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

COMMENTARY NUMBER 498
Fourth-Quarter GDP, December Durable Goods

January 30, 2013

Although Recovery Never Took Place, Official Double-Dip Recession Likely Will Be Clocked from Second- or Third-Quarter 2012

Reported Contraction in Real GDP Designed to Discourage Fiscal Reform?

Fourth-Quarter Nominal GDP Growth Collapsed to 0.46% from 5.91%

Real Durable Goods Orders Contracted Year-to-Year, Despite Temporary Orders Boost from Year-End Defense Spending

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PLEASE NOTE: The next regular Commentary *is scheduled for Friday, February 1st, covering January 2013 employment and unemployment—including the annual benchmark revisions to nonfarm payrolls—and December construction spending. The* Special Commentary*, analyzing the GAAP-based 2012 Financial Statement of the United States Government, will be published this week (week of January 28th).*

Best wishes to all — John Williams

Opening Comments and Executive Summary. The economic and systemic-solvency crises of the last seven years continue. There never was a post-2009 recovery in business, just a protracted period of economic stagnation, which began to turn down anew in second- and third-quarter 2012. Prospects for a pending economic recovery remain nil. As discussed in *Hyperinflation 2012* and *No. 485: Special Commentary*, consumer liquidity remains structurally impaired, which supports neither the government's

claims of economic recovery since June 2009, nor current expectations or hype of any unfolding improvement in the broad economy.

Although not statistically significant, the headline decline of 0.1% in real (inflation-adjusted) fourth-quarter GDP—the first quarterly contraction since the official recession—could have been produced with simple massaging of the data. Given the level of guessing included in today's (January 30th) GDP guesstimate (see below), the Bureau of Economic Analysis (BEA) had the ability to bring in headline growth at any level desired, certainly within a couple of tenths of an annualized-percentage point. Decisions of at least that magnitude had to be made in order to put out the fourth-quarter guesstimate.

At first, deliberately producing a headline GDP contraction may appear to be counterintuitive from a political standpoint, but consider the negotiations ahead in Washington, D.C. With a small contraction reported in the economy, it could be argued by those opposed to cutting the budget deficit, that any move towards fiscal constraint now only would drive the economy into renewed recession, the long-feared double-dip becoming a reality.

In reality, however, the economy already is in that double-dip, a byproduct of the unfolding crises in play since 2006 and before. A sustainable recovery cannot and will not be forthcoming until consumers' structural income problems are resolved, and until the nation's extreme fiscal imbalances are addressed.

In other reporting, December new orders for durable goods rose by 4.6%, thanks largely to a temporary surge defense capital spending. That circumstance, however, ran counter to the sharp decline in fourth-quarter defense spending, which helped to drag down the headline growth rate for fourth-quarter GDP.

In addition, as shown at the end of this *Opening Comments* section, consumer confidence fell sharply in January 2013, beginning to reflect a pattern of movement consistent with a renewed downturn in economic activity.

Fourth-Quarter GDP Contraction. Although the first estimate of fourth-quarter GDP showed a 0.14% annualized quarter-to-quarter contraction, that decline was statistically insignificant. It was no more meaningful than the reporting of otherwise insignificant quarterly gains in recent quarters. Irrespective of revisions to fourth-quarter 2012 GDP data in next two months, first-quarter 2013 also is a candidate for a formal quarterly contraction. Along with the annual GDP revisions due in July 2013, revamped numbers should show quarterly contractions extending well backwards into 2012.

As put forth by the BEA, the 0.14% headline fourth-quarter GDP contraction reflected the following. Please note that the growth number in each subheading is the additive contribution to the aggregate, headline change in GDP, where 1.52% - 0.08% - 0.25% - 1.33% = -0.14%:

- ***Consumer Spending Contributed 1.52% to Growth.*** The annualized 2.2% quarterly growth in personal consumption expenditure was dominated by 13.9% growth in durable goods, such as automobiles and household furnishings. To the extent that those estimates were realistic, they were spiked by the replacement demand for autos and goods destroyed by Hurricane Sandy. That pattern would tend to reverse in first-quarter 2013.
- ***Business Investment Subtracted 0.08% from Growth.*** The annualized 0.6% contraction in gross private demand (including residential investment) was dominated by a liquidation of private inventories (primarily nonfarm), which by itself subtracted 1.27% from the annualized growth

rate. Final sales (GDP net of inventory change), accordingly, reflected annualized quarterly growth of 1.13%.

- ***Net Exports Subtracted 0.25% from Growth.*** As suggested by two months of trade reporting for the fourth-quarter, a widening trade deficit knocked a quarter point off the aggregate growth rate.
- ***Government Spending Subtracted 1.33% from Growth.*** Dominated by an annualized 22.2% plunge in defense spending, the 6.6% decline in government spending was the largest negative contributor to fourth-quarter GDP activity. This reporting, however, appears to run somewhat counter to the 110.4% monthly surge in December 2012 defense capital goods orders, which accounted for the bulk of the 4.6% gain just reported in December new orders for durable goods, discussed in the next section.

