

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

COMMENTARY NUMBER 497
Monetary and Fiscal Developments, December Home Sales

January 25, 2013

**Congress Tries to Buy More Time to Balance Fiscal Conditions
But Patience of Global Markets is Finite**

Ongoing Economic Downturn Means Budget Prognostications Are Overly Optimistic

**QE3 Begins to Surface: Monetary Base at All-Time High,
Broad Money Growth Rises**

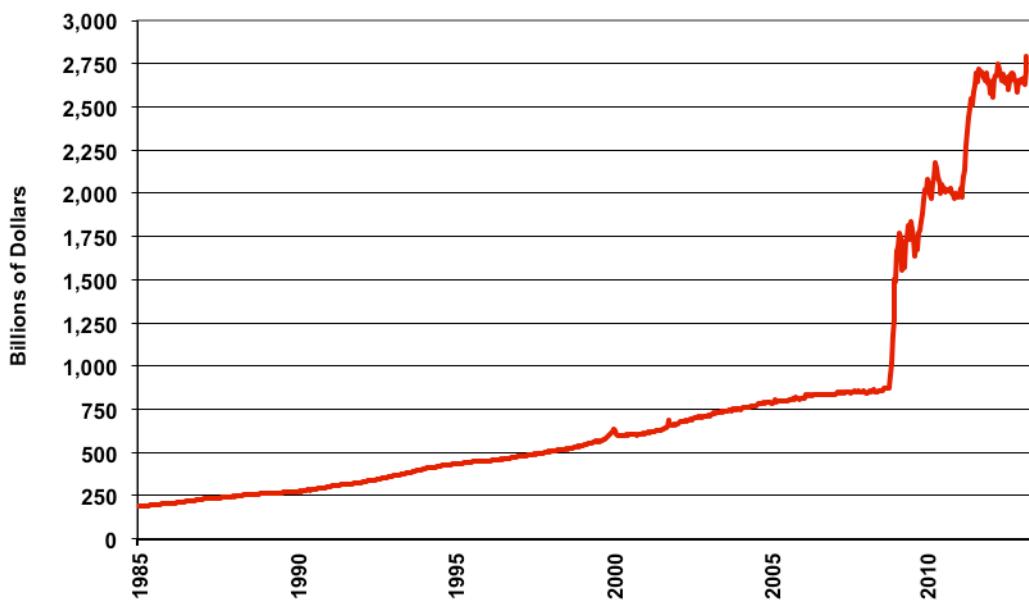
PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, January 30th, covering the first or “advance” estimate of fourth-quarter 2012 GDP, as well as December 2012 new orders for durable goods. It will be followed on Friday, February 1st, by a Commentary covering January 2013 employment and unemployment—including the annual benchmark revisions to nonfarm payrolls—and December construction spending.

A Special Commentary, analyzing the GAAP-based 2012 Financial Statement of the United States Government, will be published within the week of January 28th.

Best wishes to all — John Williams

Opening Comments and Executive Summary. In a week shy of meaningful new economic data, the politicians in Washington, D.C. have added further delay to addressing the U.S. fiscal crisis, while the Fed’s QE3 has begun to spike the monetary base and to boost growth in the broad money supply.

St. Louis Fed Adjusted Monetary Base
Bi-Weekly through January 23, 2013, SA, St. Louis Fed



