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

COMMENTARY NUMBER 479
Presidential Election, Hurricane Sandy, October Employment and Unemployment, September M3, Construction and PCE Deflator

November 2, 2012

October Jobs and Unemployment Numbers Were Not Credible, Artifacts of a Broken Reporting System and/or Direct Manipulation

With Consistent Seasonal Adjustments, October Jobs Gain Would Have Been About 117,000 Instead of 171,000

October Unemployment: 7.9% (U.3), 14.6% (U.6), 22.9% (ShadowStats.com)

M3 Annual Growth Picks Up Again

PLEASE NOTE: With some contents of the still-pending Special Commentary *shifted to today's missive, the special report has been rescheduled for release as soon as is practicable following the November 6th election results. The report will update fully the broad economic, systemic and inflation outlooks, in the context of the latest economic reporting, the available detail on fiscal-2012 operations of the federal government and the monetary activities of the Federal Reserve. Further publication detail will be posted in the schedule box on www.ShadowStats.com.*

The next regular Commentary *is scheduled for Thursday, November 8th, covering the release of the September U.S. trade balance.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Despite some happier employment headlines, the U.S. economy is not in recovery. Where it is not illegal for an administration to manipulate its economic reporting, it is illegal for anyone outside of the preparing statistical Bureau (including the White House and the Fed) to have access to market-sensitive numbers before the New York financial markets close on the afternoon prior to the release. Four days before the release of the October labor data, on October 29th, *Washington.Examiner.com* published a story "Axelrod: Romney camp won't be saved by a bad jobs report." As to the Romney campaign being "bouyed [sic] by a bad jobs report," Obama campaign senior strategist David Axelrod was quoted as indicating, "I think they're going to be disappointed."

With the headline October 2012 unemployment rate holding below 8.0% and the headline jobs growth stronger than market expectations, in conjunction with upside revisions to August and September reporting, Mr. Axelrod's assessment was borne out, a lucky guess or otherwise. The headline numbers (or the general substance of the reporting results) usually are known a week or so in advance, and early release of data to officials in various administrations and at the Federal Reserve has been common in the past and as suggested in former Clinton Labor Secretary Robert Reich's autobiography.

With a downturn in October's online help-wanted advertising, weakening employment growth in the ISM's October purchasing managers manufacturing survey, and significant indications of slowing activity, not accelerating economic growth—to be discussed in the upcoming *Special Commentary*—the October labor data indeed were not credible. At best, the numbers were heavily flawed in consistency by the use of concurrent-seasonal factor-adjustments (see discussion in *Commentary No. 473*). None of the revised estimates to prior months unemployment, which are recalculated every month, are published. This is particularly misleading where publication of the latest September estimate is needed in order for consistent month-to-month comparisons between the October and September data. The BLS has the actual numbers, but it will not publish them. The same is true for all but the two-most recent months in the employment series, which allows for the shifting of previously-reported employment activity into the headline month, from earlier periods, without an accounting for same.

With lack of full transparency in the calculation processes, reporting for the establishment (payroll) survey and particularly the household (unemployment) survey is open to direct political manipulation.

Overstated Employment Gains. Also as noted in the October 5th *Commentary No. 473*, covering the September employment numbers, in the *Concurrent Seasonal Factor Distortions* section, "Unreported, seasonally-adjusted monthly payroll numbers still are showing a shift of first-half of the year jobs to the second-half of the year, with the peak upside reporting effect due for October 2012, the last employment report before the November election."

With payroll reporting, the Bureau of Labor Statistics (BLS) publishes only the current and two-prior months on a consistent basis. All numbers published today (November 2nd) for the period of July 2012 and before have not been revised in official reporting, although they were revised in the context of the highly-volatile concurrent-seasonal-factor-adjustment process in order to calculate the new monthly numbers for August, September and October of 2012. The latest reporting simply is not consistent with published past history.

As part of that process, some of those distorted aggregate seasonal-factor-adjustments are hinted at in the latest detail, in terms of the difference in the year-to-year growth in the unadjusted and adjusted series, which generally should be extremely close to each other. Using the year-to-year growth published for the

seasonally-unadjusted series as an alternative year-to-year measure for the seasonally-adjusted series, monthly jobs growth would have been reported at 117,000 in October, instead of the headline 171,000.

Hard-number aggregate differentials can be calculated using BLS data, where the official reporting is fixed and not subject to anything other than annual revisions. On that basis, August 2012, which now will be unrevised, going forward, showed an official monthly jobs gain of a revised 192,000, but that gain actually revised to 168,000 on a consistent basis. The frozen official jobs gain of 181,000 for July 2012, really revised to 164,000. One might wonder where those now lost (but not published) gains went, given the constantly changing seasonal factors that can shift prior activity into the latest period.

Understated Unemployment Rates and Overstated Unemployment Improvement. Similar hard calculations are not possible with the unemployment rate, because the BLS does not publish any prior-period revisions or data than enable consistent seasonal-factor calculation by outside entities. Assuming there is commonality to the seasonal adjustments in the household and establishment surveys—a dangerous assumption—the patterns of overstatement with the payrolls would suggest a pattern of understatement with the recent headline unemployment rates and overstatement of recent headline month-to-month unemployment-rate improvements.

Main Street U.S.A. Is Sensitive to Real-World Economic Activity. As was seen in something of a similar circumstance, when the first President Bush was up for re-election, economic data that were too good simply lacked credibility with the public, and the president was viewed as being out of touch with economic reality. Economic reality, today, also is much worse than suggested by the headline data, with the effect that actual pocketbook issues still should play-out negatively against the incumbents, perhaps much more severely than currently is indicated in the polling numbers hyped by the popular media.

The balance of this section touches upon potential impact of the upcoming election on the dollar and gold, explores possible economic impact of Hurricane Sandy, and provides a summary of more-normal analysis of current economic reporting. The preliminary estimate of October M3 growth is covered in the *Hyperinflation Watch* section.

U.S. Presidential Election. On Tuesday, November 6th, voters will select the President of the United States who will serve for the term extending from January 2013 to January 2017. Regardless of whether Barrack Hussein Obama or Willard Mitt Romney wins the election, the next presidential term most likely will see the onset of a domestic, hyperinflationary great depression. That is the ultimate domestic financial disaster that has been predicted here for a number of years, with an outside timing of 2014 (see *Hyperinflation 2012* and links therein to preceding reports). While the longer-range outlook should not be affected much by the election results, the impact of a very-short-lived shift in global confidence in the U.S. dollar is a possibility.

In recent days, London bookmaker Ladbrokes has shown odds shifting increasingly in favor of Obama, who has been that bookie's long-term, odds-on favorite. As of this writing, November 2nd, the odds were 1-4 for Obama (meaning a winning bet of $4 would generate a profit of $1), versus 3-1 for Romney (a winning bet of $1 would generate a profit of $3). Domestic polling—always of questionable quality—shows a close race. Pocketbook issues that historically have dominated voter preferences—such as voting

out incumbents when real income is contracting—strongly favor Romney. If I were placing a bet on the election, I would take the odds on Romney.

The long-term solvency issues of the United States remain the primary threat to domestic financial, economic and political stability and to the relative global valuation of the U.S. dollar. The dollar's vulnerability to this issue has been seen consistently with ongoing failed federal budget negotiations and ever-expanding quantitative easing by the Federal Reserve.

The current U.S. government has demonstrated a political inability and lack of desire and to bring the federal government's fiscal problems under control, to address long-term U.S. sovereign solvency issues. Accordingly, a new President—particularly if he had control of both the U.S. Senate and U.S. House of Representatives—likely would be allowed a grace period by the global markets to act meaningfully in this area. Otherwise the circumstances should fall back to an ever-deteriorating position, as usual.

With an Obama win, look for higher taxes—that already are in place—with a resulting much-weaker economy, much-increased government spending and a rapidly-expanding federal deficit. These are factors that, on balance, should result in sharp deterioration of the foreign-exchange value of the U.S. dollar and correspondingly lead to higher gold prices.

With a Romney win, look for relatively lower taxes, with a minimally less-negative economy and somewhat slower expansion of the federal budget deficit, than with Obama. In response, near-term market perceptions could some provide short-lived support for the dollar and detraction from gold. The market effects here, however, should be transient, particularly if there is divided control of Congress. Bringing a roughly $5-trillion GAAP-based deficit (GAAP here means generally accepted accounting principles) under control would be extremely painful for the nation, but that is absolutely necessary, if the United States as we know it is to survive.

The budget-balancing task will not be easy, contrary to what has been popularized in the campaign, and I still view it as a political impossibility. The system was pushed beyond the point of no return, in the wake of the 2008 financial panic and near-collapse of the financial system. Phony budget surpluses (non-GAAP), as generated during the Clinton Administration might be attainable, but the global markets are looking for truly balanced fiscal circumstances (see *Hyperinflation 2012*).

Neither Obama nor Romney, as president, has much if any chance of stabilizing the economy or fiscal conditions in the short-term, and of preventing a hyperinflationary collapse of the U.S. currency. Where Mr. Obama, upon entering office in 2009, had the chance to change the future of U.S. fiscal conditions dramatically, he did so, but in the wrong direction. Mr. Romney has promised to take immediate actions to balance the budget, to restore fiscal normalcy. Any President, new or re-elected, deserves the benefit of the doubt—irrespective of truly intractable deficit difficulties that largely were ignored during the presidential race.

The issues here need to be discussed openly, net of political hype. For purposes of disclosure, I am an old-line conservative Republican, with a libertarian bent, and do the best I can to keep my comments free of politics. Fault for the extreme financial and economic problems besetting the United States lies on both sides of the aisle, and neither major political party has shown the political will to address the underlying fundamental issues beyond political window dressing. This has been discussed in *Hyperinflation 2012* and will be reviewed extensively in the post-election *Special Commentary*.