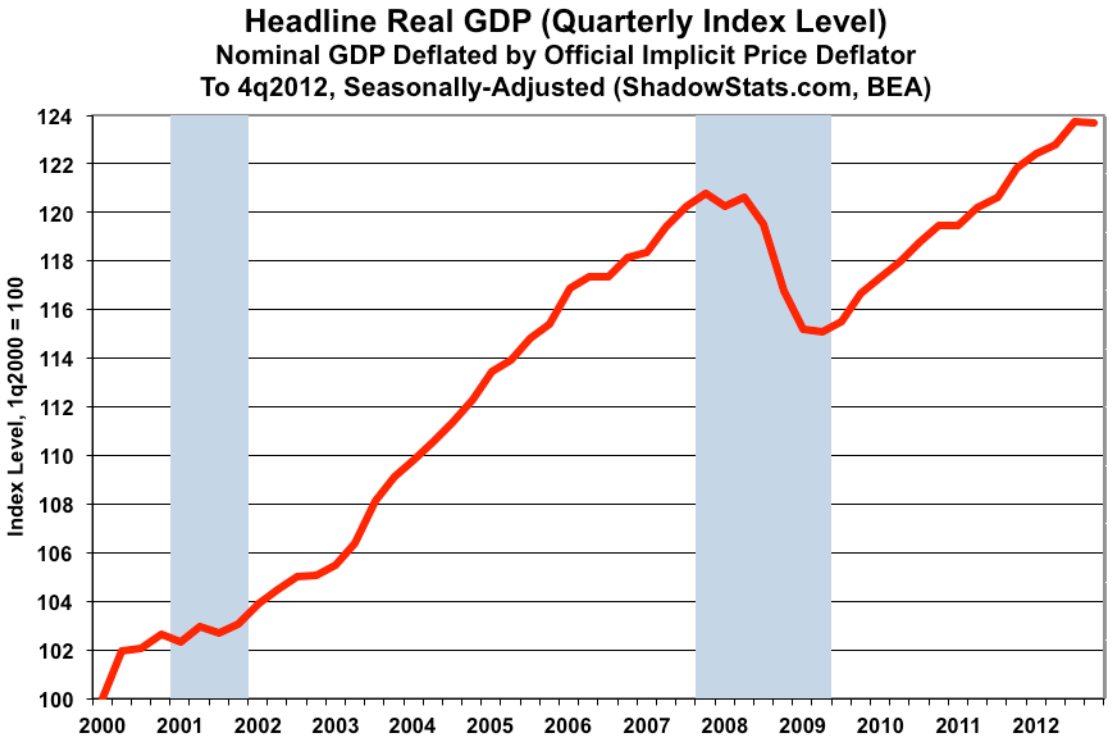
Guesstimates. As to a sampling of BEA guesstimates, keep in mind that the trade data were based on only two of an eventual three months of reporting. Also, as noted in today's BEA news release, explaining a surge in reported personal income:

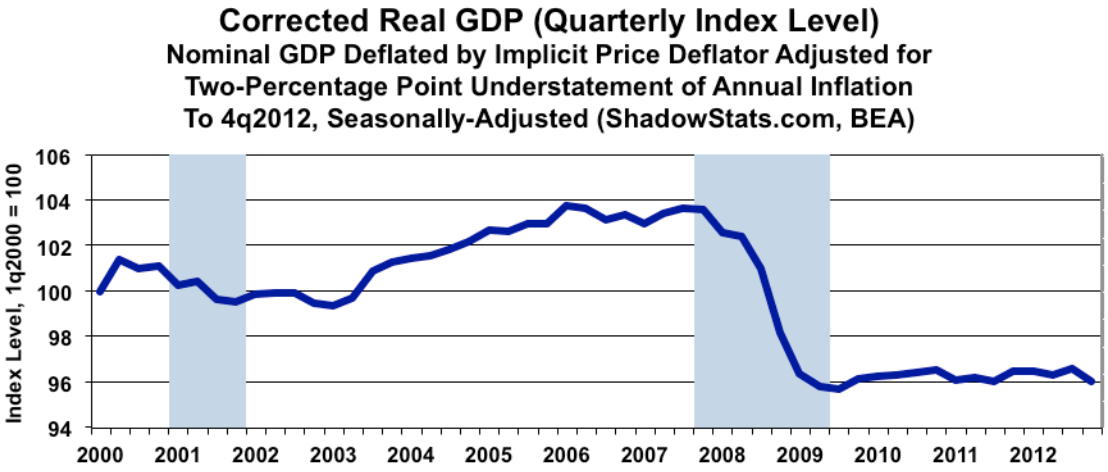
"Current-dollar [not adjusted for inflation] personal income increased $256.2 billion (7.9 percent) in the fourth quarter, compared with an increase of $72.7 billion (2.2 percent) in the third. The acceleration in personal income primarily reflected a sharp acceleration in personal dividend income, an upturn in personal interest income, and an acceleration in wage and salary disbursements. The sharp acceleration in personal dividend income reflected accelerated and special dividends that were paid by many companies in the fourth quarter in anticipation of changes in individual income tax rates. The upturn in personal interest income primarily reflected an upturn in interest rates for Treasury Inflation Protected Securities. The acceleration in wages and salaries reflected the pattern of monthly Bureau of Labor Statistics employment, hours, and earnings data for the fourth quarter, as well as a ***judgmental estimate*** [emphasis added] of accelerated compensation in the form of bonus payments and other irregular pay in the fourth quarter."

