

**Low-Level Stagnation in New Home Sales Continued with A Statistically-Insignificant Monthly Gain.** September 2012 new home sales remained in a state of depressed bottom-bouncing, despite the September spike in housing starts (see the accompanying graphs). As discussed in [Commentary No. 477](#), the aberrational jump in September housing starts likely will be found to have been an artifact of poor-quality seasonal adjustments or other non-economic distortion. With significant smoothing, existing-home sales also are showing a similar pattern, although the monthly change was negative for the month of September (see next section). There have been no developments in underlying economic fundamentals that would suggest a pending housing-industry turnaround or an unfolding, broad economic recovery.





**September Reporting.** The October 24th release of September 2012 new-home sales (counted based on contract signings, Census Bureau) showed an ongoing pattern of volatile stagnation and bottom-bouncing, with the minimal headline gain being statistically-insignificant and enhanced by downside prior-period revisions. Lack of statistical significance has been common circumstance on a monthly basis for more than three years. The September headline gain was 5.7% (4.3% before prior-period revisions) +/- 17.3% (all confidence intervals are at the 95% level). In turn, the revised August monthly decline of 1.3% initially had been estimated as a 0.3% decline.

September's year-to-year gain of 27.1% +/- 22.6% in new-home sales was statistically-significant. The August annual gain was revised to 26.0% (previously 27.7%). Recent volatility in annual change reflects partially the effects of lapsing stimulus efforts last year.

## EXISTING HOME SALES (September 2012)

**September Existing-Home Sales Retreat Despite Rising “Distressed” Sales.** As has been noted regularly in the monthly *Commentaries* covering the existing-home sales series—despite recent massive corrections and revisions to the series—reporting remains subject to significant seasonal-factor instabilities, as also has been seen 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, effectively a discontinuity in the series. Seasonal-factor distortions have been skewed, not only by protracted, collapsing activity, but also by the impact of various stimulus/tax-incentive packages, which pulled some future sales activity into the periods of the incentives. With the sales swings generated by the stimulus packages, and lapsing of same, averaged out—as shown in the graph—the pattern of activity resembles the bottom-bouncing seen otherwise in the new-home sales and housing-starts activity discussed in the prior section, although the peak-to-trough contraction never was as severe as that seen in the sales tied to new construction.

For those interested in the latest detail, however, we continue to look at the regular reporting of the new existing-home sales series, although a heavy caution is offered on the quality of what is being published.

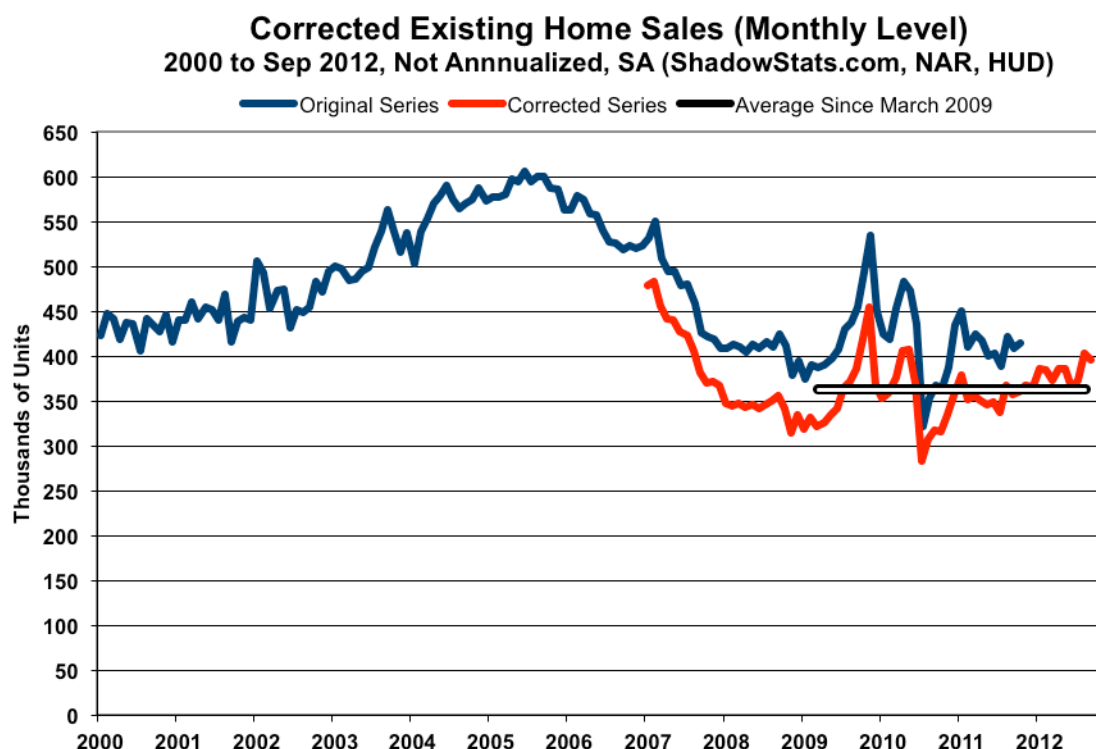
**September 2012 Reporting.** The October 19th release of September 2012 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly decline of 1.7%. That reflected a seasonally-adjusted monthly pace of 395.8 thousand homes sold, the second-strongest monthly showing this year (after August). That said, given the previously-discussed instabilities in seasonal factors and in underlying reporting, there is little significance, if any, that can be attributed to the headline monthly number for September, at this time.

