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

COMMENTARY NUMBER 865
December 2016 Trade Deficit

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Quarterly and Annual Real Merchandise-Trade Deficits Were Worst Since 2007

Implied Downside Revision to Fourth-Quarter GDP

U.S. Trade Swings to a 2016 Surplus with OPEC,
Given Shifting Oil Prices and Production

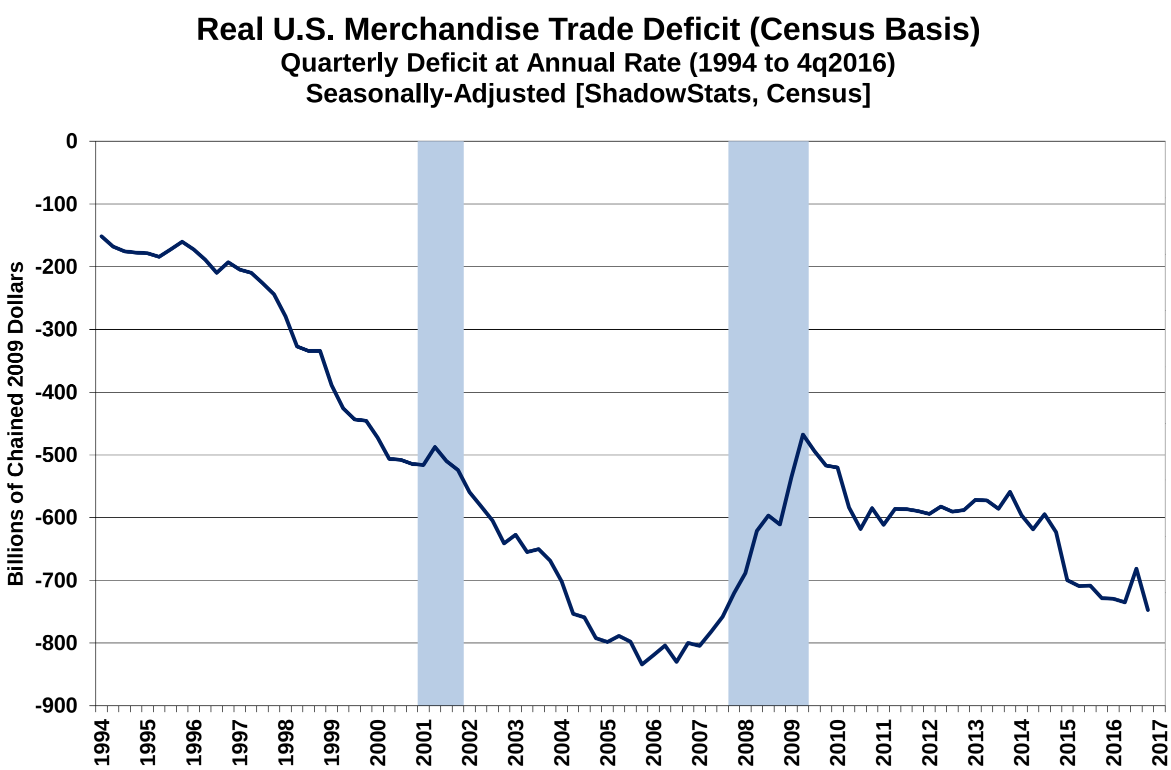
PLEASE NOTE: The next regular Commentary, *scheduled for Thursday, February 16th will cover January 2017 detail of Industrial Production, nominal and real Retail Sales, Residential Construction and the Consumer and Producer Price Indices. Those data are previewed in the* Week, Month and Year Ahead *Section.*

Best wishes to all — John Williams

U.S. BALANCE OF TRADE - 2016

Trade Deficit—December 2016—Intensified Quarterly Real Deterioration Suggested Downside GDP Revision. The accompanying graph shows the sharp deterioration in the fourth-quarter 2016 inflation-adjusted, real merchandise trade deficit. That fourth-quarter deficit was the worst since third-quarter 2007, while the 2016 real annual trade shortfall was the worst since 2007. Despite the headline narrowing of the monthly December 2016 deficit, the fourth-quarter deterioration was worse than the prior trend, suggestive of some downside revision pending for real fourth-quarter 2016 GDP growth on February 28th. That narrowing of the December deficit—seen in both nominal and real terms—was in the context of meaningful upside prior-period revisions.