Watch out for first-quarter 2013! To the extent that those fourth-quarter income estimates hold, the patterns should reverse sharply in reporting of first-quarter 2013 GDP and gross domestic income, as the one-time changes will not be repeated, and as new or renewed taxes kick in. The fourth-quarter surge in personal consumption should turn to decline, while cuts in defense spending and inventories should be muted versus fourth-quarter performance.

Fourth-quarter 2012 GDP year-to-year real growth slowed to 1.54%, down from 2.60% in third-quarter 2012, and from 1.97% in fourth-quarter 2011. Annual average real GDP growth was 2.18% in 2012, versus 1.81% in 2011.

Nominal GDP. All that has been discussed here, so far, has been in terms of inflation-adjusted data. In nominal terms, before adjustment for inflation—the way the average business sees its revenue stream—annualized fourth-quarter 2012 growth imploded to just 0.46%, from an annualized pace of 5.91% in the third-quarter. To the extent that the nominal GDP numbers are meaningful, business people in the real world are seeing a slowdown in sales. To the extent that the BEA has understated the GDP inflation rate (implicit price deflator) of 0.60% in the fourth-quarter, versus 2.72% in the third-quarter, the decline in real GDP has been underestimated on a percentage-point-by-percentage-point basis.





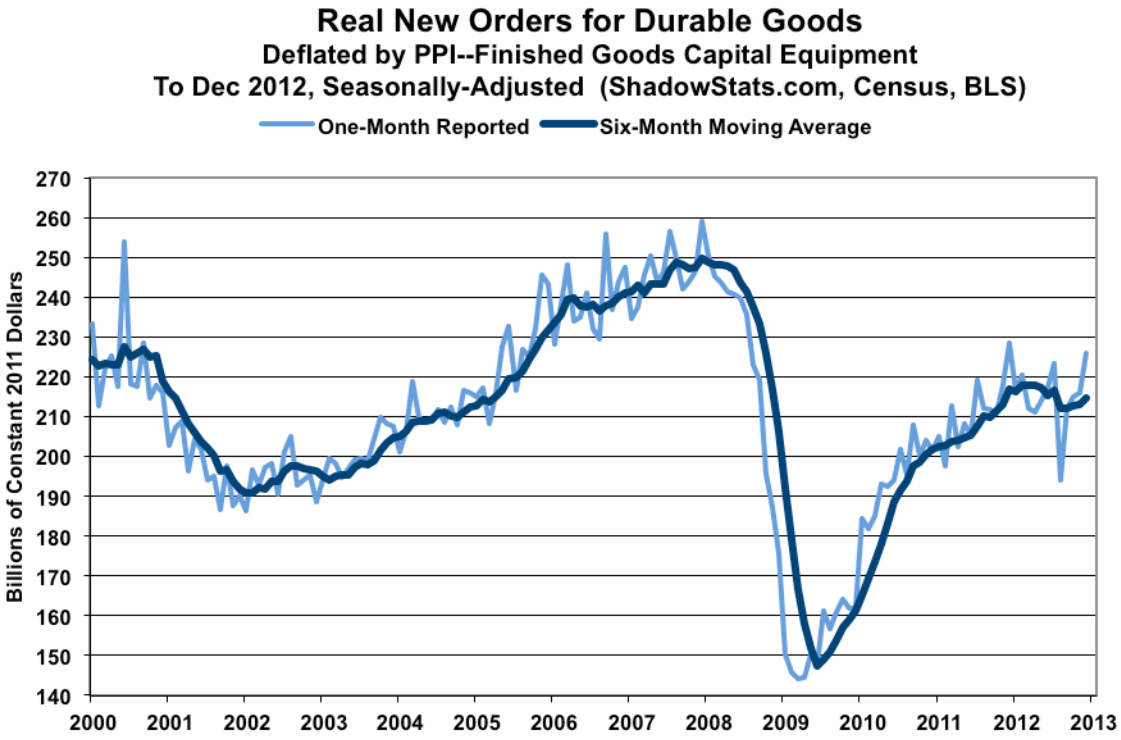
Corrected Gross Domestic Product. As usually discussed in *Commentaries* covering the monthly GDP reporting and revisions, the full economic recovery indicated by the official real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. The preceding two graphs tell that story. They are the same graphs on pages 10 and 11 (*Graphs 1* and *2*) of *No. 485: Special Commentary*, updated for the initial reporting of fourth-quarter 2012 GDP.

