

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

**COMMENTARY NUMBER 353**

**January Inflation**

**February 17, 2011**

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**January Annual Inflation Rose to 1.6% (CPI-U), 1.8% (CPI-W), 9.1% (SGS)**

**Accelerating December and January Inflation Was Muted by Unstable Seasonal Adjustments**

**C-CPI-U Revisions Generated "Needed" Lower Inflation Reporting**

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*PLEASE NOTE: The next regular Commentary is scheduled for Friday, February 25th, following release of the first revision to fourth-quarter 2010 GDP, along with detail on new orders for durable goods and for new and existing home sales released earlier in the week.*

*The Hyperinflation Special Report (Update 2011) is on target for publication next week but most likely towards the end of the week/weekend.*

*-- Best wishes to all, John Williams*

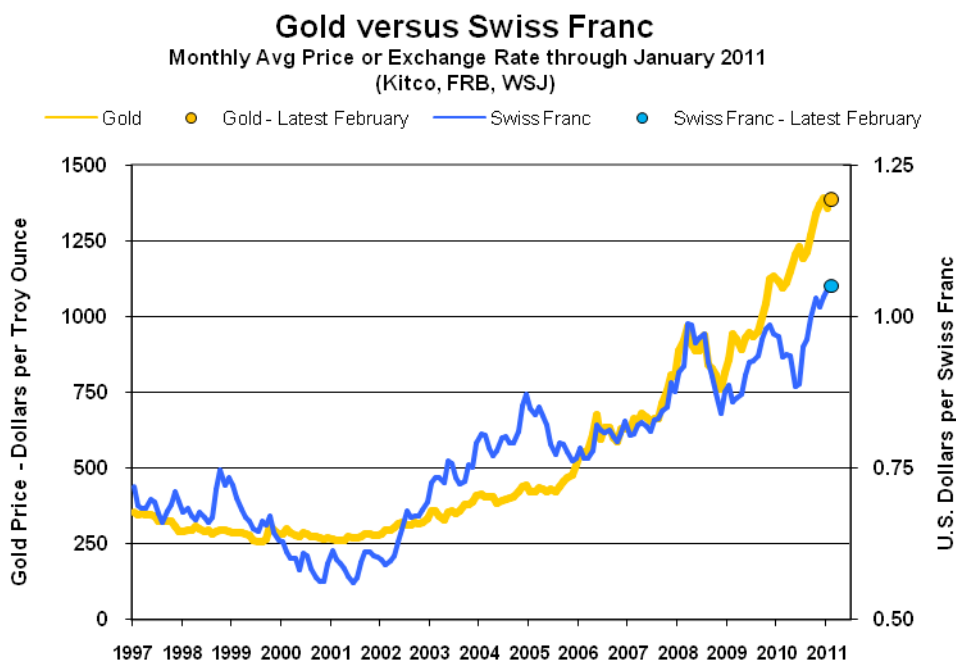
**Surging Inflation Continues in Response to Fed's Dollar-Debasement Efforts.** Consumer prices again rose by more than was expected by the markets, both in aggregate and in the nonsensical "core" inflation number hyped by the Fed and Wall Street's inflation apologists. The Federal Reserve's ongoing efforts at debasing the U.S. dollar have placed direct downside pressure on the exchange-rate value of the U.S. dollar and upside pressure on commodities priced in same. At work here not only is in the impact of

