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

COMMENTARY NUMBER 757
August Trade Deficit

October 6, 2015

Headline August Trade Shortfall Widened Sharply

Exacerbated by Declining Oil Prices, Inflation-Adjusted Third-Quarter 2015 Trade Deficit on Track for Worst Showing Since 2007

Negative Implications for Third-Quarter GDP

Trade-Flow Distortions from Early-Year Port Labor Disputes Now Appear to Be Worked Through Fully

Not Reflective of Common Experience, Social Security 2016 COLA Should Be Zero

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PLEASE NOTE: The next regular Commentary*, scheduled for Wednesday, October 14th, will cover September nominal Retail Sales and the Producer Price Index, followed by subsequent* Commentaries *on October 15th covering the September Consumer Price Index (and Real Retail Sales and Earnings), and on October 16th covering September Industrial Production.*

Best wishes to all! — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Expectations for Third-Quarter Growth Should Take a Heavy Hit in the Next Two Weeks. Detailed in the coverage of the today's (October 6th) August trade-deficit report, a new, meaningful hit to the initial estimate of real, annualized third-quarter 2015 GDP growth appears to be in place. Beyond this relatively brief *Commentary*, reporting of subsidiary monthly economic series in the next two weeks will finalize the already-softening outlook for the initial third-quarter GDP estimate on October 29th. A preview of next week's likely reporting of weakening September real retail sales and industrial production is found in the *Week Ahead* section. September housing starts also are a fair bet to dampen consensus economic expectations a bit. Coincident with the housing starts release on October 20th, ShadowStats will update the broad economic outlook and provide an estimate of initial headline GDP-growth reporting for third-quarter 2015 in *Commentary No. 761*.

The general outlook has not changed. Broad economic activity has entered a period of renewed downturn, one that eventually should gain recognition as a "new" recession, timed from its likely formal onset in December 2014.

Social Security Cost of Living Adjustment (COLA) Should Be Zero, Reflecting Annual Contractions in the CPI-W. Also discussed in the *Week Ahead* section, with annual CPI-W having been negative in July and August 2015, and with September 2015 also likely to show a small year-to-year decline, the headline annual change in third-quarter 2015 CPI-W—the inflation measure used to set the annual cost-of-living-adjustment (COLA) increase for Social Security recipients—likely will be around negative 0.3% (-0.3%). That means there would be no COLA increase for 2016. Negative inflation readings are not subtracted from the government's payments, but they are carried forward against the next year's COLA calculations. Inflation reality in common experience versus the government's games-playing on artificially reducing COLA adjustments are discussed in the *Public Commentary on Inflation Measurement* and will be reviewed anew in *Commentary No. 759* of October 15th, covering the September CPI detail.

Today's *Commentary* (October 6th). The balance of these *Opening Comments* provides a summary of the reporting on the August trade balance. The *Hyperinflation Outlook Summary* has not been changed. The *Week Ahead* previews reporting for September Retail Sales and Industrial Production, as well as the September CPI and PPI inflation measures.

U.S. Trade Balance—August 2015—Shaping Up as the Worst Quarterly Shortfall Since Before the Economic Collapse. The nominal August 2015 trade deficit in goods and services, on a balance of payments basis, widened by $6.5 billion for the month. Viewed on a consistent definitional and reporting basis, that deterioration was minimally less than the "advance" reporting of an $8.0 trillion monthly deterioration in the census-based, trade-deficit in just goods, as reported on September 29th.

Moving into the realm of the real or inflation-adjusted trade series, however, falling oil prices masked some of the net deterioration seen both in the August and in the implied third-quarter real-trade shortfall.

That detail suggested the net-export account, which had contributed roughly 0.2% of the annualized headline aggregate 3.9% growth in second-quarter GDP (*Commentary No. 755*), was on track for a net-negative contribution of roughly 0.5% (-0.5%) to the initial, annualized real growth estimate for third-quarter 2015 Gross Domestic Product (GDP).