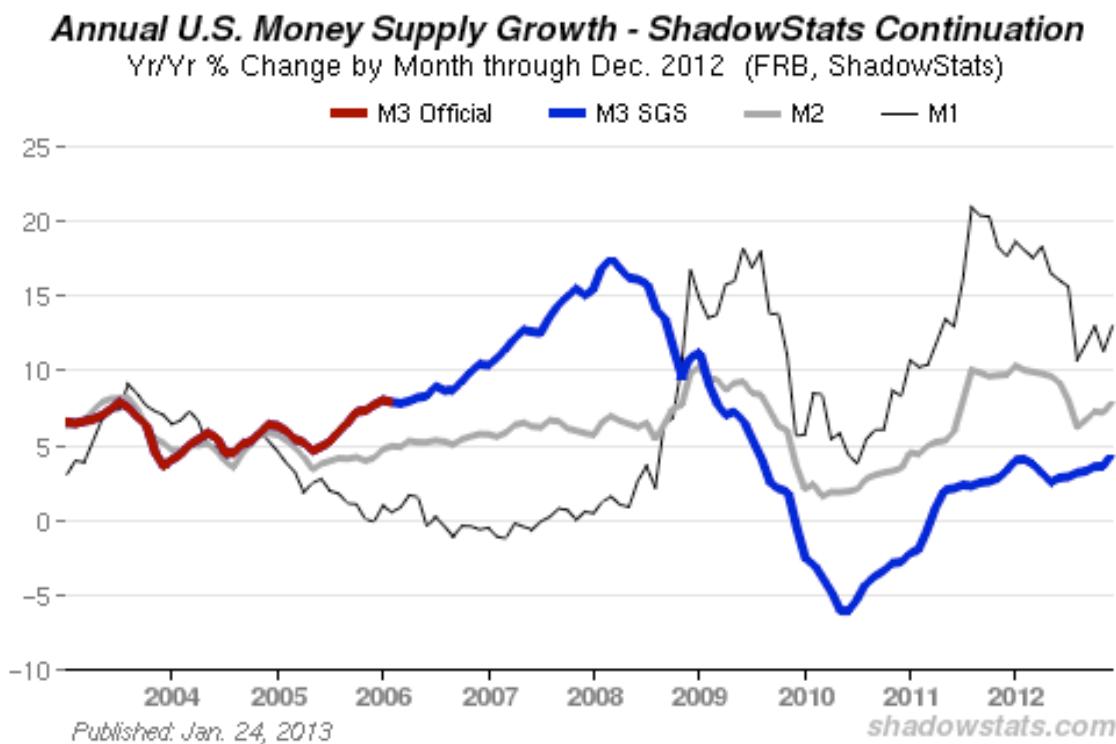
St. Louis Fed Adjusted Monetary Base
Yr/Yr %, Bi-Weekly through Jan 23, 2013, SA, SGS, St. Louis Fed



Impact of Fed Easing Begins to Surface. Shown in the preceding graphs, the Fed has begun 2013 executing its promised QE3, with the effect of pushing the seasonally-adjusted (SA) St. Louis Fed's adjusted monetary base to a record-high level. As discussed in [Commentary No. 488](#), the Federal Reserve announced on December 12, 2012, that it would extend its current quantitative easing effort (QE3) to include regular purchases of U.S. Treasury securities at a pace of \$540 billion per year, effectively monetizing about half of all new net U.S. Treasury issuance of debt to the public. The graph of year-to-year change in the monetary base, would show annual growth pushing towards 40% in the year ahead, assuming the Fed's purchases of securities continue at the prescribed pace.

The monetary base is a factor that usually drives money supply growth, but is not part of the money supply, per se. It consists of currency in circulation, which also is part of the narrowest money supply measure, M1, plus bank reserves, both required and excess. An increasing level of bank reserves usually supports bank lending and money supply growth. In the current circumstance, excess reserves stand at an extraordinarily high level of about \$1.5 trillion, versus \$0.1 trillion in required reserves.

Instead of substantially increasing lending into the normal flow of commerce, banks generally are parking their excess cash with the Fed. The result has been unusually weak money supply growth, instead of the surging money supply growth that would be expected with such Fed accommodation.



Where the Fed has purchased mortgage-backed securities, those transactions generally have affected banks, without much impact flowing through to the money supply. Where the Fed has purchased U.S. Treasury securities, however, the effect has been more direct in impact on bank accounts in the money

supply. As a result, even with limited lending of new funds to the public by banks, the broad money supply has tended to show some upturn in annual growth from the increasing monetization of Treasury debt, as was seen with QE2 and as will be seen increasingly with this new phase of QE3.

As shown in the preceding graph, year-to-year change in M3 turned to the positive, following the introduction of QE2 in late-2010. Growth began to accelerate in December 2012, hitting a two-year high, and the pattern of annual growth appears to be on track for further acceleration in January 2013.

Generally, higher annual M3 growth is an indicator for higher inflation (see detail in [*Money Supply Special Report*](#)).

Delaying Tactics for Addressing the Federal Fiscal Crisis. The latest negotiations on the federal budget deficit again have delayed action. The negotiations of mid-2011 pushed the hard decisions off until after the 2012 election. The “fiscal cliff” negotiations pushed those decisions a couple of months into 2013, and another couple of months appear to have been tacked onto the process during this last week, with a delay in handling the debt-ceiling issues, and with promises of negotiating a ten-year balanced federal budget.

