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

COMMENTARY NUMBER 708
Revised Fourth-Quarter 2014 GDP, Real Median Household Income

March 27, 2015

GDP Held at 2.22% but Broader GNP Tumbled to 1.36%

Shifting Global Financial and Economic Distortions Impair Domestic Economic Activity

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PLEASE NOTE: The next regular Commentary, *scheduled for Thursday, April 2nd, will cover the February 2015 trade deficit and construction spending. A subsequent* Commentary *on Friday, April 3rd, will cover March 2015 employment and unemployment.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Third Estimate of Fourth-Quarter GDP Headline Growth Held at 2.2%, but Initial Reporting Showed GNP Growth at just 1.4%. Coming in below consensus expectations for upwardly-revised 2.4% growth [Bloomberg], the third estimate of, second revision to fourth-quarter 2014 was no more than statistical noise, leaving the headline, annualized quarterly real growth rate at an unchanged 2.2% (at the first decimal point). The "final" revision to fourth-quarter Gross Domestic Product (GDP) was no such thing, however, given pending, July 30th annual benchmark revisions to the GDP.

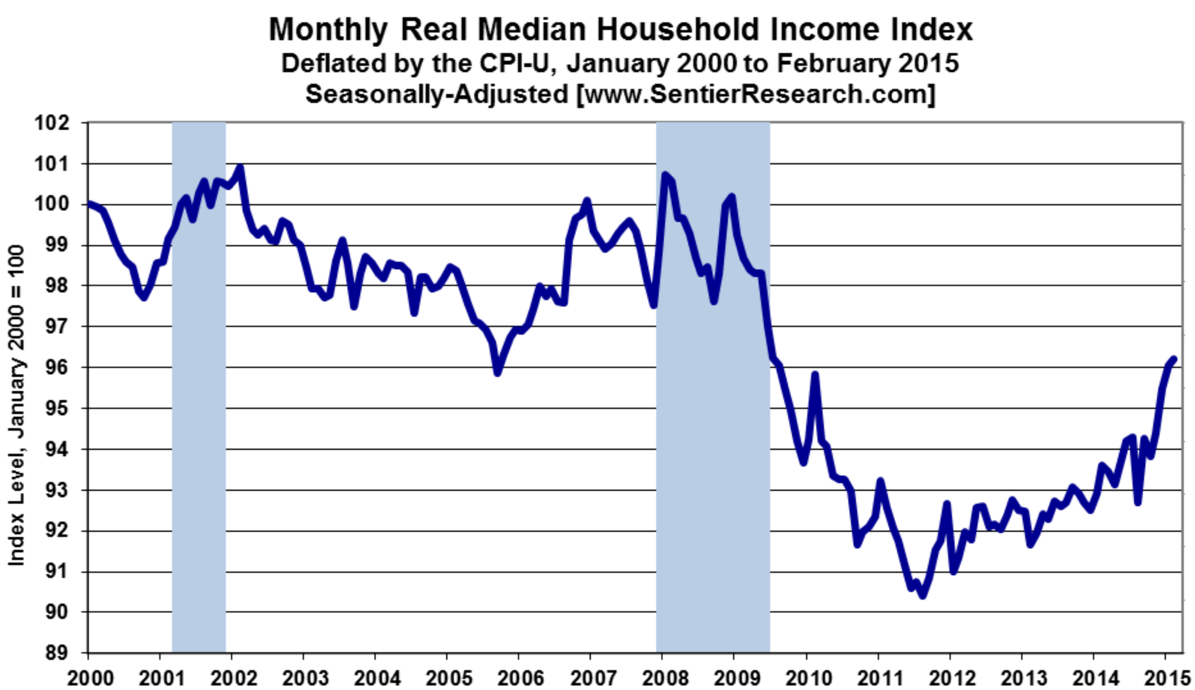
The third estimate of fourth-quarter GDP publication did hold some surprise, though, with the accompanying initial estimate from the Bureau of Economic Analysis (BEA) of headline Gross National Product (GNP) growth at 1.4%. GNP is the broadest measure of U.S. economic activity, encompassing the GDP. GDP is GNP net of the trade balance in factor income (interest and dividend payments).

The slower GNP growth rate reflected a sharp pullback of foreign payments to the United States in fourth-quarter 2014, likely an artefact of the still-unfolding economic and financial imbalances outside the United States, as well as of the Federal Reserve's "tapering" and operational gimmicks around same, including the recent U.S. dollar rally. These elements have begun to have a negative impact on aggregate U.S. economy, reflected in the slowing of the GNP growth.

In contrast, the initial reporting of fourth-quarter 2014 Gross Domestic Income (GDI) came in at 3.1%. The GDI is the income-based equivalent of the consumption-based GDP number; the growth rates should be identical. With a surging statistical discrepancy (the numerical equalizer for the two series), the detail here served to highlight the increasing inconsistencies and lack of near-term significance (as within several years) of the national-income reporting, as defined by the BEA.

Discussed in *No. 692 Special Commentary: 2015 - A World Out of Balance*, headline GDP reporting simply is not credible. Contrary to common experience, second- and third-quarter 2014 growth estimates were the strongest in more than a decade. Even at less than half the pace of the preceding quarters, headline fourth-quarter growth still significantly overstated economic reality; it should have been flat-to-minus. Nonetheless, headline quarterly contractions are likely soon in this otherwise bloated series.

Downside revisions to recent GDP quarters await the July 30, 2015 annual GDP revisions, yet current underlying economic detail of the last several months has been weak enough for even the bloated, headline GDP reporting of pending quarters to turn negative, quarter-to-quarter, for both the current and upcoming quarter. That was discussed in *Commentary No. 707* and will be reviewed and updated in the pending April 3rd *Commentary*, which will encompass new detail from the February trade deficit and construction spending, and from the March reporting of domestic employment and unemployment.



Monthly Real Median Household Income—February 2015—Real Growth Slowed as Inflation Rebounded. As we go to press, www.SentierResearch.com has released its monthly real median household income estimate for February 2015, shown in the preceding graph. Discussed previously (see *Commentary No. 705* for detailed general comments), most of the recent increase in these monthly numbers has been due to negative CPI-U inflation, which increased "real" or inflation-adjusted changes in data. As the February CPI-U turned to the upside, the growth in the February real median income number softened (it was not statistically meaningful). More will follow with the next *Commentary*.

Today's Missive (March 27th). The balance of today's *Commentary* concentrates on the specifics of the third estimate, of fourth-quarter 2014 GDP. The *Hyperinflation Watch* section has not changed since *Commentary No. 706*. The *Week Ahead* section previews next week's reporting of the February trade deficit and new construction spending, as well as the report on March 2015 labor conditions.

Gross Domestic Product (GDP)—Fourth-Quarter 2014, Third Estimate—Awaiting Corrections in the Benchmark Revisions. The third estimate of, second revision to fourth-quarter 2014 GDP reflected statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline growth of 2.2% (2.22% at the second decimal point), revised from 2.2% (2.19% at the second decimal point), initially reported at 2.6% (2.64% at the second decimal point).

That followed headline annualized real growth of 4.97% in third-quarter 2014, 4.59% real growth in second-quarter 2014, and a real annualized contraction of 2.11% (-2.11%) in first-quarter 2014. Again, all these numbers face likely significant downside revisions in the annual benchmarking of July 30, 2015.

Shown in the graphs of the *Reporting Detail* section, headline year-to-year growth in real fourth-quarter 2014 GDP revised to 2.38%, versus 2.70% in third-quarter 2014, 2.59% annual growth in the second-quarter 2014, and 1.89% in the first-quarter 2014. Year-to-year growth in fourth-quarter 2013 was 3.13%.