As background, the following comments were offered in the ShadowStats.com *Commentary* of November 14, 2008, following Mr. Obama's election win: ***Obama Faces Same Fiscal Limitations as Bush.*** *The Obama Administration will face the same fiscal constraints that the Bush Administration has faced but largely ignored. Presumably, if Bush could ignore the fiscal constraints, then so could Obama. As the U.S. government's effective long-term bankruptcy gains broader recognition, however, Uncle Sam increasingly will have difficulty selling its debt to anyone other than the Federal Reserve (see the* Hyperinflation Special Report *of April 8, 2008). Shy of what new debt can be foisted on a gullible public or severely pressured U.S. trading partners, there should be zero new funds available to pay for new government programs, expanded programs or fiscal stimulus.*

Nonetheless, the political miscreants in Washington will continue to spend money they do not have and that they have no prospects of ever raising, at least until the financial markets start to say "no more." With the economy in a structural contraction, promised further fiscal stimulus will have increasingly short-lived positive impact on the economy, but increasingly dire consequences for the U.S. fiscal condition and the U.S. dollar.

Views expressed by President-Elect Obama have been heavily suggestive of a rapid push by his Administration for a more-expansive, more-controlling, more-intrusive and more-expensive central government. As a rule of thumb, forced redistributions of income and wealth, greater government control of production and commerce, and more-intrusive government programs such as nationalized health insurance tend to lead to a less productive and less competitive society. Such programs limit economic growth and—at the extreme—ultimately condemn business activity to perpetual bottom-bouncing. Such programs not only would exacerbate the current structural downturn in the U.S. economy, but also would accelerate the timing on the eventual hyperinflation, given the deficit financing needs of same.

Hurricane Sandy. A renewed downturn in economic activity was in the numbers before the Hurricane Sandy turned into Super-Storm Sandy and hit the Eastern Seaboard. Nonetheless, the storm likely will take the blame for much of any near-term weakness in the economy. Indeed, economic impact will be spread across at least several quarters, with the negative effects up front.

The storm's unprecedented scope and the resulting extraordinary disruption to normal business activity in areas from Virginia to Massachusetts, with severe disruptions particularly to normal business activity in the New York metropolitan area, indeed will have dampened fourth-quarter 2012 business activity and should have noticeable impact on the current quarter's GDP.

The GDP does not take a hit due to property destruction, but it does get a reported boost from reconstruction activity, which will be evident in the quarters ahead.

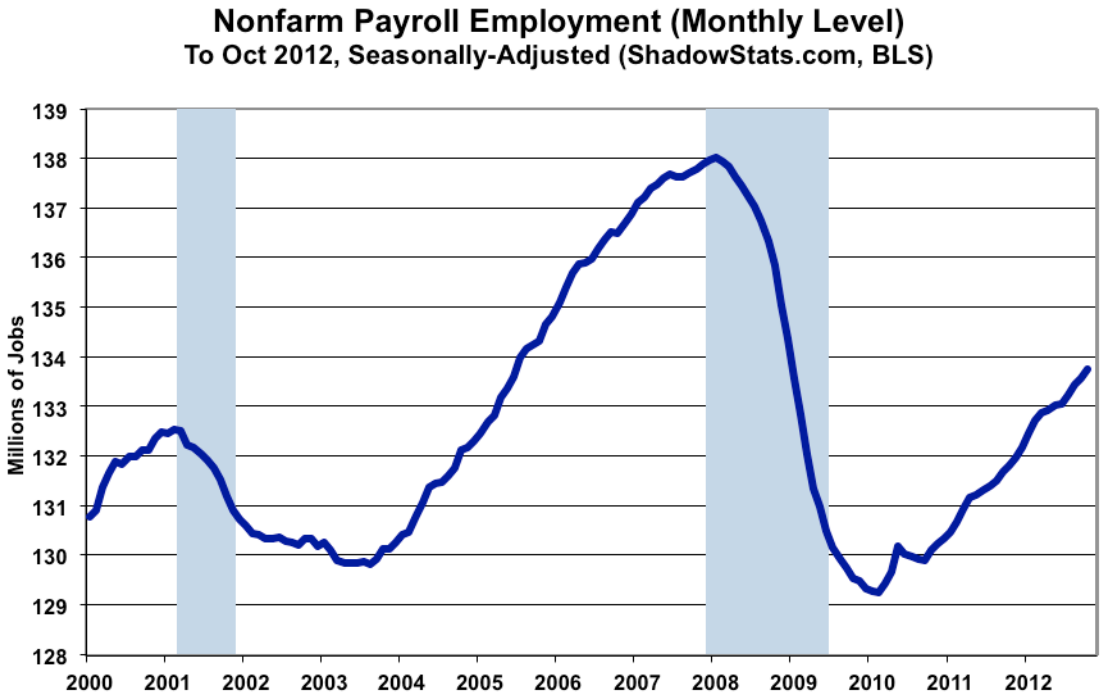
November employment and unemployment reporting should reflect transient mixed impact.

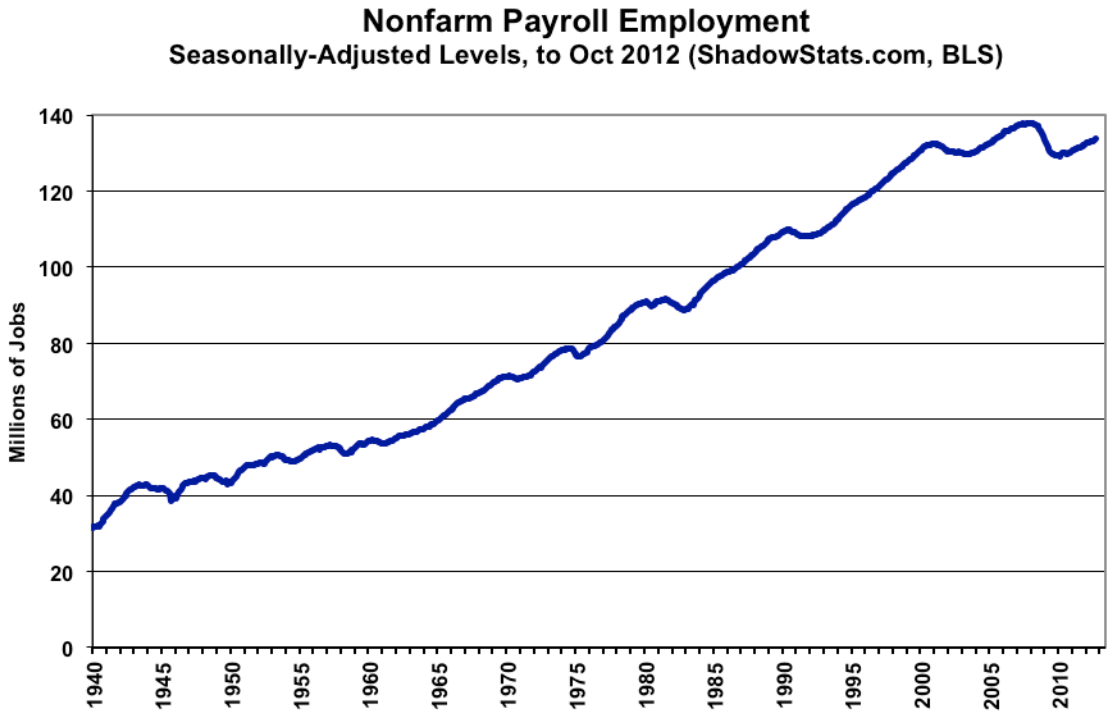
Looking at the scope of the damage, insured losses likely will run well above early estimates. Separately, an early assessment by the A.M. Best Co., the primary and largest rating agency for insurance companies, sees the property casual insurance industry likely being able to handle losses reasonably well, due partially to reserves that have been built up during a year with no major catastrophe losses.

Insurance payments only boost economic activity to the extent that damaged property is replaced. The flow of related reinsurance payments from offshore companies once would have boosted GDP, with the effect of reducing the trade deficit by increasing the services-side surplus. That happened after 9-11, but the Bureau of Economic Analysis (BEA) later neutralized such reporting and the impact of those payments. Given disruptions to operations at the Port of New York and surrounding areas, however, the trade deficit for October/November could be reduced by a short-lived dip in imports and exports (imports tend to exceed exports, hence a general reduction in trade activity tends to reduce the related deficit, but those numbers should recover in December).

Overall, the aggregates economic impact of the storm on the economy should be limited, with the short-term news more likely to be negative, and with longer-term activity likely to benefit from rebuilding as well as from catch-up in some early negative impact on activity.

Current Economic Reporting. Reporting issues with the October payroll and unemployment measures are detailed in the *Opening Comments*. Shown below are the usual graphs of nonfarm payrolls with the first graph following showing seasonally-adjusted payroll levels (indexed to January 2000 = 100), reflecting detail of the current employment level well below its pre-2007 recession peak. There has been no full recovery as reported in the GDP. The second, longer-term graph of the payroll employment level, shows historical detail back to 1940 and, in perspective, that payroll levels still are minimally above levels in 2000.





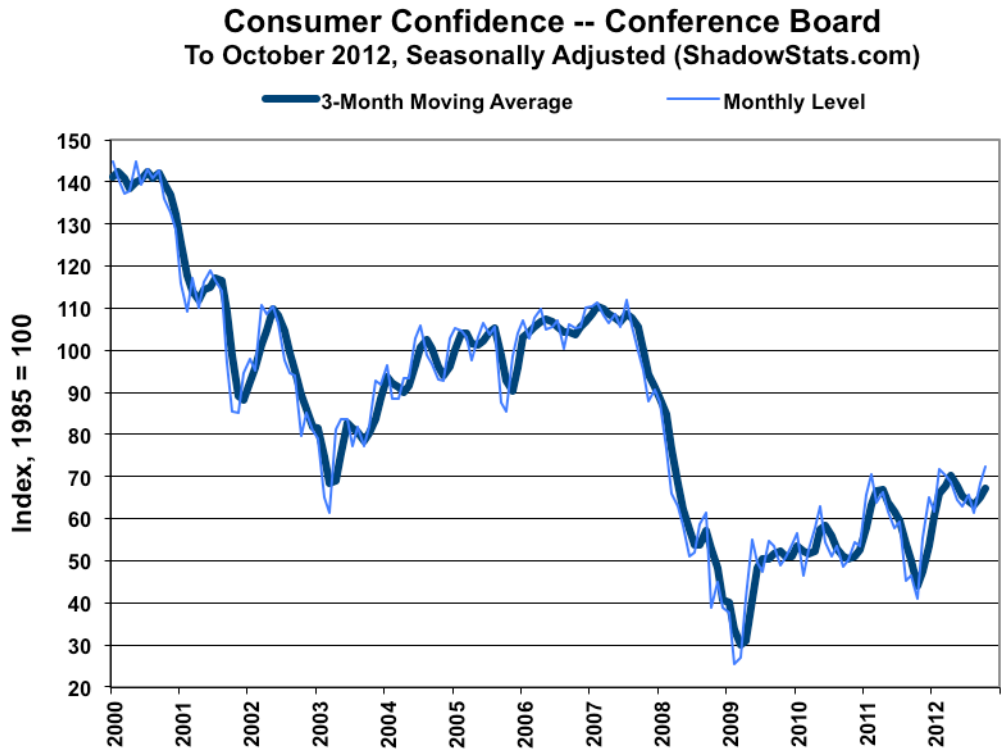
The 171,000 headline gain in October nonfarm payrolls was not credible, reflecting an influx of previously-reported seasonally-adjusted jobs growth that appears to have been revised into the current reporting, without the full revisions to prior history being published.