Inflation-Adjusted, Quarterly U.S. Merchandise Trade Deficit through 4q2016



Nominal (Not-Adjusted-for-Inflation) December 2016 Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported February 7th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for December 2016 narrowed on a balance-of-payments basis. Such was in the context of a revised, greater widening of the previously-reported level of the November 2016 monthly deficit, and general-widening revisions to all prior monthly data in 2016.

The headline December 2016 deficit of $44.262 billion narrowed by $1.468 billion versus a revised $45.730 [previously $45.240] billion in November 2016, but if prior monthly numbers had not been revised, it would have widened by $3.018 billion, a net trade-deficit deterioration swing of $4.486 billion that otherwise was redistributed throughout 2016. Nonetheless, the official headline improvement in the monthly deficit reflected an increase of $5.036 billion in monthly exports, offset by a $3.568 billion rise in in imports. The headline December 2016 deficit, however, widened versus the unrevised, year-ago $41.487 billion trade shortfall of December 2015.

The dominant factors in the net improvement of the headline December deficit were increased exports of civilian aircraft and engines, with some offset from increasing imports of automotive vehicles. Activity in energy-related products had negligible impact on the change in the monthly trade-balance.

Energy-Related Petroleum Products. From an import standpoint, declining oil prices bottomed out in February 2016, inched higher by 0.7% in March, gained 6.5% in April, 16.0% in May, 15.2% in June and 4.2% in July, but fell by 4.0% (-4.0%) in August and 0.9% (-0.9%) in September, only to bounce anew by 2.5% in October, 2.0% in November and 1.5% in December 2016. The impact of the December price gain on oil imports largely was offset by declining physical oil-import volume in the month.

The not-seasonally-adjusted average price of imported oil rose to $41.45 per barrel in December 2016, versus $40.82 per barrel in November 2016, and it was up as well from $36.63 per barrel in December 2015. Separately, not-seasonally-adjusted physical oil-import volume in December 2016 averaged 7.688 million barrels per day, down from 8.016 million in November 2016 and down from 8.149 million in December 2015.

Balance of U.S. Trade in Goods and Services
(Billions of Current Dollars)

	2016	2015
Total	-502.3	-500.4
China	-334.1	-314.5
EU	-102.9	-95.7
Mexico	-57.9	-51.9
Japan	-55.4	-53.7
India	-29.9	-30.3
South Korea	-18.7	-14.9
Taiwan	-10.3	-8.6
Canada	6.1	-10.3
Singapore	17.5	19.0
Brazil	25.3	33.3
OPEC	30.9	-28.1
Hong Kong	31.7	36.8

Sources: U.S. Census Bureau, BEA

Annual Nominal Trade Narrowed Minimally, on Declining Trade Volume. For all of 2016, the nominal deficit in goods and services widened by $1.891 billion to $502.252 billion, versus $500.361 billion in 2015. Such suggested a slowing in the global economy, with a slackening in nominal trade activity. U.S. exports were down by 2.29% (-2.29%) [down by $51.745 (-$51.745) billion], with imports down by 1.81% (-1.81%) [down by $49.854 (-$49.854) billion].

The preceding table reflects summary trade balance detail of a number of major U.S. trading partners, accounting for about eighty percent of last year's trading activity. While the deficit with China is the dominant one, it should be considered in the context of trading activity with Hong Kong, Singapore and transshipments of product through countries not included in the sampling.

Ongoing Cautions and Alerts on Data Quality. Potentially heavy distortions in headline data continue from seasonal adjustments. Similar issues affect other economic releases, such as labor conditions and retail sales, where the headline number reflects seasonally-adjusted month-to-month change. Discussed frequently (see *2014 Hyperinflation Report—Great Economic Tumble* for example), the extraordinary length and depth of the current business downturn and disruptions have distorted regular patterns of seasonality.

Real December 2016 Trade Deficit. Seasonally-adjusted, net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), and in the context of a revised wider deficit for November 2016, the December 2016 merchandise trade deficit (no services) narrowed to $62.308 billion, versus $63.869 [previously $63.582] billion in November, and against monthly revisions back to the beginning of the year. The December 2016 shortfall, however, did deteriorate versus a $60.767 billion deficit in December 2015.