With the third-quarter 2015 real trade deficit on track to be the worst trade shortfall since fourth-quarter 2007, and with trade-flow disruptions apparently now fully stabilized from early-year trade disputes at U.S. ports, the trend going forward generally should continue for headline monthly and quarterly trade-deficit deterioration, both before and after adjustment for inflation.

Nominal (Not-Adjusted-for-Inflation) August 2015 Trade Deficit. The nominal, seasonally-adjusted monthly trade deficit in goods and services for August 2015, on a balance-of-payments basis, widened by $6.523 billion to $48.330 billion, versus a minimally-revised $41.807 billion in July 2015. The August 2015 nominal deficit also widened versus the now, non-comparable (see *Reporting Detail*) $41.275 billion trade shortfall in August 2014.

In terms of month-to-month trade patterns, that headline $6.523 billion widening in the August deficit reflected a decline of $3.713 billion in monthly exports, combined with a $2.809 billion increase in monthly imports [difference is in rounding]. The import increase largely was seen with cellphones, games and sporting goods, reflecting a resumption of more-normal trade patterns following the flow-of-goods distortions that resulted from labor disputes at U.S. ports early in the year. Also, headline oil imports declined sharply, largely reflecting declining oil prices.

The decline in exports was seen largely in industrial supplies and petroleum-related goods (also affected by declining oil prices).

Considering the dampening effects of declining oil prices on nominal U.S. imports and exports, the headline nominal August trade deficit would have widened by about $7.2 billion, instead of $6.5 billion, but for the drop in oil prices. Therein are implications for greater deterioration in the inflation-adjusted headline detail.

Energy-Related Petroleum Products. For August 2015, the not-seasonally-adjusted average price of imported oil dropped to $49.33 per barrel, versus $54.20 per barrel in July 2015, and versus $96.34 per barrel in August 2014. Also not-seasonally-adjusted, physical oil-import volume in August 2015 averaged 7.078 million barrels per day, down from 7.632 million in July 2015 but up from 6.962 million in August 2014.

Real (Inflation-Adjusted) August 2015 Trade Deficit. Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), but not reflective at this point of the change in import-reporting methodology, the August 2015 merchandise trade deficit (no services) widened to $63.429 billion, from a minimally-revised $56.129 billion in July 2015. The August 2015 shortfall widened sharply, though, versus a still-comparable $48.820 billion real deficit in August 2014.

As currently reported, the annualized quarterly real merchandise trade deficit stood at $613.4 billion for second-quarter 2014, $588.6 billion for third-quarter 2014, $605.5 billion for fourth-quarter 2014, $692.1 billion for first-quarter 2015 and $694.3 billion for second-quarter 2015. Widening quarter-to-quarter real trade deficits subtract growth from the quarterly real GDP estimates, while narrowing deficits boost GDP.

With August's first, and July's second trade-deficit estimates in place, the initial trend for the annualized quarterly real trade shortfall in third-quarter 2015 was $717.3 billion. Such would be the worst real trade deficit since fourth-quarter 2007, the formal onset of the 2007 recession.

Based on just two months of initial reporting, that detail suggested a widening of the third-quarter 2015 real trade deficit, versus second-quarter 2015, with a negative trade-based contribution from the net-export account of roughly 0.5% (-0.5%) to the "advance" estimate of the aggregate, annualized real third-quarter 2015 GDP growth rate (due for publication on October 29th).

[The* Reporting Detail *includes some expanded information on the August trade data.]

HYPERINFLATION WATCH

HYPERINFLATION OUTLOOK SUMMARY

Broad Outlook Is Unchanged: Economy Remains in Downturn; Questions Mount on Systemic Stability; Dollar Faces Massive Decline with Ongoing Implications for Hyperinflation. This *Summary* has not been changed since *Commentary No. 754* of September 24th, other than for updated internal references or links and minor language corrections.