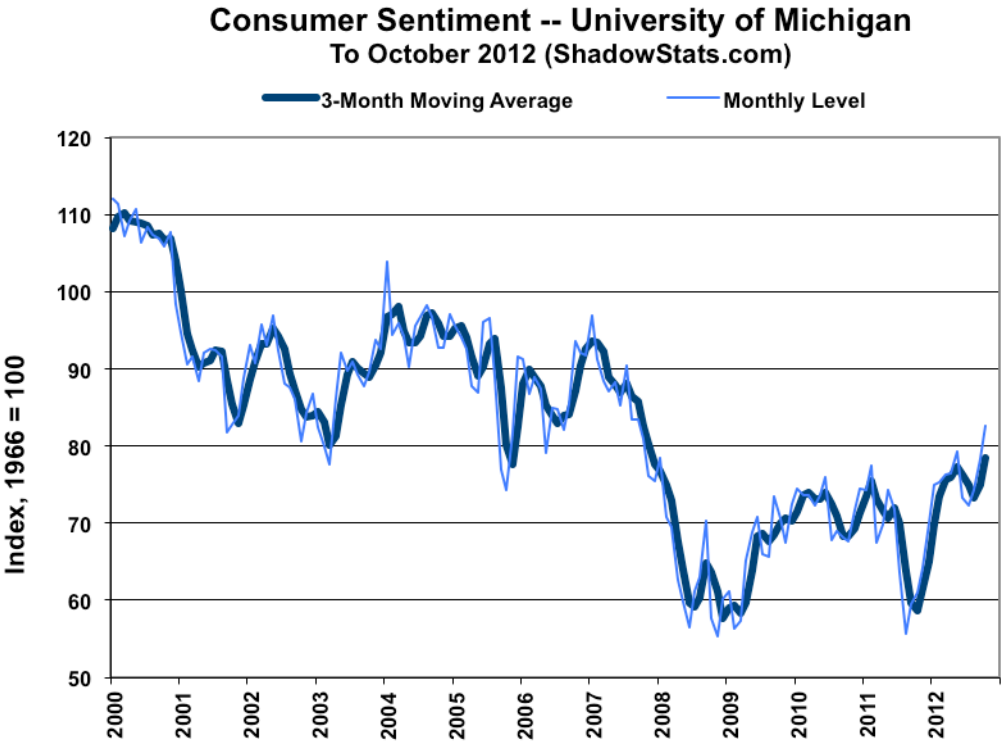
As discussed above, the published monthly unemployment rates are not consistent and not comparable with each other. That said, October's 7.87% (rounded at 7.9%) headline U.3 unemployment rate was up by seven-one-hundredths of a percentage point for the month, rounded to a headline 0.1% monthly gain. That contrasted with a 0.1% decline in the broader October U.6 rate to 14.6%, and a 0.1% increase in the SGS-Alternate Unemployment Measure to 22.9%.

Other Reporting—Construction, PCE Deflator, Consumer Sentiment and Confidence. There were few surprises in September construction spending. Despite continuing upside revisions to prior-period reporting, the series continued to show an ongoing low level of stagnation.

Year-to-year inflation in the September PCE deflator rose to 1.7% from 1.5% in August, moving in tandem with the consumer inflation measures published by the BLS. PCE inflation held below the 2.0% target of the Federal Reserve for the sixth-straight month.

October readings for both the University of Michigan's sentiment measure and the Conference Board's consumer confidence measure, both showed gains on a monthly as well as a six-month moving-average basis. Both series, however, continued to fluctuate within recent bounds, with trends that remain at levels seen only in the depths of the worst post-World War II recessions.





[More complete details on October employment and unemployment, and the details on September construction spending and the PCE deflator are found in the* Reporting Detail *section.]

Hyperinflation Watch—Annual Growth in October M3 Money Supply Continued Its Upswing. Based on roughly three weeks of reported data, the preliminary estimate of annual growth in the SGS Ongoing-M3 Estimate for October 2012—to be published tomorrow (November 3rd) in the Alternate Data section—is on track to hit 3.5%, up from an unrevised 3.3% in September. As usual, any revisions to prior months in this or the following numbers are due primarily to Federal Reserve revisions to underlying data. Nonetheless, with recent annual growth having peaked at 4.1% in February 2012, the upturn in annual broad money growth that began in February 2011, had faltered, dropped back to 2.7% in June and now is notching higher again. Such a pattern of slow pick up—in an environment of massive Federal Reserve accommodation—still remains suggestive of an uncontained systemic-solvency crisis.

The seasonally-adjusted, month-to-month change estimated for October 2012 money supply M3 likely will be around 0.5%, versus a revised 0.2% (previously a 0.4% gain) in September. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

For October 2012, early estimates of year-to-year and month-to-month changes follow for the narrower M1 and M2 measures (M2 includes M1, M3 includes M2). Full definitions are found in the *Money Supply Special Report*. M2 for October is on track to show year-to-year growth of about 6.8%, versus a revised 7.1% (previously 6.9%) in September, with month-to-month growth estimated at roughly 0.8% in October, versus a revised 0.8% (previously 0.7%) in September. The early estimate of M1 for October shows year-to-year growth of roughly 12.2%, versus a revised 13.0% (previously 12.4%) in September, with month-to-month change a likely gain of 1.3% in October, versus a revised 2.2% (previously 2.1%) gain in September. The variability in year-to-year growth rates reflects sharp monthly gains a year ago in M1 and M2 that reflected a shifting of funds out of M3 accounts into the M1 and M2 accounts.

***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*, other than for minor detail, but it is included here for those who may not be familiar with it, including new subscribers. This summary outlook here basically is unchanged from *Hyperinflation 2012*.

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 release following the results of the presidential election on November 6th.

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 formal full recovery as of fourth-quarter 2011, and that "recovery" has continued through third-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.

REPORTING DETAIL

EMPLOYMENT AND UNEMPLOYMENT (October 2012)

Severe and Deliberate Disruptions to Unemployment and Employment Reporting Accuracy Continued in October. As discussed in the *Opening Comments and Executive Summary*, changes in the October headline data versus September, and monthly changes in reported nonfarm payrolls have been warped by the concurrent seasonal-factor adjustment policies of the Bureau of Labor Statistics (BLS).

As has been discussed frequently, reporting of month-to-month changes in both payroll employment and the unemployment rate is of such poor quality that the headline labor data of recent months have become worthless as indicators of current economic activity, almost as bad as growth rates reported for the GDP.

Problems with seasonal-factor distortions—created by the economic collapse and exacerbated by the use of concurrent seasonal factors—have widened the likely margins of reporting error in the payroll survey to something well beyond usual monthly +/- 129,000 jobs, or in the household survey to something well beyond the confidence interval around the monthly unemployment rate change of +/- 0.23%, both series at the 95% confidence level. Nonetheless, these numbers regularly are pulled apart by the financial markets and politicians well beyond the extremely limited significance of the numbers. To the extent that there is significance in the monthly reporting, it is that the economy is not in recovery, and that unemployment—as viewed by common experience—remains at a level that rivals any other downturn of the post-Great Depression era.

PAYROLL SURVEY DETAIL. The BLS reported today (November 2nd) a statistically-significant, seasonally-adjusted October 2012 month-to-month payroll employment gain of 171,000 (a gain of 255,000 before prior-period revisions) +/- 129,000 (95% confidence interval). [Concurrent-seasonal-factor distortions most certainly have widened the margin of reporting error—the 95% confidence interval—to meaningfully beyond the official +/-129,000.] As discussed in the *Opening Comments and Executive Summary*, consistent seasonal-factors suggest that the monthly gain was roughly 117,000.

The adjusted September month-to-month change was revised to a 148,000 (previously 114,000) gain, while the August month-to-month gain was a revised 192,000 (previously 142,000, initially 96,000). If, however, the August change were counted on a consistent basis, with the latest concurrent seasonal factor calculations, the revised August gain actually was 168,000. As discussed in the *Opening Comments and Executive Summary* the inconsistent use of concurrent-seasonal-adjustment factors has had the effect of pushing relative payroll gains into the pre-election reporting period.