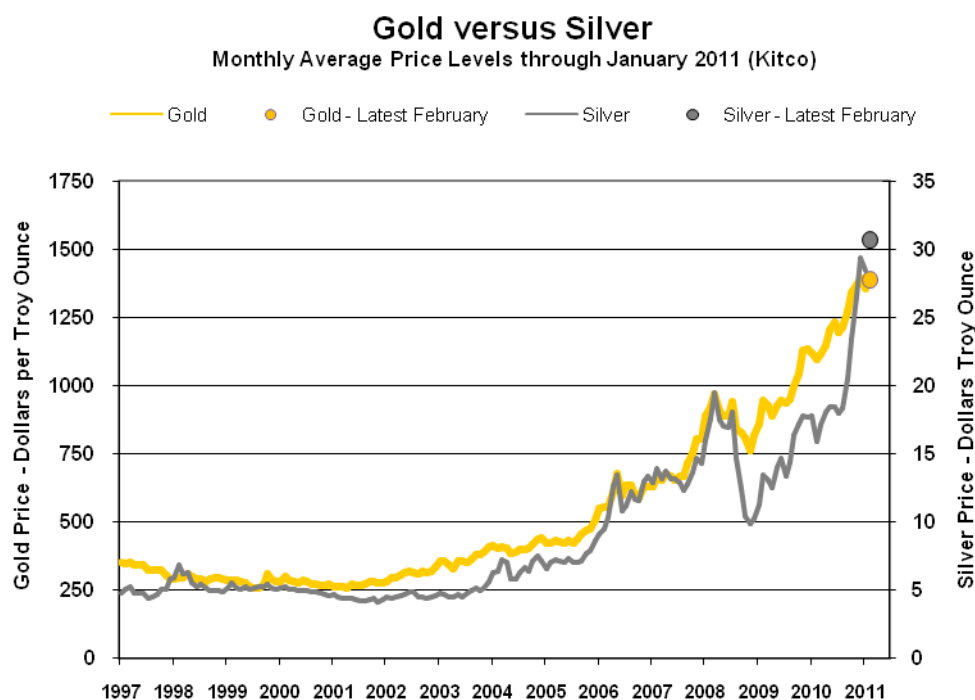
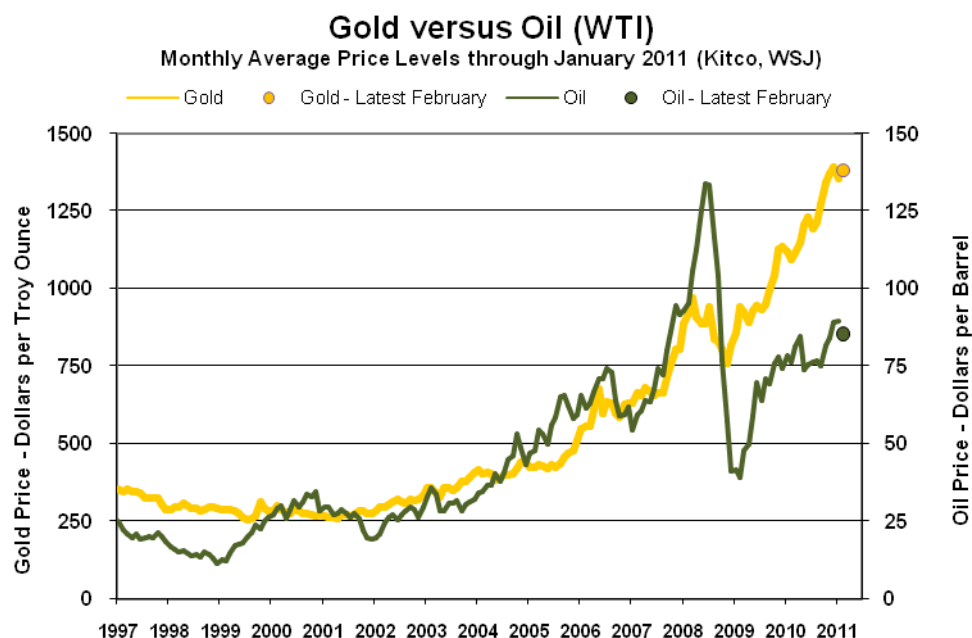
higher prices in dollar-denominated commodities such as oil and food, but also is in the spreading of those cost pressures into the broad economy.

This morning's (February 27th) inflation report also included revisions to the seasonally-adjusted CPI data, but the unadjusted data remained unchanged. As seen with yesterday's PPI reporting, revised and unstable seasonal adjustments reduced adjusted monthly inflation reporting in both January 2010 (which also means a dampening of the January 2011 number) and December 2010. January and December 2010 adjusted monthly gains respectively revised from 0.2% to 0.1% and from 0.5% to 0.4%. January 2011's gain likely would have been 0.5%, following December's initially-reported monthly gain of 0.5%, had the seasonal "recalculations" not taken place. See *Commentaries* [No. 349](#) and [No. 352](#) for background detail on the seasonal-factor distortion issues.