Implicit Price Deflator (IPD). As general guidance, the weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth. The third estimate of fourth-quarter 2014 GDP inflation, or the implicit price deflator (IPD), revised to an annualized quarterly gain of 0.16%. The minimal fourth-quarter inflation gain was versus annualized inflation of 1.38% in third-quarter 2014, 2.15% in second-quarter 2014, and 1.33% in first-quarter 2014.

Year-to-year, fourth-quarter 2014 IPD inflation was an unrevised 1.25%, versus 1.57% in third-quarter 2014, 1.64% in second-quarter 2014, 1.37% in first-quarter 2014, and 1.40% in fourth-quarter 2013. Annual average IPD inflation held at an unrevised 1.46% in 2014, versus 1.49% in 2013.

The following comparison of headline CPI-U inflation versus the IPD, on a seasonally-adjusted, annualized quarter-to-quarter basis, reflects annual revisions to CPI-U seasonal adjustments, published by the Bureau of Labor Statistics (BLS) on February 20th (see *Commentary No. 698*).

Fourth-quarter CPI-U contracted at an annualized rate of 0.85% (-0.85%), versus gains of 1.18% in third-quarter 2014, 2.44% in second-quarter 2014, and 2.09% in first-quarter 2014.

Unadjusted, year-to-year quarterly inflation was 1.25% in fourth-quarter 2014, versus 1.78% in third-quarter 2014, 2.05% in second-quarter 2014, 1.41% in first-quarter 2014, and 1.23% in fourth-quarter 2013. Annual average CPI-U was 1.62% in 2014 versus 1.46% in 2013.

Gross National Product (GNP). Given the poor-quality of broad economic data available, year-end reporting of the fourth-quarter GNP and GDI traditionally have been delayed for the release of the third-estimate of fourth-quarter GDP growth. Accordingly, initial fourth-quarter estimates were published today (March 27th) for both series. See the opening paragraphs for discussions on the GNP and GDI.

GNP is the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments). As a reporting gimmick aimed at boosting the headline reporting of economic growth for net-debtor nations such as Greece and the United States, international reporting standards were shifted some decades back to reporting headline GDP instead of GNP.

Headline, annualized, real fourth-quarter 2014 GNP growth was 1.36%, down from 5.28% in third-quarter 2014. Fourth-quarter, year-to-year annual growth slowed to 2.05%, versus 2.64% in third-quarter 2014.

Gross Domestic Income (GDI). GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a "statistical discrepancy" to the GDI-side of the equation, but the discrepancy just as easily could be added to the GDP number. In nominal terms, the statistical discrepancy widened from -165.7 billion dollars in the third-quarter 2014, to -207.2 billion dollars in fourth-quarter 2014.

Headline, annualized, real fourth-quarter 2014 GDI growth was 3.15%, down from 5.20% in third-quarter 2014. Year-to-year annual growth increased to 2.86% in fourth-quarter 2014, versus 2.42% in third-quarter 2014.

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. The second revision, third guesstimate of headline, annualized quarterly growth in fourth-quarter 2014 GDP was 2.22% (previously 2.19%, initially 2.64%), following 4.97% headline growth in third-quarter 2014, 4.59% growth in second-quarter 2014, and a contraction of 2.11% (-2.11%) in first-quarter 2014 GDP. The third revision here was minimal, in aggregate, encompassing a further downturn in inventory building, with an offsetting gain in healthcare spending/insurance issues and a minor narrowing the in the net-export deficit.

The third estimate of the fourth-quarter 2014 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 2.98% + 0.61% - 1.03% - 0.35% = 2.21% (rounding difference versus 2.22%). When all the dust settles from the July 30th benchmark revisions, headline fourth-quarter 2014 GDP quarter-to-quarter growth, again, should be flat-to-minus. Details from prior distributions for earlier fourth-quarter estimates are found in *Commentary No. 700* and *Commentary No. 691*.

- ***Consumer Spending Contributed 2.98% [Previously 2.83%, Initially 2.87%] to Fourth-Quarter Growth; Contributed 2.21% to Third-Quarter.*** The upside revision to headline fourth-quarter personal consumption reflected ongoing questionable effects and measurement of the Affordable Care Act (ACA). Healthcare spending revised higher, contributing an extra 0.35% to headline

GDP growth with a 0.16% offset in the financial services and insurance area. The almost-unknowable accounting on for the ACA likely contributed close to 1.0% of the overall 2.2% headline GDP growth rate for the quarter.

- ***Business/Residential Investment Contributed 0.61% [Previously 0.84%, Initially 1.20%] to Fourth-Quarter Growth; Contributed 1.18% to Third-Quarter.*** The reduced growth contribution here came from a complete disintegration of the involuntary inventory build-up as originally estimated for the fourth-quarter, with the latest net revision contributing a negative swing of 0.22% to aggregate GDP growth, between the first and second revisions. As a result of the downward revision to net inventory building (actually having turned negative), final sales (GDP minus inventory change) rose to 2.32%, from the prior estimate of 2.07%, and the initial estimate of 1.82%.

- ***Net Exports Subtracted 1.03% (-1.03%) [Previously 1.15% (-1.15%), Initially 1.02% (-1.02%)] from Fourth-Quarter Growth; Contributed 0.78% to Third-Quarter.*** Little changed, the net export account subtracted 0.12% (-0.12%) less from the aggregate growth rate, but most of the initial trade-deficit deterioration for the quarter was picked up in the first GDP estimate.

- ***Government Spending Subtracted 0.35% (-0.35%) [Previously 0.32% (-0.32%), Initially 0.40% (-0.40%)] from Fourth-Quarter Growth; Contributed 0.80% to Third-Quarter.*** The bulk of the revisions here continued to be in the variability of state and local government "gross investment." The federal government's numbers changed little.

Economic Reality. With the latest official estimate of fourth-quarter 2014 GDP growth at 2.22%, versus headline 4.97% growth in third-quarter 2014, 4.59% growth in second-quarter 2014 and a contraction of 2.11% (-2.11%) in first-quarter 2014, the general outlook as to underlying economic reality has not changed. Discussed briefly, earlier in these *Opening Comments*, and recently in *Commentary No. 707* and *No. 692 Special Commentary: 2015 - A World Out of Balance*, the broad economy is turning down anew, and that likely will be reflected in back-to-back headline contractions of first- and second-quarter 2015 GDP reporting. A wide variety of monthly economic detail already is suggesting that and should continue to confirm those patterns in reporting of the next several months.

In advance of the annual GDP overhaul, major benchmark revisions are due in the next couple of months for key series such as retail sales, industrial production and new orders for durable goods. The historical revisions should be massively negative in this government-shutdown-delayed, catch-up reporting. Related, serious downside revisions to recent and current GDP reporting also are likely, come the annual benchmark revisions. With the ShadowStats broad outlook unchanged, the gist of much of the following text remains along the lines of other recent GDP *Commentaries*, but the details and numbers are updated for the latest reporting.

Discussed frequently, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity shows 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 recent quarters. Irrespective of the reporting gimmicks introduced in the July 2013 and July 2014 GDP benchmark revisions, including a recent pattern of inclusion and estimation of highly-questionable data on the

Affordable Care Act (ACA), a consistent, fundamental pattern of faltering historical activity is shown in the accompanying sets of "corrected" GDP graphs.