Background Documents to this Summary. Underlying this *Summary* are *No. 742 Special Commentary: A World Increasingly Out of Balance* of August 10th, and *No. 692 Special Commentary: 2015 - A World Out of Balance* of February 2, 2015, which 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 two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts. In terms of underlying economic reality, one other reference is the *Public Commentary on Inflation Measurement*. The regular *Commentaries* also update elements of the general outlook, as circumstances develop.

Primary Summary. The U.S. economy remains in ongoing downturn, while the U.S. dollar still faces a massive decline in the wake of an extraordinary rally seen since June 2014, and in the context of a renewed economic downturn, ongoing domestic fiscal imbalances and ongoing financial-system instabilities. Financial-system concerns likely are the primary reason behind the inability or unwillingness of the Federal Reserve's Federal Open Market Committee (FOMC) to raise interest rates. Those factors have implications for a meaningful upturn in domestic inflation, eventually evolving into a great hyperinflationary crisis.

Indeed, symptomatic of a financial system in serious distress, the FOMC remains unable or unwilling to move decisively on raising interest rates, to move the financial system towards monetary normalcy. Continued inaction or waffling by the Fed has begun to shift the focus and concerns of domestic and global investors away from what appears increasingly to be perpetual moribund economic activity into the areas of systemic instabilities, prospective or otherwise, that are so troubling to the U.S. central bank (see *Commentary No. 750* and *Commentary No. 754*). Fed policy inaction, if anything, has exacerbated the long-term economic stagnation and renewed business downturn, where the quantitative easings always were intended as covert bailouts for the banking system, under the political cover of a weak economy (see for example, the *Monetary Conditions* section of *Commentary No. 756*).

Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by eventual, unfettered monetization of the national debt and obligations, leading to a hyperinflation. As first estimated by ShadowStats in 2004, such hyperinflation appeared likely by 2020. That time horizon for the hyperinflation forecast was moved to 2014, because of the 2008 Panic, the near-collapse of the financial system, and official (U.S. government and Federal Reserve) responses to same. That hyperinflation forecast remains in place, but it has been adjusted into 2015 or 2016, as discussed in *No. 742* and *No. 692*.

The basic 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 the *2014 Hyperinflation Report—The End Game Begins—First Installment Revised*.

Dollar Circumstance. Discussed in the background documents, the U.S. dollar rallied sharply from mid-2014 into early-2015, and despite some fluttering, into August. Initially, the rally reflected likely covert financial sanctions and oil-price manipulations by the United States, aimed at creating financial stresses for Russia, in the context of the Ukraine situation. Relative U.S. economic strength, and the relative virtuousness of Fed monetary policy versus major U.S. trading partners, were heavily picked-up on and over-estimated by global markets looking to support the dollar.

The still unfolding, weakening domestic-economic circumstance in 2015, in confluence with other fundamental issues, had begun to raise doubts, and more recently to confirm fears in the markets as to the sustainability of the purported U.S. economic recovery, and as to the imminence of meaningful monetary tightening by the U.S. Federal Reserve. As a result, the U.S. dollar briefly backed off its highs, with some related upside pressure having been seen on oil prices. Pressures reversed recently, spiking the U.S. dollar—also hitting oil prices anew—with false domestic economic strength being touted by Wall Street, and with some in the Fed indicating that interest rates would be raised in September, irrespective of negative indications on the economy (such did not happen). Coincident, with these events, not-so-covert central-bank actions appear to have driven the price of gold lower, also in the context of mounting global financial-market instabilities.

The U.S. economy remains in contraction (see *Commentary No. 747*, *Commentary No. 751*, *Commentary No 755* and the *Opening Comments*), with a variety of key indicators, such as industrial production, real retail sales and revenues of the S&P 500 companies continuing to show recession. Although formal recognition could take months, consensus recognition of a "new" recession should gain relatively rapidly, in tandem with a variety of monthly, quarterly and annual data reflecting the downturn in business activity. When formal recognition comes, timing of the onset of the recession likely will be December 2014.