Separately, the Chained or Chain-Weighted CPI-U (C-CPI-U) was revised on an unadjusted basis, so that reported year-to-year inflation now appears to be showing lower inflation than the CPI-U on a consistent basis. This fully substitution-based inflation measure was touted by the President's deficit commission as the preferred measure for calculating cost of living adjustments (COLA) for Social Security and other programs. Such would lower COLA adjustments, as the C-CPI fully would reflect substitution-based spending patterns, such as people buying more hamburger because steak had gotten too expensive. This is directly counter to the CPI's initial usage and purpose as a measure of the cost of living of maintaining a constant standard of living, a concept that many people wrongly assume still is the basis of the government's inflation reporting.

The regular graphs on gold, silver, oil and the Swiss franc follow.





As will be highlighted in the pending update to the *Hyperinflation Special Report*, global investors increasingly will shun the U.S. dollar, as its purchasing power gets hammered by Mr. Bernanke et al, and

as U.S. political and fiscal stability rapidly deteriorates. As investors flee the dollar and dollar-denominated paper, the precious metals and stronger major currencies will continue to be the primary beneficiaries in U.S. dollar terms, irrespective of any near-term market volatility, extreme or otherwise. More-prudent economic and fiscal actions taken by major U.S. trading partners will tend to make the U.S. dollar look all the worse on a relative basis.

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### ***Notes on Different Measures of the Consumer Price Index***

*The Consumer Price Index (CPI) is the broadest inflation measure published by U.S. Government, through the Bureau of Labor Statistics (BLS), Department of Labor:*

*The **CPI-U (Consumer Price Index for All Urban Consumers)** is the monthly headline inflation number (seasonally adjusted) and is the broadest in its coverage, representing the buying patterns of all urban consumers. Its standard measure is not seasonally adjusted, and it never is revised on that basis except for outright errors.*

*The **CPI-W (CPI for Urban Wage Earners and Clerical Workers)** covers the more-narrow universe of urban wage earners and clerical workers and is used in determining cost of living adjustments in government programs such as Social Security. Otherwise its background is the same as the CPI-U.*

*The **C-CPI-U (Chain-Weighted CPI-U)** is an experimental measure, where the weighting of components is fully substitution based. It generally shows lower annual inflation rate than the CPI-U and CPI-W. The latter two measures once had fixed weightings -- so as to measure the cost of living of maintaining a constant standard of living -- but now are quasi-substitution-based.*

*The **SGS Alternative CPI-U Measures** are attempts at adjusting reported CPI-U inflation for the impact of methodological change of recent decades designed to move the concept of the CPI away from being a measure of the cost of living needed to maintain a constant standard of living.*

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**Consumer Inflation Reshaped Slightly by Revisions.** As discussed in the opening comments, revisions to CPI seasonal adjustments back through January 2006 have shown instabilities consistent more with data distortions than with stable seasonal smoothing of an economic series. The unadjusted series (except for the C-CPI-U) were not revised, and that supports the traditional concept of using the CPI on an unadjusted instead of an adjusted basis. Some effects of the revisions (including the regular recasting of the unadjusted C-CPI) follow in the regular CPI text.

**CPI-U.** The Bureau of Labor Statistics (BLS) reported that the seasonally-adjusted January 2011 CPI-U rose for the month by 0.40% (up by 0.48%, unadjusted). Such followed a revised 0.43% (previously a 0.50%) gain (up 0.17% unadjusted) in December.

Annualized, seasonally-adjusted, quarter-to-quarter CPI-U was revised to 2.62% (originally 2.57%) in fourth-quarter 2010, versus a revised 1.43% (was 1.47%) in the third-quarter. The annualized inflation pace, though, is accelerating, up by 3.10% for the three months ended January 2011, versus 2.26% for the three months ended October 2010.

Unadjusted, January's year-to-year CPI-U inflation was 1.63%, against a 1.50% annual increase in December.

Year-to-year inflation would increase or decrease in next month's February 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.05% adjusted monthly gain seen in February 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for February 2011, the difference in February's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from January 2011's reported annual inflation rate of 1.63%.

**CPI-W.** The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose in January by 0.45% (up 0.53% unadjusted) for the month, following a revised 0.53% (previously 0.63%) gain (up 0.47% unadjusted) in December.

