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

COMMENTARY NUMBER 612
GDP Revision, February Durable Goods Orders, New-Home Sales

March 27, 2014

Fourth-Quarter GDP Revision Was Little More than Statistical Noise;
First-Quarter GDP Contraction Remains Likely

Real Durable Goods Orders on Track for 9.0% Annualized First-Quarter Contraction

New Deflated and "Corrected" Durable Goods Series Confirm No Recovery

New Homes Sales Down Year-to-Year for Second Month,
Pattern Not Seen Since Series Trough in 2011

PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, March 28th, covering the annual benchmark revisions to industrial production. A* Commentary *on Thursday, April 3rd will cover February construction and trade, followed by one on April 4th, covering March employment and unemployment.*

On Tuesday, April 1st, the Hyperinflation 2014 *report will be published, both the* Second Installment *covering the economy and potential protective/preventative actions, and a revised* First Installment*, which will include the United States Government's 2013 GAAP-accounting, as well as an update on systemic developments since the January 7th publication of the original* First Installment.

Best wishes to all — John Williams

Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com

OPENING COMMENTS AND EXECUTIVE COMMENTARY

Broad Economic Weakness Likely in March Reporting. The pending April 1st publication of the *Second Installment* to *Hyperinflation 2014* will layout an extensive analysis of economic history, recent economic reporting and likely economic developments in the year or so ahead. There has been no economic recovery since the crisis broke almost eight years ago, there is no recovery pending, and official economic reporting likely is turning down anew. Accordingly, economic reporting in the month ahead should be increasingly negative and distressing to the domestic and global financial markets.

This *Commentary* concentrates on today's (March 27th) third estimate of fourth-quarter 2013 GDP, February 2014 new orders for durable goods and new-home sales. The GDP revision largely was statistical noise. The durable goods orders and new-home sales were consistent with a likely first-quarter headline contraction in GDP. All quarterly references here are to regular calendar-year quarters.

Along with the regular durable goods detail, two new sets of graphs are introduced. The first set shows the durable goods orders deflated by a new PPI measure, while the second set corrects the first set for inflation understatement and corresponding overstatement of real (inflation-adjusted) growth.

Revised Fourth-Quarter 2013 Gross Domestic Product (GDP)—Statistical Noise. The third revision of fourth-quarter 2013 GDP to 2.6%, from a previously-estimated 2.4%, was little more than statistical noise. The upside changes primarily were in personal consumption, with surging healthcare costs and utility bills, while the aggregate consumption changes ran counter to recent downside revisions to retail sales in the same period.

Still not widely discussed, reporting of underlying fundamental activity continues to indicate strongly a reporting of a quarterly contraction in first-quarter 2014 GDP, due for release on April 30th. As discussed in prior, GDP-related *Commentaries*, both the third- and fourth-quarter 2013 GDP estimates encompassed data that were impaired—distorted heavily—by the government shutdown, in terms of surveying, data gathering and reporting. Neither quarter will be revised again until the July 2014 annual revisions, at which time recently-reported activity, including today's numbers, likely will be revised to the downside.

Headline Gross Domestic Product (GDP). The third estimate, second revision of fourth-quarter 2013 GDP showed an upwardly-revised, statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline gain of 2.63% (previously 2.38%, initially 3.23%). That was against a 4.13% headline gain in third-quarter 2013, a 2.48% increase in second-quarter 2013 and a 1.15% gain in the first-quarter.

As graphed in the *Reporting Detail* section, fourth-quarter 2013 GDP annual growth was revised to 2.59% (previously 2.53%, initially 2.74%) year-to-year, versus 1.97% in the third-quarter, 1.63% in the second-quarter and 1.32% in the first-quarter 2013. The average annual real growth rate revised minimally to 1.88% (previously 1.86%, initially 1.92%) in the calendar-year 2013, from 2.78% in 2012.

Implicit Price Deflator (IPD). The third estimate of fourth-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized quarterly pace of 1.58% (previously 1.60%, initially 1.29%), versus 1.97% in the third-quarter, 0.58% in the second-quarter and against 1.67% in the first-quarter. Year-to-year, fourth-quarter 2013 IPD inflation was an unrevised 1.45% (initially 1.38%), versus 1.41% in the third-quarter, 1.44% in the second-quarter and 1.74% in the first-quarter. In terms of average annual inflation, the 2013 IPD was unrevised at 1.51% (initially 1.49%), versus 1.75% in 2012.

For comparison purposes, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation published by the Bureau of Labor Statistics (BLS), headline CPI-U inflation was 1.14% in fourth-quarter 2013, versus 2.16% in the third-quarter, 0.40% in the second-quarter, and 1.19% in the first-quarter. On a year-to-year basis, fourth-quarter 2013 CPI-U (unadjusted) was 1.23%, versus 1.55% in the third-quarter, 1.39% in the second-quarter, and 1.68% in the first-quarter. The average-annual CPI-U inflation was 1.46% in 2013, versus 2.07% in 2012.

The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

Gross National Product (GNP). The initial estimate of fourth-quarter 2013 GNP was published today, where GNP is the broadest measure of U.S. economic activity, and GDP is GNP net of trade flows in factor income (interest and dividend payments).

The headline fourth-quarter GNP real growth was 3.06%, versus 4.44% in the second-quarter. Year-to-year GNP growth was 2.69% in fourth-quarter 2013, versus 2.01% in the third-quarter. The still relatively stronger headline GNP growth reflected an increase in U.S. payments of factor income to the rest of the world, which was more than offset by an even greater increase in receipts from the rest of the world. Where annual average real GDP growth slowed to 1.9% in 2013, versus 2.8% in 2012, GNP followed a similar pattern, slowing to 1.9% in 2013, versus 2.7% in 2012.

Gross Domestic Income (GDI). The initial estimate of fourth-quarter 2013 GDI also was published today, where the GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. Any difference between the GDP and GDI is accounted for by adding a "statistical discrepancy" into the GDI account. The headline third-quarter GDI real growth rate was 2.67% versus a revised 1.77% (previously 1.80%) in the third-quarter. Year-to-year GDI growth was 2.52% in fourth-quarter 2013 versus a revised 3.06% (previously 3.07%) in third-quarter 2013. Where annual average real GDP growth slowed to 1.9% in 2013, versus 2.8% in 2012, GDI growth rose to 2.6% in 2013, versus 2.5% in 2012.

Distribution of Headline GDP Growth. Despite the severely-limited significance of the following detail, it is included for those interested in the reported internal patterns of GDP growth, as guessed at by the BEA. Reflecting little more than statistical noise, the second revision of headline growth in fourth-quarter 2013 GDP was a statistically-insignificant estimate of 2.63%. That annualized growth rate is detailed in the following aggregation of contributed growth. Please note that the annualized growth number in each sub-category is the additive contribution to the aggregate, headline change in GDP, where 2.22% + 0.41% + 0.99% - 0.99% = 2.63%. Previously, fourth-quarter aggregate headline growth rate was estimated at 2.38%, initially 3.23%; third-quarter headline growth was 4.13%:

- ***Consumer Spending Contributed a Revised 2.22% to Fourth-Quarter Growth (Previously 1.73%, Initially 2.26%; 1.36% in Third-Quarter).*** Consumer-dependent personal consumption accounts for 68% of the GDP. The upside revision primarily reflected rising healthcare costs and some spiked utility usage, which generally are unproductive components of economic activity, as discussed in *Commentary No. 611*.