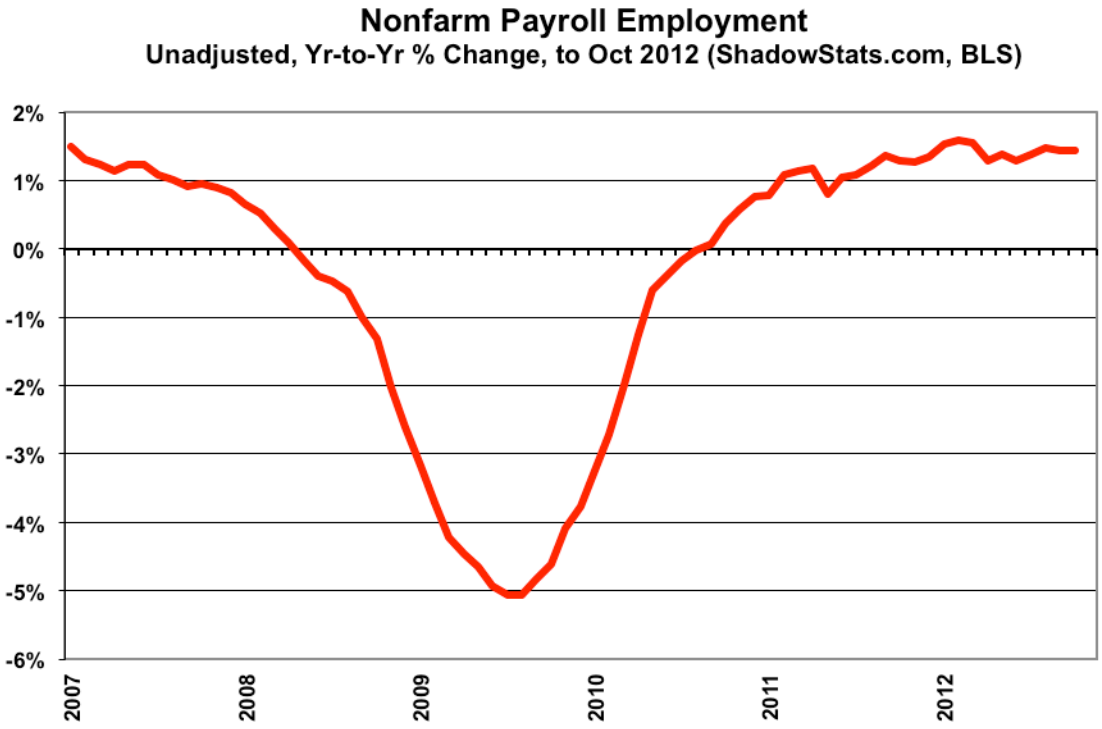
The BLS publishes two prior months of consistent data with concurrent-seasonally-adjusted payrolls, but no prior months of consistent data with the unemployment rate. Again, this issue is discussed in detail the *Opening Comments* and *Concurrent Seasonal Factor Distortions* sections.

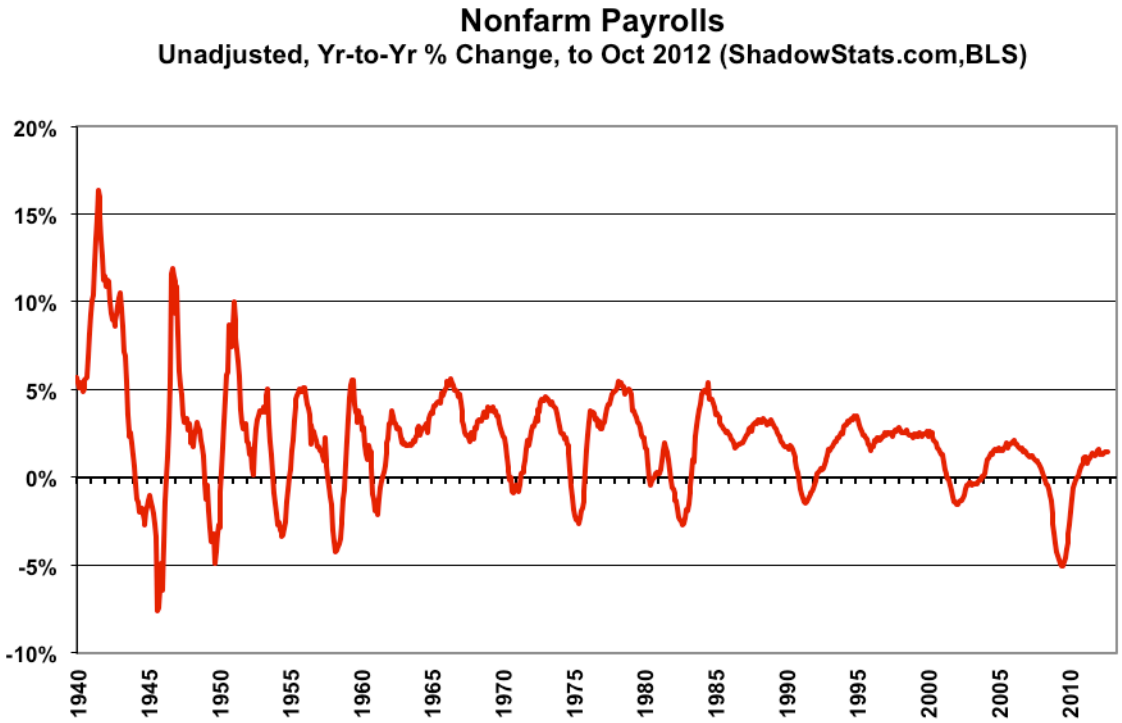
As described generally in Payroll Trends, the trend indication from the BLS seasonal-adjustment model is for a 126,000 monthly payroll gain in November 2012, based on today's reporting. While the trend indication often misses actual reporting (the indication for October was an 83,000 gain versus the official 171,000 headline gain), it usually becomes the basis for the consensus outlook.

In terms of year-to-year change, the not-seasonally-adjusted growth in October 2012 payrolls was 1.45%, versus an upwardly revised 1.44% (previously 1.38%) in September.

The following graphs of year-to-year unadjusted payroll change had shown a slowly rising trend in annual growth into 2011, which primarily reflected the still-protracted bottom-bouncing in the payroll series. That pattern of growth flattened out in late-2011, as shown in the first graph of the near-term detail in year-to-year change, and it has fluttered around a slightly lower level since April 2012.

As shown in the longer-term graph (historical detail back to 1940), with the bottom-bouncing of recent years, current annual growth has recovered from the post-World War II record 5.06% decline in August 2009, which remains the most severe annual contraction seen since the production shutdown at the end of World War II (a trough of a 7.59% annual contraction in September 1945). Disallowing the post-war shutdown as a normal business cycle, the August 2009 annual decline was the worst since the Great Depression. Still, even with small annual growth in the series since mid-2010, the current level of employment is far from reflecting any economic recovery.

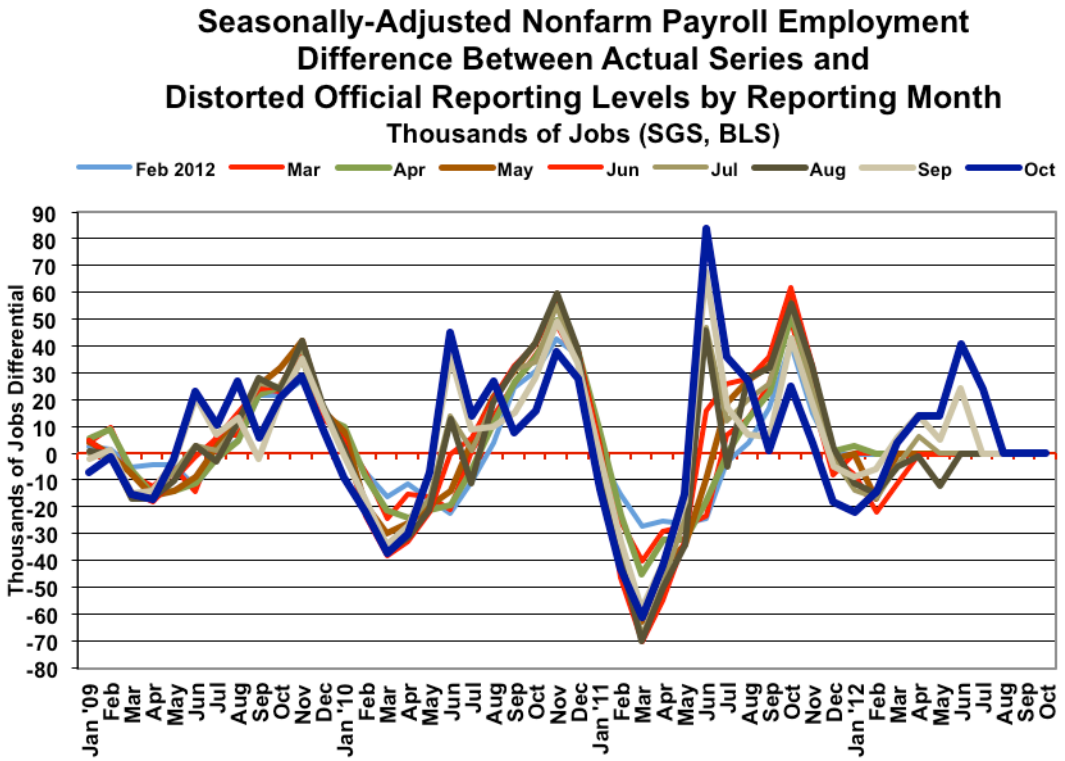




The regular graph of seasonally-adjusted payroll levels since 2000, showing detail of the current employment level well below its pre-2007 recession peak, as well as a longer-term graph of the payroll employment level, showing historical detail back to 1940 and, in perspective, that payroll levels still are minimally above levels in 2000, are located in the *Opening Comments and Executive Summary* section.

Concurrent Seasonal Factor Distortions. Unreported, seasonally-adjusted monthly payroll numbers still are showing a shift of first-half of the year jobs to the second-half of the year, with the peak upside reporting effect seen in October, although there was an increased historical shift into April 2011 along with the reporting of October 2012.

Despite revisions in the monthly data each month, that go back years, the BLS only publishes two months of revisions with each nonfarm payrolls release (August and September in the current instance), so as not to confuse data users. (The BLS publishes no revised data on a monthly basis for the household survey, despite a similar seasonal-adjustment approach, as discussed in the *Opening Comments and Executive Summary*, and in *Commentary No. 473*, *Commentary No. 461*, *Commentary No. 451* and *Commentary No. 453*.) As a result, the reported August-through-October 2012 seasonally-adjusted payroll data are not consistent with earlier published reporting. Conceivably, the shifting and unstable seasonal adjustments could move 90,000 jobs or more from earlier periods and insert them into the current period as new jobs, without there being any published evidence of that happening. The following graph suggests that something along those lines happened in October's reporting.



The issues with the BLS's concurrent-seasonal-factor adjustments and related inconsistencies in the monthly reporting of the historical time series are further discussed and detailed in the ShadowStats.com posting on May 2nd of *Unpublished Payroll Data*.