As market expectations move towards an imminent, new recession, such not only should reduce expectations for a significant tightening in Fed policy, but also should renew expectations for a more-accommodative or newly-accommodative Fed. While such could help to fuel further stock-market mania, any resulting rallies in equity prices should be more than offset in real terms, by percentage declines in the exchange-rate value of the U.S. dollar or in the eventual increases in headline consumer inflation.

Faltering expectations on the direction of domestic economic activity, also would place mounting and eventually massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the Panic of 2008. Physical gold and silver, and holding assets outside the U.S. dollar, remain the ultimate primary hedges against an eventual total loss of U.S. dollar purchasing power. These circumstances should unwind what has been the sharp and generally ongoing rally in the U.S. dollar's exchange rate since mid-2014, and the broadly-related selling pressures seen in the gold and silver markets. Further, oil prices should spike anew, along with a sharp reversal in the dollar's strength.

A crash back to recognition of more-realistic domestic-economic circumstances looms, possibly in the weeks and certainly in the months ahead. It should be accompanied by a crash in the U.S. dollar versus major currencies, such as the Swiss franc, Canadian dollar and Australian dollar (currencies with some perceived ties to gold); and related rallies in precious metals and oil. Further, a sharp deterioration in the near-term outlook for domestic and global political stability continues and is of meaningful risk for fueling further heavy selling of the dollar. Once in heavy downturn, the dollar's gains since June 2014 should reverse fully, pushing the exchange-rate value of the dollar to new historic lows. Again, the nascent currency crisis also has meaningful potential to resurrect elements of the Panic of 2008.

Unexpected economic weakness intensifies stresses on an already-impaired banking system, increasing the perceived need for expanded, not reduced, quantitative easing. The highly touted "tapering" by the FOMC ran its course. Future, more-constructive Fed behavior—moving towards normal monetary conditions in what had been an unfolding, purportedly near-perfect economic environment—was pre-conditioned by a continued flow of "happy" economic news. Fed tightening likely is not now on the horizon until after the 2016 presidential election. Suggestions that all was right again with world were nonsense. The Fed's games likely now will be played out as far as possible, with hopes, once again, of avoiding a financial-system collapse.

Inaction by the FOMC on September 17th was telling. The Panic of 2008 never was resolved, and the Fed increasingly has found that it has no easy escape from its quantitative easing (QE3), which continues; only overt expansion of QE3 ceased. If the Fed does not act quickly to extricate itself from prior actions, QE4 will become the near-term question. Again, despite loud promises now of higher rates before year-end or next year, banking-system issues (not the economy) may keep the "pending" interest rate hike in a continual state of suspension. The economy certainly will supply continuing political cover for the Fed's "inaction," with the U.S. central bank having lost control of the system.

Unexpected economic weakness—a renewed downturn—also savages prospective federal budget deficit prognostications (particularly the 10-year versions). Such throws off estimates of U.S. Treasury funding needs and estimates as to how long the Treasury effectively can dodge the limits of the recently re-imposed debt ceiling. Current fiscal "good news" remains from cash-based, not GAAP-based accounting projections and is heavily impacted by changes in business activity.

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 significant, renewed market speculation in the near future, as to an added round of Federal Reserve quantitative easing, QE4, may 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 thought it could, with continual, negative impact on the U.S. economy. The easings to date, however, appear to have been largely a prop to banking system and to the increasingly unstable equity markets. While higher domestic interest rates would tend to act as a dollar prop, a hike in rates also could crash the stock market, as some on Wall Street fear, triggering a round of other systemic problems. Again, there is no happy way out of this for the Fed.