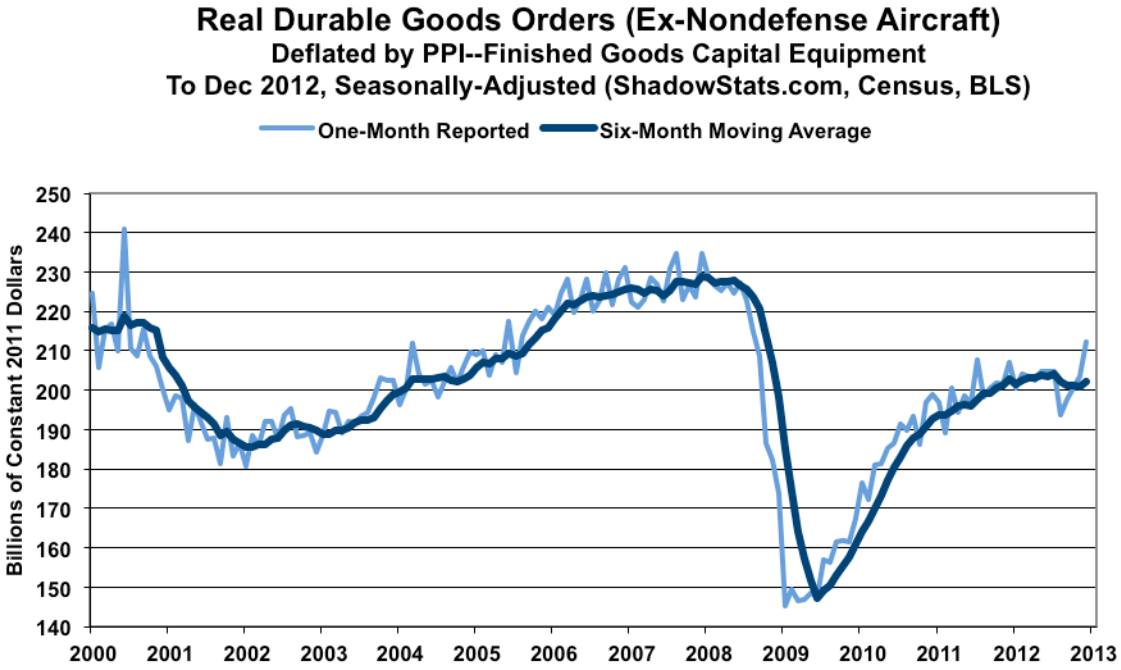
In the first graph, the official real GDP activity has been reported above pre-2007 recession levels—in full recovery—since fourth-quarter 2011. No other major economic series has shown a parallel pattern of full economic recovery and beyond (although uncorrected real retail sales are close to that full-recovery point, as discussed in *Commentary No. 495*). Either the 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 plots the GDP corrected for the understatement inherent in official inflation estimates, with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in *Hyperinflation 2012*, *No. 485: Special Commentary* and *Public Comment on Inflation*. Both graphs are indexed to first-quarter 2000 = 100, with the plots to consistent scales.

December 2012 Durable Goods Orders. Boosted primarily by defense spending and irregular commercial aircraft orders, the increasingly volatile reporting of new orders for durable goods in recent months argues for a continuing close look at the smoothed series (six-month moving average).

Headline durable goods orders for December 2012 rose by 4.6%, following an unrevised 0.7% gain in November. Helping to boost December orders, irregular and highly volatile long-term nondefense aircraft orders rose month-to-month by 10.1% in December, following a revised decline of 12.9% in November. The dominant factor in December's report, however, was a jump of 110.4% in year-end defense capital goods orders, which had been up by 3.3% in November. Net of capital goods and commercial aircraft, the more-regular commercial orders were unchanged for the month.





Previously shown and discussed in the regular *Commentaries* that cover the reporting of new orders for durable goods, the preceding two graphs plot new orders for durable goods, adjusted for inflation (using the PPI finished goods capital equipment index) and smoothed. These graphs plot the monthly as well as a six-month moving average of activity levels. The first graph shows the aggregate new orders series; the second series is net of the extremely volatile commercial-aircraft order sector. The first graph also is an updated version of *Graph 10*, on page 16 of *No. 485: Special Commentary*. As reflected in these graphs, the durable goods series appears to be in a renewed economic downturn.

In terms of inflation-adjusted level, these series have shown a slowing uptrend and flattening-out in the last two-to-three years—now in a pattern of downturn—clearly not the recovery that is seen in official GDP reporting. The real (inflation-adjusted) level of orders in December and November 2012 remained below both the pre-2001 and pre-2007 recession highs.

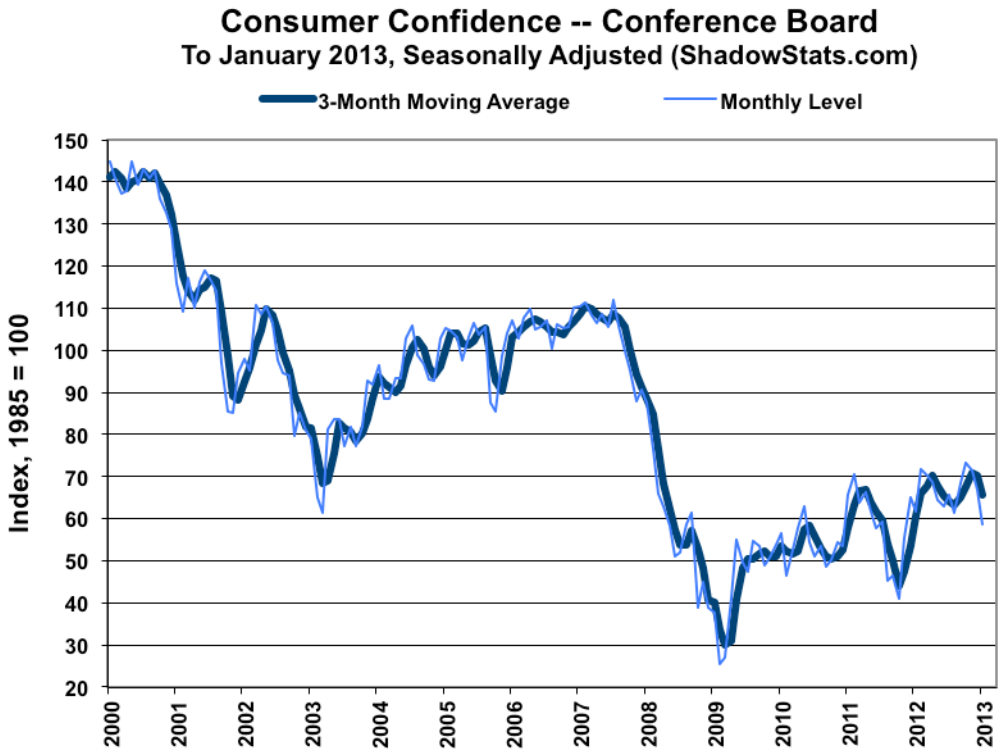
The pattern of decline unfolding in the smoothed new orders series in these historical graphs is one that usually precedes or is coincident with a recession.