As with last year, aberrant seasonal adjustments spiked the August 2012 headline gain, with September reporting partially offsetting the August gain. That said, the 1.7% decline in September 2012 sales followed a revised monthly gain of 8.1% (previously 7.8%) in August sales.

On a year-to-year basis, September 2012 sales rose by 11.0%, versus a revised 9.5% (previously a 9.3%) gain in August. Recent volatility in annual change reflects partially the effects of lapsing housing stimulus efforts a year ago.

The portion of distressed properties increased in the month, remaining a significant component of existing home sales activity. The NAR estimated September's "distressed" sales at 24% (13% foreclosures, 11% short sales), versus August's 22% (12% foreclosures, 10% short sales). The Census Bureau does not publish estimates of foreclosures for the new home sales series.

Both the median and average sales price data for existing homes (as with the government's estimates of home sales price data) tend to be of extremely limited usefulness, since they usually reflect shifting patterns of home buying between differently-priced segments more than they do changes in truly comparative prices. That said, both median and mean home sales prices in September 2012 (not seasonally-adjusted) were reported down month-to-month, but up year-to-year, for both existing- and new-home sales.



**Week Ahead.** As noted in [Commentary No. 474](#), public speculation as to political manipulation of labor-related data, produced by the Department of Labor, has hit a level of activity that is unprecedented. Whether or not manipulations have taken place with current reporting, supporting evidence either way likely will be forthcoming in the year ahead. The upcoming October labor report on November 2nd—the last major economic release before the election on Tuesday, November 6th—would be a likely

manipulation target, if the data indeed were being massaged. In any event, numbers that are far removed from common experience will tend to be viewed by the public with extreme skepticism.

Nonetheless, market recognition of an intensifying double-dip recession has taken stronger hold, while recognition of a mounting inflation threat has been rekindled a bit by recent Fed monetary policy announcements and rising headline inflation numbers. The incumbent 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, otherwise, it puts a happy spin on the numbers; and the financial markets 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, as discussed in the *Hyperinflation Watch* section.

Until such time as financial-market expectations catch up fully with underlying reality, or underlying reality catches up with the markets—shy of manipulated data—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 continue to show up in prior-period revisions.

***Personal Consumption Expenditure (PCE) Deflator (September 2012).*** The Bureau of Economic Analysis is scheduled to release the September 2012 PCE deflator on Monday, October 29th. The Federal Reserve's targeted inflation measure should be moving higher, closing in on the prescribed 2.0% year-to-year inflation rate, increasing in tandem with changes seen in the various September CPI measures (see [Commentary No. 476](#)). Nonetheless, 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.

***Construction Spending (September 2012).*** Due for release on Thursday, November 1st, by the Census Bureau, September construction spending likely will show continuing stagnation at low levels of activity, particularly after inflation-adjustment. Once again, monthly changes should not be statistically significant.

***Employment and Unemployment (October 2012).*** October labor data are due for release by the Bureau of Labor Statistics (BLS) on Friday, November 2nd. Commonly, the consensus jobs estimate settles around the trend estimate that comes out of the BLS seasonal-adjustment models. The October payroll trend number is an 83,000 gain, as discussed in [Commentary No. 473](#), but the consensus seems to be settling in the range of 120,000 to 130,000. The consensus for October unemployment is for a back-up to 7.9%, after the controversial decline to 7.8% in September, from 8.1% in August.

Shy of manipulation, the October payroll number should disappoint market expectations, given intensifying underlying weakness in related fundamentals. Payroll growth could be well below 100,000, even below the trend estimate. While the *actual* U.3 unemployment rate should be moving higher, meaningfully, versus September's headline 7.8% number. The October *headline* number, however, could come in anywhere, with absolutely no significance whatsoever as to the implied month-to-month change in the unemployment rate. That is due to the inconsistent, concurrent-seasonal-factor adjustments that will make the October number not comparable with the September number (see the unemployment concurrent-seasonal-factor discussion in the *Opening Comments* of [Commentary No. 461](#)).

Simply put, the headline October unemployment rate will be calculated in the context of a set of seasonal factors unique to October's reporting. That same calculation also will generate revised unemployment

rates for September, and earlier, which would be consistent with the October estimate, but the BLS will not publish the revised, consistent September or earlier numbers, so as “to avoid confusing data users.”

As a result, that uniquely-calculated October unemployment rate will be published and compared with the unrevised September unemployment rate that was uniquely calculated and published last month. The headline October and September numbers put before the public will be inconsistent and, accordingly, not comparable.

This all is despite the BLS knowing the actual, consistent September 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, conceivably markedly different from what the mainstream media will be touting, and around which the financial markets most likely will be gyrating nonsensically. This issue may have been responsible for the sharp “decline” in September’s unemployment rate.

Potential Political Manipulation. Last month’s unemployment report was unbelievable enough to fuel speculation of possible political manipulation of the data. Manipulation indeed is a possibility, and it has happened in earlier administrations. Any numbers that appear to be “too good,” likely will fuel further speculation of manipulation. Nonetheless, the public generally views official reporting against common experience, with “too good” numbers often being dismissed as not reflecting or being out of touch with reality.

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