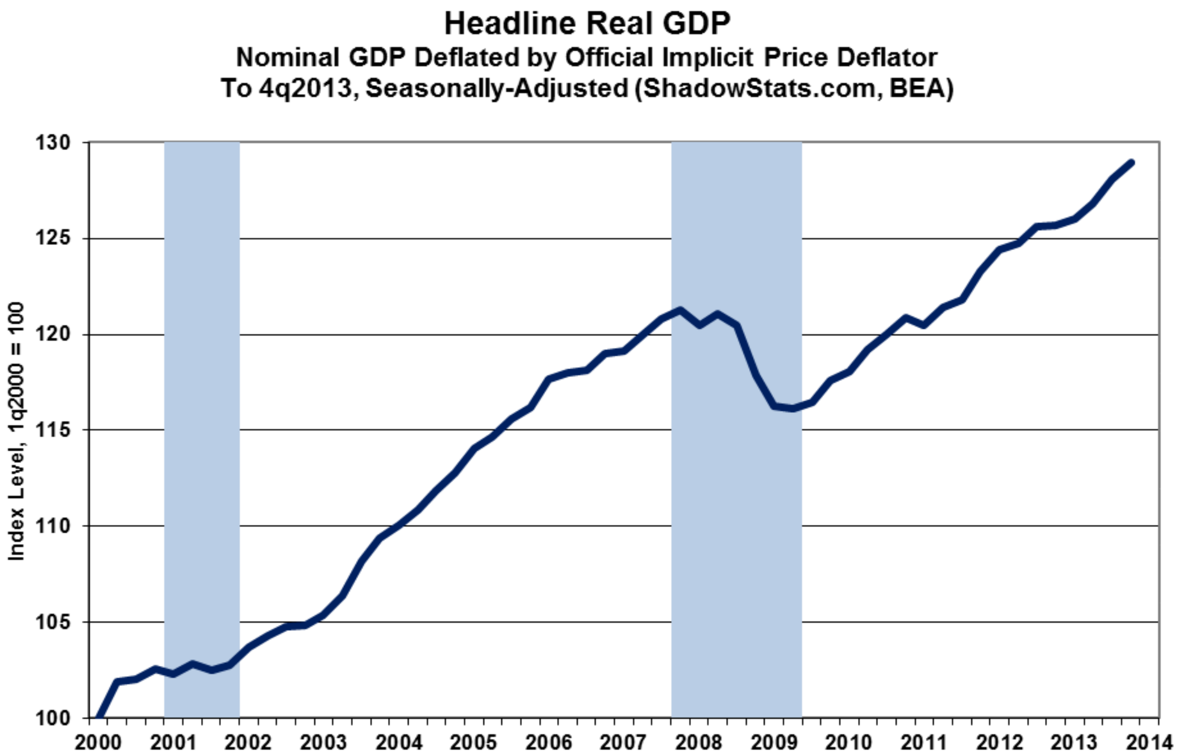
- ***Business/Residential Investment Contributed a Revised 0.41% to Fourth-Quarter Growth (Previously 0.72%, Initially 0.56%; 2.56% in Third-Quarter).*** The net downside revision to private investment was reflected in reduced estimates of nonresidential construction and software purchases. Also previously-estimated inventory levels were reduced. What had been a net 0.14% contribution to headline GDP growth, now is a 0.02% contraction, which means that "final sales"—GDP net of inventory change—was a revised 2.61% (previously 2.52%, initially 2.81%), versus 2.47% in the third-quarter.
- ***Net Exports Contributed an Unrevised 0.99% to Fourth-Quarter Growth (Initially 1.33%; 0.14% in Third-Quarter).*** Consistent with recent, headline monthly trade data, the trade deficit and the deficit in the related net-export account were little changed in revision.
- ***Government Spending Subtracted a Revised 0.99% from Fourth-Quarter Growth (Previously Subtracted 1.05%, Initially 0.93%; Contributed 0.08% in Third-Quarter).*** The contribution (net subtraction) from government spending was little changed, with nearly all differences at the level of state and local gross investment.

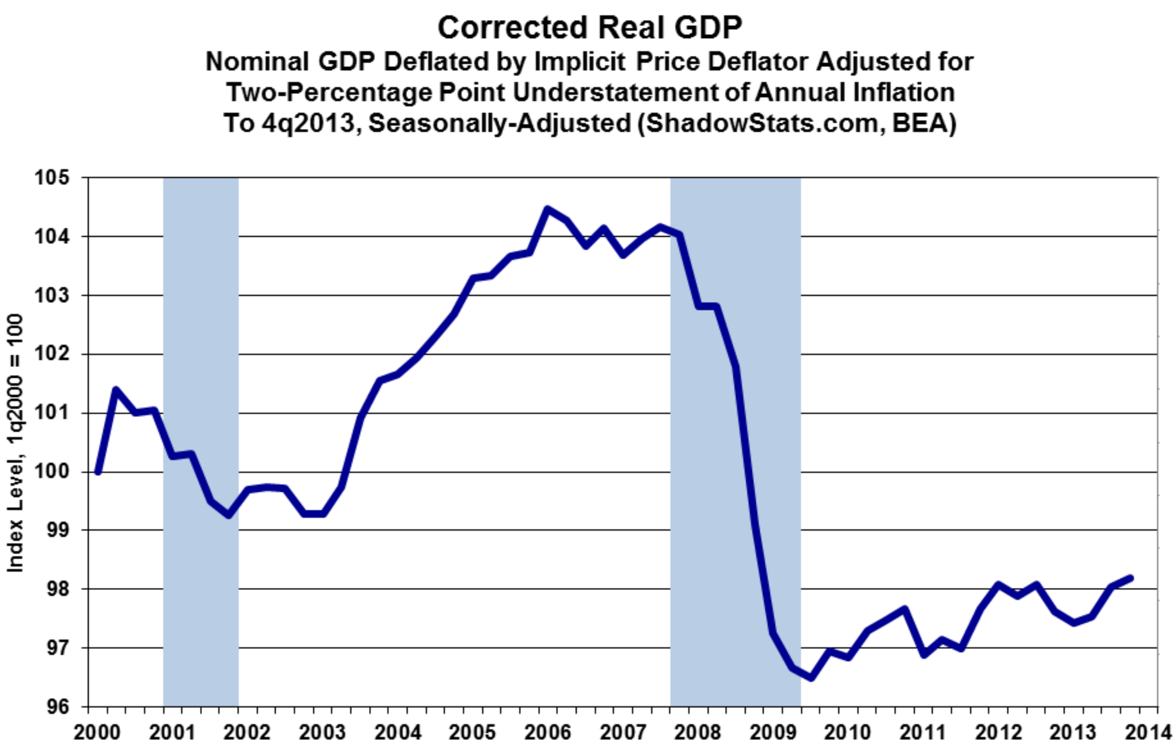
Further Official Detail. Further official detail on today's third revision to fourth-quarter 2013 GDP is available to our readers at ShadowStats affiliate www.ExpliStats.com.

Economic Reality. With the minimal upside revision in the third estimate of fourth-quarter 2013 GDP growth still at the level of statistical-noise, the general outlook is unchanged. Recent underlying economic fundamentals strongly indicate a looming quarterly contraction in headline first-quarter 2014 GDP reporting. The gist of much of the following text is along the lines of other recent GDP commentaries, but the details and numbers have been updated for today's third reporting of, and second revision to, aggregate fourth-quarter 2013 economic activity.

The GDP remains the most-worthless and the most-heavily modeled, massaged and politically-manipulated of government economic series. It does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity suggests that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in second- and third-quarter 2012 (see *Special Commentary (No. 485)*, *Hyperinflation 2012* and pending detail in the *Second Installment* of *Hyperinflation 2014—The End Game Begins*). Irrespective of the reporting gimmicks introduced in the July 2013 GDP benchmark revision, the consistent, fundamental pattern of historical activity is shown in the accompanying "corrected" GDP graph.

Please note that the pattern of activity shown for the "corrected" GDP series is much closer to the patterns shown in the graphs of monthly real median household income, other liquidity measures and economic series not otherwise reliant on understated inflation for their reported growth (see *Commentary No. 611*). A sustainable business recovery could not have taken place since 2009, and a recovery will not be forthcoming until the consumer's structural income and liquidity problems are resolved.


Headline Real GDP
Nominal GDP Deflated by Official Implicit Price Deflator
To 4q2013, Seasonally-Adjusted (ShadowStats.com, BEA)
Index Level, 1q2000 = 100
130
125
120
115
110
105
100
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Corrected Real GDP
Nominal GDP Deflated by Implicit Price Deflator Adjusted for
Two-Percentage Point Understatement of Annual Inflation
To 4q2013, Seasonally-Adjusted (ShadowStats.com, BEA)
Index Level, 1q2000 = 100
105
104
103
102
101
100
99
98
97
96
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

Official and Corrected GDP. As usually discussed in the *Commentaries* covering the quarterly GDP reporting and monthly 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, updated for the third estimate of fourth-quarter 2013 GDP.

Shown in the first graph of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011 (it had been fourth-quarter 2011 before the most-recent benchmarking), and headline GDP has shown sustained growth since. Adjusted for official GDP inflation (the implicit price deflator), the level of fourth-quarter 2013 GDP now stands at an un-revised 6.3% (initially 6.5%) above the pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, shows fourth-quarter activity at a revised 6.0% (initially 5.9%) below the pre-recession peak of first-quarter 2006.

No other major economic series has shown a parallel pattern of official full economic recovery and meaningful expansion beyond. Although uncorrected real retail sales—a leading indicator of GDP activity—recently moved minimally past that full-recovery point, such happened seven quarters after the GDP reached that point. In like manner, uncorrected industrial production—a coincident indicator of GDP activity—first moved beyond its pre-recession high in November 2013 reporting. Both the retail and production series have started to back-off those "post-recession" highs.

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 still attempt to survey real-world activity. Flaws in the GDP inflation methodologies and simplifying reporting assumptions have created the "recovery."

The second graph plots the *Corrected Real 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*, and as will be reviewed in the *Second Installment* of the *Hyperinflation 2014* report. Both graphs here are indexed to first-quarter 2000 = 100.

Gain in February Durable Goods Orders Was in Context of Soaring Commercial Aircraft Orders and Downside to January Activity. In line with most other major economic series, real (inflation-adjusted) new orders for durable goods are on track for a 9.0% annualized pace of quarterly contraction in first-quarter 2014, based on two months of reporting. That follows an annualized pace of quarterly gain in fourth-quarter 2013 of 7.1%.