The 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, increasingly against the U.S. currency. That process likely will become dominated by deteriorating global perceptions of stability in U.S. economic activity and political system, and the ability of the Federal Reserve to control its monetary 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 and contracting production, 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. 752*). Sharply-negative economic reporting shocks, versus softening consensus forecasts, remain a heavily-favored, proximal trigger for intensifying the pending dollar debacle (see *Opening Comments* of *No. 756*).

- ***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 did not alter the systemic unwillingness to address 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, with total net obligations of the U.S. government pushing $100 trillion, including the net present value of unfunded liabilities. Still, many in Washington look to continue increasing spending and to take on new, unfunded liabilities. This circumstance now operates in the context of the formal constraint of a renewed debt ceiling that is within a month of being in crisis (see *Opening Comments* of *No. 756*).

- ***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 2014 monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury, but more of that lies ahead. If the Fed does not move soon to boost interest rates, it may be trapped in a renewed expansion of quantitative easing, 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 any new or expanded systemic accommodation in the intensifying 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 fiscal and economic issues remain nil. Issues such as non-recovered, faltering economic activity, the consumer liquidity crisis and the nation's long-range solvency issues should continue to devolve into extreme political crises.

- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are intensifying, 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 versus Russia and extraordinarily-volatile circumstances in the Middle East. U.S. response to Russian activity in the Ukrainian situation likely was 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. These situations have yet to run their full courses, and they have the potential for rapid and massive negative impact on the financial and currency markets.

- ***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 global financial instabilities and a quick, significant reversal in the dollar's strength should intensify the "dump-the-dollar" rhetoric rapidly. Consider that China has been selling some of its U.S. Treasury debt holdings to raise cash in for its near-term financial needs. Again, much of the rest of the world also has been backing away from holding U.S. treasury securities. Slack demand for U.S. Treasuries always can be taken up by the Federal Reserve's renewed monetization of the debt.

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, still 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. See Chapter 10, *2014 Hyperinflation Report—Great Economic Tumble* for detailed discussion on approaches to handing the hyperinflation crisis and *No. 742*, for other factors afoot in the current environment.

REPORTING DETAIL

U.S. TRADE BALANCE (August 2015)

August Trade Deficit Had Sharply Negative Implications for Third-Quarter GDP. The nominal August 2015 trade deficit in goods and services, on a balance of payments basis, widened by $6.5 billion for the month. Viewed on a consistent-definitional and reporting basis, that deterioration was minimally less than the "advance" reporting of an $8.0 trillion monthly deterioration in the census-based, trade-deficit in just goods, as reported on September 29th.

Moving into the realm of the real or inflation-adjusted trade series, however, falling oil prices masked some of the net deterioration seen both in the August and in the implied third-quarter real-trade shortfall. That detail suggested the net-export account, which had contributed roughly 0.2% of the annualized headline aggregate 3.9% growth in second-quarter GDP (*Commentary No. 755*), was on track for a net-negative contribution of roughly 0.5% (-0.5%) to the initial, annualized real growth estimate for third-quarter 2015 Gross Domestic Product (GDP).

With the third-quarter 2015 real trade deficit on track to be the worst trade shortfall since fourth-quarter 2007, and with trade-flow disruptions apparently now fully stabilized from early-year trade disputes at U.S. ports, the trend going forward generally should continue for headline monthly and quarterly trade-deficit deterioration, both before and after adjustment for inflation.

Temporary Reporting Distortions Allow for Near-Term Consistency in Trade Balance Detail . Noted in prior trade-related *Commentary No. 748*, at least a three-percent understatement of the historical U.S. trade deficit awaits correction in its June 2016 benchmark revision, along with implied, subsequent downside benchmark revisions to historical GDP growth in July 2016.

Where imports are counted on the negative side of the trade balance, a change in reporting methodology has shown that imports have been understated regularly, with the effect of underestimating the size of the U.S. trade deficit by at least three-percent. Such has negative implications for historical, broad economic growth and indeed for future GDP benchmark revisions.