If the deflation measure here were corrected meaningfully for the 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.

January 2013 Consumer Confidence Tumbled Anew. Other highly volatile series that benefit from being viewed in terms of smoothing, in addition to the raw data, include the Conference Board's consumer confidence measure and the University of Michigan's consumer sentiment series.

Consumer confidence fell sharply month-to-month in January 2013, with the results shown in the accompanying graph. January consumer sentiment will be published on Friday, February 1st, and will be included in the *Commentary* of that date.

Consumer confidence remains at levels not seen out of the depths of the most-severe historical recessions. Intensifying consumer liquidity problems remain primary constraints on confidence and on the ability and indeed the willingness of the consumer to fuel sustainable growth in consumption.



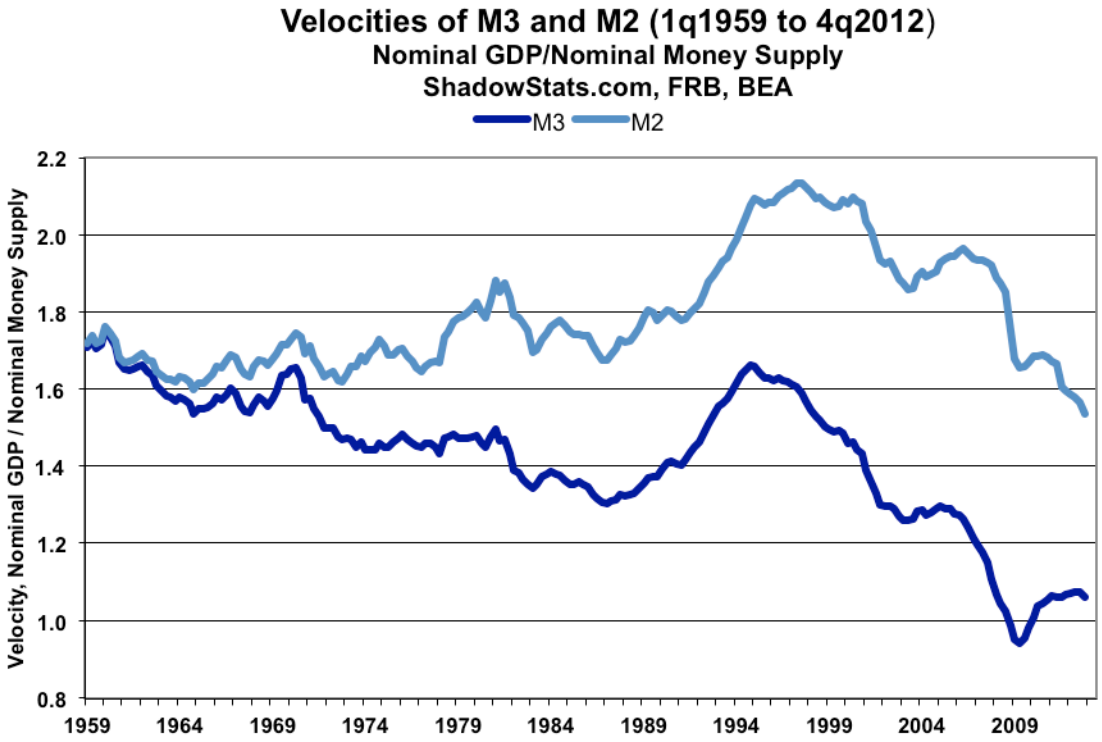
[More complete reporting detail and graphs for the GDP, and more detail on new orders for durable goods, are found in the* Reporting Detail *section.]

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 continued to fall for M2, but, where M3 velocity had been rising for the last three years, it also turned lower in fourth-quarter 2012.

M3 Velocity Slowed Minimally in Fourth-Quarter 2012. Subscribers frequently ask for specifics on the velocity of the money supply, 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 still is falling, and the velocity of M3 (using the ShadowStats Ongoing-M3 Measure) has turned lower in the last estimate, 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 a 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 had been flat or rising through third-quarter 2012. It turned lower in the fourth-quarter, reflecting a pattern of accelerating M3 growth and decelerating GDP growth. 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 had been showing opposite patterns, because growth in M3 had been much weaker than growth in M2. The reason behind that difference largely was that much of the relatively stronger M2 growth 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 had no impact on M3, but it spiked M2 growth. The clarity of what happened there is why I like to follow

the broadest money measure available. Again, full definitions can be found in the *Money Supply Special Report*.