Annualized, seasonally-adjusted, quarter-to-quarter CPI-W was 3.09% (revised from 3.10%) in fourth-quarter 2010, versus 1.71% (revised from 1.76%) in the third-quarter. As with the CPI-U, however, the annualized inflation pace is accelerating, up by 3.56% for the three months ended January 2011, versus 2.73% for the three months ended October 2010.

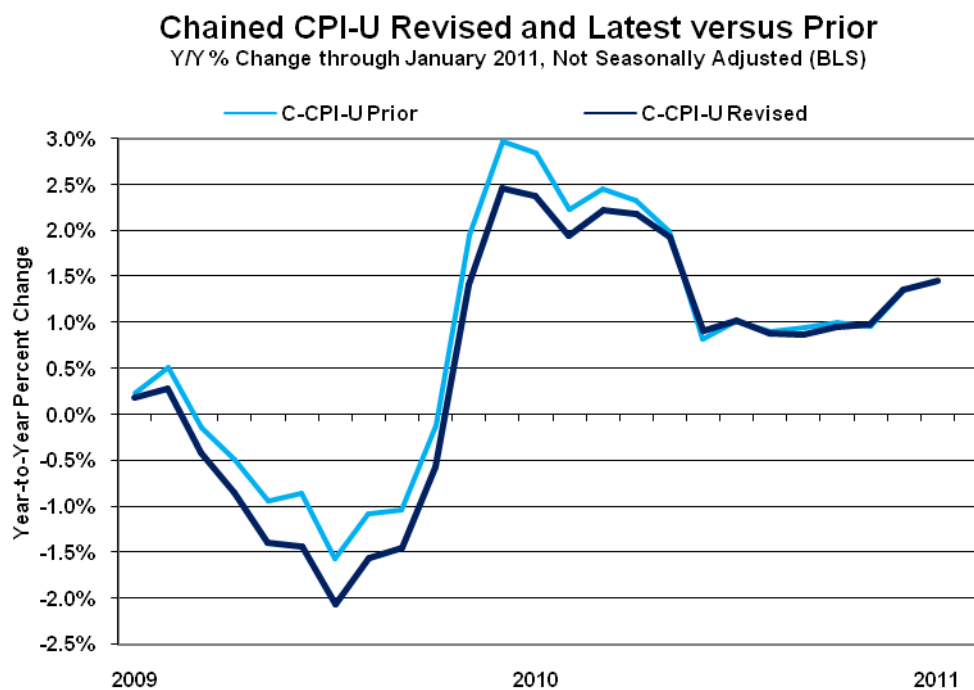
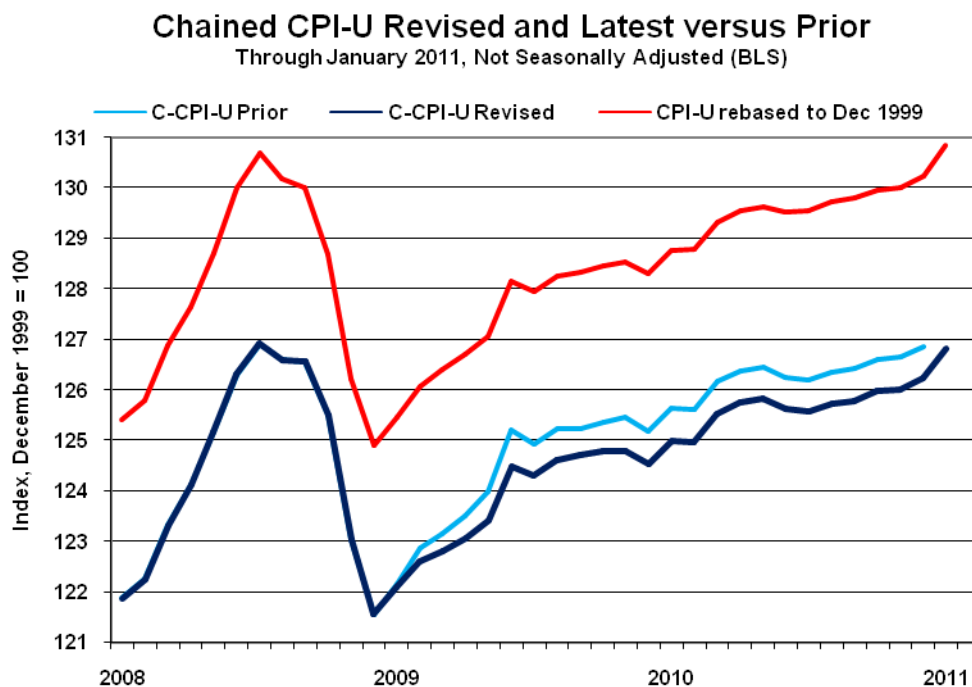
Unadjusted, January 2011's year-to-year CPI-W inflation was 1.80% against a 1.68% annual increase in December.