Beginning with the headline reporting for July 2015, the Bureau of Economic Analysis (BEA) and the Census Bureau introduced a change in the trade-deficit calculation, now counting low-value imports, which previously neither were reported nor calculated in the monthly balance-of-payments estimates. To allow for near-term reporting consistency in recent headline data, trade detail back to January 2015 also was restated with last month's July reporting so as to incorporate a "temporary balance of payments adjustment for low-value imports," included in the trade calculations.

Those changes, along with other regular minor revisions to the trade deficit for first-half 2015, had the net effect of widening the six-month trade deficit by 3.3%. The bulk of that was due to the new reporting approach. Even-greater trade deterioration looms with further, new detail, still to be added. Separately, as a result of the temporary restatement of historical post-December 2014 reporting, current headline balance-of-payment data no longer are consistent with earlier data, such as might be seen with year-ago comparisons.

Noted in the July trade balance *Press Release*, "The Census Bureau will revise historical statistics in June 2016 with the annual revision release. To maintain time-series consistency for imports of goods on a balance of payments (BOP) basis, the U.S. Bureau of Economic Analysis has applied temporary BOP adjustments to imports of goods on a Census basis beginning with January 2015 statistics. These adjustments will be removed from imports of goods on a BOP basis in June 2016 when the Census Bureau revises historical statistics."

Nominal (Not-Adjusted-for-Inflation) August 2015 Trade Deficit. The BEA and the Census Bureau reported this morning, October 6th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for August 2015, on a balance-of-payments basis, widened by $6.523 billion to $48.330 billion, versus a minimally-revised $41.807 [previously $41.863] billion in July 2015. The August 2015 nominal deficit also widened versus the now, non-comparable $41.275 billion trade shortfall in August 2014.

In terms of month-to-month trade patterns, that headline $6.523 billion widening in the August deficit reflected a decline of $3.713 billion in monthly exports, combined with a $2.809 billion increase in monthly imports [difference is in rounding]. The import increase largely was seen with cellphones, games and sporting goods, reflecting a resumption of more-normal trade patterns following the flow-of-goods distortions that resulted from labor disputes at U.S. ports early in the year. Also, headline oil imports declined sharply, largely reflecting declining oil prices.

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Considering the dampening effects of declining oil prices on nominal U.S. imports and exports, the headline nominal August trade deficit would have widened by about $7.2 billion, instead of $6.5 billion, but for the drop in oil prices. Therein are implications for greater deterioration in the inflation-adjusted headline detail.

Energy-Related Petroleum Products. For August 2015, the not-seasonally-adjusted average price of imported oil dropped to $49.33 per barrel, versus $54.20 per barrel in July 2015, and versus $96.34 per barrel in August 2014. Also not-seasonally-adjusted, physical oil-import volume in August 2015 averaged 7.078 million barrels per day, down from 7.632 million in July 2015 but up from 6.962 million in August 2014.

Ongoing Cautions on Data Quality. Potentially heavy distortions in headline data continue from seasonal adjustments. Similar issues affect other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. Discussed frequently (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment* for example), the extraordinary length and depth of the current business downturn and disruptions have disrupted regular seasonality patterns. Accordingly, the markets should not rely too heavily on the accuracy of the monthly headline data.

Real (Inflation-Adjusted) August 2015 Trade Deficit. Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), but not reflective at this point of the change in import-reporting methodology, the August 2015 merchandise trade deficit (no services) widened to $63.429 billion, from a minimally-revised $56.129 [$56.208] billion in July 2015. The August 2015 shortfall widened sharply, though, versus a still-comparable $48.820 billion real deficit in August 2014.

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With August's first, and July's second trade-deficit estimates in place, the initial trend for the annualized quarterly real trade shortfall in third-quarter 2015 was $717.3 billion [previously $674.5 billion based just on initial July]. Such would be the worst real trade deficit since fourth-quarter 2007, the formal onset of the 2007 recession.

