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

COMMENTARY NUMBER 363
Inflation, Retail Sales, Production

April 15, 2011

Real Monthly Retail Sales Fell by 0.2% in March

Fed's Dollar Debasement Has Boosted Quarterly CPI Inflation to More than 5%

March Year-to-Year Consumer Inflation: 2.7% (CPI-U), 3.0% (CPI-W), 10.2% (SGS)

PLEASE NOTE: The next regularly scheduled Commentary *is for Tuesday, April 19th. It will assess the March housing starts release.*

—Best wishes to all, John Williams

Inflation Pace Accelerates. The pace of consumer inflation is accelerating rapidly, with annual CPI-U at 2.7% and CPI-W at 3.0%, while the annualized quarterly, seasonally-adjusted inflation rates have hit 5.2% for the CPI-U and 6.0% for the CPI-W. These higher inflation numbers are tied directly to the Federal Reserve's successful and ongoing efforts to debase the U.S. dollar, which in turn have boosted dollar-denominated commodity prices such as oil. The inflation pace here normally would be of concern to the Fed, except the U.S. central bank officially ignores inflation tied to food and energy prices, even though, again, those debilitating price increases for consumers are a direct result of Fed policy. Of particular discomfort to consumers, this inflation has not resulted from booming economic activity and wages, but rather from Fed monetary policy in the context of stagnant/declining broad economic activity.

Inflation has gained the upper hand in retail sales, with sales gains now more than accounted for by rising prices. A pending benchmark revision (April 29th) should show a much weaker recent history for retail sales activity, as the just-published benchmark revision to industrial production did for that series.

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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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Inflation Above 3% Tends to Rattle Consumers. Where consumers look at inflation in terms of out-of-pocket expenses, the threshold of pain has been crossed, with popularly used consumer price indices at or within one month of topping 3% annual inflation. Further, for those who do not get paid in seasonally-adjusted dollars, the 0.5% adjusted CPI-U monthly gain felt more like the 1.0% unadjusted gain.

This is separate from considering what a consumer needs in income or investment return to maintain a constant standard of living. The BLS—under Congressional direction—has altered the CPI in recent years so as no longer to reflect any sense of maintaining a constant standard of living. Those issues are addressed in the SGS-Alternate Consumer Inflation Measure below.

CPI-U. The BLS reported today (April 15th) that the seasonally-adjusted March 2011 CPI-U rose by 0.55% (up by 0.98%, unadjusted) for the month. That followed an increase of 0.55% (up by 0.49%, unadjusted) in February. The March reporting reflected an unadjusted monthly increase in gasoline prices of 11.7%, which was reduced to a 5.6% monthly gain by happy seasonal adjustments.

The pace of annualized quarterly, seasonally-adjusted, CPI-U inflation continued to accelerate in first-quarter 2011, up by 5.22%, versus 2.62% in fourth-quarter 2010, and versus1.43% in third-quarter 2010.

March's unadjusted year-to-year CPI-U inflation surged once again, to 2.68%, up from 2.11% in February and up from a 1.63% annual increase in January.

Year-to-year inflation would increase or decrease in next month's April 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the unchanged adjusted monthly level seen in April 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for April 2011, the difference in April's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from March 2011's reported annual inflation rate of 2.68%. Annual CPI-U inflation should top 3% next month, as the CPI-W did in today's reporting.

CPI-W. The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose in March 2011 by 0.65% (up 1.14% unadjusted), following February's adjusted monthly increase of 0.62% (up 0.52% unadjusted).

The pace of annualized quarterly, seasonally-adjusted, CPI-W inflation for first-quarter 2011 continued to accelerate, up by 6.04%, versus 3.09% in fourth-quarter 2010 and 1.71% in the third-quarter.

Unadjusted, March 2011's year-to-year CPI-W inflation was 3.04%, against a 2.35% annual increase in February.

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. Year-to-year inflation increased to 2.46% in March 2011 versus 1.97% in February.

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 6.0% in March 2011, up from 5.5% in February, while the SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 10.2% (10.20% for those using the extra digit) in March, from about 9.6% in February.