A big problem facing the budget negotiators is that patience is wearing thin in the global financial markets. The politicians in Washington do not have unlimited ability to delay the hard decisions, without the potential of a rapid and severe negative reaction in the currency markets hitting the U.S. dollar.

There appears to be nothing here other than some new rhetoric. The chances of the Congress and the White House meaningfully addressing the longer-range solvency issues of the U.S. government remain nil. The changes required to balance the system are too politically painful and, accordingly, are politically impossible for those controlling the government to put in place.

The budget that Congress and the Administration generally are talking about balancing over the next ten years is the cash-based deficit. The cash-based deficit in 2012 was \$1.1 trillion. In contrast, the GAAP-based deficit for 2012 was \$6.9 trillion, as will be discussed soon in the pending *Special Commentary*. It is the GAAP-based deficit that has to be balanced.

Projecting fiscal operations over ten years is a regular political game, but the numbers have little meaning beyond a year or so ahead. A major factor in the projections is the underlying assumption of economic growth. Usually, overly-optimistic economic forecasts are used in these budget projections, with the effect of underestimating future shortfalls in fiscal operations. This area will be discussed more completely in the upcoming *Special Commentary*.

December Existing- and New-Home Sales. December home sales activity generally suggested an ongoing pattern of stagnation, with neither the monthly 7.3% decline in new-home sales, nor the 1.0% decline in existing home sales, respectively, being statistically meaningful or outside the range of normal series volatility. The same can be said for year-to-year growth, which, though positive, slowed in December for both series. Neither home-sales number supported the December housing starts monthly growth, although the monthly change there (a gain of 12.1%) also lacked statistical significance.

As discussed in [*Hyperinflation 2012*](#) and [*No. 485: Special Commentary*](#), consumer liquidity remains structurally impaired, which does not support expectations of any unfolding recovery in the broad economy, let alone the housing sector.

[More complete reporting detail and graphs for December 2012 existing- and new-home sales are found in the Reporting Detail section.]

HYPERINFLATION WATCH

Hyperinflation Outlook: Fiscal and Monetary Changes. The following text has been updated to reflect detail in the *Opening Comments*. It will be fully rewritten following the pending *Special Commentary* on the U.S. government's financial statements. These comments are intended particularly for new subscribers, as well as for those who otherwise are not familiar with the hyperinflation report or the recent special commentary, linked below. Those documents are suggested as background reading on the financial turmoil and currency upheaval facing the United States in the next year or two.

The November 27, 2012 [*Special Commentary \(No. 485\)*](#) updated [*Hyperinflation 2012*](#) and the broad outlooks for the economy and inflation, as well as for systemic stability and the U.S. dollar. These remain the two primary articles outlining current conditions and the background to the hyperinflation forecast.

Subsequent to *Special Commentary (No. 485)*, neither new economic data nor fiscal developments have altered the broad outlook. As discussed in the *Opening Comments*, the expansion of QE3 by the Fed, on December 12th, has begun to impact the monetary system, spiking the monetary base and beginning to boost annual growth in the broad money supply. That circumstance should begin to contribute to the inflation outlook, even in the absence of normal bank lending.

Despite the near-term political hype that Congress will come up with a plan to balance the budget in a ten-year time frame, little but further political hype and gimmicked numbers are likely to come out of the current negotiations. Ongoing economic woes assure that the usual budget forecasts—based on overly-optimistic economic projections will fall far short of fiscal balance and propriety. Further, the chances of the government addressing the GAAP-based deficit, which hit \$6.9 trillion in 2012, versus the official cash-based accounting of \$1.1 trillion, remain nil.

The ongoing unwillingness and political inability of the current government to address seriously the longer-range U.S. sovereign-solvency issues, only continue the regular unfolding of events that eventually will trigger a domestic hyperinflation, as discussed in [*Commentary No. 491*](#).

The Fed's current liquidity actions can be viewed as a signal of deepening problems in the banking system. As discussed by Mr. Bernanke, the Fed can do little to stimulate the economy, but it can create inflation. Nonetheless, the Fed's move here was to prop-up the banking system and to provide back-up liquidity to the U.S. Treasury in the months ahead. The renewed direct monetization of Treasury debt will tend to savage the U.S. dollar's exchange rate, boost oil and gasoline prices, boost money supply growth and domestic U.S. inflation.