In this traditionally-volatile series, some of the headline 2.2% February gain can be attributed to an irregular surge of 13.6% in commercial aircraft orders, and it also should be viewed in the context of a downside revision to headline January activity. In any event, the monthly reporting was within the normal scope of month-to-month volatility for this series.

ShadowStats is pleased to introduce a new inflation-adjusted series for durable goods orders, using the aggregated "Durable Manufactured Goods" series from the PPI. Also introduced is a plot of a "corrected" real new orders for durable goods series, backing out inflation understatement from the previously-mentioned PPI series.

However viewed, the ongoing longer-term pattern of stagnation has remained in place for the durable goods orders—particularly when viewed net of inflation—despite any short-term blips. The growth patterns in this series remain of a nature that commonly precedes or coincides with a recession or deepening business downturn.

Nominal (Not-Adjusted-for-Inflation) February 2014 Reporting. The headline, seasonally-adjusted nominal level of February 2014 new orders for durable goods rose by 2.23% for the month, following a revised 1.29% (previously 0.97%) decline in January. Before the prior-period revisions, total new orders in February rose by 1.96%.

The reporting of contractions and surges in commercial aircraft orders is seen in an irregularly-repeating process throughout the year and often dominates headline durable goods orders. These extremely volatile aircraft orders are booked well into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

In February, nondefense (or commercial) aircraft orders rose by 13.56% month-to-month, following a revised 22.12% drop in January. Net of prior-period revisions, February commercial-aircraft orders rose by 10.83%. Net of the aircraft numbers, total new orders rose by 1.52% in February, versus a revised 0.39% (previously 0.59%) gain in January.

What these numbers show over the last nine months or so is no meaningful change (down by 2.46%)—effectively stagnation—in new orders for durable goods, net of commercial-aircraft order activity and before any consideration for the effects of inflation. The nine-month change is down by 3.39% net of PPI inflation for "Durable Manufactured Goods."

Aircraft-order volatility also has impacted year-to-year change in seasonally-adjusted, total new orders. Total orders in February 2014 were up year-to-year by 0.24%, up by 1.86% ex-commercial aircraft; versus a revised 4.33% year-to-year gain in January, up by a revised 2.29% ex-commercial aircraft.

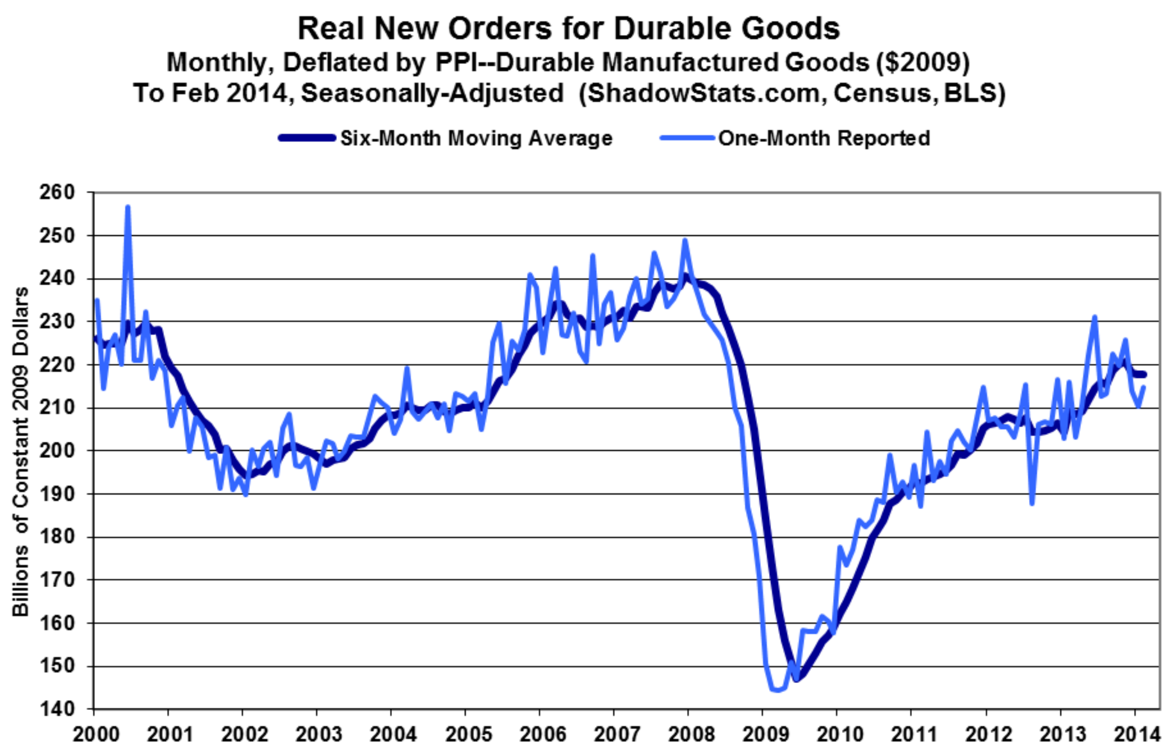
Further affected by aircraft-order activity were the seasonally-adjusted new orders for nondefense capital goods, which fell by 2.83% month-to-month in February, but were down by 6.21% ex-commercial aircraft; versus a revised 5.29% decline in January 2014, which was down a revised 0.87% (previously a 0.41% gain) ex-commercial aircraft.

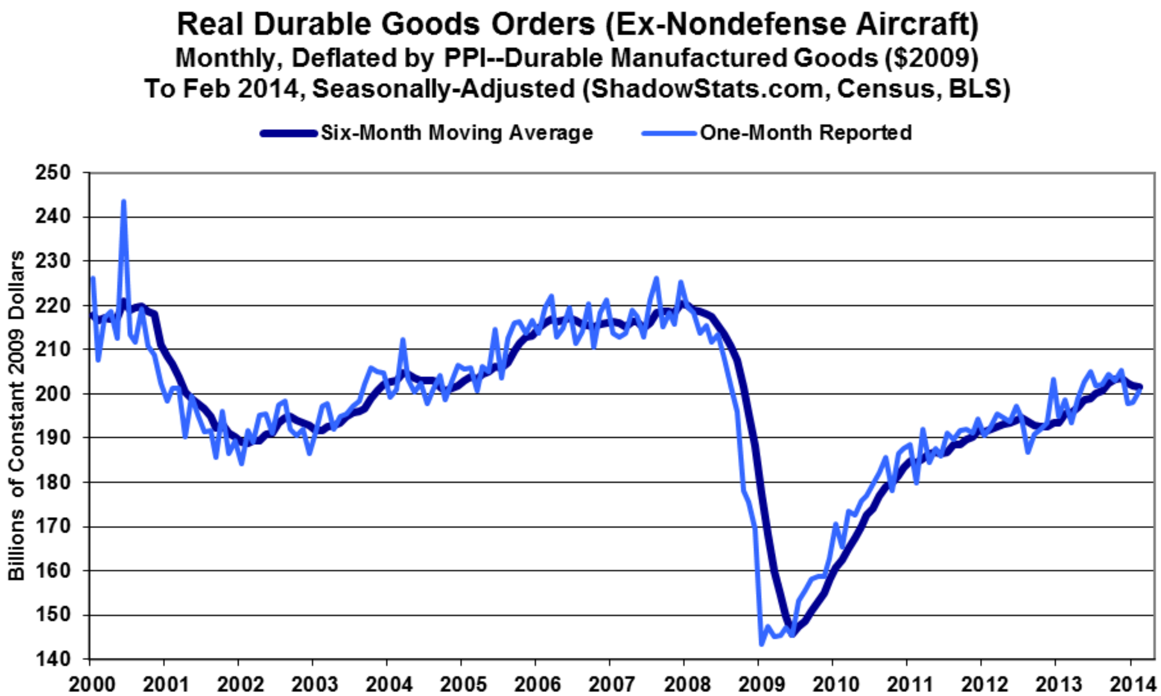
Real (Inflation-Adjusted) Durable Goods Orders—January 2014. Going forward, ShadowStats will use the PPI aggregated inflation measure "Durable Manufactured Goods" for deflating the new orders for durable goods series. Published only on a not-seasonally-adjusted basis, the related PPI series reflected headline monthly inflation of 0.2% in February 2014, versus 0.6% in January, with headline annual inflation of 0.8% in February, versus 0.7% in January.

Adjusted for that inflation, and as reflected in the accompanying graphs, real month-to-month aggregate orders rose by 2.04% in February, following a 1.59% decline in January. Ex-commercial aircraft, orders rose for the month by 1.33% in February, versus a monthly gain of 0.09% in January. Real year-to-year aggregate orders fell by 0.55% in February, after a 3.64% gain in January, and, ex-commercial aircraft, they rose by 1.07% in February, following a gain of 1.61% in January.

Graphs of Inflation-Adjusted and Smoothed Durable Goods Orders. The following two graphs plot the new orders for durable goods, adjusted for inflation. Consistent with the revamped PPI series, the inflation measure used here is an aggregation published with PPI for "Durable Manufactured Goods." These graphs show monthly as well as a six-month moving average of the activity level. The first graph shows the aggregate new orders series. The second series is net of the unstable commercial-aircraft order sector, and, accordingly, it is somewhat smoother than the first graph.