Please note that the pattern of activity shown for the "corrected" GDP series is much closer to the patterns shown in the graphs of employment and monthly real median household income and other consumer measures as detailed most recently in *Commentary No. 702*, *Commentary No. 705* and in *No. 692 Special Commentary: 2015 - A World Out of Balance*. Similar patterns are found in recent indications of annual consumer expenditures (see *Commentary No. 656* and *Commentary No. 673*) and economic series not otherwise reliant on understated inflation for their reported growth, such as housing starts (see *Commentary No. 705* and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*).

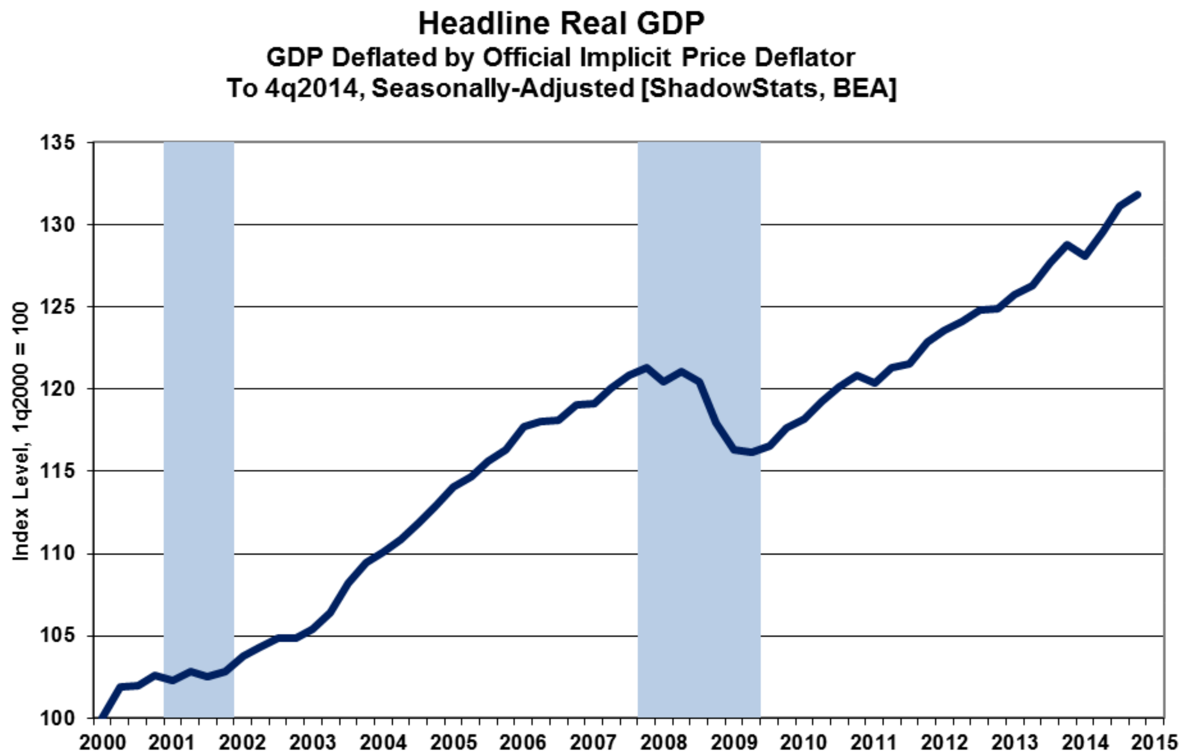
With liquidity-strapped consumers unable to fuel sustainable growth in consumption, a full business recovery could not have taken place since 2009, and a recovery will not be forthcoming until consumer structural income and liquidity problems are resolved.

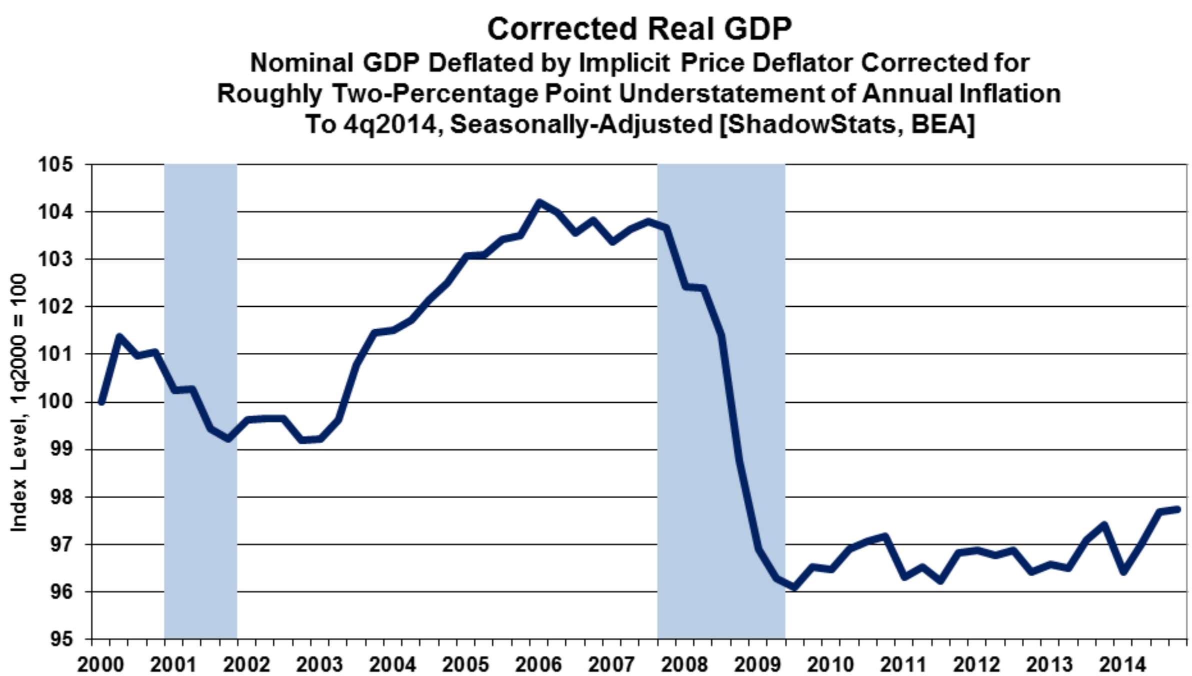
Official and Corrected GDP. As usually discussed in these *Commentaries* covering the quarterly GDP reporting and monthly updates, the full economic recovery indicated by the official, real GDP numbers remains an illusion. It is a statistical illusion created by using too-low a rate of inflation in deflating (removing inflation effects) from the GDP series. The accompanying two sets of graphs tell that story, updated for the third estimate of fourth-quarter 2014 GDP.

The first set of graphs (2000-to-date) is the one traditionally that has been incorporated in the GDP *Commentaries*, and is expressed on an index base where first-quarter 2000=100.0. The second set updates the longer-term graphs (1970-to-date), expressed in billions of 2009 dollars as used in headline GDP reporting, and as published initially in the second installment of the *Hyperinflation Report* and updated in *No. 692 Special Commentary* (both linked above). The graphs also show official periods of recession as shaded areas (the ShadowStats-defined recessions are indicated by the lighter shading in the second graph of the second set).