Note: Incomplete and inconsistent BLS payroll reporting continues. Nine months have passed since the annual benchmark revisions to payroll employment, and the latest concurrent seasonal factors show renewed misreporting of the BLS's own historical payroll levels, as well as ongoing instabilities in the BLS's seasonal factors.

As discussed in prior writings (see Hyperinflation 2012, for example), seasonal-factor estimation for most economic series has been distorted severely by the extreme depth and duration of the economic contraction. These distortions are exacerbated for payroll employment data based on the BLS's monthly seasonal-factor re-estimations and lack of full reporting.

Where the BLS recalculates the monthly seasonal factors each month for payroll employment, going back a number of years, outside of benchmarks, it only publishes the revised data for the last two months of reporting. The benchmark revision that accompanied the release of January 2012 payrolls, in theory, included a full update of the revised concurrent seasonally-adjusted data (actually it is off by a month or two). In the preceding graph, though, the latest revised (but not published by the BLS) adjusted payroll data show increasingly volatile, monthly seasonal-adjustment distortions of up to 90,000 jobs per month, with previously-reported payroll employment being shifted from the first-half to the second-half of the

year. If seasonal-adjustment factors were stable in month-to-month reporting, which they should be under normal circumstances, then the graph of differences would be flat and at zero.

Note: A further big issue remains that the month-to-month seasonally-adjusted payroll data have become increasingly worthless, with reporting errors likely now well beyond the official 95% confidence interval of +/- 129,000 jobs in the reported monthly payroll change. Yet the media and the markets tout the data as meaningful, usually without question or qualification.

Birth-Death/Bias Factor Adjustment. Despite the ongoing and regular overstatement of monthly payroll employment—as evidenced usually by regular and massive, annual downward benchmark revisions (2011 and the recently-announced 2012, excepted)—the BLS generally adds in upside monthly biases to the payroll employment numbers. The process was created simply by adding in a monthly "bias factor," so as to prevent the otherwise potential political embarrassment of the BLS understating monthly jobs growth. The "bias factor" process resulted from an actual such embarrassment, with the underestimation of jobs growth coming out of the 1983 recession. That process eventually was recast as the now infamous Birth-Death Model (BDM), which purportedly models the effects of new business creation versus existing business bankruptcies.

October 2012 Bias. The not-seasonally-adjusted October 2012 bias was a positive 90,000, versus a negative 9,000 in September 2012, and versus a current estimation of a positive 116,000 bias in October 2011. The aggregate upside bias for the twelve months ended October 2012 was 537,000, versus 563,000 in September. At present, that is a monthly average of roughly 45,000 jobs created out of thin air, on top of some indeterminable amount of other jobs that are lost in the economy from business closings. Those losses simply are assumed away by the BLS as part of the BDM, as discussed below.

Problems with the Model. The aggregated upside annual reporting bias in the BDM reflects an ongoing assumption of a net positive jobs creation by new companies versus those going out business. Such becomes a self-fulfilling system, as the upside biases boost reporting for financial-market and political needs, with relatively good headline data, while often also setting up downside benchmark revisions for the next year, which traditionally are ignored by the media and the politicians. Where the BLS cannot measure meaningfully the impact of jobs loss and jobs creation from employers starting up or going out of business, on a timely basis (within at least five years, if ever), such information is estimated by the BLS along with the addition of a bias-factor generated by the BDM.

Positive assumptions—commonly built into government statistical reporting and modeling—tend to result in overstated official estimates of general economic growth. Along with happy guesstimates, there usually are underlying assumptions of perpetual economic growth in most models. Accordingly, the functioning and relevance of those models become impaired during periods of economic downturn, and the current downturn has been the most severe—in depth as well as duration—since the Great Depression.

Indeed, historically, the BDM biases have tended to overstate payroll employment levels—to understate employment declines—during recessions. There is a faulty underlying premise here that jobs created by start-up companies in this downturn have more than offset jobs lost by companies going out of business. So, if a company fails to report its payrolls because it has gone out of business, the BLS assumes the firm still has its previously-reported employees and adjusts those numbers for the trend in the company's industry.

Further, the presumed net additional "surplus" jobs created by start-up firms, get added on to the payroll estimates each month as a special add-factor. These add-factors are set now to add an average of about 45,000 jobs per month in the current year, but the actual overstatement of monthly jobs likely exceeds that number by a significant amount. Nonetheless, the BLS published its preliminary estimate for the 2012 benchmark revision September 27th, indicating an upside revision to not-seasonally-adjusted March 2012 payrolls of 386,000, or roughly 32,000 per month. At that pace, there will be no relief in current reporting issues before the 2013 benchmark to be published in February of 2014.

HOUSEHOLD SURVEY DETAILS. As discussed in the *Opening Comments and Executive Summary* and earlier writings such as *Commentary No. 461*, seasonally-adjusted month-to-month comparisons of components in the household survey have no meaning other than from the impact they have as hyped by the media, Wall Street and election-year politicians. The 0.1-percentage-point increase reported in the October headline unemployment rate could have been that, by extreme coincidence, but the headline number just easily could have increased by more, reflected no change, or even decreased month-to-month.

The actual numbers could be revealed by the BLS, if it chose to do so. There is no way to tell what the actual numbers are, given current BLS reporting policies; the BLS calculates but does not report consistent data, as part of its standard monthly-estimation process.

With that as background, following are the meaningless seasonally-adjusted numbers and absolutely worthless month-to-month comparisons, that will cause today's markets to gyrate, will excite the popular press and will lead the political candidates into their final pre-election pontifications. Separately, at least the not-seasonally-adjusted numbers are consistent in their preparation.

Headline Household Employment. Based on the October household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including multiple job holders more than once), October 2012 employment soared by a further incredible (as in unbelievable) 410,000, after booming by 873,000 in September, and after falling by 119,000 in August. As just discussed above, though, the seasonally-adjusted monthly change here is without significance, due to the underlying data not being comparable on a month-to-month basis.

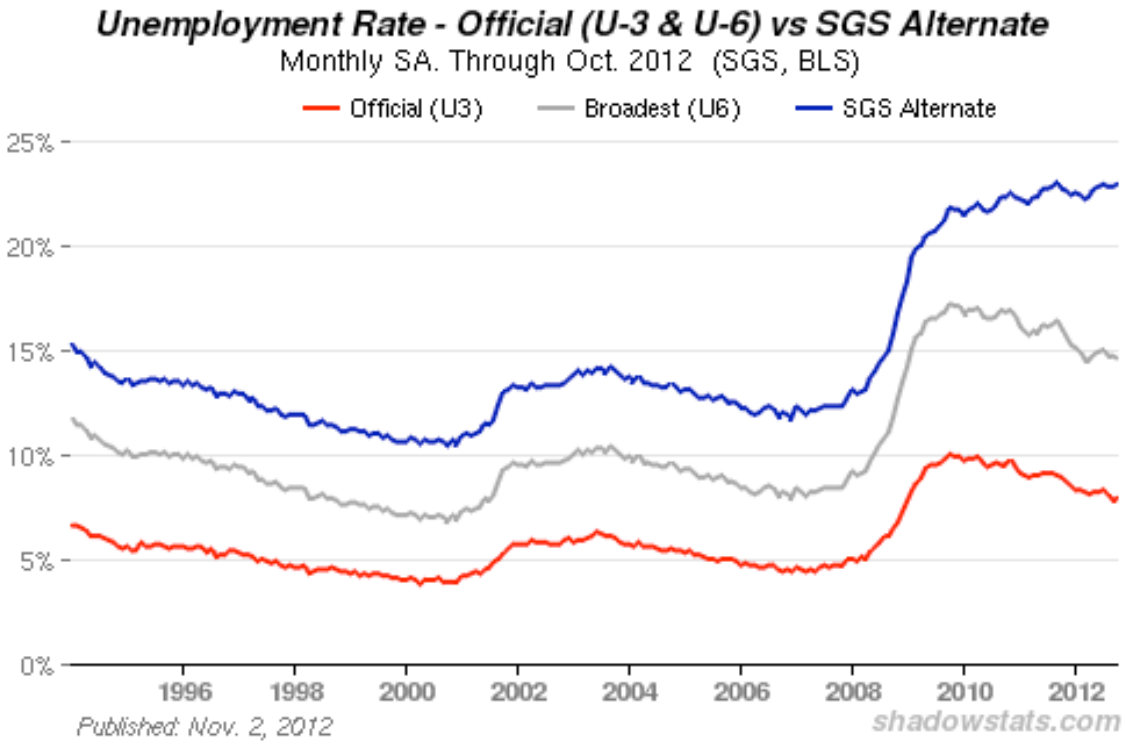
Unemployment Rates. The reported October 2012 seasonally-adjusted headline (U.3) unemployment rate of 7.87% was up by 0.07 percentage point for the month, which rounds to the headline 0.1 percentage point gain, when compared with the 7.80% unemployment rate that was separately and inconsistently estimated for September. In turn, similar numbers were separately and inconsistently estimated for August at 8.11%. The official +/- 0.23 percentage-point 95% confidence interval for the monthly headline number is meaningless in the context as discussed above, where the headline monthly change cannot be calculated due to underlying data inconsistencies, as discussed in the *Opening Comments*. On an unadjusted basis, October's U.3 unemployment rate was 7.5%, versus August's 7.6%.

The broadest unemployment rate published by the BLS, U.6 includes accounting for those marginally attached to the labor force (including short-term discouraged workers) and those who are employed part-time for economic reasons (they cannot find a full-time job). The October U.6 unemployment rate notched lower to a seasonally-adjusted 14.6%, versus 14.7% in September and August. The unadjusted October U.6 rate eased to 13.9%, from 14.2% in September and from 14.6% in August.

Discouraged Workers. The count of short-term discouraged workers (never seasonally-adjusted) rose to 813,000 in October, versus 802,000 in September, but still was down from 844,00 in August. Keep in mind, though, that he published number reflects a flow of unemployed, or the balance of the headline unemployed—increasingly giving up looking for work—leaving the U.3 unemployment category and being rolled into the U.6 measure as short-term "discouraged workers," versus those moving from short-term status into the netherworld of long-term discouraged-worker status. It is the long-term discouraged worker category that defines the SGS-Alternate or ShadowStats.com Unemployment Measure.