In terms of inflation-adjusted activity, both of these series have shown a slowing uptrend and flattening-out in the last two-to-three years—with a dip and upside bouncing into 2013, and renewed downturn in recent reporting. Broadly, there has been a recent general pattern of stagnation or bottom-bouncing evident in the orders—clearly not the booming recovery that is seen in official GDP reporting. The real (inflation-adjusted) level of orders in February 2014 remained at or below both the pre-2001 and pre-2007 recession highs. The pattern of recent stagnation in the inflation-adjusted series also is one that commonly precedes or is coincident with a recession.

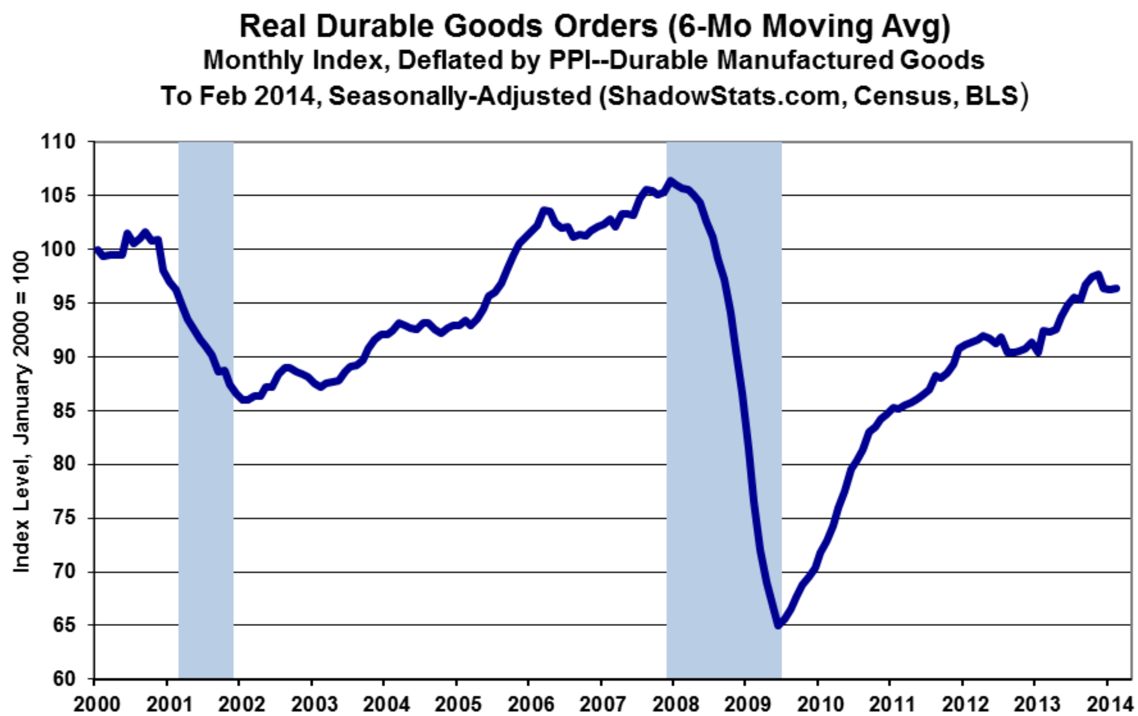


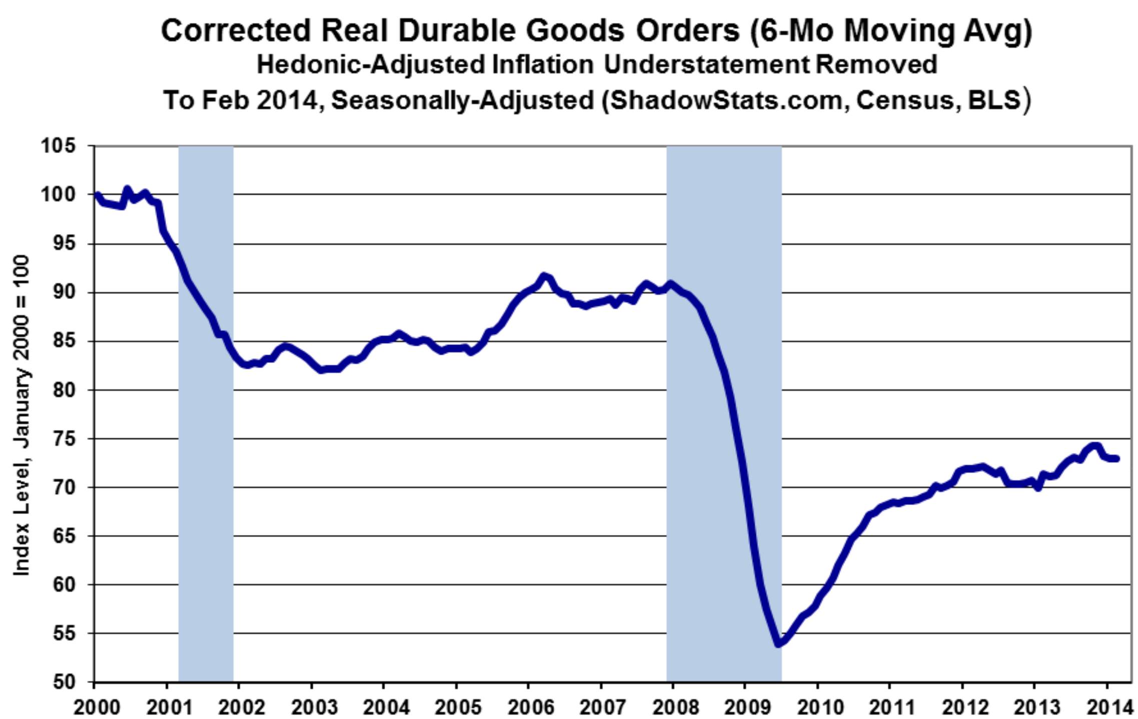


As with other economic series that are deflated by official government inflation measures, estimates of inflation-adjusted growth are overstated, due to the understatement of the official inflation. That understatement here is through the use of hedonic-quality adjustments—usually not perceived by the consumer—used to reduce the pace of headline inflation (see *Public Comment on Inflation*). As has been done with other series such as the GDP, retail sales and industrial production, ShadowStats is pleased to introduce an experimental corrected version of the inflation-adjusted graph of real new orders for durable goods, corrected for the understatement of the related headline PPI inflation.

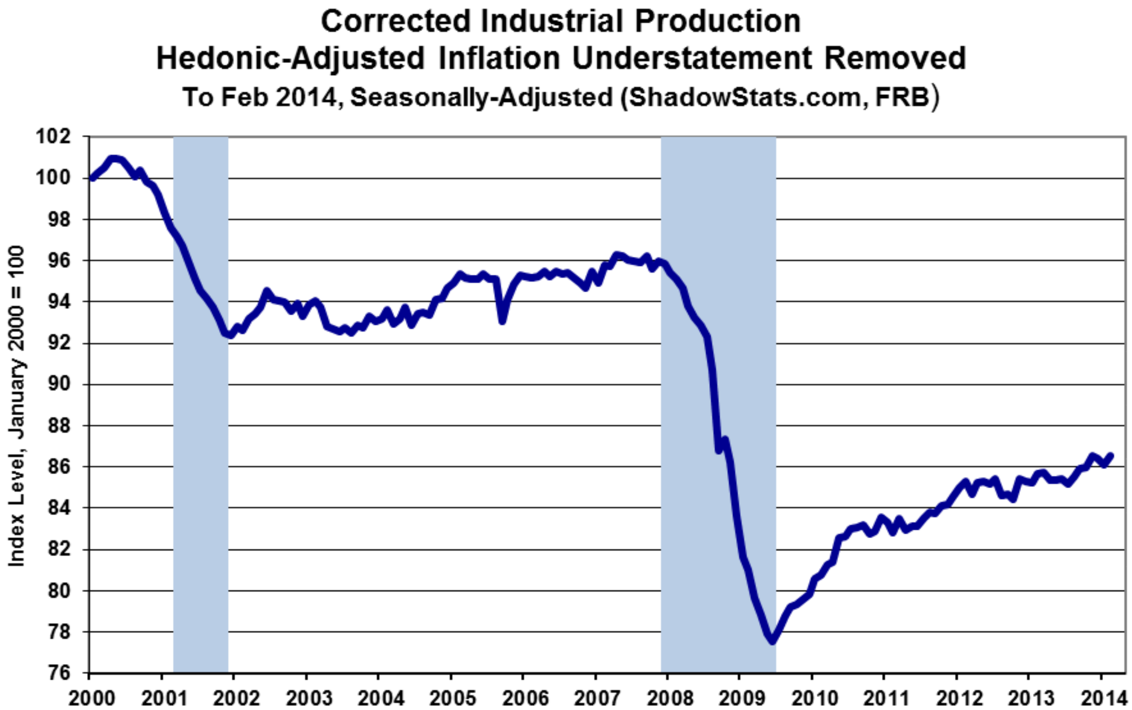
The first of the three following graphs reflects a smoothed version of the real total durable goods orders series (using a six-month moving average).