Hyperinflation Outlook: Summary. The following text has been updated minimally 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. The economic and systemic solvency crises of the last seven years continue. There never was an actual recovery following the economic collapse into 2009, just a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012.

Subsequent to *Special Commentary (No. 485)*, neither new economic data nor fiscal developments have altered the broad outlook. 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 gimmicked numbers, further smoke-and-mirrors 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 exhausted. 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

GROSS DOMESTIC PRODUCT—GDP (Fourth-Quarter 2012, First or "Advance" Estimate)

Minimal Fourth-Quarter GDP Contraction Was Not Statistically Significant. Although the first estimate of fourth-quarter GDP showed a small quarter-to-quarter contraction, it has no more significance than the reporting of other recent quarters that generally have shown statistically-insignificant gains. Nonetheless, underlying real-world economic activity continues to suggest that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter, and then began to turn down anew in second- and third-quarter 2012 (see *Special Commentary (No. 485)* and *Hyperinflation 2012*).

As discussed in the *Opening Comments*, irrespective of any near-term revisions to the fourth-quarter 2012 data, first-quarter 2013 also is a candidate for formal contraction. With the annual GDP revisions due in July 2013, revamped numbers should show quarterly contractions extending backwards into 2012.

This most-worthless and most-heavily-politicized of government economic series still does not reflect properly or accurately the changes to the underlying fundamentals that drive the series. The GDP remains the only major economic series to show a full economic recovery, since the onset of official recession in December 2007. Either the GDP numbers are wrong, or all the other major economic releases are wrong. As discussed and graphed, again, in the *Opening Comments*, the real GDP's upswing in activity since mid-2009 has been no more than a statistical illusion resulting from the use of bad-quality inflation data.

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.*

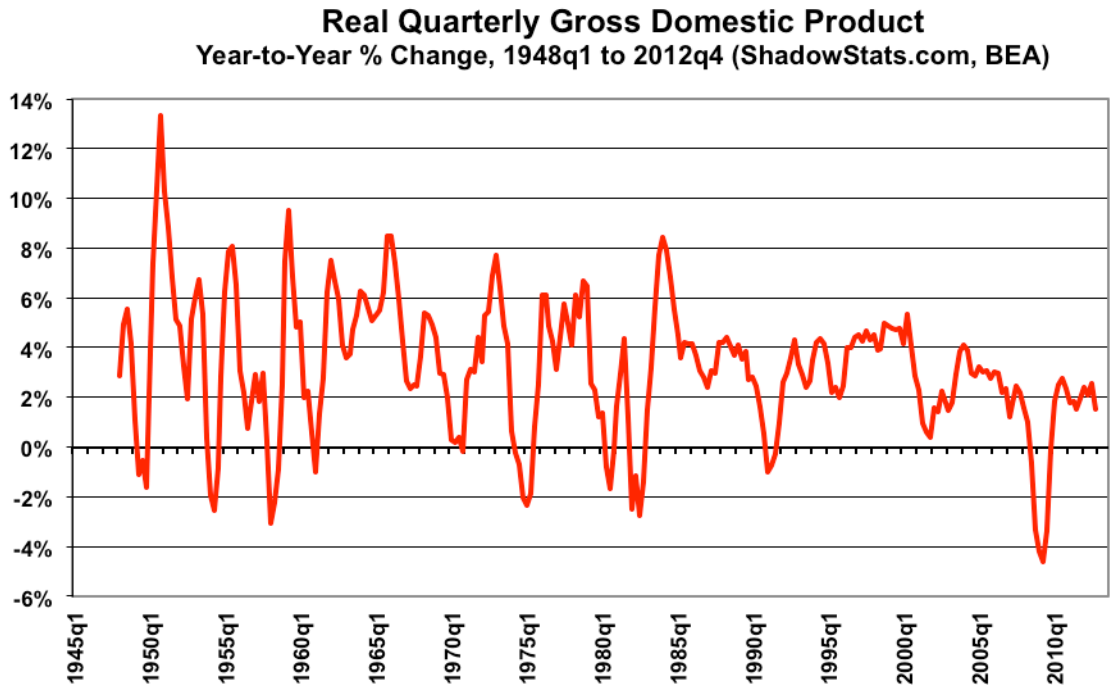
Quarterly *growth, unless otherwise stated, is in terms of seasonally-adjusted, annualized quarter-to-quarter growth, i.e., the growth rate of one quarter over the prior quarter, raised to the fourth power, a compounded annual rate of growth. While some might annualize a quarterly growth rate by multiplying 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 x 1.01 x 1.01 x 1.01 = 1.0406 or 4.1%, instead of 4 x 1% = 4%.*