Again, reflected in the graph, the annualized quarterly real merchandise trade deficit was $623.1 billion for fourth-quarter 2014, $700.0 billion for first-quarter 2015, $709.1 billion for second-quarter 2015, $708.4 billion for third-quarter 2015, $728.6 billion for fourth-quarter 2015. For last year, the annualized deficit was $729.6 [previously $725.2] billion for first-quarter 2016, $735.1 [previously $731.3] billion for second-quarter 2016, $681.4 [previously $679.2] billion for third-quarter 2016, and $747.2 [previously trending at $743.4] billion for fourth-quarter 2016. The fourth-quarter 2016 deficit was the worst quarterly showing since third-quarter 2007.

The annual real merchandise trade deficit widened to $723.3 billion in 2016, versus $711.5 billion in 2015. The 2016 annual trade shortfall was the worst since 2008.

Headline deficits likely will continue to deteriorate sharply in the months and quarters ahead, revising and intensifying the ongoing and commonly-negative impact on headline GDP.

WEEK, MONTH AND YEAR AHEAD

Deepening Economic Downturn Promises a Frustrated Fed and Rapidly Deteriorating Support for the U.S. Dollar, Despite Market Optimism for the New Administration. *[The opening section here has not been revised.]* *No. 859 Special Commentary* updated near-term economic and inflation conditions, and the outlook for same, including the general economic, inflation and systemic distortions evolving out of the Panic of 2008 that have continued in play, and which need to be addressed by the new Administration in the near future (see also the *Hyperinflation Watch* of *Commentary No. 862*).

Contrary to the official reporting of an economy that collapsed from 2007 into 2009 and then recovered strongly into ongoing expansion, underlying domestic reality remains that the U.S. economy started to turn down somewhat before 2007, collapsed into 2009 and never fully recovered. While the economy bounced off its 2009 trough, it began to turn down anew in December 2014, a month that should mark the beginning of a "new" formal recession.

Coincident with and tied to the economic collapse and the Panic of 2008, the U.S. banking system moved to the brink of collapse, a circumstance from which U.S. and global central bank policies never have recovered. As this ongoing crisis evolves towards its unhappy end, the U.S. dollar ultimately should face unprecedented debasement with a resulting runaway domestic inflation.

The current general trend in weakening data and what should be increasingly-negative expectations for near-term business activity, along with movement towards looming recession recognition, reflect an ongoing broad spectrum of market-disappointing headline data. That should pressure the FOMC back towards expanded quantitative easing, despite the Fed's December 2016 and rate hike and continuing market hype as to multiple rate hikes looming in the year ahead.

In response to an intensifying downturn, financial market expectations should shift towards renewed Fed "easing," with the effect of triggering a massive U.S. dollar sell-off, accompanied by a sharp upturn in oil prices, domestic inflation and heavy flight to the safe-haven qualities of physical gold and silver, with a commensurate rally in the prices of those precious metals. Again, see *No. 859* for extended discussion.

Broad economic and systemic conditions are reviewed regularly, with the following *Commentaries* of particular note: *No. 777 Year-End Special Commentary* (December 2015*)*, *No. 742 Special Commentary: A World Increasingly Out of Balance* (August 2015) and *No. 692 Special Commentary: 2015 - A World Out of Balance* (February 2015). Those publications updated the long-standing hyperinflation and economic outlooks published in *2014 Hyperinflation Report—The End Game Begins – First Installment Revised* (April 2014) and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* (April 2014). The two *Hyperinflation* installments remain the primary background material for the hyperinflation circumstance. Other references on underlying economic reality are the *Public Commentary on Inflation Measurement* and the *Public Commentary on Unemployment Measurement*.

Commentaries *of the last month:*

Commentary No. 864 analyzed the January 2017 Employment and Unemployment detail, including benchmark and population revisions, December Construction Spending, Household Income and an update to Consumer Liquidity.

Commentary No. 863 assessed the "advance" estimate of fourth-quarter 2016 GDP and reviewed December 2016 New Orders for Durable Goods and New- and Existing-Home Sales.

Commentary No. 862 discussed December 2016 Industrial Production, Housing Starts, Consumer Prices (including real Retail Sales and earnings), along with December detail of the CASS Freight Index™.

Commentary No. 861 covered December 2016 nominal Retail Sales, the PPI, with a brief look at some summary GAAP reporting on the U.S. government's fiscal 2016 operations.

No. 859 Special Commentary reviewed and previewed economic, financial and systemic developments of the year passed and the year or so ahead.

Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. Beyond the pre-announced gimmicked changes to reporting methodologies of the last several decades, which have tended to understate inflation and to overstate economic activity—as generally viewed in common experience by Main Street, U.S.A.—ongoing headline reporting issues are tied largely to systemic distortions of monthly seasonal adjustments.

Data instabilities—induced partially by the still-evolving economic turmoil of the last nine-to-eleven years—have 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, with the use of concurrent seasonal adjustments (as seen with retail sales, durable goods orders, employment and unemployment data). That issue is discussed and explored in the labor-numbers related *Supplemental Commentary No. 784-A* and *Commentary No. 695*.

Further, discussed in *Commentary No. 778*, a heretofore unheard of spate of "processing errors" surfaced in 2016 surveys of earnings (Bureau of Labor Statistics) and construction spending (Census Bureau). This is suggestive of deteriorating internal oversight and control of the U.S. government's headline economic reporting. That construction-spending issue now appears to have been structured as a gimmick to help boost the July 2016 GDP benchmark revisions, aimed at smoothing the headline reporting of the GDP business cycle, instead of detailing the business cycle and reflecting broad economic trends accurately, as discussed in *Commentary No. 823*.

Combined with ongoing allegations in the last year or two of Census Bureau falsification of data in its monthly Current Population Survey (the source for the BLS 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*). John Crudele of the *New York Post* continues his investigations in reporting irregularities: *Crudele Investigation*, and as updated on October 24th: *Crudele*. Mr. Crudele's latest investigation focuses on retail sales reporting: *John Crudele on Retail Sales.*

PENDING RELEASES:

Producer Price Index—PPI (January 2017). The Bureau of Labor Statistics (BLS) will release the January 2017 PPI on Tuesday, February 14th, with detail covered in *Commentary No. 866* of February 16th. Odds favor relatively flat wholesale inflation on the goods side of the reporting, due largely to somewhat negative seasonal-factor adjustments exacerbating relatively soft monthly gains in unadjusted prices of petroleum products. The dominant services sector, however, often provides a counter-move to the hard-inflation estimate on the goods side. Such comes from counterintuitive "deflation" or "inflation," reflecting falling or rising "margins," in turn reflecting rising or falling costs. Guesstimation in that services sector remains highly problematic, as discussed in *Inflation that Is More Theoretical than Real World?* in *Commentary No. 861*, where, again, the services component could offset any weakness in the headline goods inflation.

Unadjusted oil prices rose minimally in January 2017, but wholesale gasoline prices fell minimally. Based on the two most-widely-followed oil contracts, not-seasonally-adjusted, monthly-average oil prices increased by 1.0% and 2.3%. That was accompanied by a 0.4% (-0.4%) decline in unadjusted, monthly-average wholesale gasoline prices (Department of Energy). Where PPI seasonal adjustments for energy costs in January turn negative, such should help to contain the adjusted Final Demand Goods component of the PPI, keeping it flat, plus or minus.

Consumer Price Index—CPI (January 2017). The Bureau of Labor Statistics (BLS) will release the January 2017 CPI on Wednesday, February 15th, which will be covered in *Commentary No. 866* of February 16th. The headline January CPI-U is a good bet to show a continued month-to-month increase, perhaps 0.3%, in the context of strongly rising gasoline prices being offset partially by minimally-negative seasonal adjustments to same. Headline, unadjusted year-to-year annual inflation for January 2017 likely will increase to around 2.4%, versus 2.1% in December 2016.

Further Positive Monthly Inflation Impact from Rising Gasoline Prices. Average gasoline prices gained in January 2017 by 3.89% for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). Where BLS seasonal adjustments to gasoline prices in January are minimally negative, that should contain the gain in the unadjusted gasoline prices, with seasonally-adjusted numbers contributing roughly a positive 0.11% to the headline monthly change in the CPI-U. Boosted further by higher food and "core" (net of food and energy) inflation, a headline monthly CPI-U reading of 0.3% is a reasonable expectation.

***Annual Inflation Rate*.** Noted in *Commentary No. 862*, year-to-year, CPI-U inflation would increase or decrease in January 2017 reporting, dependent on the seasonally-adjusted month-to-month change, versus the adjusted, negligible headline gain of 0.03% in January 2016 CPI-U. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2017 the difference in January's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the December 2016 annual inflation rate of 2.07%. A seasonally-adjusted gain of 0.3%, in the monthly January 2017 CPI-U would move the annual CPI-U inflation rate for January 2017 up to about 2.4%, plus-or-minus, depending on rounding.