The primary issue, however, remains the failure of the government to make any serious effort at bringing the nation's extreme and dangerous fiscal conditions into balance. Efforts at delaying meaningful fiscal action, and at briefly postponing addressing the Treasury's debt ceiling, have bought the politicians in Washington a little time in the global markets, but the patience in the global financial markets is wearing thin. Market tranquility likely will not last much longer, despite the tactics of delay in Washington. This should become increasingly evident as disgruntled global markets begin to move against the U.S. dollar.

REPORTING DETAIL

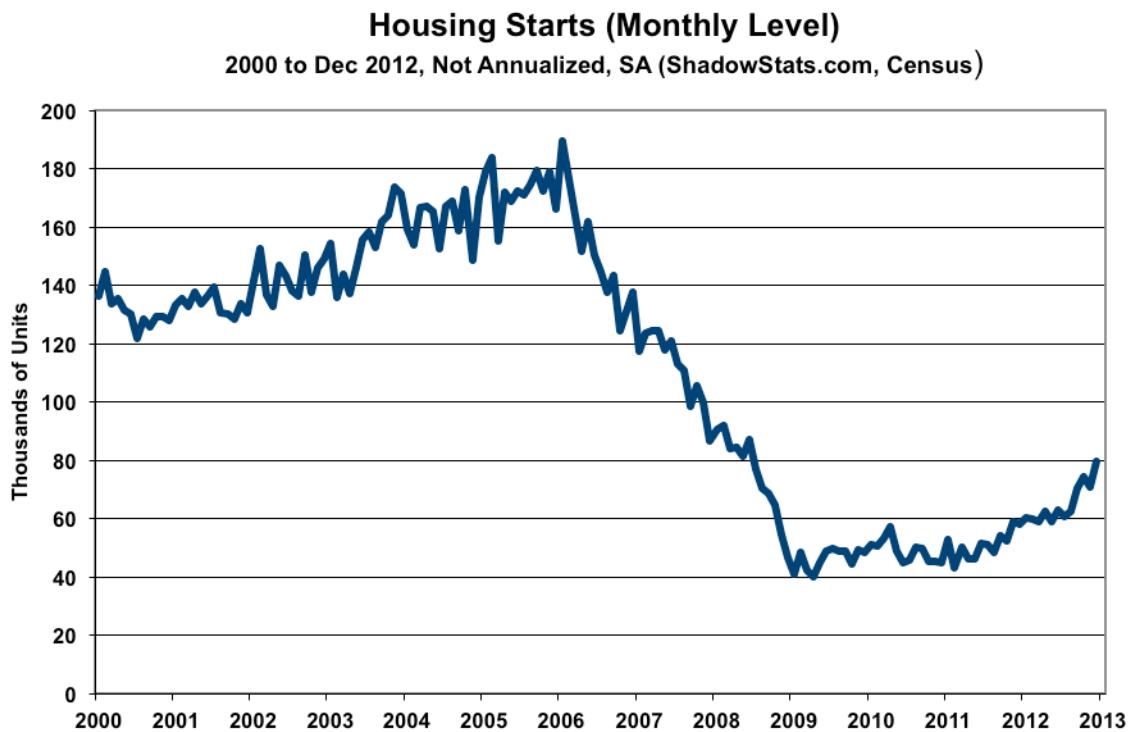
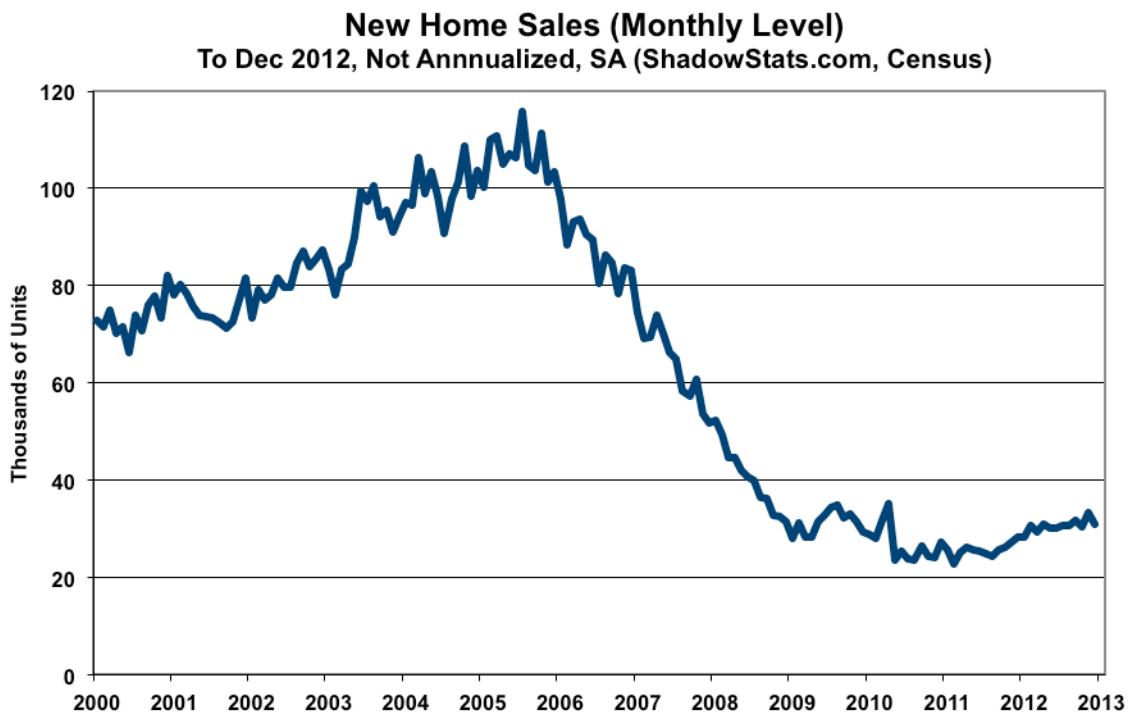
NEW-HOME SALES (December 2012)