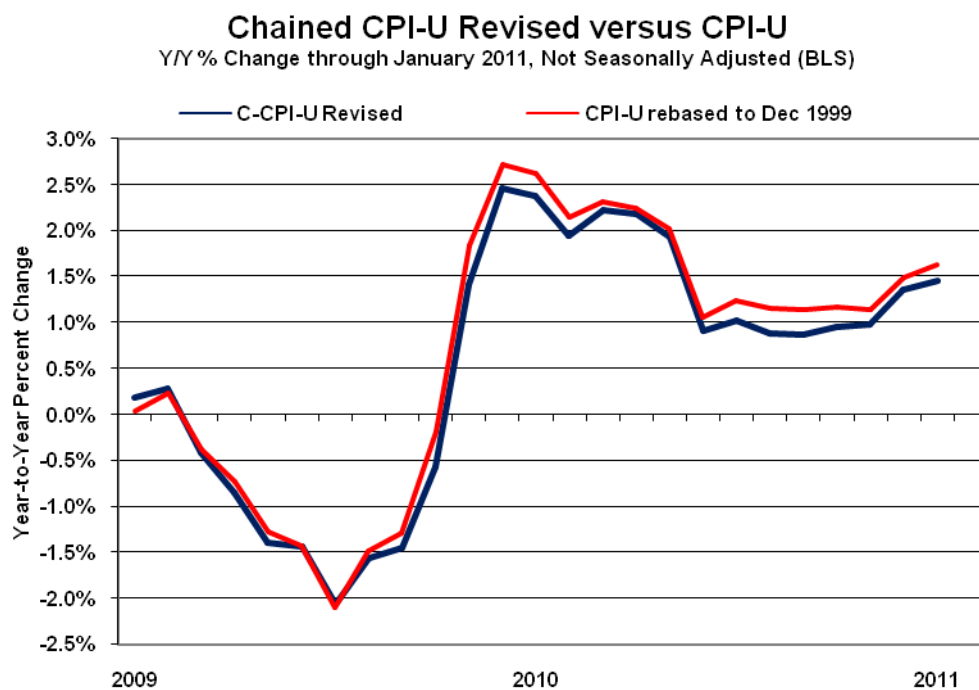
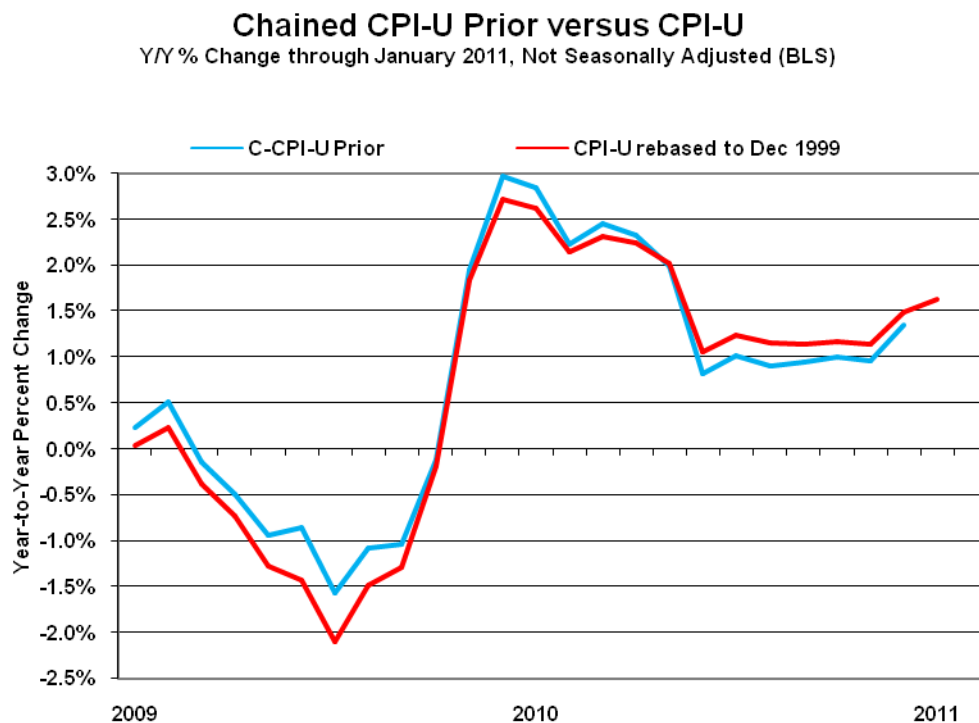
**C-CPI-U.** The Chain-Weighted CPI-U -- the fully substitution-based series that gets touted by CPI opponents and inflation apologists, including the recent presidential deficit commission, as the replacement for the CPI -- is reported only on an unadjusted basis. It was revised going back to January 2009.