The “corrected” real new orders for durables goods, in the second graph, shows similar patterns to the “corrected” industrial production graph, from *Commentary No. 609*, shown here as the third graph, a pattern of plunge and stagnation. This new series will be included in and discussed futher in the upcoming *Second Installment* to *Hyperinflation 2014*.





Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com



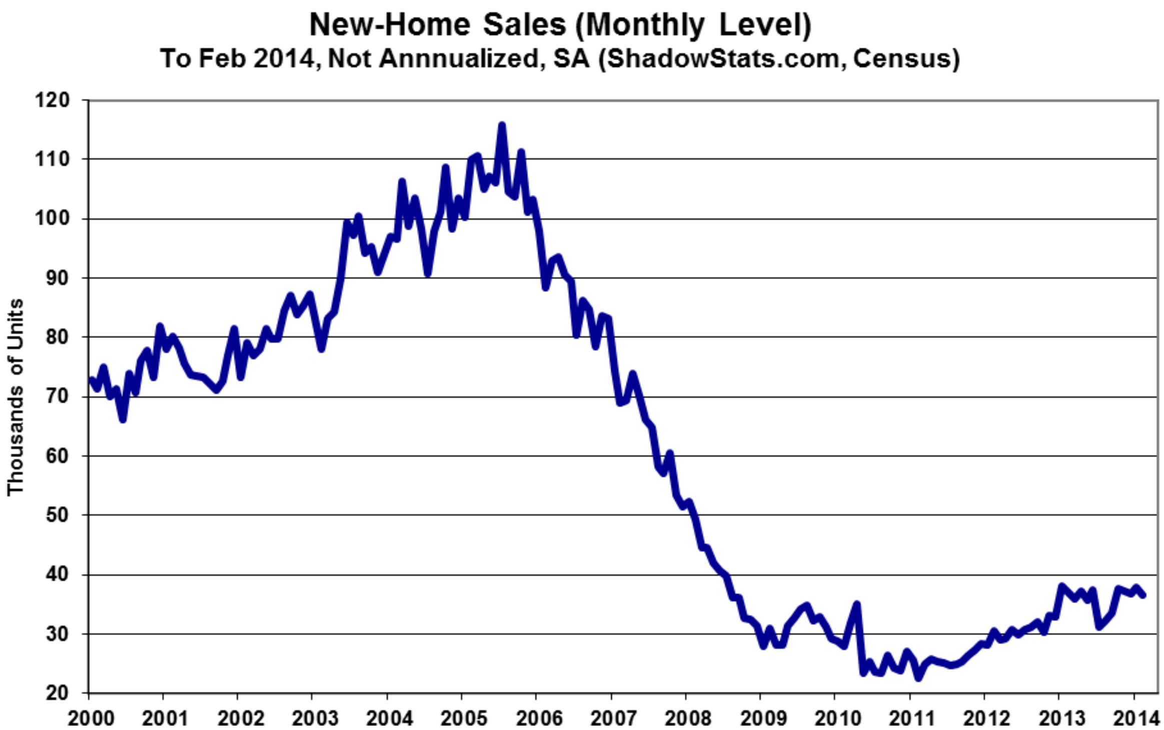
New-Home Sales—February 2014—Negative Signals in An Unstable Series. The 3.3% headline decline in February 2014 new-home sales followed a downside revision to January sales activity. Net of prior-period revisions, February sales were down by 6.0% from the initial level reported for January 2014. February 2014 activity also was down by 1.1% from the year before. None of these numbers, however, was statistically meaningful, and reporting here remains unstable.

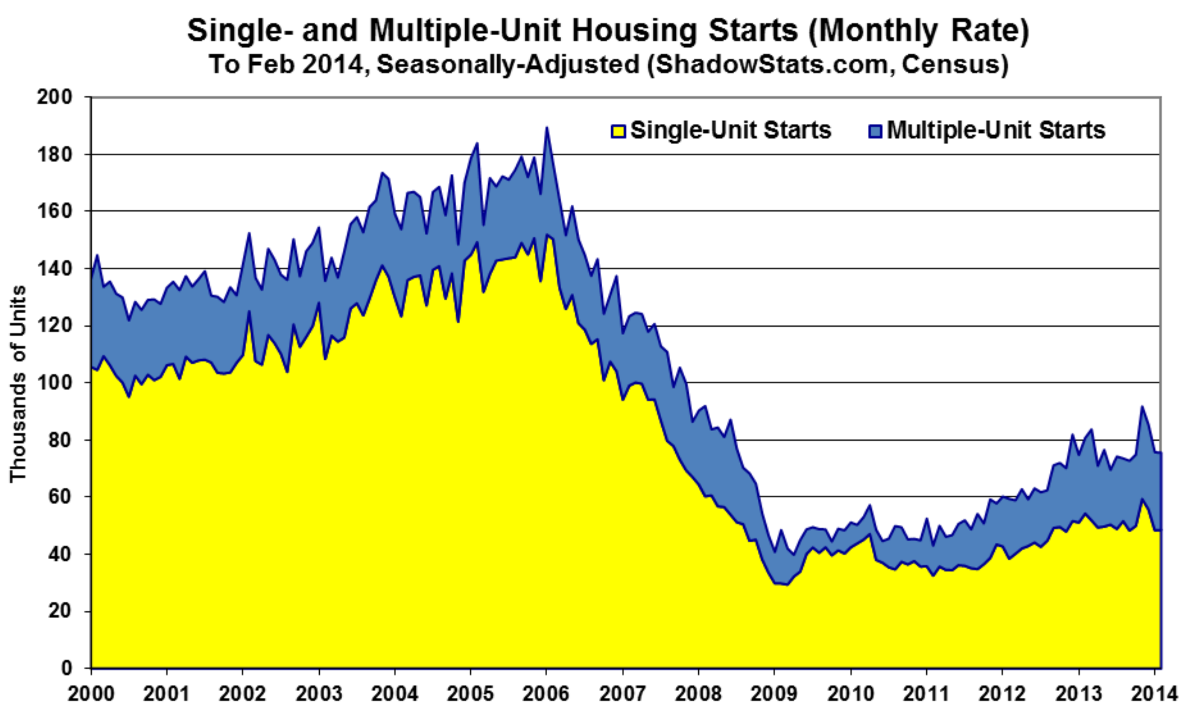
Although headline February 2014 sales activity was not meaningfully different from the level of activity in January 2014, it still was down 68.3% from the pre-recession peak activity, seen in July 2005, and, with two months of reporting, first-quarter 2014 new-home sales were on track to fall at an annualized 4.0% quarterly pace. Where year-to-year change in February was negative for the second straight month, such had not happened since 2011, when the collapsing new-home sales series "bottomed."

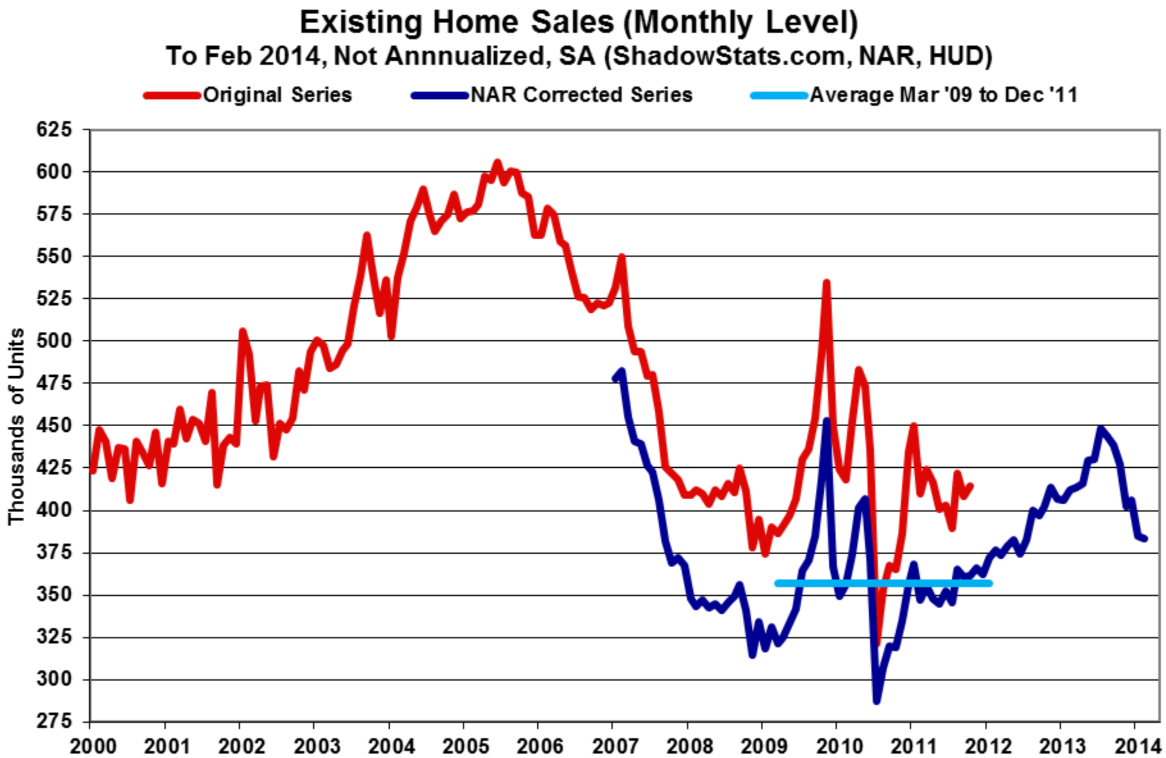
As discussed in *Commentary No. 611*, there has been no underlying improvement in fundamental consumer liquidity conditions, and most underlying economic numbers are showing a renewed economic downturn. There has not been and there is no basis here for an imminent recovery in the housing market.