In 1994, during the Clinton Administration, "discouraged workers"—those who had given up looking for a job because there were no jobs to be had—were redefined so as to be counted only if they had been "discouraged" for less than a year. This time qualification defined away the long-term discouraged workers. The remaining short-term discouraged workers (less than one year) are included in U.6.

CAUTION: Month-to-month comparisons of the various unemployment rates are meaningless due to deliberate inconsistencies in BLS reporting.



Adding the SGS estimate of excluded long-term discouraged workers back into the total unemployed and labor force, unemployment—more in line with common experience as estimated by the SGS-Alternate Unemployment Measure—rose to 22.9% in October, up from 22.8% in September and August, and regaining its level of July, reflecting the toll of an increasing number of unemployed leaving the headline labor force. The SGS estimate generally is built on top of the official U.6 reporting, and tends to follow

its relative monthly movements. Accordingly, the SGS measure often will suffer some of the current seasonal-adjustment woes afflicting the base series.

There continues to be a noticeable divergence, however, in the ShadowStats.com series versus U.6. The reason for this is that U.6, again, only includes discouraged workers who have been discouraged for less than a year. As the discouraged-worker status ages, those that go beyond one year fall off the government counting, and new workers enter "discouraged" status. Accordingly, with the continual rollover, the flow of headline workers continues into the short-term discouraged workers (U.6), and from U.6 into long-term discouraged worker status (ShadowStats.com Measure), at what has been an accelerating pace. The aggregate August data show an increasing rate of individuals dropping out of the headline (U.3) labor force. See the Alternate Data tab for more detail.

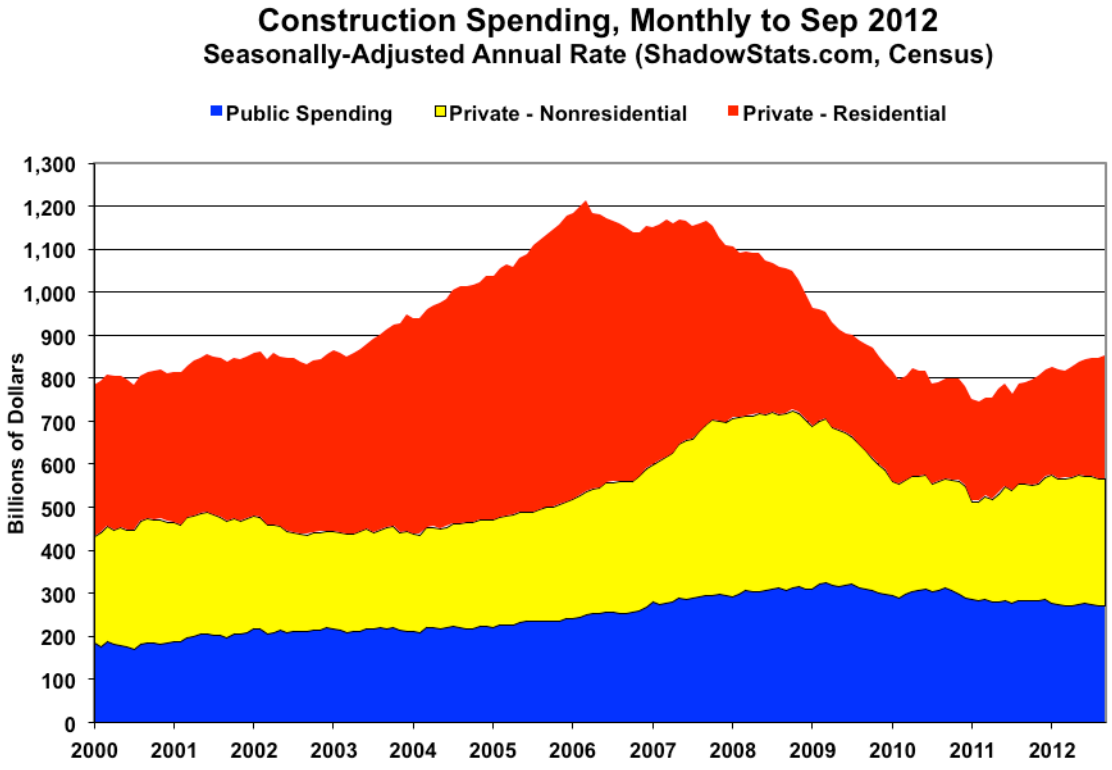
As discussed in previous writings, an unemployment rate nearing 23% might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%. The SGS level likely is about as bad as the peak unemployment seen in the 1973 to 1975 recession. The Great Depression unemployment rate was estimated well after the fact, with 27% of those employed working on farms. Today, less that 2% work on farms. Accordingly, for purposes of Great Depression comparison, I would look at the estimated peak nonfarm unemployment rate in 1933 of 34% to 35%.

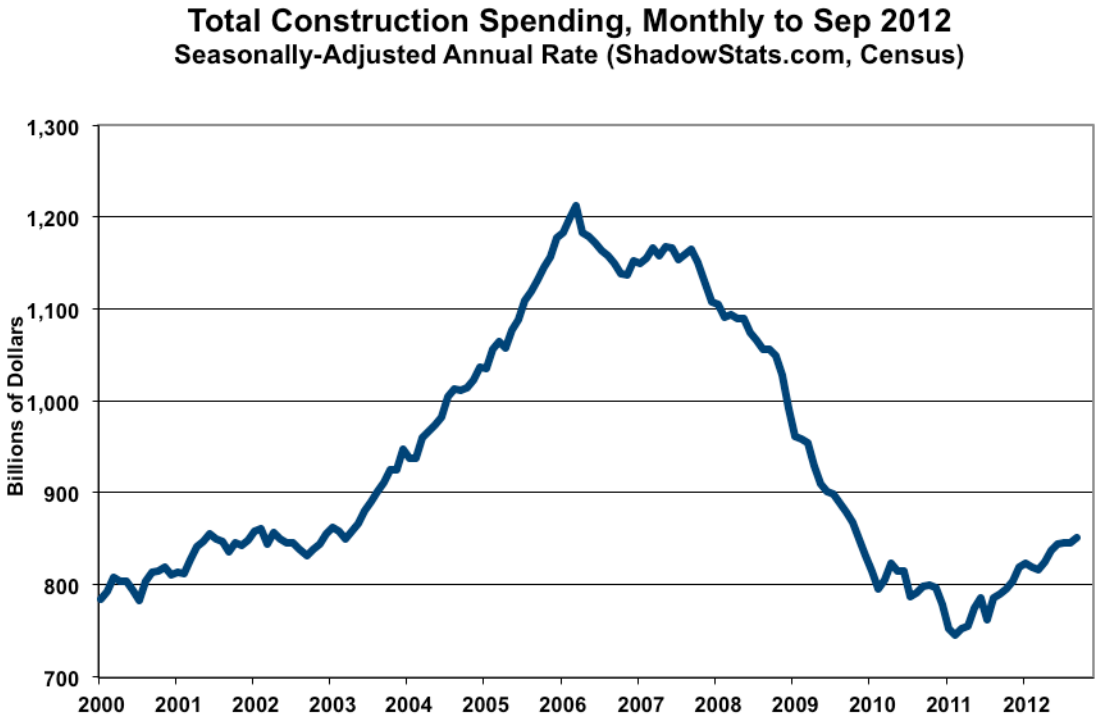
CONSTRUCTION SPENDING (September 2012)

Gain in September Construction Spending Continued to Reflect Bottom-Bouncing. The trend of stagnation in construction spending, at low levels of activity, continued in the the latest survey. The Census Bureau reported November 1st that the total value of construction put in place in the United States during September 2012 was $851.6 billion, on a seasonally-adjusted—but not inflation-adjusted—annual-rate basis. That estimate was up for the month by a statistically-insignificant 0.6% +/- 2.5% (all confidence intervals are at a 95% level), from an upwardly revised $846.2 billion (previously $837.1) in August. Before prior-period revisions, the September level actually was up by 1.7% from initial August reporting. The monthly decline in August, versus July, revised to 0.1%, from an initial estimate of a 0.6% monthly contraction.

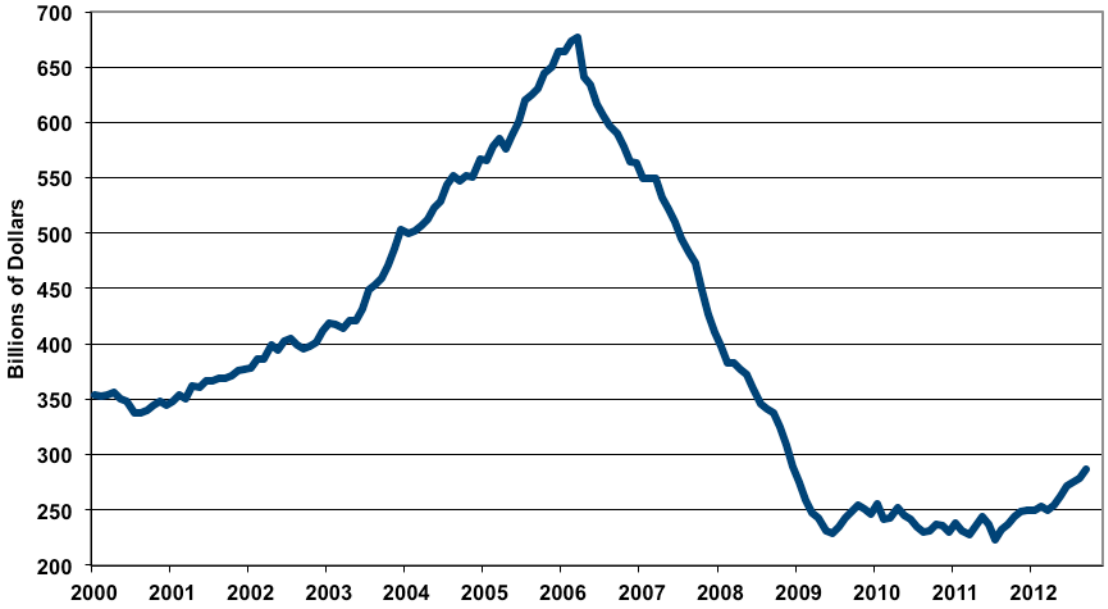
Although aggregate September construction spending was up year-to-year by a statistically-significant 7.8% +/- 2.5%, the gain likely was more than covered by increases in actual construction costs. The Bureau of Economic Analysis (BEA) underestimated year-to-year inflation in "structures" at 2.9% for third-quarter 2012. Year-to-year, August 2012 construction growth was revised higher to 7.6% (previously 6.5%).