Unadjusted year-over-year, average 2010 over 2009 annual C-CPI-U inflation was revised to 1.46% from the 1.56% indicated last month, versus a contraction of 0.05% (revised from a 0.06% contraction) in 2009 over 2008.

C-CPI-U year-to-year inflation increased to 1.45% in January 2011, versus an unrevised 1.35% in December 2010.

The following series of graphs show the C-CPI revisions. The first graph shows the C-CPI-U and revisions, against the CPI-U (re-indexed to December 1999 = 100, the C-CPI-U base). The next three graphs show the revisions in year-to-year change. As a result of the re-estimation, the C-CPI now shows annual inflation rates below the CPI in most cases. That pattern was the purpose behind creating the C-CPI-U series. Eventually the C-CPI will be used artificially to reduce COLAs for Social Security, etc. Please note that earlier reporting (Prior versus CPI-U) had strayed from underlying theory, hype and political needs.





**Alternate Consumer Inflation Measures.** Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 5.0% in January 2011, up from 4.8% in December, while the SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 9.1% (9.07% for those using the extra digit) in January, from about 8.9% in December.

The SGS-Alternate Consumer Inflation Measure adjusts on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made by the BLS (the series is not recalculated). Over the decades, the BLS has altered the meaning of the CPI from being a measure of the cost of living needed to maintain a constant standard of living, to something that no longer reflects the constant-standard-of-living concept. Roughly five percentage points of the additive SGS adjustment reflect the BLS's formal estimate of the annual impact of methodological changes; roughly two percentage points reflect changes by the BLS, where SGS has estimated the impact not otherwise published by the BLS.

**Gold and Silver Highs Adjusted for CPI-U/SGS Inflation.** Despite November 9th's historic high gold price of \$1,421.00 per troy ounce (London afternoon fix) and the multi-decade high silver price of \$30.77 per troy ounce (London fix) yesterday (February 16th), gold and silver prices have yet to approach their historic high levels, adjusted for inflation. The earlier all-time high of \$850.00 (London afternoon fix, per Kitco.com) of January 21, 1980 would be \$2,406 per troy ounce, based on January 2011 CPI-U-adjusted dollars, \$8,047 per troy ounce based on SGS-Alternate-CPI-adjusted dollars (all series not seasonally adjusted).