February 2014 New-Home Sales Reflected a Return to Normal Instability. Headline new-home sales in February 2014 fell by a statistically-insignificant 3.3%, following a downwardly revised 3.2% gain in January and a revised, less-negative 1.6% decline in December. Before prior-period revisions, February sales sank by a still-statistically-insignificant 6.0% for the month.

Year-to-year, February 2014 sales declined by a statistically-insignificant 1.1%. That followed a revised 0.7% annual decline in January and a revised 11.3% annual gain in December. Again, the numbers here are unstable and not reliable.


New-Home Sales (Monthly Level)
To Feb 2014, Not Annnualized, SA (ShadowStats.com, Census)
Thousands of Units
120
110
100
90
80
70
60
50
40
30
20
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Single- and Multiple-Unit Housing Starts (Monthly Rate)
To Feb 2014, Seasonally-Adjusted (ShadowStats.com, Census)
Single-Unit Starts
Multiple-Unit Starts
Thousands of Units
200
180
160
140
120
100
80
60
40
20
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014



New-Home Sales Graphs. The regular monthly graph of new-home sales activity is the first of the three graphs preceding. For purposes of comparison, the second graph is of February single- and multiple-unit housing starts (from *Commentary No. 610*) and the third graph is of February existing-home sales (from *Commentary No. 611*).

[For further detail on the GDP revision, new orders for durable goods and new-home sales, see the* Reporting Detail *section.]

HYPERINFLATION WATCH

This section will be recast shortly following the release of the *First Installment (Updated)* and the *Second Installment* of the *Hyperinflation 2014* report on Tuesday, April 1st.

REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Fourth-Quarter 2013, Third Estimate, Second Revision)

No More than Statistical Noise. This morning's (March 27th) third revision of fourth-quarter 2013 GDP to 2.6%, from a previously-estimated 2.4%, was little more than statistical noise. The upside changes primarily were in personal consumption, with surging healthcare costs and utility bills, while the aggregate consumption changes ran counter to downside revisions to retail sales in the same period.

Still not widely discussed, reporting of underlying fundamental activity continues to indicate strongly a reporting of a quarterly contraction in first-quarter 2014 GDP, due for release on April 30th.

As discussed in prior, GDP-related *Commentaries*, both the third- and fourth-quarter 2013 GDP estimates encompassed data that were impaired—distorted heavily—by the government shutdown, in terms of surveying, data gathering and reporting. Neither quarter will be revised again until the July 2014 annual revisions, at which time recently-reported activity, including today's numbers, likely will be revised to the downside.

Aside from near-term distorted reporting, the GDP remains the only major economic series to show a full economic recovery and meaningful new expansion, since the onset of official recession in December 2007. Based on the third estimate of fourth-quarter GDP, real GDP was an unrevised 6.3% (previously 6.5%), versus 5.6% in the third-quarter, above the pre-recession peak-GDP activity of fourth-quarter 2007. With common experience and the vast bulk of other economic data showing no recovery, though, the headline upswing in GDP activity, since mid-2009, has been no more than a statistical illusion created by the use of bad-quality inflation data. Understated inflation has resulted in overstated real growth (see the updated discussion and graph of the ShadowStats estimate of "corrected" GDP in the *Opening Comments*).

Underlying real-world economic activity still indicates that the broad economy began to turn down in 2006 and 2007, plunged into 2009, entered a protracted period of stagnation thereafter—never recovering—and then began to turn down anew in second- and third-quarter 2012 (see *No. 527: Special Commentary*, *No. 485: Special Commentary*, *Commentary No. 575* and *Hyperinflation 2012*). Extensive detail will be covered in the pending *Second Installment* of *Hyperinflation 2014*.

The GDP continues to be the most worthless, and the most-heavily modeled, massaged and politically-manipulated of the major economic series published by the U.S. government. Again, temporarily, some data of the last two quarters appear to have been skewed by the effects of the government shutdown.

___

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 2009 Dollars," as introduced with the 2013 comprehensive revisions, where 2009 is the base year for inflation. "Chained" refers to the substitution methodology which gimmicks the reported numbers so much that the aggregate of the deflated GDP sub-series missed adding to the theoretically-equivalent deflated total GDP series by $41.8 billion in "residual," as of the initial estimate of second-quarter 2013.*

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.*

___

Gross Domestic Product (GDP). Published this morning, March 27th, by the Bureau of Economic Analysis (BEA), the third estimate, second revision of fourth-quarter 2013 GDP showed an upwardly-revised, statistically-insignificant, real (inflation-adjusted), annualized, quarterly gain of 2.63% (previously 2.38%, initially 3.23%) +/- 3.5% (95% confidence interval). That was against a 4.13% headline gain in third-quarter 2013, a 2.48% increase in second-quarter 2013 and a 1.15% gain in the first-quarter.

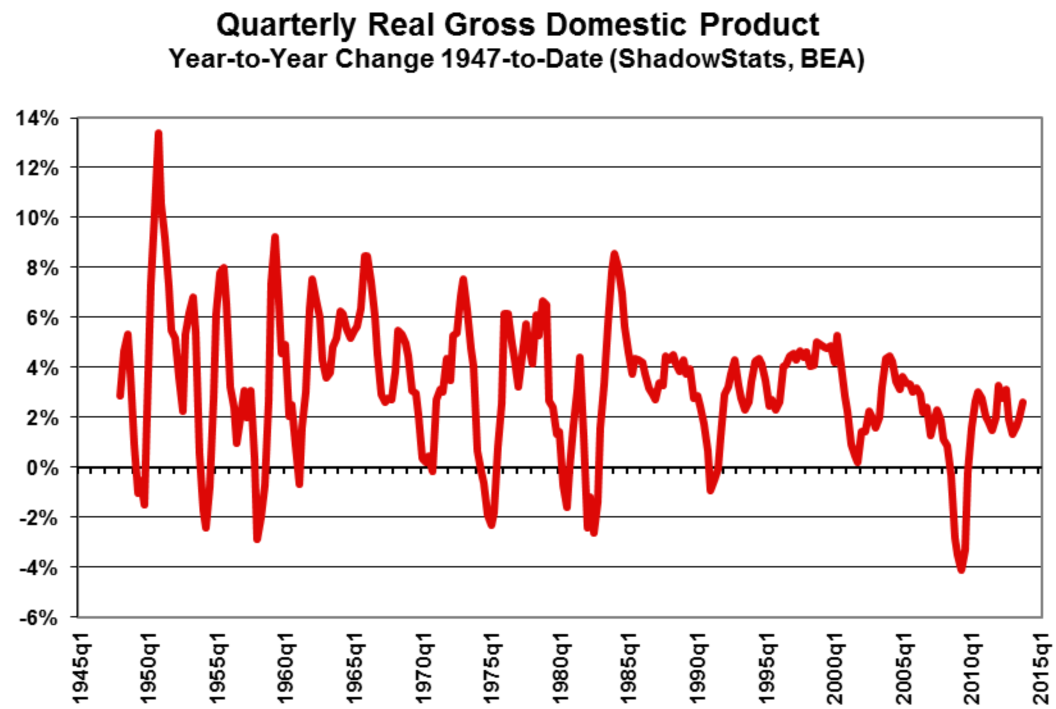
Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com