Based on just two months of initial reporting, that detail suggested a widening of the third-quarter 2015 real trade deficit, versus second-quarter 2015, with a negative trade-based contribution from the net-export account of roughly 0.5% (-0.5%) to the "advance" estimate of the aggregate, annualized real third-quarter 2015 GDP growth rate (due for publication on October 29th).

WEEK AHEAD

Economic Reporting Generally Should Trend Much Weaker than Expected; Inflation Will Rise Anew, Along with a Renewed Rebound in Oil Prices. Still in a fluctuating trend to the downside, amidst mixed reporting in headline data, market expectations for business activity nonetheless tend to move with the latest economic hype in the popular media. That general effect holds the consensus outlook at overly-optimistic levels, with current expectations still exceeding any potential, underlying economic reality. Again, the expectations trend generally has continued to soften.

Headline reporting of the regular monthly economic numbers increasingly should turn lower in the weeks and months ahead, along with likely downside or otherwise much weaker-than-expected reporting for at least the next several quarters of GDP (and GDI and GDP) into 2016.

CPI-U consumer inflation—driven lower earlier this year by collapsing prices for gasoline and other oil-price related commodities—may have seen its near-term, year-to-year low. It turned positive in June 2015, for the first time in six months, notched somewhat higher in July and still somewhat higher in August, despite a headline monthly decline in gasoline prices and a minimal decline in the headline monthly CPI-U, the sharp decline in September gasoline prices should be enough, though, to pull the annual CPI-U inflation slightly negative, year-to-year.

Upside inflation pressures should mount anew, once oil prices begin to rebound meaningfully. Again, that process eventually should accelerate, along with a pending sharp downturn in the exchange-rate value of the U.S. dollar. Those areas, the general economic outlook and longer range reporting trends were reviewed broadly, recently, in *No. 742 Special Commentary: A World Increasingly Out of Balance*, *No. 692 Special Commentary: 2015 - A World Out of Balance* and in the *Hyperinflation Outlook Summary*.

A 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 actual inflation and to overstate actual economic activity, 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 eight-to-ten 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, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data, discussed and explored in the labor-numbers 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:

Nominal and Real Retail Sales (September 2015). The Census Bureau has scheduled release of September 2015 nominal (not-adjusted-for-inflation) retail sales for Wednesday, October 14th, which will be covered in *Commentary No. 758* of that date. Real (inflation-adjusted) retail sales for September will be published in ShadowStats *Commentary No. 759* of October 15th, in conjunction with the detail on headline CPI-U reporting for September (see below). Although the early-consensus for nominal retail sales is a headline gain of 0.3% [MarketWatch], in the current environment, downside-reporting surprises usually are a good bet, including a weaker-than-expected headline number for September and potential downside revisions to the July and August detail. An outright contraction in headline September retail sales remains a fair possibility.

Real (inflation-adjusted) sales should be less negative, or more positive, given a likely monthly decline in the headline September CPI-U (see below). As with the industrial production series, retail sales is one of the traditional markers of the onset of formal recession. Continued weakness in these numbers should intensify the shift in consensus expectations towards renewed economic contraction, a "new" recession. Such would include a downgrading of still-positive but rapidly-softening expectations for the initial estimate of third-quarter 2015 GDP on October 29th.

Constraining retail sales activity, the consumer remains in an extreme liquidity bind with weakening confidence, detailed in the review of consumer liquidity circumstances in *Commentary No. 752* of September 16th, with a brief update in prior *Commentary No. 756* of October 2nd and an upcoming new, full review in *Commentary No. 758*, accompanying the nominal retail sales reporting. Without sustained growth in real income, and without the ability and/or willingness to take on meaningful new debt in order to make up for the income shortfall, the U.S. consumer is unable to sustain positive growth in domestic personal consumption, including retail sales, real or otherwise.