In like manner, the all-time high price for silver in January 1980 of \$49.45 per troy ounce (London afternoon fix, per silverinstitute.org) has not been hit since, including in terms of inflation-adjusted dollars. Based on January 2011 CPI-U inflation, the 1980 silver price peak would be \$140 per troy ounce and would be \$468 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

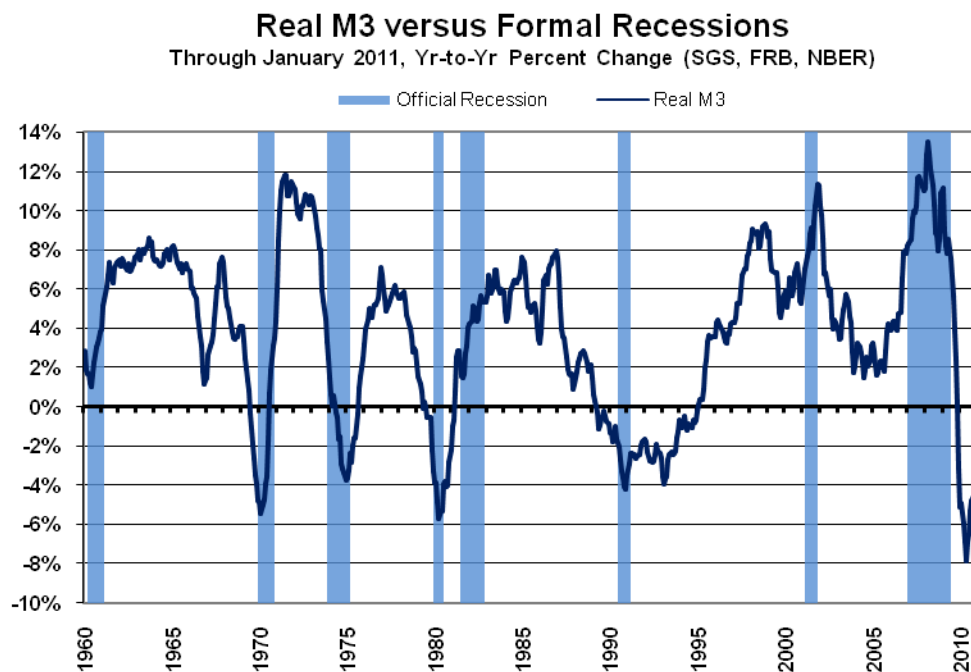
As shown on page 22 in the [Hyperinflation](#) report, over the decades, the price of gold has compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, while it has effectively fully compensated for the loss of purchasing power of the dollar based on the SGS-Alternate.

**Real Money Supply M3.** The signal of the still unfolding double-dip recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), most recently was discussed graphed in [Special Commentary No. 342](#), continues and is graphed below. Based on the January CPI-U report and the latest January SGS-Ongoing M3 Estimate, the annual contraction in January 2011 real M3 was 3.8%, versus a 4.3% contraction in December 2010.

The signal for a downturn or an intensified downturn is generated when annual growth in real M3 first turns negative in a given cycle; the signal is not dependent on the depth of the downturn or its duration. The current downturn signal was generated just over one year ago, in December 2009. The broad economy tends to follow in downturn or renewed deterioration roughly six to nine months after the signal, as has appeared to have started in recent months, with flat-to-down nonfarm payrolls, flattening industrial production, flattening real retail sales (see the following section), and renewed contraction in the already severely-constrained real estate market. Increasing weakness in a number of series should become evident as benchmark revisions to industrial production, retail sales and GDP show weaker than currently



assumed economic activity for the last year or so, and as current reporting turns increasingly negative. Such eventually will lead to recognition of a double-dip recession.



**Real Retail Sales.** Based on the January 2011 CPI-U reporting, inflation- and seasonally-adjusted monthly January 2011 retail sales declined by 0.06%, where, before inflation adjustment, the current number was up by 0.34%. Real December sales notched higher by 0.09% in revision, revised from a prior 0.1% contraction thanks to the seasonal-factor revisions in the CPI-U. See [Commentary No. 351](#) for other January 2011 retail sales detail.