Nominal and Real Retail Sales (January 2017). The Census Bureau will release January 2017 nominal (not-adjusted-for-inflation) Retail Sales on Wednesday, February 15th, which will be covered in *Commentary No. 866* of February 16th, along with detail on real (adjusted-for-inflation) Retail Sales adjusted for CPI inflation, which also will be released on February 15th. The headline nominal sales number should be down for the month and weaker than expected, along with providing negative indications for early activity in 2017.

With a likely headline increase in the monthly January 2017 CPI-U of 0.3%, or so, and an annual increase of roughly 2.4% in inflation, headline real sales growth in January accordingly would be more-negative or weaker, in parallel, than the headline nominal sales activity.

Consensus expectations for headline nominal January Retail Sales should be to the downside, at least minimally, reflecting weaker auto sales and retail outlet activity. Downside revisions to previously-estimated December and November sales are a fair bet.

Discussed in *Commentary No. 864* and the *CONSUMER LIQUIDITY* section of *No. 859 Special Commentary*, without sustainable growth in real income, and without the ability and/or willingness to take on meaningful new debt in order to make up for an income shortfall, the liquidity-strapped U.S. consumer is unable to sustain growth in broad economic activity, including personal-consumption expenditures and retail sales, real or otherwise.

Index of Industrial Production (January 2017). The Federal Reserve Board will publish its estimate of January 2017 Industrial Production activity on Wednesday, February 15th, with coverage in *Commentary No. 866* of February 16th. As has most frequently been the case, recently, the headline monthly reporting likely will come in on the downside of flat, and below consensus. While consensus expectations may settle on the plus-side of flat, a headline monthly production drop remains likely, reflecting weaker manufacturing, as well as some relative pullback in weather-spiked utility usage. That also should be in the context of downside revisions within the last six months of data.

Residential Construction—Housing Starts (January 2017). The Census Bureau will release January 2017 residential construction detail, including Housing Starts, on Thursday, February 16th, and covered in *Commentary No. 866* of that date. In line with common-reporting experience of recent years, monthly results are likely to be unstable and not statistically meaningful, holding in a general pattern of down-trending stagnation. That said, in the wake of the nonsensical extreme swings in the last several months of activity, the series appears due for a monthly downturn, although almost anything is possible in this unstable series.

Irrespective of the generally meaningless headline detail, the broad pattern of housing starts still should remain consistent with the low-level, stagnant activity, seen at present, where December 2016 activity was down by 46% (-46%) from recovering the pre-recession high of the series. That stagnation is particularly evident with the headline detail viewed in the context of a six-month moving average. Again, this series remains subject to regular and extremely-large, prior-period revisions.

Discussed in *Commentary No. 660* on the August 2014 version of this most-unstable of major monthly economic series, the headline detail here simply is worthless. The series best is viewed in terms of a six-month moving average. Again, not only is month-to-month reporting volatility frequently extreme, but also the headline monthly growth rates rarely come close to being statistically significant.

Discussed in *Commentary No. 864* and the *CONSUMER LIQUIDITY* section of *No. 859 Special Commentary*, without sustainable growth in real income, and without the ability and/or willingness to take on meaningful new debt in order to make up for an income shortfall, the liquidity-strapped U.S. consumer is unable to sustain growth in broad economic activity, including sustainable growth in demand for residential construction.

Pending *SPECIAL COMMENTARIES*. Discussed in *Opening Comments* of *Commentary No. 861* and in the *FEDERAL DEBT AND DEFICIT* section of *No. 859 Special Commentary*, the U.S. Treasury released the GAAP-based accounting (based on Generally Accepted Accounting Principles) financial statements of the United States government for fiscal-year 2016, on January 12th. Audited by the GAO, that detail will be combined with prior annual reporting and related analyses to prepare a *Special Commentary* updating and summarizing—including in graphic and tabular form—the U.S. government's GAAP-based obligations and annual operations, as well as a discussion as to different approaches to looking at the concept of net present value. Publication of that analysis will follow shortly.

The long-planned and delayed consolidation of the major *ShadowStats* reporting into one volume, including the recommended reading list, will follow soon thereafter.

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