The insignificant 0.6% gain in monthly September construction spending included a 0.8% drop in September public construction spending, which had revised to a 0.3% (previously 0.8%) contraction in August. September private construction rose by 1.3% in the month, versus a revised 0.1% gain (previously 0.5% monthly decline) in August. The accompanying graphs show the 0.6% monthly gain in September total construction, with private residential construction up by 2.8%, private nonresidential construction down by 0.1% and public construction down by 0.8% for the month.

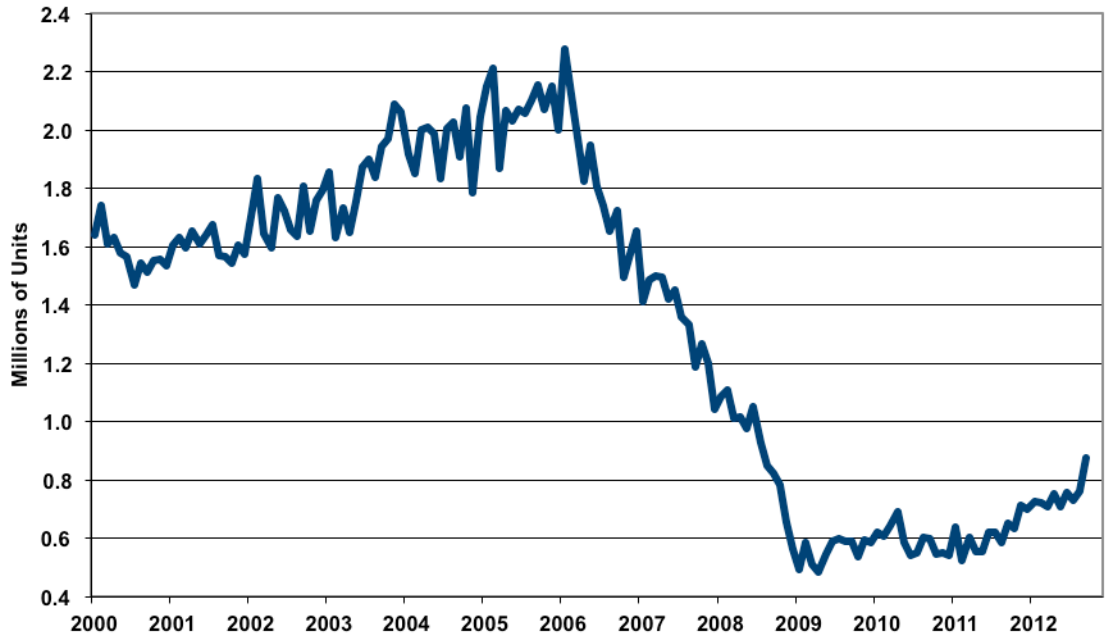

Construction Spending, Monthly to Sep 2012
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Public Spending
Private - Nonresidential
Private - Residential
Billions of Dollars
1,300
1,200
1,100
1,000
900
800
700
600
500
400
300
200
100
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012


Total Construction Spending, Monthly to Sep 2012
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)
Billions of Dollars
1,300
1,200
1,100
1,000
900
800
700
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

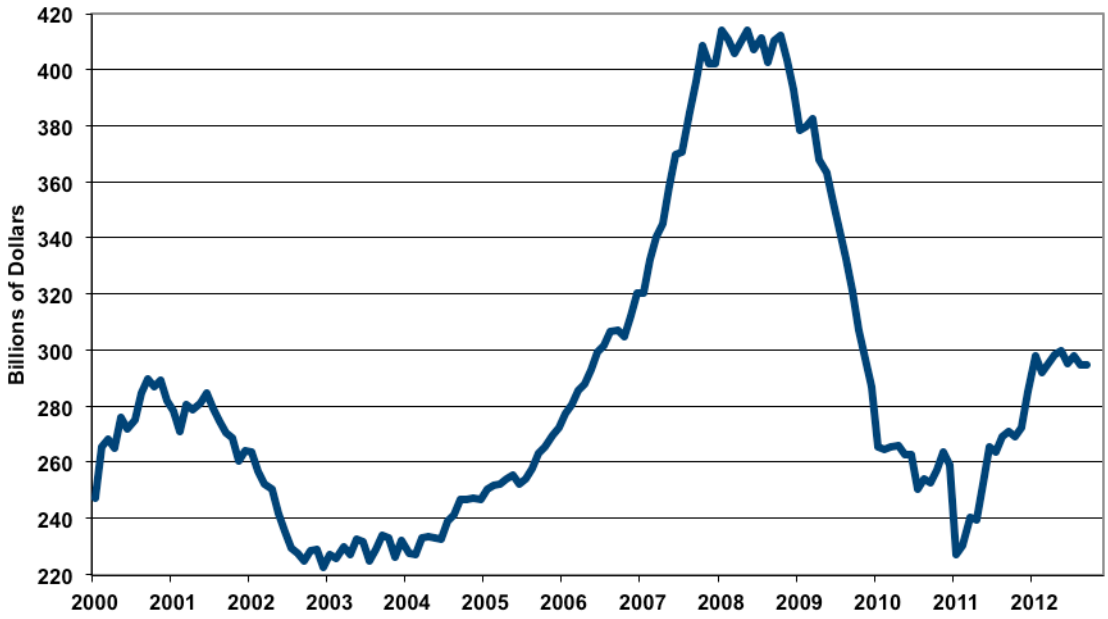
Private Residential Construction to Sep 2012
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)



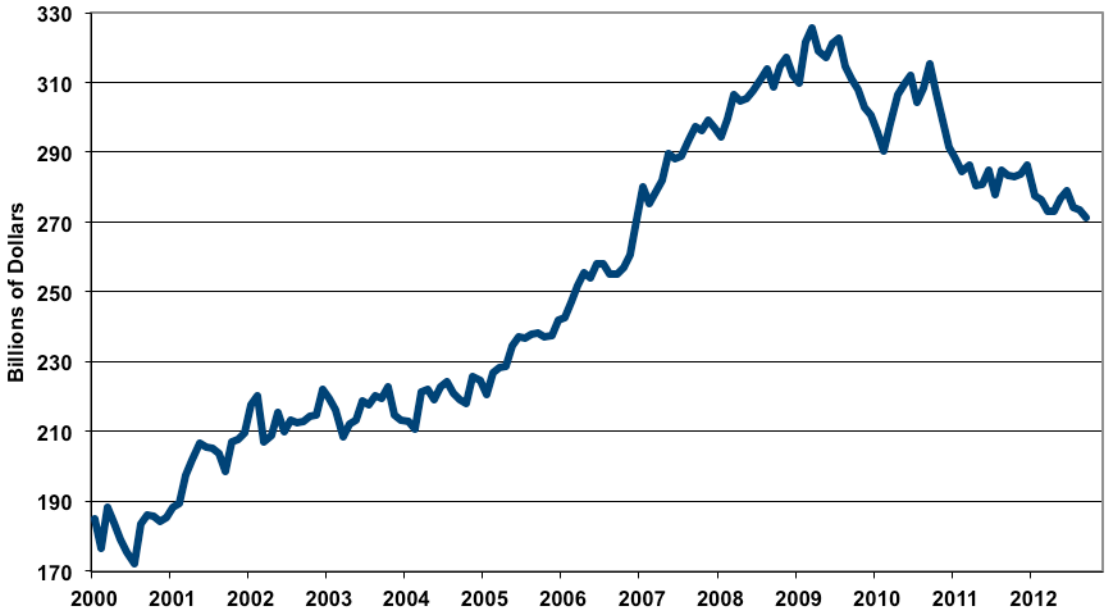
Housing Starts (Annual Rate by Month)
2000 to Sep 2012, Seasonally-Adjusted (ShadowStats.com, Census)



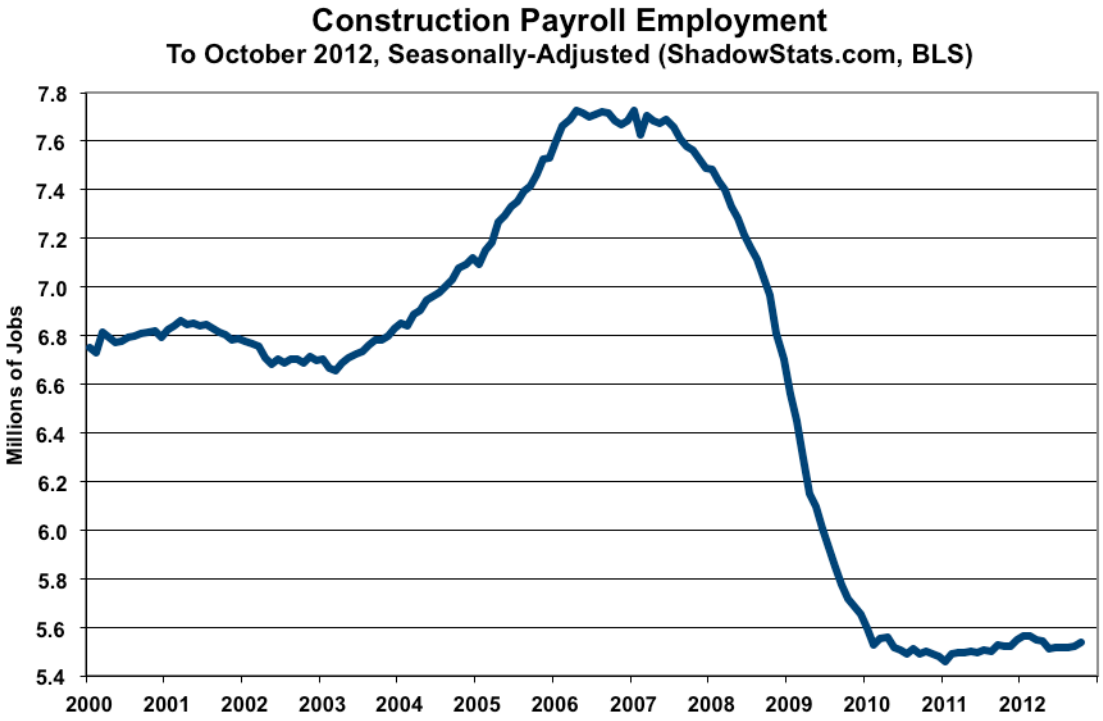
Private Nonresidential Construction to Sep 2012
Seasonally-Adjusted Annual Rate (ShadowStats.com, Census)



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



The third graph, covering private residential spending is shown along with an accompanying graph on the housing starts data as of September 2012. The difference is the smoother pace of actual spending (not-adjusted for inflation), instead of the more-irregular count of physical monthly starts.