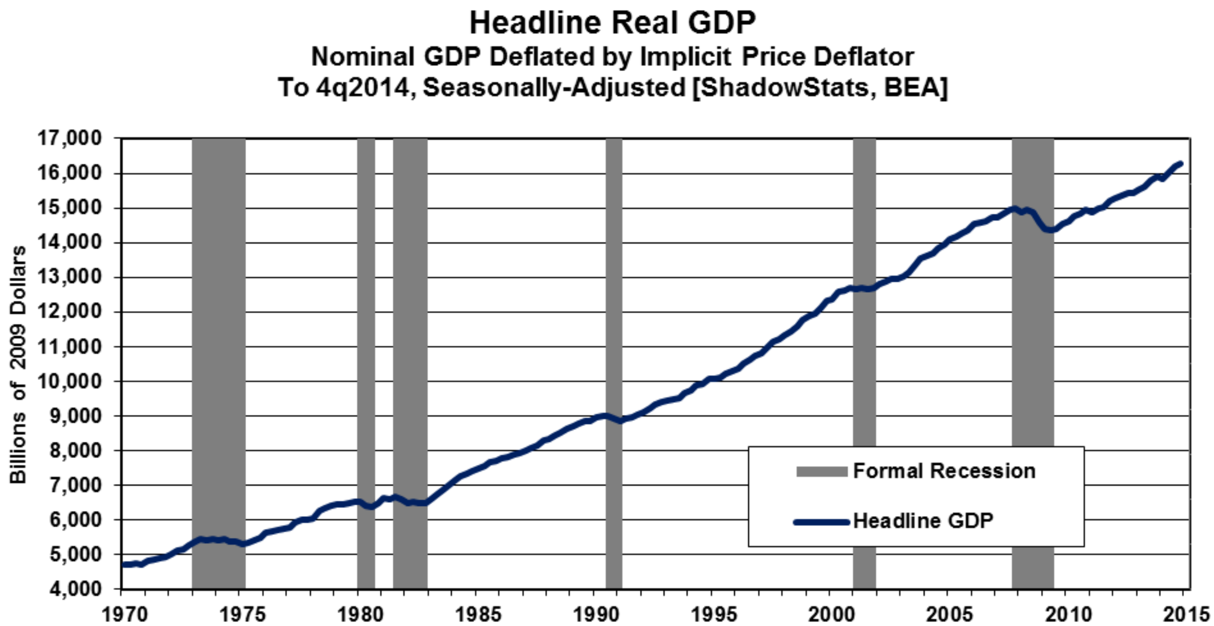
Shown in the first graph of official *Headline Real GDP*, GDP activity has been reported above pre-2007 recession levels—in full recovery—since second-quarter 2011, and headline GDP has shown sustained growth since (a growth interruption for first-quarter 2014 excepted). Adjusted for official GDP inflation (the implicit price deflator), the level of headline fourth-quarter 2014 GDP currently stands 8.7% above its pre-recession peak-GDP estimate of fourth-quarter 2007. In contrast, the "corrected" GDP version, in the second graph, shows fourth-quarter 2014 GDP activity at 6.2% (-6.2%) below its pre-recession peak of first-quarter 2006.

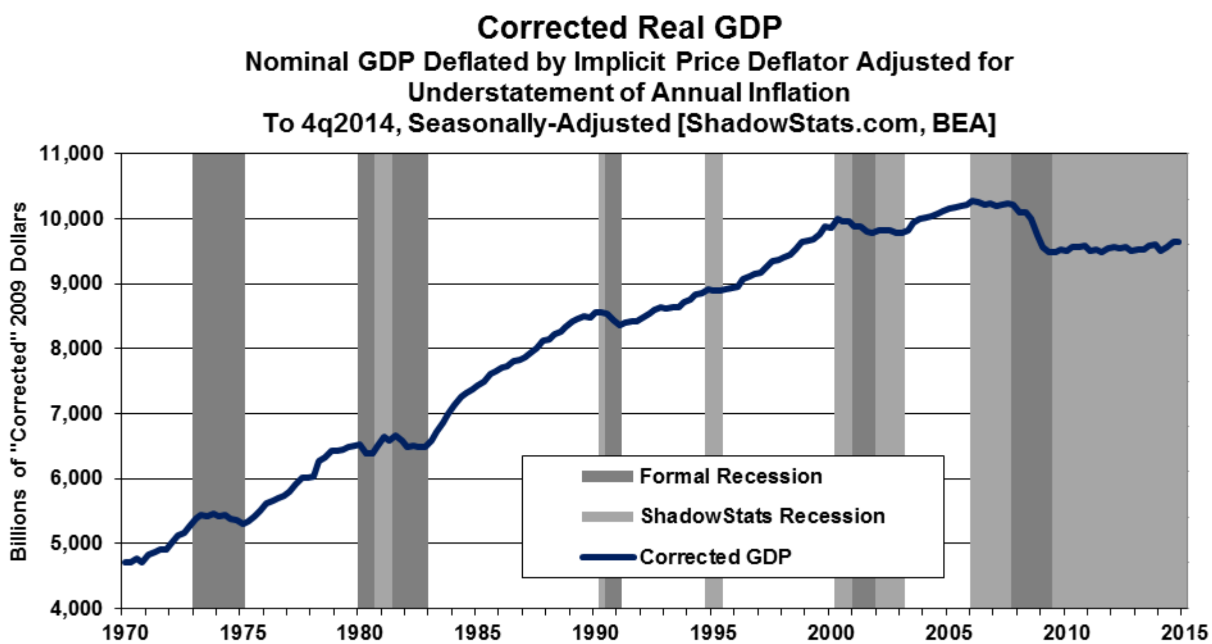
Further, discussed in the second installment of the *Hyperinflation Report*, and again in *No. 692 Special Commentary*, no other major economic series has shown a parallel pattern of official full economic recovery and meaningful expansion thereafter, consistent with the GDP reporting. Such is covered in discussions on the industrial production, real retail sales and real durable goods orders series in *Commentary No. 704*, *Commentary No. 706* and *Commentary No. 707*. 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 measure real-world activity. Flaws in the GDP inflation methodologies and simplifying reporting assumptions have created the "recovery."





The second graph in each series plots the *Corrected Real GDP*, corrected for the understatement inherent in official inflation estimates (see *Public Commentary on Inflation Measurement*), with the deflation by the implicit price deflator (IPD) adjusted for understatement of roughly two-percentage points of annual inflation in recent years. The inflation understatement has resulted from hedonic-quality adjustments, as discussed in the *Hyperinflation Reports*.





[The* Reporting Detail *section contains further background material on the updated estimate of fourth-quarter 2014 GDP. Various drill-down and graphics options on the headline GDP numbers are available to subscribers at our affiliate: www.ExpliStats.com.]

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HYPERINFLATION WATCH

HYPERINFLATION OUTLOOK SUMMARY

General Outlook Unchanged; Intensifying Economic Weakness Begins to Impact Fed Policy and U.S. Dollar Strength. *[Note: The text has not been changed since* Commentary No. 706 *of March 24th, other than for adjustments to internal links.]*

No. 692 Special Commentary: 2015 - A World Out of Balance of February 2, 2015 updated the *Hyperinflation 2014* reports and the broad economic outlook. Previously, the long-standing hyperinflation and economic outlooks were updated with the publication of *2014 Hyperinflation Report—The End Game Begins – First Installment Revised*, on April 2, 2014, and publication of *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*, on April 8, 2014. The outlooks also are updated regularly in the weekly *Commentaries*. The *Opening Comments* of *No. 692* should be considered in terms of recent circumstances and near-term, proximal triggers for massive dollar selling. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts. One other reference should be considered here, in terms of underlying economic reality, and that is the *Public Commentary on Inflation Measurement*.

Primary Summary. Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation. The 2008 Panic and near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same, pulled the elements of the eventual hyperinflation crisis at the end of this decade into the current period. The primary and basic summary of the broad outlook and the story of how and why this fiscal, financial and economic crisis has unfolded and developed over the years—particularly in the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked earlier). The following summarizes the underlying current circumstance and recent developments.