New-Home Sales Activity Remained Stagnant in December. December 2012 new home sales remained in a state of depressed stagnation or bottom-bouncing, in the ongoing aftermath of the housing-industry collapse from 2006 into 2009. That same pattern has been seen consistently with the housing starts data. The two graphs following show the largely parallel patterns of new-home sales activity versus housing starts. Although the starts have been somewhat stronger than the sales, recently, that has been due partially to the inclusion of apartments in the starts and to bad-quality seasonal adjustments. In any event, the monthly changes continue to be statistically insignificant (see [Commentary No. 495](#) for reporting detail on December housing starts). The graph reflecting the December existing-home sales is included in the next section. Note that all three graphs here (including existing-home sales) are expressed in monthly sales of thousands of units, rather than annualized rates of millions of units).

Shy of any temporary boost to sales from storm-replacement activity, there have been no developments in underlying economic fundamentals that would suggest a pending housing-industry turnaround or an unfolding, broad economic recovery, as discussed in [No. 485: Special Commentary](#).

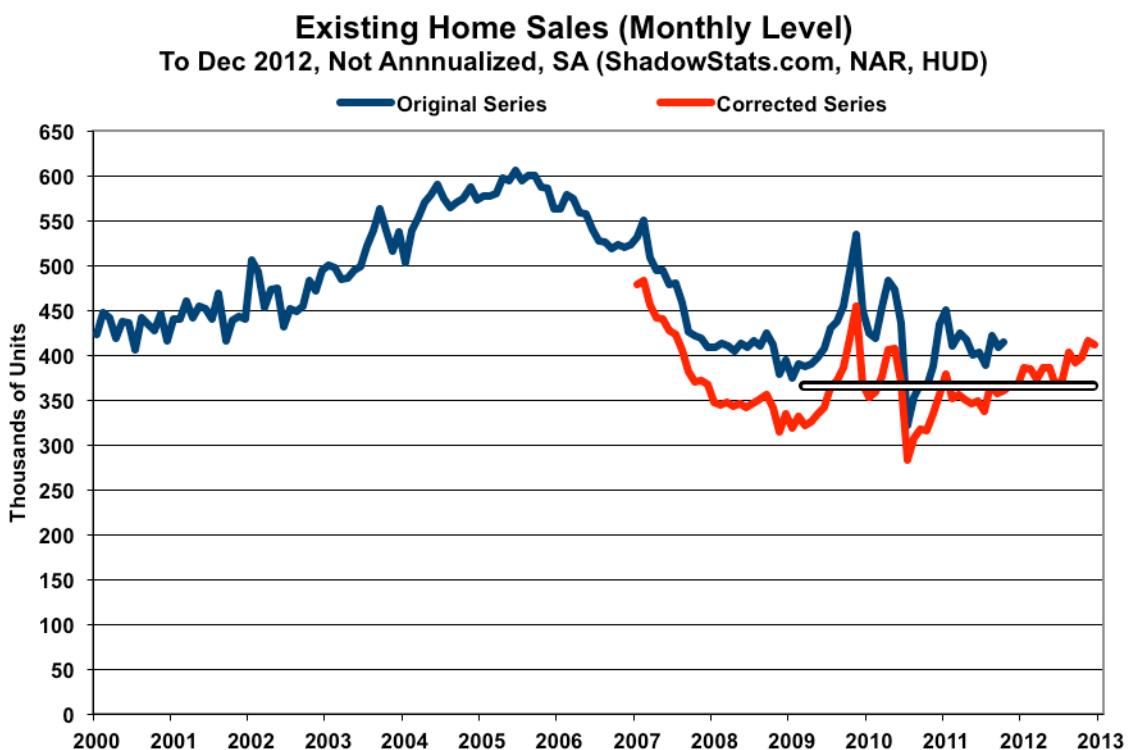
December Reporting. Today's (January 25th) release of December 2012 new-home sales (counted based on contract signings, Census Bureau) showed a statistically-insignificant 7.3% month-to-month decline (down by 2.1% before prior-period revisions) +/- 17.9% (all confidence intervals are at the 95% level). Lack of statistical significance in month-to-month change for this series has been a common circumstance for more than three years. In turn, November's monthly gain was revised to 9.3% (previously 4.4%).