As shown in the graph above, still in line with the ongoing bottom-bouncing reported through September 2012 in construction spending, and suggestive of continued industry stagnation in October, the seasonally-adjusted October construction-employment level was reported at 5.539, up by 0.3% or 17,000 jobs (16,800 in specialty-trade contractors), little changed from a revised 5.522 (previously 5.523) million reading in September, per the October payroll survey as published by the Bureau of Labor Statistics.

PERSONAL CONSUMPTION EXPENDITURE (PCE) DEFLATOR (September 2012)

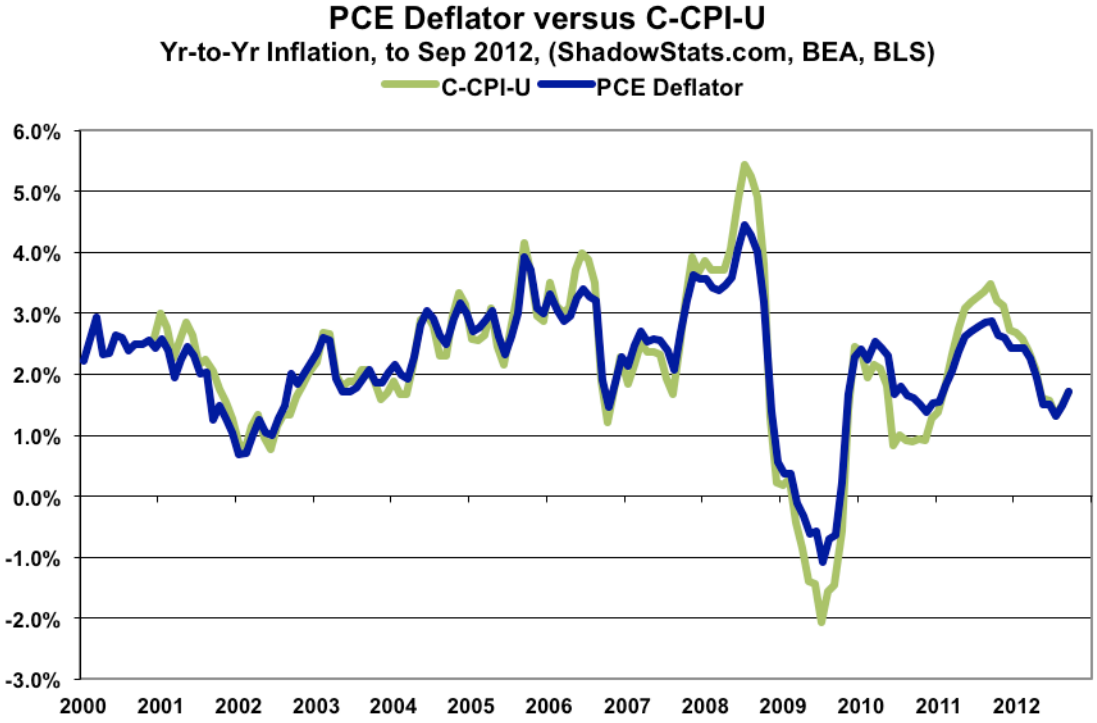
September PCE Deflator Rose 0.4% for the Second Month, with Year-to-Year Inflation Jumping to 1.7%. Published on October 29th by the Bureau of Economic Analysis (BEA), the seasonally-adjusted September PCE deflator was up by 0.38% for the month, versus a revised 0.41% (previously 0.43%) monthly gain in August.

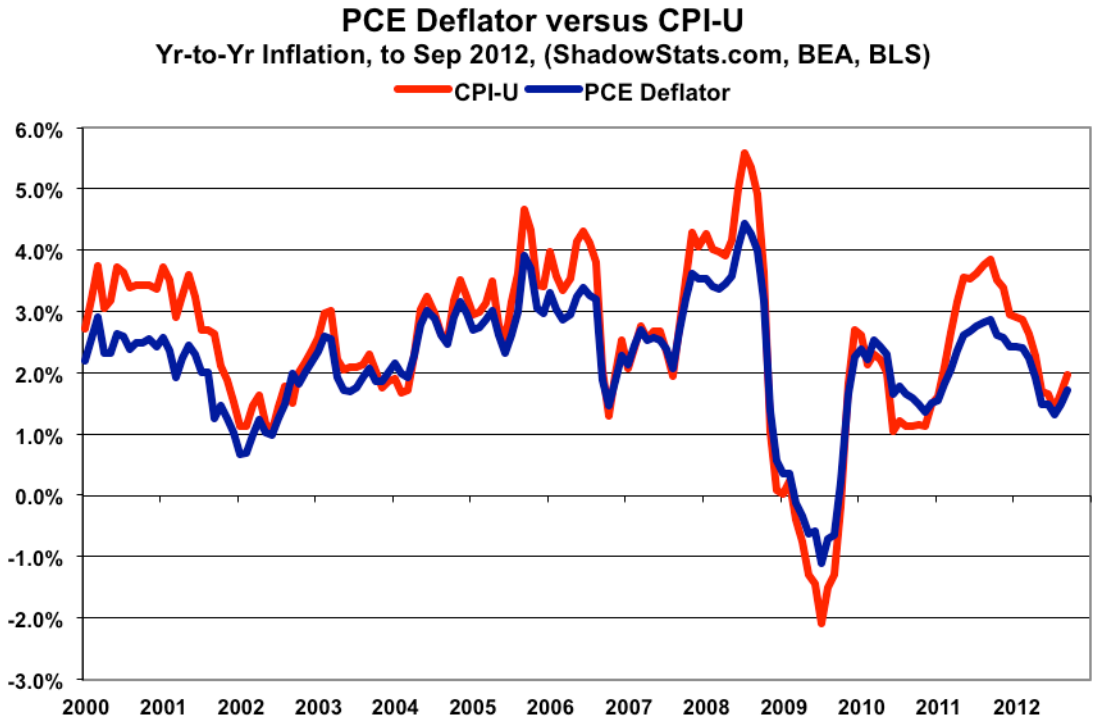
Year-to-year PCE-deflator growth picked up to 1.71% in September 2012 versus a revised 1.48% (previously 1.49%) annual gain in August. Annual PCE inflation held below the Fed's 2.0% target for the

sixth straight month. Nonetheless, the differential is narrowing, and below-target PCE inflation reporting should not become a protracted pattern here. The PCE deflator tends to follow the general direction of the CPI annual inflation rates, which are likely to show small increases in October.

PCE Deflator versus Other Inflation Measures. Where, in theory, the PCE deflator measure should be virtually identical to the fully substitution-based chain-weighted-CPI (C-CPI-U) (see *Commentary No. 476* for details of the latest C-CPI-U and other inflation measures), it actually has moved in tandem with, and has held at the same level as the C-CPI-U in the last three months of reporting. In contrast, despite all the methodological manipulation aimed at making the CPI-U a fully-substitution based index, that process is not complete, and the reported CPI-U inflation generally remains above the PCE deflator and C-CPI-U measures. Those series are shown in the accompanying graphs; see the *Public Comment on Inflation* for further detail on the methodological machinations.

The September 2012 PCE deflator showed 1.7% year-to-year inflation, versus 1.5% in August. That compared with annual inflation in the September C-CPI-U at 1.7%, versus 1.5% in August; September CPI-U at 2.0%, versus 1.7% in August; September CPI-W at 2.0%, versus 1.7% in August; and the September SGS-Alternate (1980-Base) at 9.6%, versus 9.3% in August.





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 still-fragile banking-system solvency. The Fed's primary function remains keeping the banking system afloat, at any cost, as suggested by the introduction of QE3, and as likely will be demonstrated again as the U.S. central bank overtly reacts to a re-intensifying systemic solvency crisis.

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—generally tends to yield, and currently is yielding the lowest annual consumer inflation rate of the major series (actually for that honor tied with the C-CPI-U level, at present, per 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. As noted in *Commentary No. 474,* public speculation as to political manipulation economic numbers hit a level of activity that was unprecedented with September's labor-data releases, a circumstance that did not go away with October's reporting. Whether or not manipulation has taken place with recent reporting, supporting evidence either way likely will be forthcoming in the year ahead.

Nonetheless the reporting quality for employment and unemployment, and GDP growth is abysmal. In any event, numbers that are too far removed from common experience will tend to be viewed by the public with extreme skepticism.

Recognition of an intensifying double-dip recession still has taken a 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; 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, reporting generally should continue to show higher-than-expected inflation and resume indicating weaker-than-expected economic results in the post-election months and year ahead. Increasingly, previously unreported economic weakness should continue to show up in prior-period revisions.

U.S. Trade Balance (September 2012). The September 2012 trade deficit detail will be released on Thursday, November 8th. The U.S. trade deficit continues in fundamental deterioration, with the September number having a fair shot of deteriorating by more than market expectations. The September report will complete the third-quarter merchandise trade data used in estimating the third-quarter GDP's net-export account. Where a deteriorating deficit has negative impact on GDP growth, a significantly wider-than-expected deficit in September (or August in revision) would tend to result in a downward revision in the upcoming first-revision to the third-quarter GDP estimate on November 29th. An unexpected narrowing of the September deficit would tend to boost the GDP revision. The general trend here going forward, though, should be for trade deterioration and net negative impact on the GDP estimates.