Consistent with the above *Special Commentaries*, the unfolding economic circumstance, in confluence with other fundamental issues, should place mounting and massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic. Physical gold and silver, and holding assets outside the U.S. dollar, remain the primary hedges against the pending total loss of U.S. dollar purchasing power, despite sharp and generally ongoing rally in the U.S. dollar's exchange rate since mid-2014 and broadly related selling pressures in the gold and silver markets.

Current relative U.S. economic strength and the relative virtuousness of Fed monetary policy versus major U.S. trading partners have been over-estimated heavily by the global markets, and structural faults have started to appear in the foundation underpinning recent U.S. dollar strength (see *Commentary No.*

706 and *Commentary No. 705*). Some minor pullback in the dollar has taken place in in recent days, as increasing signs of U.S. economic weakness—unanticipated by the global markets—have begun to threaten the expected near-term hiking of U.S. interest rates by the Federal Reserve.

A crash back to recognition of more-realistic domestic-economic circumstances looms, and it likely will be accompanied by a crash in the U.S. dollar versus major currencies, such as the Swiss franc, Canadian dollar and Australian dollar; related rallies in precious metals and oil; and related sell-offs in the domestic stock and bond markets. Further, a sharp deterioration in near-term domestic U.S. political stability continues to intensify and is of meaningful near-term risk for providing further fuel for heavy selling of the dollar.

***Current Economic Issues versus Underlying U.S. Dollar Fundamentals*.** U.S. economic activity is turning down anew, despite overstated growth in recent GDP reporting. GDP and other major economic series face heavy downside-benchmark revisions through the end of July. Weak, underlying economic reality has begun to surface in headline reporting and should become increasingly and painfully obvious to the financial markets in the headline detail and revisions of the weeks and months ahead, for series such as real retail sales, production, housing and construction, the trade deficit and payroll employment.

As financial-market expectations shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, particularly deteriorating domestic political conditions, should intensify mounting and eventually massive selling pressures against the U.S. dollar, fully reversing the dollar's gains of the last eight months, pushing the dollar to historic lows. The nascent currency crisis also has meaningful potential to resurrect elements of the Panic of 2008.

Unexpected economic weakness intensifies the known stresses on an already-impaired banking system, increasing the perceived need for expanded, not reduced, quantitative easing (see *Commentary No. 706*). The highly touted "tapering" by the FOMC ran its course. Future, more-constructive Fed behavior—purportedly moving towards normal monetary conditions in what had been an unfolding, near-perfect economic environment—was pre-conditioned by a continued flow of "happy" economic news. Suggestions that all was right again with world were nonsense. The Panic of 2008 never was resolved, and the Fed soon will find that it has no easy escape from its quantitative easing (QE3), which continues. Only overt expansion of QE3 ceased; QE4 will become the near-term question.

The economy has not recovered; the banking system is far from stable and solvent; and the Federal Reserve and the federal government still have no way out. Significant banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs will be provided, as needed, by the Fed, under the ongoing political cover of a weakening economy—a renewed, deepening contraction in business activity. The Fed has no choice. Systemic collapse is not an option for the Board of Governors. This circumstance simply does not have a happy solution.

Accordingly, any renewed market speculation as to an added round of Federal Reserve quantitative easing, QE4, could become a major factor behind crashing the dollar and boosting the price of gold. The Fed has strung out its options for propping up the system as much as it could, with continual, negative impact on the U.S. economy. The easings to date, however, appear to have been largely a prop to the increasingly unstable equity markets.

In the event of a QE4, any resulting renewed boost to U.S. equities would be a fleeting illusion, at least in terms of real value (purchasing power of the dollar). Such gains would tend to be losses, in real terms, with the stocks valued in terms of Swiss francs, for example, or valued against what would become a rapidly-increasing pace of domestic U.S. inflation.

Unexpected economic weakness also savages projections of headline, cash-based, federal-budget deficits (particularly the 10-year versions) as well as projected funding needs for the U.S. Treasury. Current fiscal "good news" is from cash-based, not GAAP-based and accounting projections.

All these crises should combine against the U.S. dollar, likely in the very-near future, if they have not already begun to do so. That said, recent faux market perceptions of domestic economic, financial-system and monetary tranquility had boosted the U.S. dollar's strength significantly in global trading and contributed to savaging the prices of oil and in weakening the prices of precious metals. That process may be reversing.

The January 2015 shift in the Swiss franc, due to the elimination of the effective pegging of the franc to the euro and, by default to the U.S. dollar, also had the effect of allowing some temporary upside movement in the dollar prices of gold and silver. Recent intensified weakness in the euro, however, had led to increasingly-negative domestic Swiss interest rates and interventions aimed at depressing the franc, prop the dollar. Such policies usually prove to be fleeting, due to significant undesired side effects on the domestic economy and in financial-market distortions. Again, these markets remain in a state of flux, with recent movement continuing against the dollar.

Strength in the U.S. dollar should continue to reverse, sharply in the context of underlying reality outlined here and in the sections that follow. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed; it is just a matter of market perceptions shifting anew, against the U.S. currency. That process, again, started with the shift in Swiss National Bank policy. Key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008, is turning down anew, with no potential for recovery in the near-term.*** The circumstance includes a renewed widening in the trade deficit, as well as ongoing severe, structural-liquidity constraints on the consumer, which are preventing a normal economic rebound in the traditional, personal-consumption-driven U.S. economy (see *Commentary No. 702*). Sharply-negative economic reporting shocks, versus still-unrealistically-positive consensus forecasts, remain a heavily-favored, proximal trigger for the intensifying the unfolding dollar debacle.

- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of willingness to address long-term U.S. solvency issues, but also the current political impossibility of doing so. The shift in control of Congress has not altered the systemic unwillingness to address the underlying fundamental issues, specifically to bring the GAAP-based deficit into balance. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version continues to run around $5 trillion for the annual shortfall, while those in Washington continue to increase spending and to take on new, unfunded liabilities. The history and issues here are explored in the first installment of the *Hyperinflation Report*, as previously linked; the initial fiscal-2014 details were discussed in *Commentary No. 672*, and the official GAAP-based financial statements for 2014 will be discussed fully, soon (see *Commentary No. 702*).

- ***Monetary malfeasance by the Federal Reserve, as seen in central bank efforts to provide liquidity to a troubled banking system, and also to the U.S. Treasury.*** Despite the end of the Federal Reserve's formal asset purchases, the U.S. central bank monetized 78% of the U.S. Treasury's fiscal-2014 cash-based deficit (see *Commentary No. 672*). The quantitative easing QE3 asset purchase program effectively monetized 66% of the total net issuance of federal debt to be held by the public during the productive life of the program (beginning with the January 2013 expansion of QE3). The monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury. With highly tenuous liquidity conditions for the banking system and the Treasury, it would not be surprising in this period of increasing instability to see covert Federal Reserve activities masked in the purchases of Treasury debt by nations or other entities financially friendly to or dependent upon the United States. Renewed expansion to quantitative easing remains likely, given ongoing banking-system stresses, vulnerable stock markets and weakening, actual U.S. economic activity. As has been commonplace, the Fed likely would seek political cover for new or expanded systemic accommodation in any "renewed" economic distress.

- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, usually with a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. The weaker the rating, the weaker tends to be the U.S. dollar. The positive rating for the President is off its historic low, but still at levels that traditionally are traumatic for the dollar. Chances of a meaningful shift towards constructive cooperation between the White House and the new Congress, in addressing fundamental issues are nil. Issues such as non-recovered, faltering economic activity and the consumer liquidity crisis, and addressing the nation's long-range solvency issues should continue to devolve, into extreme political crisis.

- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, or sitting in place, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the ongoing situation in Ukraine versus Russia and extremely-volatile circumstances in the Middle East. U.S. response to the Ukrainian situation may be behind part of the recent strength in the U.S. dollar and related weakness in oil prices, with U.S. actions aimed at causing financial distress for Russia. The situation has yet to run its full course, and it has the potential to reverse rapidly.

- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar continue to expand. In particular, anti-dollar rhetoric and actions have been seen with Russia, China, France, India and Iran, along with some regular rumblings in OPEC and elsewhere. Temporary, recent dollar strength may have bought some time versus those who have to hold dollars for various reasons. Nonetheless, developing short-term instabilities and a quick reversal in the dollar's strength could intensify the "dump-the-dollar" rhetoric rapidly.

When the selling pressure breaks massively against the U.S. currency, the renewed and intensifying weakness in the dollar will place upside pressure on oil prices and other commodities, boosting domestic inflation and inflation fears. Domestic willingness to hold U.S. dollars will tend to move in parallel with global willingness, or lack of willingness, to do the same. These circumstances will trigger the early stages of a hyperinflation, likely in the year ahead.

Both the renewed dollar weakness and the resulting inflation spike should boost the prices of gold and silver, where physical holding of those key precious metals remains the ultimate hedge against the pending inflation and financial crises. Investors need to preserve the purchasing power and liquidity of their wealth and assets during the hyperinflation crisis ahead. Again, see Chapter 10, *2014 Hyperinflation Report—Great Economic Tumble* for detailed discussion on approaches to handing the hyperinflation crisis and *No. 692 Special Commentary: 2015 - A World Out of Balance*, for other factors afoot in the current environment.

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REPORTING DETAIL

GROSS DOMESTIC PRODUCT—GDP (Fourth-Quarter 2014, Second Revision, Third Estimate)

GDP Growth Held at 2.2% in Its Third Estimate; Initial Reporting Showed Headline Growth of 1.4% in GNP, 3.1% in GDI. *[Note: The first four paragraphs here largely repeat the beginning of the* Opening Comments *section.]* Coming in below consensus expectations of upwardly-revised 2.4% growth [Bloomberg], the third estimate of, and second revision to fourth-quarter 2014 was no more than statistical noise, leaving the headline, annualized quarterly real growth rate at an unchanged 2.2%. The "final" revision to fourth-quarter Gross Domestic Product (GDP) was no such thing, however, given that annual benchmark revisions to the GDP are scheduled for July 30th.

The release of the third estimate of fourth-quarter GDP did hold some surprise, however, with the accompanying initial estimate of headline Gross National Product (GNP) growth at 1.4%. GNP is the broadest measure of U.S. economic activity, encompassing GDP. GDP is GNP net of the trade balance in factor income (interest and dividend payments). The slower GNP growth rate reflected a sharp pullback of foreign payments to the United States in fourth-quarter 2014, possibly an artefact of the still-unfolding economic and financial imbalances outside the United States, as well as of the Federal Reserve's "tapering" and operational gimmicks around same.

In contrast, the initial reporting of fourth-quarter 2014 Gross Domestic Income (GDI) came in at 3.1%. The GDI is the income-based equivalent of the consumption-based GDP number. With a surging statistical discrepancy, the detail here served to highlight the increasing inconsistencies and lack of near-term significance (as within several years) of the national income reporting, as defined by the Bureau of Economic Analysis (BEA).

Discussed in *No. 692 Special Commentary: 2015 - A World Out of Balance*, headline GDP reporting simply is not credible. Contrary to common experience, second- and third-quarter 2014 growth estimates were the strongest in more than a decade. Even at less than half the pace of the preceding quarters, headline fourth-quarter growth still significantly overstated economic reality; it should have been flat-to-minus. Downside revisions to recent periods await the July 30, 2015 annual GDP revisions, yet current underlying economic detail already has been weak enough for even the bloated headline GDP reporting to turn negative, quarter-to-quarter, in the current and upcoming quarters.

Discussed frequently, the GDP does not reflect properly or accurately the changes to the underlying fundamentals that drive the economy. Underlying real-world economic activity shows 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 recent quarters.

The GDP simply remains the most worthless of the popular government economic series, in terms of determining what really is happening to U.S. business activity. The series is the most heavily-modeled, politically-massaged and gimmicked government indicator of the economy. It has been so since at least the days when President Lyndon Johnson reportedly reviewed the numbers before their release, and would return them to the Commerce Department, if Commerce had gotten them "wrong."

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 $60.4 billion in "residual," as of the second estimate of fourth-quarter 2014.*

***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 today, March 27th, by the Bureau of Economic Analysis (BEA), the third estimate of, second revision to fourth-quarter 2014 GDP reflected statistically-insignificant, real (inflation-adjusted), annualized, quarterly headline growth of 2.2% (2.22% at the second decimal point) +/- 3.5% (95% confidence interval), revised from 2.2% (2.19% at the second decimal point), initially reported at 2.6% (2.64% at the second decimal point).

That followed headline annualized real growth of 4.97% in third-quarter 2014, 4.59% real growth in second-quarter 2014, and a real annualized contraction of 2.11% (-2.11%) in first-quarter 2014. All these numbers face likely significant downside revisions in the annual benchmarking of July 30, 2015. Distribution detail of the headline quarterly GDP growth is detailed in the *Opening Comments*.

Shown in the accompanying graphs, headline year-to-year growth in real fourth-quarter 2014 GDP revised to 2.38% (previously 2.37%, initially 2.48%), versus 2.70% in third-quarter 2014, 2.59% annual growth in the second-quarter 2014, and 1.89% in the first-quarter 2014. Year-to-year growth in fourth-quarter 2013 was 3.13%.

The latest quarterly year-to-year growth remained below that near-term peak of 3.13% seen in fourth-quarter 2013. The current-cycle trough in annual change was in second-quarter 2009, at a 4.09% pace of decline (-4.09%). That was the deepest year-to-year contraction for any quarterly GDP in the history of the series, which began with first-quarter 1947.

In terms of annual average growth, average real 2014 GDP was up by an unrevised 2.39% (initially 2.42%) over 2013, which, in turn was up by 2.22% over 2012. The annual decline in real GDP activity of 2.78% (-2.78%) in 2009 was the deepest since the 11.58% (-11.58%) plunge in the 1946 post-war production shutdown. War disruptions excluded, the headline 2009 decline was the worst since the economic plunge of 3.31% (-3.31%) in 1938, the second down leg of the Great Depression.

The first graph following shows current year-to-year quarterly detail, from 2000-to-date, where the second graph shows the same series in terms of its full quarterly history. The third graph shows the plot of historical average annual real growth, also for the full history of the series.