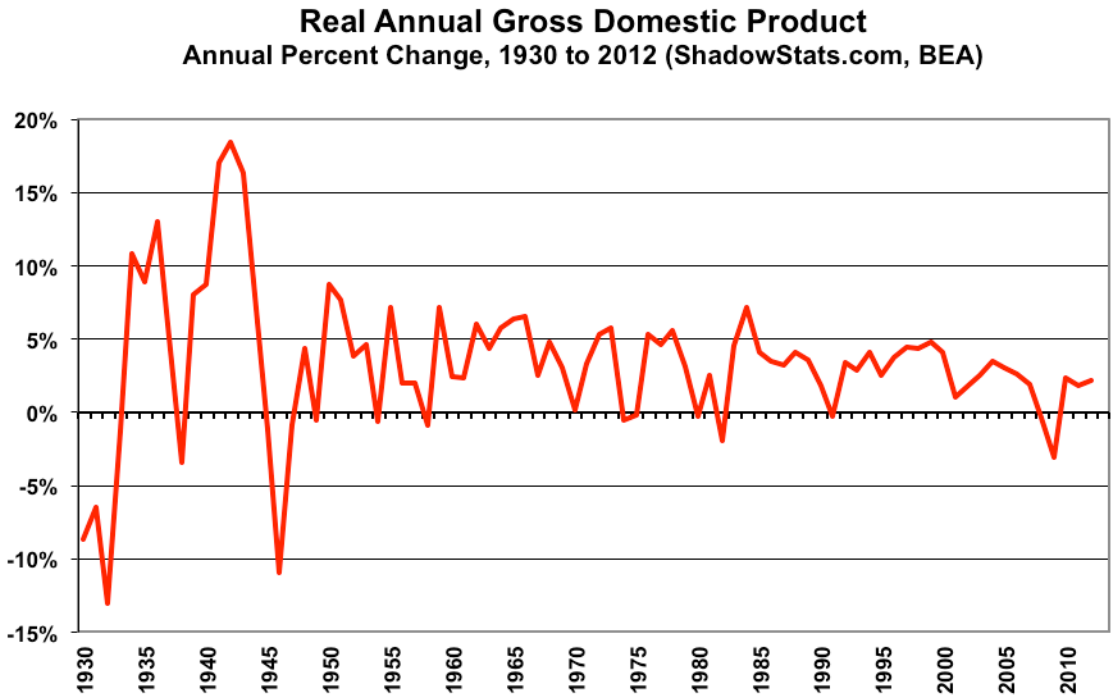
Annual *growth refers to the year-to-year change of the referenced period versus the same period the year before.*

GDP. Published this morning, January 30th, by the Bureau of Economic (BEA), the first or "advance" estimate of fourth-quarter 2012 gross domestic product (GDP) showed a real (inflation-adjusted) annualized quarterly contraction at a statistically-insignificant 0.14% +/- 3.5% (95% confidence interval). The headline fourth-quarter contraction estimate was against an annualized 3.11% headline gain in the third-quarter, 1.25% growth in the second-quarter, and 1.96% growth in the first-quarter.

For seven of the eight 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 were massaged to keep the quarterly growth rates in minimally-positive, as opposed to minimally-negative territory, through the election. Today's minimal contraction, however, could have been massaged, in an effort to discourage fiscal reform. As discussed in the *Opening Comments,* it could be argued that the budget deficit cannot be cut when the economy is so weak.

Updated in the accompanying graphs are estimates of year-to-year real change in fourth-quarter 2012 GDP, as well as in the estimated annual real growth for 2012. As shown in the first graph, fourth-quarter year-to-year growth was 1.54%, versus 2.60% in the third-quarter, 2.14% in second-quarter, and 2.45% in first-quarter. The latest year-to-year growth remains off the near-term peak 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. That was the deepest annual contraction seen for any quarterly GDP in the history of the series, which began with first-quarter 1947.





The second graph shows average annual real GDP growth by year, with 2012 up by 2.18% versus 2011, which, in turn, was up by 1.81% from 2010, and where 2010 was up by 2.39% from 2009. The annual decline of 3.07% seen in 2009, versus 2008, was the steepest fall-off in activity since the post-World War II production shutdown in 1946.

Implicit Price Deflator (IPD) and PCE Deflator. Fourth-quarter 2012 GDP inflation, or the implicit price deflator (IPD), dropped to an annualized pace of 0.60%, versus 2.72% in the third-quarter, 1.53% in the second-quarter and 2.17% in the first-quarter. Fourth-quarter year-to-year IPD inflation was estimated at 1.75%, versus 1.63% in the third-quarter, 1.70% in the second-quarter and 1.98% in the first-quarter.

For comparison purposes, annualized seasonally-adjusted quarterly inflation for the CPI-U in fourth-quarter 2012 was 2.05%, versus 2.30% in the third-quarter, 0.75% in the second-quarter and 2.48% in the first-quarter, with year-to-year fourth-quarter CPI-U at 1.89%, versus 1.70% in the third-quarter, 1.89% in the second-quarter and 2.82% in the first-quarter.

For the year of 2012, GDP average annual inflation was 1.77%, versus 2.13% in 2011. The comparable numbers for the CPI-U were 2.07% and 3.16%, respectively.

The lower the inflation rate that is used in deflating the GDP, the stronger will be the resulting inflation-adjusted number and vice versa.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for fourth-quarter 2012 is a 2.2% year-to-year contraction versus the official estimate of a 1.5% gain. The alternate fourth-quarter estimate is a deeper contraction than the 2.1% estimated for third-quarter 2012, versus the official estimate of 2.6% 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 fourth-quarter 2012, as it has been for seven of the last eight quarters, a period of protracted business bottom-bouncing in the real world. Although fourth-quarter 2012 GDP initially has been reported in contraction, the quarter-to-quarter change is no more statistically meaningful than seven out of the eight last quarters (fourth-quarter 2012 included).