December's year-to-year gain of 8.8% +/- 29.0% in new-home sales also was statistically-insignificant. The November annual gain was revised to 21.7% (previously 15.3%). Recent volatility in annual change reflects partially the effects of lapsing stimulus efforts last year.



EXISTING-HOME SALES (December 2012)

December Existing-Home Sales Decline of 1.0% Remained Well Within Normal Scope of Month-to-Month Volatility. Beyond the massive downside corrections to the existing-home sales series—published with November 2011 data—reporting for the existing-home sales series remains subject to a high level of irregular volatility and 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, and lapsing of same, for home buyers that pulled some future sales activity into the periods of the incentives. The horizontal line in the graph is the average monthly level for the period of extreme sales volatility.

With those sales swings, averaged out—as shown in the graph—the pattern of activity resembles the bottom-bouncing seen previously in the new-home sales, and in housing-starts activity discussed in the prior section, although the existing home sales peak-to-trough contraction never was as severe as that seen in the sales tied to new construction.

Existing Home Sales Reporting. The January 22nd release of December 2012 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly decline of 1.0% (down by 2.0% net of prior-period revisions) versus a revised gain of 4.8% (initially estimated at 5.9% in November).

December's 1.0% sales decline to a seasonally-adjusted monthly pace 411.7 thousand was well within the normal month-to-month volatility for this series. Shy of the revised November monthly pace of 415.8 (previously 420.0) thousand, December showed the highest level of activity since the re-defined November 2009 number.

On a year-to-year basis, December 2012 sales rose by 12.8%, versus a revised 13.4% (previously 14.5%) annual sales gain in November. Recent volatility in annual change still partially reflects the effects of lapsing housing stimulus efforts the year before. Smoothed for irregular distortions, the series remains statistically consistent with an ongoing pattern of broad stagnation.

The portion of distressed properties in existing sales rose anew in the latest reporting. The NAR estimated December's "distressed" sales at 24% (12% foreclosures, 12% short sales), versus November's 22% (12% foreclosures, 10% short sales).

Reflecting ongoing lending issues within the banking industry, all-cash sales in December 2012 were 29%, versus 30% in November, versus 31% in December 2011.

The published median and average sales price data for existing homes tend to be of 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 existing-home sales prices in December 2012 (not seasonally-adjusted) were reported up month-to-month, and year-to-year.

WEEK AHEAD

Weaker Economic and Stronger Inflation Data Are Likely. *Beyond the dissipating effects of the repair, replacement and reconstruction activity generated by Hurricane Sandy, and in anticipation of the likely negative impact of expanded QE3 and the ongoing fiscal crisis/debt-ceiling negotiations on the currency markets, reporting in the months and year ahead generally should reflect higher-than-expected inflation and indicate weaker-than-expected economic results. Increasingly, previously unreported economic weakness should continue to show up in prior-period revisions.*

Significant reporting-quality problems continue with most major economic series. Headline reporting issues remain tied largely to systemic distortions of seasonal adjustments, distortions that have been induced by the still-ongoing economic turmoil of the last five years. The recent economic collapse has been without precedent in the post-World War II era of modern economic reporting. These distortions have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series. In any event, where numbers are too far removed from common experience, they tend to be viewed by the public with extreme skepticism.