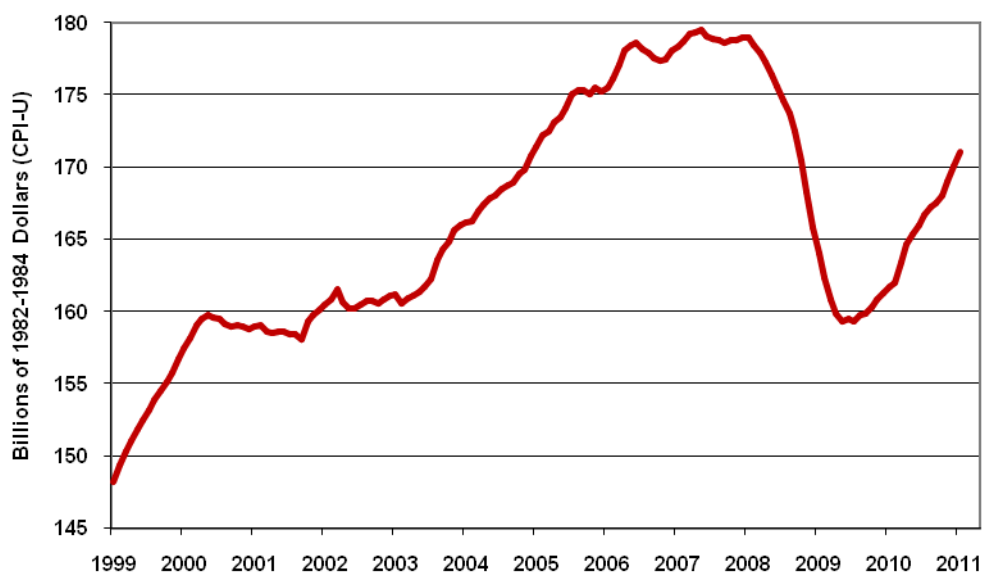
January real retail sales rose at a year-to-year pace of 6.01%, versus the revised 6.17% (previously 6.45%) annual gain reported for December.

Since November 2008, monthly real retail sales (CPI-U deflated) have been fluctuating around an average of \$164.3 billion (the deflated January number was \$172.6 billion). The first graph following reflects the relatively volatile monthly levels of real retail sales, as reported. The monthly levels for December 2010 and January 2011 appear to be topping out, but that is not shown in the six-month-moving-average pattern in the second graph, yet.

**Inflation-Adjusted Monthly Retail Sales**  
Through January 2011, Seasonally-Adjusted (SGS, Census, BLS)



**Inflation-Adjusted Retail Sales (6-Mo Moving Avg)**  
Through January 2011, Seasonally-Adjusted (SGS, Census, BLS)



Smoothed on a six-month moving-average basis, the pattern of activity here has been one of bottom-bouncing in terms of the level of inflation-adjusted sales. The recent upturn/bounce from short-lived stimulus factors and warped-seasonals still lingers in seasonal-adjustment problems, which likely await the April seasonal-factor and benchmark revisions for catch-up. There has been no change in underlying fundamentals that would support a sustainable turnaround in personal consumption or in general economic activity -- no recovery -- just general bottom-bouncing. Accordingly, real retail sales levels in the months ahead likely will be increasingly negative.

**Week Ahead.** Given the unfolding reality of an intensifying double-dip recession and more-serious inflation problems than generally are anticipated by the financial markets, risks to reporting will tend towards higher-than-expected inflation and weaker-than-expected economic reporting in the months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

***New and Existing Homes Sales (January 2011).*** January existing home sales (National Association of Realtors) are due for release on Wednesday, February 23rd, followed by new home sales (Census Bureau) on Thursday, February 24th. As with the underlying weakness in housing starts, these volatile series should remain extremely weak, with any monthly change (new homes) again lacking statistical significance. As usual, given the extreme volatility, reporting error and revisions in these series, given the poor-quality seasonal adjustments, given continuing negative anecdotal evidence, and given ongoing massive distortions from increasingly volatile foreclosure activity, the monthly movements in these numbers remain particularly meaningless.

***New Orders for Durable Goods (January 2011).*** Due for release on Thursday, February 24th, January new orders for durable goods also likely will not show meaningful monthly change, again, even with the upside biases built into these numbers in the last benchmark revision. This series remains irregularly volatile.

***Gross Domestic Product -- GDP ("Second Estimate" Fourth-Quarter 2010).*** The Bureau of Economic Analysis' second estimate (first revision) of fourth-quarter 2010 GDP is due for release on Friday, February 25th. Based on the December trade reporting, some downside revision is possible (see [Commentary No. 350](#)). Due to inadequate annual data (an unstated problem also with the GDP) the Gross Domestic Income and Gross National Product initial estimates are not likely to be published until next month.