Producer Price Index—PPI (September 2015). The Bureau of Labor Statistics (BLS) will release the September 2015 PPI also on Wednesday, October 14th. Odds favor near-flat monthly wholesale inflation, although the early-consensus [MarketWatch] is for a headline drop of 0.4% (-0.4%) in the September PPI.

Unadjusted oil prices rose in September 2015, but gasoline prices fell. Based on the two most-widely-followed oil contracts, not-seasonally-adjusted, monthly-average oil prices increased by 2.1% and 6.1% in the month. Such was accompanied by a decline of 9.7% (-9.7%) in unadjusted monthly-average retail-gasoline prices (Department of Energy), down somewhat more at the wholesale level. PPI seasonal adjustments for energy in September generally are minimally positive. The seasonals are slightly more favorable for gasoline prices, than is the circumstance with the CPI, but not enough to come close to pulling gasoline out of negative territory.

That said, there are unusual dynamics at play in the margin shifts in the dominant services sector of the PPI—where lower gasoline prices often translate initially into higher wholesale margins and offsetting increased "inflation." Such, along with some likely added monthly inflation from wholesale food and "core" goods (everything but food and energy), has a fair chance of holding the headline PPI change at minimally-flat-to-negative for September 2015.

Consumer Price Index—CPI (September 2015). The Bureau of Labor Statistics (BLS) plans to release the September 2015 CPI on Wednesday, October 15th. The headline September CPI-U should be down month-to-month by perhaps 0.2% (-0.2%), reflecting a sharp monthly decline in gasoline prices. The corresponding year-to-year annual inflation rate likely will notch lower, too, into minimally-negative territory. Early expectations for a headline monthly inflation decline of 0.3% (-0.3%) [MarketWatch] are not unreasonable.

The average gasoline price moved lower in September 2015, by 9.14% (-9.14%) for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). While BLS seasonal adjustments to gasoline prices in September traditionally are sharply on the plus-side, they are enough only to narrow the current drop in gasoline prices to about 8.5% (-8.5%) on a seasonally-adjusted basis. That one factor is enough to reduce the headline monthly CPI-U change by 0.35% (-0.35%). Higher food and "core" (net of food and energy) inflation partially should offset the impact of the lower gasoline prices, leaving the headline CPI-U down by 0.1% (-0.1%) to 0.2% (-0.2%) for the month.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in the September 2015 reporting, depending on the seasonally-adjusted monthly change, versus the adjusted, headline inflation gain of 0.09% for September 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2015, the difference in September's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the August 2015 positive annual inflation rate of 0.20%. For example, a seasonally headline monthly contraction of 0.2% (-0.2%) in September 2015 CPI-U would leave annual September 2015 inflation down by about 0.1% (-0.1%) [- 0.2% - 0.09% + 0.20% ≈ -0.1%], depending on the rounding.

Social Security Cost of Living Adjustment (COLA) Likely Will Be Zero, Reflecting Annual Contractions in the CPI-W. Discussed in the *Opening Comments*, annual CPI-W inflation in third-quarter 2015 likely will be around a negative 0.3% (-0.3%). That means there will be no COLA increase in 2016 for Social Security recipients. Inflation reality as reflected in common experience, versus the government's successful efforts at artificially-reducing COLA adjustments, have been discussed in the *Public Commentary on Inflation Measurement* and will be reviewed anew in *Commentary No. 759* of October 15th, covering the September CPI detail.

Index of Industrial Production (September 2015). On Friday, October 16th, the Federal Reserve Board will release its estimate of the Index of Industrial Production for September 2015. Despite what already are early-expectations to the downside [down month-to-month by 0.2% (-0.2%) per MarketWatch], the headline reporting detail likely will come in well below consensus, with downside revisions to prior-period reporting also a fair bet.

As one of the traditional markers of the onset of formal recession, a continued downtrend in these numbers should intensify the shift in consensus expectations towards renewed economic contraction, including a downgrading of still positive but rapidly softening expectations for the initial estimate of third-quarter 2015 GDP on October 29th.

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