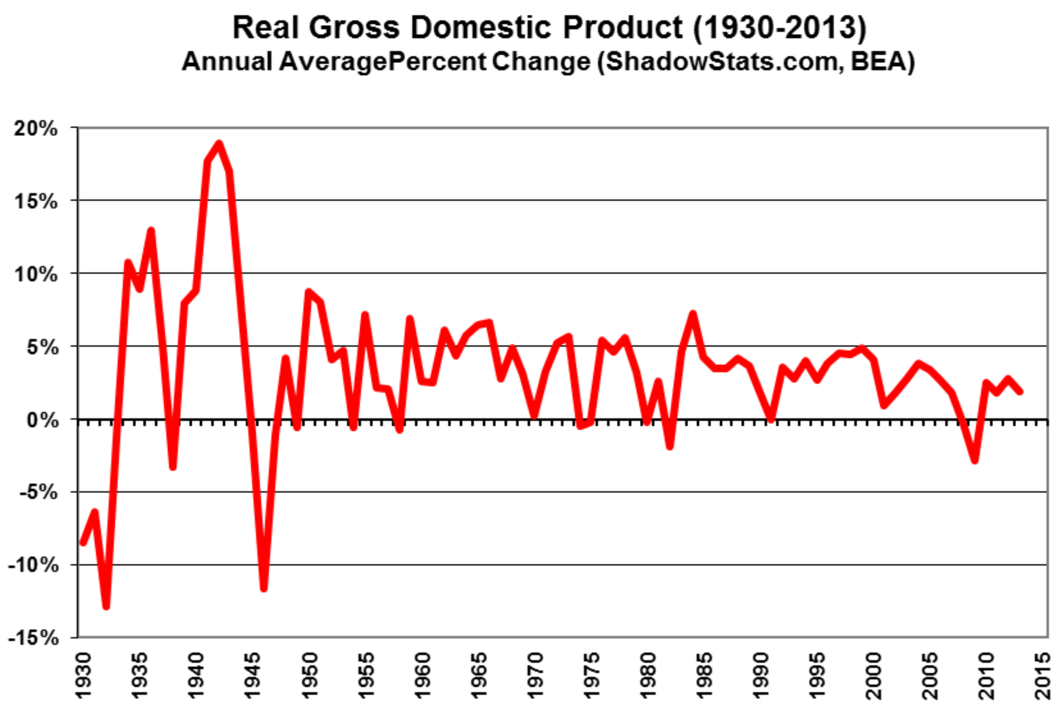
Distribution of the headline quarterly GDP growth rate, by major component, is detailed in the *Opening Comments* section.

Shown in the following three graphs are the revised year-to-year or annual real rates of change for the GDP series. For the first two graphs, fourth-quarter 2013 GDP annual growth was a revised 2.59% (previously 2.53%, initially 2.74%) year-to-year, versus 1.97% in the third-quarter, 1.63% in the second-quarter and 1.32% in the first-quarter 2013.

The first graph shows near-term historical detail since 2000. The second graph shows the full history of the series. The latest quarterly year-to-year growth remained below the near-term peak of 3.13% growth reported for third-quarter 2012. The current cycle-trough was in second-quarter 2009 at a 4.09% 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 third graph shows the average annual real growth rate, which revised minimally to 1.88% (previously 1.86%, initially 1.92%) in the calendar-year 2013, from 2.78% in 2012. The 2.80% annual contraction in 2009 real GDP was the largest contraction seen in the series since the post-World War II production shutdown in 1946, when GDP fell by 11.59%. Otherwise, the 2009 contraction was the steepest decline since the Great Depression, actually rivaling the second-half of that economic disaster of the 1930s.


Quarterly Real Gross Domestic Product
Year-to-Year Change 1947-to-Date (ShadowStats, BEA)
14%
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
1945q1
1950q1
1955q1
1960q1
1965q1
1970q1
1975q1
1980q1
1985q1
1990q1
1995q1
2000q1
2005q1
2010q1
2015q1


Real Gross Domestic Product (1930-2013)
Annual AveragePercent Change (ShadowStats.com, BEA)
20%
15%
10%
5%
0%
-5%
-10%
-15%
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015

Implicit Price Deflator (IPD). The third estimate of fourth-quarter 2013 GDP inflation, or the implicit price deflator (IPD), was at a revised annualized quarterly pace of 1.58% (previously 1.60%, initially 1.29%), versus 1.97% in the third-quarter, 0.58% in the second-quarter and against 1.67% in the first-quarter. Year-to-year, fourth-quarter 2013 IPD inflation was an unrevised 1.45% (initially 1.38%), versus 1.41% in the third-quarter, 1.44% in the second-quarter and 1.74% in the first-quarter. In terms of average annual inflation, the 2013 IPD was unrevised at 1.51% (initially 1.49%), versus 1.75% in 2012.

For comparison purposes, on a seasonally-adjusted, annualized quarter-to-quarter basis, CPI-U inflation published by the Bureau of Labor Statistics (BLS), headline CPI-U inflation was 1.14% in fourth-quarter 2013, versus 2.16% in the third-quarter, 0.40% in the second-quarter, and 1.19% in the first-quarter (see *Commentary No. 592* and *Commentary No. 602*). On a year-to-year basis, fourth-quarter 2013 CPI-U (unadjusted) was 1.23%, versus 1.55% in the third-quarter, 1.39% in the second-quarter, and 1.68% in the first-quarter. The average-annual CPI-U inflation was 1.46% in 2013, versus 2.07% in 2012.

The weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for fourth-quarter 2013 is a 1.4% year-to-year contraction, versus an upwardly-revised headline year-to-year gain of 2.6%. The alternate third-quarter estimate was a 1.7% year-to-year contraction, versus a headline gain of 2.0% (see the Alternate Data tab).

While annualized real quarterly growth is not estimated formally on an alternate basis, a quarter-to-quarter contraction remains a possibility for actual headline growth in the fourth-quarter, but that would not be evident until after the annual revisions to the GDP are published in July 2014. An actual quarterly contraction appears to have been a realistic possibility for the real GDP in most quarters since the official second-quarter 2009 end to the recession.

Adjusted for gimmicked inflation and other methodological changes (such as the inclusion of intellectual property, including software), 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* 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 reversing additional methodological distortions ("Pollyanna Creep") of recent decades.

Gross National Product (GNP). The initial estimate of fourth-quarter 2013 GNP was published today, where GNP is the broadest measure of U.S. economic activity, and GDP is GNP net of trade flows in factor income (interest and dividend payments).

The headline fourth-quarter GNP real growth was 3.06%, versus 4.44% in the second-quarter. Year-to-year GNP growth was 2.69% in fourth-quarter 2013, versus 2.01% in the third-quarter. The still relatively stronger headline GNP growth reflected an increase in U.S. payments of factor income to the rest of the world, which was more than offset by an even greater increase in receipts from the rest of the world. Where annual average real GDP growth slowed to 1.9% in 2013, versus 2.8% in 2012, GNP followed a similar pattern, slowing to 1.9% in 2013, versus 2.7% in 2012.

Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com

Gross Domestic Income (GDI). The initial estimate of fourth-quarter 2013 GDI also was published today, where the GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. Any difference between the GDP and GDI is accounted for by adding a "statistical discrepancy" into the GDI account. The headline third-quarter GDI real growth rate was 2.67% versus a revised 1.77% (previously 1.80%) in the third-quarter. Year-to-year GDI growth was 2.52% in fourth-quarter 2013 versus a revised 3.06% (previously 3.07%) in third-quarter 2013. Where annual average real GDP growth slowed to 1.9% in 2013, versus 2.8% in 2012, GDI growth rose to 2.6% in 2013, versus 2.5% in 2012.

NEW ORDERS FOR DURABLE GOODS (February 2014)

Gain in February Durable Goods Orders Was in Context of Soaring Commercial Aircraft Orders and Downside to January Activity. In line with most other major economic series, real (inflation-adjusted) new orders for durable goods are on track for a 9.0% annualized pace of quarterly contraction in first-quarter 2014, based on two months of reporting. That follows an annualized pace of quarterly gain in fourth-quarter 2013 of 7.1%.

In this traditionally-volatile series, some of the headline 2.2% February gain can be attributed to an irregular surge of 13.6% in commercial aircraft orders, and it also should be viewed in the context of a downside revision to headline January activity. In any event, the monthly reporting was within the normal scope of month-to-month volatility for this series.

ShadowStats is pleased to introduce a new inflation-adjusted series for durable goods orders, using the aggregated "Durable Manufactured Goods" series from the PPI. Also introduced is a plot of a "corrected" real new orders for durable goods series, backing out inflation understatement from the previously-mentioned PPI series (see *Opening Comments*).

However viewed, the ongoing longer-term pattern of stagnation has remained in place for the durable goods series—particularly when viewed net of inflation—despite any short-term blips. The growth patterns in this series remain of a nature that commonly precedes or coincides with a recession or deepening business downturn.

Nominal (Not-Adjusted-for-Inflation) February 2014 Reporting. The Census Bureau reported March 26th, that the regularly-volatile, seasonally-adjusted nominal level of February 2014 new orders for durable goods rose by 2.23% for the month, following a revised 1.29% (previously 0.97%) decline in January. Before the prior-period revisions, total new orders in February rose by 1.96%.

The reporting of contractions and surges in commercial aircraft orders is seen in an irregularly-repeating process throughout the year and often dominates headline durable goods orders. These extremely volatile aircraft orders are booked well into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

In February, nondefense (or commercial) aircraft orders rose by 13.56% month-to-month, following a revised 22.12% (previously 20.20%) drop in January. Net of prior-period revisions, February commercial-aircraft orders rose by 10.83%. Net of the aircraft numbers, total new orders rose by 1.52% in February, versus a revised 0.39% (previously 0.59%) gain in January.