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 corrected real GDP graph (see the *Opening Comments and Executive Summary* section and *Hyperinflation 2012* and *No. 485: Special Commentary*) 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 ShadowStats-Alternate GDP, which reflects the impact of reversing additional methodological distortions of recent decades.

GDI and GDP. The BEA's advance estimate of fourth-quarter gross domestic product (GDP) growth largely is a guess, and it is targeted usually at consensus forecasts. That said, the BEA does not even try to put out early estimates of gross domestic income (GDI), which is the income-side reporting equivalent of the consumption-side GDP; or of gross national product (GNP), which is the broadest measure of U.S. economic activity, where GDP is GNP net of trade in factor-income (interest and dividend payments).

The BEA will not publish fourth-quarter estimates of the GDI and GDP for another two months. The BEA's rationale for not publishing advance estimates here is that it lacks the data needed to make those measures meaningful. Unfortunately, those same qualifications apply to the advance GDP reporting.

Nonetheless, the markets need some hyped data to increase trading volatility, and the politicians need some happy or not-so-happy news for their budget talks, so this most-worthless of major government series has been guessed at and published, today, for a quarter that ended just 30 days ago.

NEW ORDERS FOR DURABLE GOODS (December 2012)

December Durable Goods Orders Boosted by Year-End Defense Orders. The 4.6% monthly gain reported for December 2012 new orders for durable goods reflected a temporary 100.4% year-end monthly surge in defense capital goods and a 10.1% jump in the usually-volatile commercial aircraft orders. Also complicated by what have become regular instabilities in concurrent seasonal factors, the monthly gain for the series was within the scope of normal volatility.

Still, the recent broad pattern of downturn has continued. It is of a nature that usually precedes or coincides with a recession (contracting, broad economic activity), as suggested in the historical graphs of the real (inflation-adjusted) series, both aggregate and net of nondefense aircraft, published in the *Opening Comments* section. The level of December 2012 real new orders remained below 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 December Reporting. The Census Bureau reported January 28th that the regularly-volatile, seasonally-adjusted nominal (not adjusted for inflation) level of December 2012 new orders for durable goods rose by 4.6% (up by 4.4% before prior-period revisions) month-to-month, following an unrevised 0.7% monthly gain in November.

The irregular and highly volatile long-term nondefense aircraft orders rose month-to-month by 10.1% (up by 11.3% before prior-period revisions) in December, following a revised decline of 12.9% (previously 13.9%) in November. Aircraft orders usually are placed years in advance of delivery and rarely impact near-term economic activity. Net of the distorted and unstable commercial aircraft orders, aggregate new orders still rose by 4.2% in the month, following a 1.7% gain in November.

The dominant factor in December's report, however, was a jump of 110.4% in year-end defense capital goods orders, which had been up by 3.3% in November. Net of capital goods and commercial aircraft, the more-regular commercial orders were unchanged for the month.

Nonetheless, unadjusted, year-to-year change in total December 2012 new orders was nil, versus a revised 0.4% (previously 0.5%) gain in November.

Seasonally-adjusted new orders for nondefense capital goods rose by 3.8% for the month of December, following a revised monthly decline of 2.4% (previously 2.8%) in November. For December 2012, the unadjusted year-to-year decline in the series was 7.5%, following an unrevised annual drop of 9.0% in November.

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 4.6% gain in aggregate December orders also was a real (inflation-adjusted) gain of 4.6%, after adjusting for a minimal monthly decline in the PPI finished goods capital equipment deflator. The unrevised nominal 0.7% gain in November was an inflation-adjusted 0.5%. On a year-to-year basis, the inflation- and seasonally-adjusted year-to-year change contracted for a second month, down by 1.1% in December, versus a 0.9% contraction in November.

In terms of inflation-adjusted level, however, as indicated in the two graphs in the *Opening Comments*, both the smoothed aggregate new orders and aggregate orders net of commercial aircraft series, have shown a slowing uptrend and flattening-out in the last two-to-three years—now in a pattern of downturn—clearly not the recovery that is seen in official GDP reporting. The real (inflation-adjusted) level of orders in December and November 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 post-2009 uptrend in seen in the graphs of 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 recent pattern of downturn now well entrenched.

WEEK AHEAD

Weaker Economic and Stronger Inflation Data Are Likely. *Reflecting the worsening structural liquidity issues facing the consumer, 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 it still appears to be trying to work numerical slight-of-hand with series such as the GDP and related projections of the federal budget deficit. The media do their best to avoid publicizing unhappy economic news or, otherwise, they put a happy spin on the numbers. Pushing the politicians and media, the financial markets and related spinmeisters 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.

Employment and Unemployment (January 2013, Annual Benchmark Revision to Payrolls) UPDATED. 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*, but the early consensus appears to have settled in above that at roughly 170,000, plus or minus, with the unemployment rate considered likely to hold at, or ease slightly from the 7.8% headline U.3 number of December 2012.

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, however, 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 2013 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 employment and unemployment detail published previously in the December 2012 household survey will be consistent or comparable with the January 2013 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. See the discussion in *Commentary No. 451* for detail of the regular monthly issues, which resume in January 2013 reporting, tied to concurrent seasonal adjustments.

Construction Spending (December 2012). Also 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.