Quarterly Real Gross Domestic Product
Year-to-Year Change 1q2000-to-4q2014 [ShadowStats, BEA]
6%
5%
4%
3%
2%
1%
0%
-1%
-2%
-3%
-4%
-5%
2000q1
2001q1
2002q1
2003q1
2004q1
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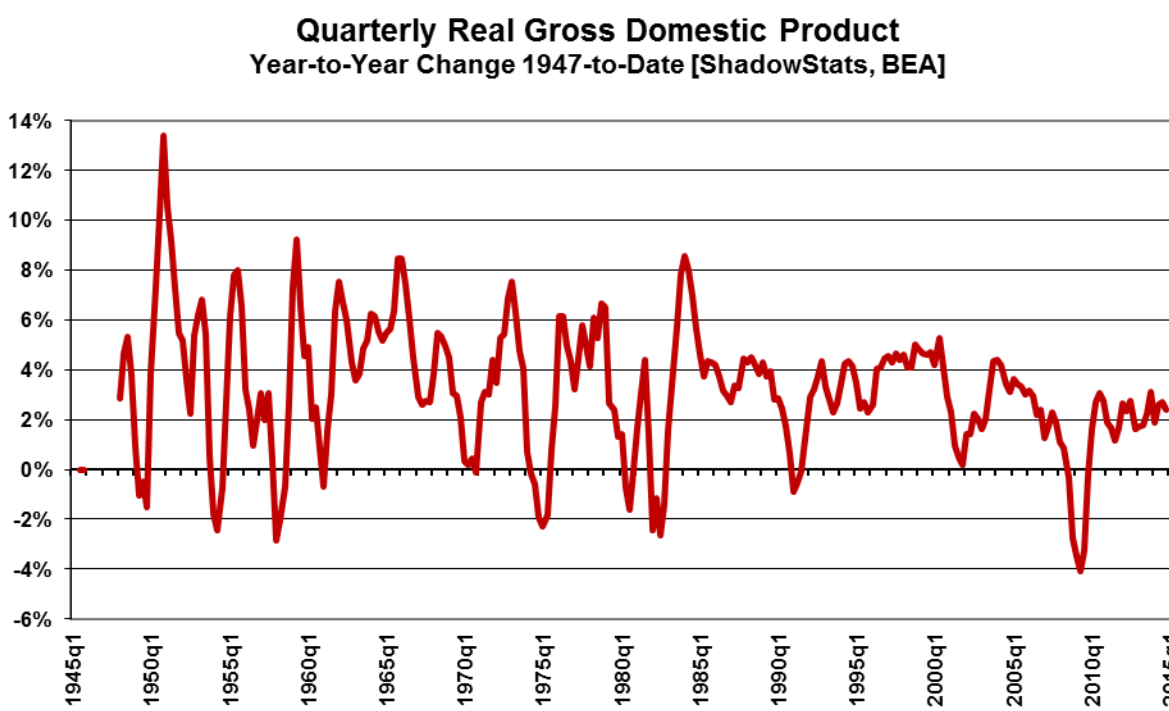
2012q1
2013q1
2014q1
2015q1


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
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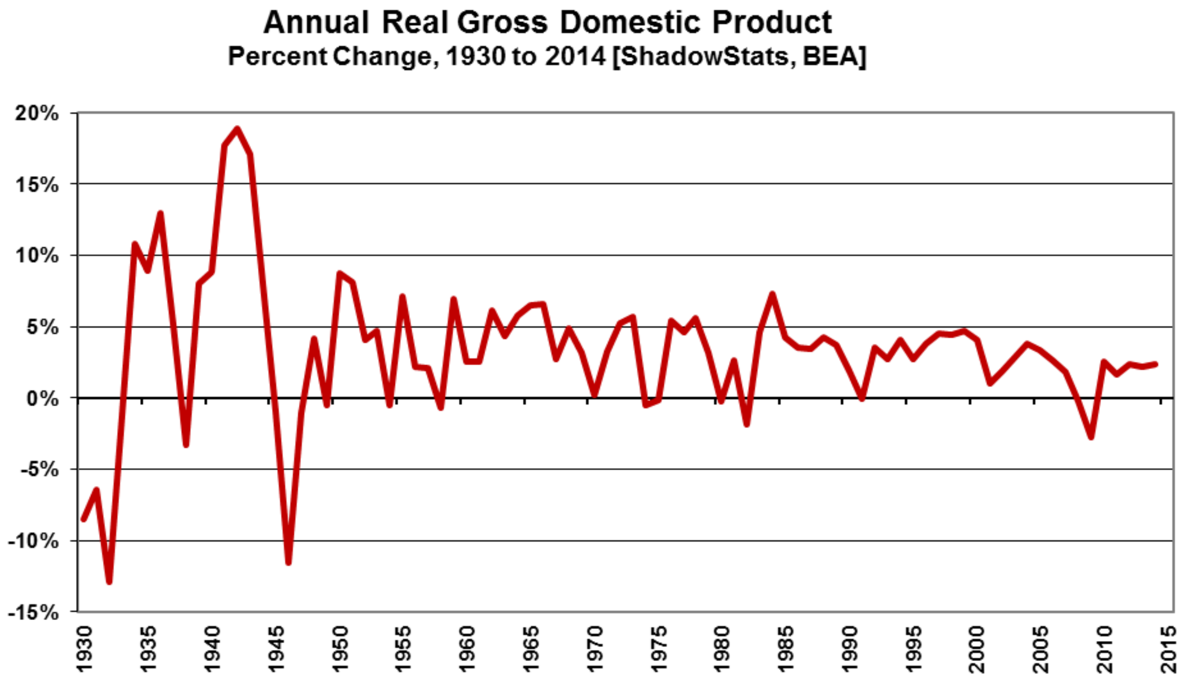
1975q1
1980q1
1985q1
1990q1
1995q1
2000q1
2005q1
2010q1
2015q1



Implicit Price Deflator (IPD). As general guidance, the weaker the inflation rate used in deflating an economic series, the stronger will be the resulting inflation-adjusted growth. The third estimate of fourth-quarter 2014 GDP inflation, or the implicit price deflator (IPD), revised to an annualized quarterly gain of 0.16% [previously a gain 0.13%, initially a contraction of 0.09% (-0.09%)]. The minimal fourth-quarter inflation gain was versus annualized inflation of 1.38% in third-quarter 2014, 2.15% in second-quarter 2014, and 1.33% in first-quarter 2014.

Year-to-year, fourth-quarter 2014 IPD inflation was an unrevised 1.25% (previously 1.19%), versus 1.57% in third-quarter 2014, 1.64% in second-quarter 2014, 1.37% in first-quarter 2014, and 1.40% in fourth-quarter 2013.

Annual average IPD inflation held at an unrevised 1.46% (initially 1.44%) in 2014, versus 1.49% in 2013.

The following comparison of headline CPI-U inflation versus the IPD, on a seasonally-adjusted, annualized quarter-to-quarter basis, reflects annual revisions to CPI-U seasonal adjustments, published by the Bureau of Labor Statistics (BLS) on February 20th (see *Commentary No. 698*).

As revised, fourth-quarter CPI-U contracted at an annualized rate of 0.85% (-0.85%) [previously down by 1.20% (-1.20%)], versus revised gains of 1.18% [previously 1.10%] in third-quarter 2014, 2.44% [previously 3.03%] in second-quarter 2014, and 2.09% [previously 1.91%] in first-quarter 2014.

Unadjusted, year-to-year quarterly inflation was unrevised at 1.25% in fourth-quarter 2014, versus 1.78% in third-quarter 2014, 2.05% in second-quarter 2014, 1.41% in first-quarter 2014, and 1.23% in fourth-quarter 2013

Annual average CPI-U was unrevised at 1.62% in 2014 versus 1.46% in 2013.

Gross National Product (GNP). Given the poor-quality of broad economic data available, year-end reporting of the fourth-quarter GNP and GDI traditionally have been delayed for release of the third-estimate of GDP growth. Accordingly, initial fourth-quarter estimates were published today (March 27th) for both series. See the *Opening Comments* on the GNP and GDI detail.

GNP is the broadest measure of U.S. economic activity, where GDP is GNP net of trade flows in factor income (interest and dividend payments). As a reporting gimmick aimed at boosting the headline reporting of economic growth for net-debtor nations such as Greece and the United States, international reporting standards were shifted some decades back to reporting headline GDP instead of GNP.