What these numbers show over the last nine months or so is no meaningful change (down by 2.46%)—effectively stagnation—in new orders for durable goods, net of commercial-aircraft order activity and before any consideration for the effects of inflation. The nine-month change is down by 3.39% net of PPI inflation for "durable manufactured goods."

Aircraft-order volatility also has impacted year-to-year change in seasonally-adjusted, total new orders. Total orders in February 2014 were up by 0.24%, up by 1.86% ex-commercial aircraft, versus a revised 4.33% (previously 4.61%) year-to-year gain, up by a revised 2.29% (previously 1.17%) ex-commercial aircraft in January.

Further affected by aircraft-order activity were the seasonally-adjusted new orders for nondefense capital goods, which fell by 2.83% month-to-month in February, but were down by 6.21% ex-commercial aircraft; versus a revised 5.29% (previously 3.89%) decline in January 2014, which was down a revised 0.87% (previously a 0.41% gain) ex-commercial aircraft.

Caution: Current durable goods reporting remains subject to many of the same sampling and concurrent-seasonal-adjustment problems that are seen with retail sales, payroll and unemployment reporting. Unusual seasonal-factor volatility raises issues as to the significance of reported seasonally-adjusted monthly and annual changes. While those issues are brought into balance, temporarily, with an annual benchmark revision to durable goods orders (May 15th this year), subsequent reporting makes all historical reporting prior to December 2013 inconsistent with the current headline numbers.

Real (Inflation-Adjusted) Durable Goods Orders—January 2014. Going forward, ShadowStats will use the PPI aggregated inflation measure "durable manufactured goods" for deflating the new orders for durable goods series. Published only on a not-seasonally-adjusted basis, the related PPI series reflected headline monthly inflation of 0.2% in February 2014, versus 0.6% in January, with headline annual inflation of 0.8% in February, versus 0.7% in January.

Adjusted for that inflation, and as reflected in the graphs of the *Opening Comments* section, real month-to-month aggregate orders rose by 2.04% if February, following a 1.59% decline in January. Ex-commercial aircraft, orders rose for the month by 1.33% in February, versus a monthly gain of 0.09% in January. Real year-to-year aggregate orders fell by 0.55% in February, after a 3.64% gain in January, and, ex-commercial aircraft, they rose by 1.07% in February, following a gain of 1.61% in January.

Graphs of Inflation-Adjusted and "Corrected" Smoothed Durable Goods Orders. Two inflation-adjusted graphs (using the new deflation series) are found in the *Opening Comments* section. Those graphs show the monthly as well as a six-month moving-average activity for both the aggregate new orders series and the series net of the unstable commercial-aircraft order sector. The moving-average levels in both series have been holding in a pattern of near-stagnation, with some recent upside trend having turned to the downside, recently.

Real levels of the February 2014 orders remained at or below both the pre-2001 and pre-2007 recession highs. The pattern of recent stagnation in the inflation-adjusted series also is one that commonly precedes or is coincident with a recession.

A second set of graphs in the *Opening Comments* section also shows the pattern of historical real new durable goods orders net of official inflation and "corrected" for the understatement of that inflation (overstatement of official, inflation-adjusted growth)

NEW-HOME SALES (February 2014).

Drop in February New-Homes Sales Was After Downside Revision to January. The 3.3% headline decline in February 2014 new-home sales followed a downside revision to January sales activity. Net of prior-period revisions, February sales were down by 6.0% from the initial level reported for January 2014 sales. February 2014 activity also was down by 1.1% from the year before. None of these numbers, however, were statistically meaningful, and reporting here remains unstable.

Although the headline February 2014 sales activity was not meaningfully different from the level of activity in January 2014, it still was down 68.3% from the pre-recession peak activity, seen in July 2005. Where year-to-year change was negative for the second straight month, such had not happened since 2011, when the new-home sales series "bottomed out."

As discussed in *Commentary No. 611*, there has been no underlying improvement in fundamental consumer liquidity conditions, and most underlying economic numbers are showing a renewed economic downturn. There is no basis here for an imminent recovery in the housing market.

February 2014 New-Home Sales Reflected a Return to Normal Instability. As reported March 26th by the Census Bureau, February 2014 headline new-home sales (counted based on contract signings) fell by a statistically-insignificant 3.3% +/- 20.9% (all confidence intervals are at the 95% level), following a revised 3.2% (previously 9.6%) gain in January and a revised 1.6% (previously a 3.8%, initially a 7.0%) decline in December. Before prior-period revisions, February sales sank by a still-statistically-insignificant 6.0% for the month.

Year-to-year, February 2014 sales declined by a statistically-insignificant 1.1% +/- 17.8%. That followed a revised 0.7% annual decline (previously a 2.2% gain) in January, and a revised 11.3% (previously a 7.8%, initially a previously 4.5%) annual gain in December. Again, the numbers here are unstable and not reliable.

New-Home Sales Graph. The regular monthly graph of new-home sales activity is included in the *Opening Comments* section, along with graphs of the latest existing-home sales and housing starts. Even with the recent, unusually unstable numbers, new-home sales activity appears to be stagnant, at best, with the first two months of first-quarter 2014 on track for a 4.0% annualized quarterly pace of contraction.

Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com

WEEK AHEAD

Much Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead. Although shifting to the downside, market expectations generally still appear to be overly optimistic as to the economic outlook. Expectations should continue to be hammered, though, by continuing, downside corrective revisions and continued, disappointing headline economic activity. The initial stages of that process have been seen in the recent headline reporting of most major economic series.

That corrective circumstance and underlying weak economic fundamentals remain highly suggestive of deteriorating business activity. Accordingly, weaker-than-consensus economic reporting should become the general trend until such time as the unfolding "new" recession receives general recognition.

Stronger inflation reporting remains likely. Upside pressure on oil-related prices should reflect intensifying impact from a weakening U.S. dollar in the currency markets, and from ongoing global political instabilities. The dollar faces pummeling from continuing QE3, the ongoing U.S. fiscal-crisis debacle, a weakening U.S. economy and deteriorating U.S. and global political conditions (see *Hyperinflation 2014—The End Game Begins*). Particularly in tandem with a weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected inflation.

A Note on Reporting-Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-evolving economic turmoil of the last eight years, which has been without precedent in the post-World War II era of modern economic reporting. These impaired reporting methodologies provide particularly unstable headline economic results, where concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data), and they have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

PENDING RELEASES:

Industrial Production (Annual Benchmark Revision). The Federal Reserve has scheduled release of its annual benchmark revision to the index of industrial production for tomorrow, Friday, March 28th. The revision will restate the series back to 1972, including new information, new methodologies and revamped seasonal factors. Updated data likely will restate recent economic history to the downside. ShadowStats will publish an analysis of the revamped series.

Construction Spending (February 2014). The Commerce Department is scheduled to release its estimate of February 2014 construction spending on Tuesday, April 1st. The headline monthly changes, as usual, should not be statistically significant, while previous data could be subject to unusually large and unstable revisions.

Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com

U.S. Trade Deficit (February 2014). The Commerce Department and Bureau of Economic Analysis (BEA) will release the February 2014 trade-balance data on Thursday, April 3rd. By itself, January's headline deficit was worse enough against fourth-quarter 2013 reporting that a similar February reading would mean a negative contribution to first-quarter GDP growth from the first-quarter estimate of the net export account. The February estimate will be the last trade-deficit accounting before the "advance" estimate of first-quarter GDP on April 30th.

Accordingly, a flat-to-widening headline deficit result in February trade reporting should impair upcoming headline GDP growth by one-percentage point or more. Market expectations appear to be for minimal change in the headline February versus January trade deficit. Any significant narrowing of the February trade deficit would reduce the negative impact on the GDP.

Employment/Unemployment (March 2014). The Bureau of Labor Statistics (BLS) will release its March 2014 labor data on Friday, April 4th. Following February's stronger-than-consensus 175,000 gain in payroll employment, a downside surprise to expectations is a fair bet. The BLS trend model suggests a 178,000 jobs gain for March. While the consensus tends to close in around the trend, early expectations seem to be running about 20,000 above that. Underlying economic reality would suggest a downside surprise versus both the trend and market expectations.

Expectations also appear to be for the headline March U.3 unemployment rate to ease a notch from February's 6.7% reading. Underlying fundamentals would suggest an upturn in U.3, but the BLS's continuing purge of discouraged workers from the unemployment rolls would argue in favor of a lower rate. As discussed regularly in the employment/unemployment-related *Commentaries*, month-to-month comparisons of U.3 are of no meaning, because of the standard, inconsistent reporting calculations that leave the monthly data not comparable.

If U.3 drops, there likely would be some further labor-force loss associated with that. The broader U.6 and ShadowStats unemployment measures would tend to hold, or increase anew, at their broader and higher respective levels.

Again, all these numbers remain unsettled and could come in well outside general expectations.

Copyright 2014 American Business Analytics & Research, LLC, www.shadowstats.com