Still, recognition of an intensifying double-dip recession continues to gain, while recognition of a mounting inflation threat has been rekindled by the Fed's monetary policies. The political system would

like to see the issues disappear, and still appears to be trying to work numerical slight-of-hand with series such as the GDP; 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 [Hyperinflation 2012](#) and [No. 485: Special Commentary](#).

New Orders for Durable Goods (December 2012). The reporting of December 2012 new orders for durable goods is scheduled for Monday, January 28th, by the Commerce Department. Despite the sharp and irregular volatility in commercial aircraft orders, new orders have been trending lower. That trend likely will continue, even though a given month's results may not fall outside the bounds of normal variability.

In terms of the potential inflation contribution to the monthly and annual change in new orders, the seasonally-adjusted, month-to-month change in the December 2012 PPI finished goods capital equipment index was a contraction of 0.1%, with year-to-year unadjusted inflation at 1.4%. Due to hedonic-quality adjustments to this portion of the PPI series, however, as with the GDP numbers, those inflation data underestimate inflation reality and correspondingly overstate inflation-adjusted growth by perhaps two-percentage points per year.

Gross Domestic Product—GDP (Fourth-Quarter 2012, First or Advance Estimate). The initial guesstimate of fourth-quarter 2012 GDP growth is due for release by the Bureau of Economic Analysis (BEA) on Wednesday, January 30th. Where the BEA literally has to guess at the “advance” estimate, it usually tends to target consensus forecasts, which is something of a perverse self-feeding cycle.

The market expectations appear to be closing in on a headline growth rate well below 2.0%, versus the 3.1% last reported for the second-quarter. An initial estimate that surprises the eventual consensus on the downside is a fair bet, where the economy appears to have already turned down. A downturn actually could surface in the July 2013 annual GDP revisions.

Whatever is reported, the new number most certainly still will not be statistically significant, with the GDP series remaining the most worthless, the most heavily politicized and the most misleading of any major government economic statistical release.

Employment and Unemployment (January 2013, Annual Benchmark Revision to Payrolls). The January labor data, along with the annual benchmark revisions to nonfarm payrolls, are due for release on Friday, February 1st, from the Bureau of Labor Statistics (BLS). Most commonly, the consensus jobs estimate settles around the trend estimate that comes out of the BLS seasonal-adjustment models. The January 2012 payroll trend number is for a 150,000 jobs gain, as discussed in principle in [Commentary No. 492](#), and the early consensus appears to be settling in above that, with the unemployment rate considered likely to hold at 7.8%.

Where underlying fundamental economic activity remains weaker than consensus, the employment and unemployment numbers should be weaker than market expectations. Given the various revisions that are about to be reported for both the payroll and household surveys, the BLS has unusual flexibility as to what gets reported for the headline January 2013 numbers.

Nonfarm Payroll Benchmark Revision. The BLS has indicated an initial estimate of the benchmark revision to the not-seasonally-adjusted March 2012 payroll levels of plus 386,000 jobs, or roughly 32,000

jobs per month, spread out over the year from April 2011 to March 2012. The revisions, however, will be estimated and guessed at up to date, which, again, gives the BLS extraordinary leeway in the January payroll reporting.

Population Revisions to Household Survey. The usual annual population revisions to the household survey also will be published with this report. As a result, none of the unemployment numbers published in December will be consistent or comparable with the January numbers, separate from the usual monthly distortions and lack of month-to-month comparability that result from the use of (but not the publication of the results of prior) concurrent seasonal adjustments.

Construction Spending (December 2012). Due for release on Friday, February 1st, by the Commerce Department, December 2012 construction likely saw some boost in activity from unseasonably-mild weather and from reconstruction activity resulting from Hurricane Sandy damage. Net of what likely will be a short-term, storm-recovery impact, and catch-up in seasonal-factor distortions, continued stagnation at low levels of activity—particularly after inflation-adjustment—should remain the underlying trend in this series. The December monthly changes are not likely to be statistically significant. Again, however, rebuilding from the storm destruction should generate some temporary, upside gains to activity during the next several quarters.