Headline, annualized, real fourth-quarter 2014 GNP growth was 1.36%, down from 5.28% in third-quarter 2014. Year-to-year annual growth slowed to 2.05% in fourth-quarter 2014, versus 2.64% in third-quarter 2014.

Gross Domestic Income (GDI). GDI is the theoretical income-side equivalent of the consumption-side GDP estimate. The GDP and GDI are made to equal each other, every quarter, with the addition of a "statistical discrepancy" to the GDI-side of the equation, but the discrepancy just as easily could be added to the GDP number.

Headline, annualized, real fourth-quarter 2014 GDI growth was 3.15%, down from 5.20% in third-quarter 2014. Year-to-year annual growth increased to 2.86% in fourth-quarter 2014, versus 2.42% in third-quarter 2014.

In nominal terms, the statistical discrepancy widened from -165.7 billion dollars in the third-quarter 2014 to -207.2 billion dollars in fourth-quarter 2014.

ShadowStats-Alternate GDP. The ShadowStats-Alternate GDP estimate for fourth-quarter 2014 GDP remained a year-to-year contraction of 1.6% (-1.6%) versus the unrevised headline fourth-quarter GDP year-to-year gain of 2.4% (initially 2.5%), at the first decimal point. Those fourth-quarter 2014 estimates were against a ShadowStats estimated 1.7% (-1.7%) year-to-year contraction and a headline year-to-year gain of 2.7% in third-quarter 2014 GDP (see the Alternate Data tab).

While the annualized, real quarterly growth rate is not estimated formally on an alternate basis, the headline 2.2% annualized quarter-to-quarter gain for fourth-quarter 2014 likely was much weaker, flat-to-minus, net of all the regular reporting gimmicks. Some downside quarterly-growth revisions should follow for quarterly GDP in recent years with the July 30, 2015 annual benchmark revision. That remains the most likely vehicle for moving recent, gimmicked headline quarterly growth rates to more-reasonable levels. 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 2007 recession.

Adjusted for understated inflation and other methodological changes—such as the inclusion of intellectual property, software and recent accounting for the largely not-measurable and questionable impact of the Affordable Care Act (ACA)—the business downturn that began in 2006/2007 is ongoing; there has been no meaningful economic rebound. The "corrected" real GDP graph, and the longer-term "corrected" graph updated from *No. 692 Special Commentary: 2015 - A World Out of Balance* and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* (see the *Opening Comments* section) are 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.

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WEEK AHEAD

Headline Reporting and Revisions Should Trend Much Weaker versus an Overly-Optimistic Economic Consensus; Inflation Will Rise Anew, Following the Bottoming of Oil-Prices. Shifting some to the downside, again, amidst wide fluctuations in the numbers, market expectations for business activity have been, and still remain overly optimistic in the extreme. They still exceed any potential, underlying economic reality, even though downside corrective revisions and an accelerating pace of downturn in broad-based, monthly headline economic reporting already have begun to hammer those expectations. Recent GDP excesses will not face downside revisions now until the July 30, 2015 GDP benchmark revision.

Headline consumer inflation—recently driven lower by collapsing prices for gasoline and other oil-price related commodities—likely hit its near-term low in January 2015, moving minimally off bottom in February. Significant upside inflation pressures should resume as oil prices rebound, a process that already appears to be underway, and one that would accelerate rapidly with an eventual sharp downturn in the exchange-rate value of the U.S. dollar. These areas, the general economic outlook and longer range reporting trends are reviewed broadly in *No. 692 Special Commentary: 2015 - A World Out of Balance*.

A Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. Beyond gimmicked changes to reporting methodologies of the last several decades, ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. Data instabilities were induced partially 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. The severity and ongoing nature of the downturn provide particularly unstable headline economic results, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment, and unemployment data, see the prior labor data related *Commentary No. 695*). Combined with recent allegations of Census Bureau falsification of data in its monthly Current Population Survey (the source for the Bureau of Labor Statistics' Household Survey), these issues have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series (see *Commentary No. 669*).

PENDING RELEASES:

Construction Spending (February 2015). The Commerce Department will release its estimate of February 2015 construction spending on Wednesday, April 1st. The detail will be covered by ShadowStats in the *Commentary* of Thursday, April 2nd.

The headline monthly changes, as usual, should not be statistically significant, while previous data will be subject to large and unstable revisions. Most frequently, revisions here are to the downside. Irrespective of almost perpetually-positive market expectations for this series, the detail tends to be in down-trending stagnation, net of inflation.

U.S. Trade Balance (February 2015). The Commerce Department and Bureau of Economic Analysis (BEA) will release their estimate of the February 2015 trade deficit on Thursday, April 2nd. Early market expectations appear to be for little change in the nominal headline monthly deficit, but, as with the prior month's reporting, a wider-than-expected trade deficit (at least after inflation-adjustment) usually is a good bet. Once the headline February detail is place, the real or inflation-adjusted merchandise trade detail will set the tone for the initial estimate of first-quarter 2015 GDP, due on April 29th. That initial GDP estimate will be based partially on just the first two months of first-quarter trade-deficit reporting.

The headline trade shortfall in the February deficit will be before inflation adjustment. Yet, thanks to what still will be declining oil prices, the real or inflation-adjusted deficit should widen further, setting in place a significant, net-negative-growth contribution to the aggregate GDP number, based on the first-quarter's initial net-export accounting.

A wild card in the pending reporting also will be any effects of trade-flow disruptions from labor disputes and work slowdowns at major ports in The United States, or possibly in ice-related disruptions to Great Lakes-based commercial shipping traffic.

Otherwise, indeed look for a widening of the headline February deficit, along with some widening of the January shortfall, in revision. The general trend going forward should be for regular monthly and quarterly deteriorations in the real trade deficit, despite any short-lived narrowing of the nominal shortfall. The latter circumstance will end once the current downtrend in oil prices has run its course, a process that is underway and should surface in the April trade reporting.

Employment and Unemployment (March 2015). The Bureau of Labor Statistics (BLS) will release its March 2015 labor data on Friday, April 3rd. Both employment and unemployment are due for negative, headline surprises, given the general tone of the reporting of most other regular economic series. Established monthly distortions to payroll employment (excessive upside biases, and publishing irregularities with the concurrent-seasonal-factor process) continue, however, as do the regular monthly distortions to headline unemployment (definitional issues with "discouraged workers," and publishing irregularities with the concurrent-seasonal-factor process).

Early market expectations appear to be for a pullback in monthly payroll growth from February's initial headline jobs gain of 295,000 and for little, if any, change in the headline U.3 February unemployment rate of 5.5%.

As with the narrowing of the headline unemployment rate in February, any further narrowing of the headline March U.3 unemployment rate likely would encompass more employed being redefined off the unemployment rolls and out of the headline labor force, rather than gaining new employment. Underlying economic fundamentals continue to suggest deterioration in the broader unemployment rates such as U.6 and the ShadowStats Alternate Unemployment measure, as well as slowing or negative month-to-month growth in headline payrolls.

Monthly Payroll Bias Is Weaker than Early Expectations. As published previously by ShadowStats-affiliate www.ExpliStats.com, in its analysis of the biases built into the concurrent-seasonal-factor modeling of the headline February 2015 payroll employment, the implied built-in-bias trend for March 2015 is for a headline jobs gain of 243,000 (see *Commentary No. 702*). Early expectations appear to be running about 10,000 or so above the trend.

To the extent that underlying fundamentals eventually will shine through all the regular monthly volatility and distortions, headline activity increasingly should much favor much weaker-than-expected payroll gains, and higher-than-expected unemployment rates.