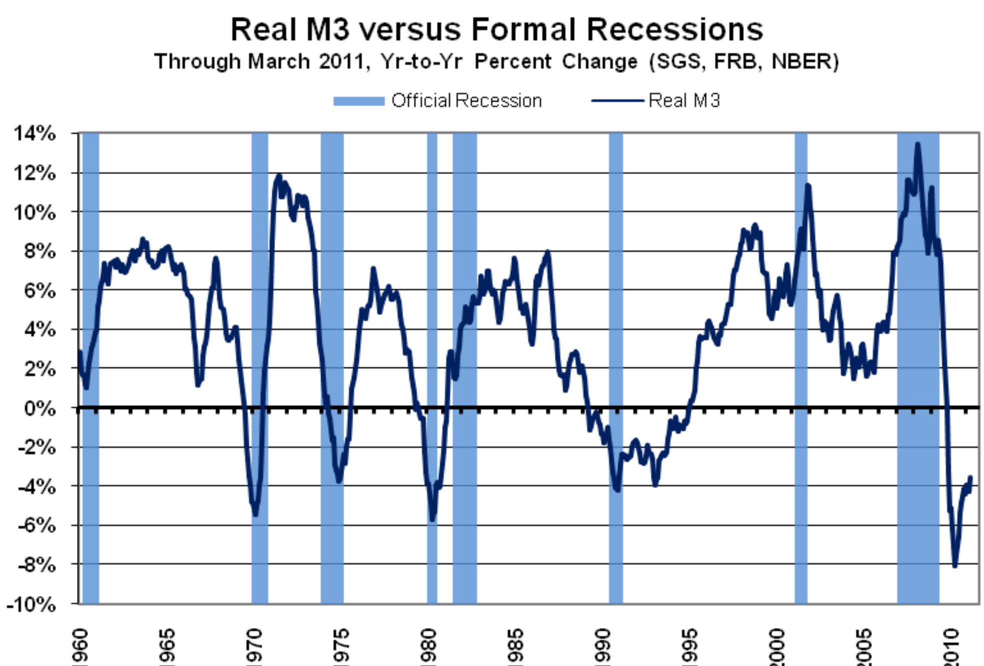
The SGS-Alternate Consumer Inflation Measure adjusts on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made by the BLS (the series is not recalculated). Over the decades, the BLS has altered the meaning of the CPI from being a measure of the 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 today's (April 15th) historic high gold price of $1,476.75 per troy ounce (London afternoon fix) and a new multi-decade high silver price of at $42.61 per troy ounce (London fix), 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 $2,441 per troy ounce, based on March 2011 CPI-U-adjusted dollars, $8,331 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 March 2011 CPI-U inflation, the 1980 silver price peak would be $142 per troy ounce and would be $485 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

As shown on page 43 of the *Hyperinflation Special Report (2011)*, 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 Consumer Price Measure (1980 Methodologies Base).

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 discussed in the *Hyperinflation Special Report (2011)*, continues and is graphed below. Based on the March CPI-U report and the latest March SGS-Ongoing M3 Estimate, the annual contraction in real M3 for March 2011 was 3.6%, versus a 4.3% annual contraction in February.



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 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. Increasing weakness in a number of series should become evident as benchmark revisions to retail sales and GDP—following patterns in the recent payroll and industrial production revisions—show weaker than currently assumed economic activity for the last year or two, and as current reporting turns increasingly negative. Such eventually will lead to recognition of a double-dip recession.

March PPI Gain Muted by Seasonal Adjustments. As reported yesterday, April 14th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) rose in March 2011 by 0.7% (up by 1.3% before seasonal adjustment) month-to-month, following a monthly increase in February of 1.6% (up by 1.4% before seasonal adjustment). The adjusted monthly PPI finished goods largely reflected upside pressures from energy and increasing "core" prices, with some offset from a purported decline food prices. The higher prices generally reflected ongoing impact of the Fed's dollar-debasement policies. With reported monthly inflation heavily muted by seasonal adjustments of energy costs, the heaviest impact from rising oil prices is still ahead.

Annualized, seasonally-adjusted PPI inflation for first-quarter 2011 was 13.1%, up from an annualized pace of 9.2% in fourth-quarter 2010. Unadjusted and year-to-year, Match 2011's PPI inflation was 5.8% versus 5.6% in February, and at the highest level in one year.

Separately, on a monthly basis, seasonally-adjusted March 2011 intermediate goods rose by 1.5% (up by 2.0% in February), with March's crude goods prices falling by 0.5%, after jumping up by 3.4% in February.

Year-to-year inflation in March intermediate goods was up by 8.9% (a 7.8% gain in February), with March's annual inflation in crude goods at 16.4% (up by 15.9% in February).

Real Retail Sales Series Likely Has Seen Its Reported Peak Level for a While. The reported 0.4% gain in March 2011 retail sales was more than accounted for by inflation, with sales—net of inflation impact—contracting by 0.2%. In two weeks, on April 29th, the series also will undergo its annual benchmark revision. Consistent with the downside patterns common to most benchmark revisions, and in line with recent downside revisions to nonfarm payrolls and to industrial production, the pending retail sales revisions likely will show a much weaker recent economic history and a much lower level of "recovery" than commonly is discussed by most economic and financial analysts.

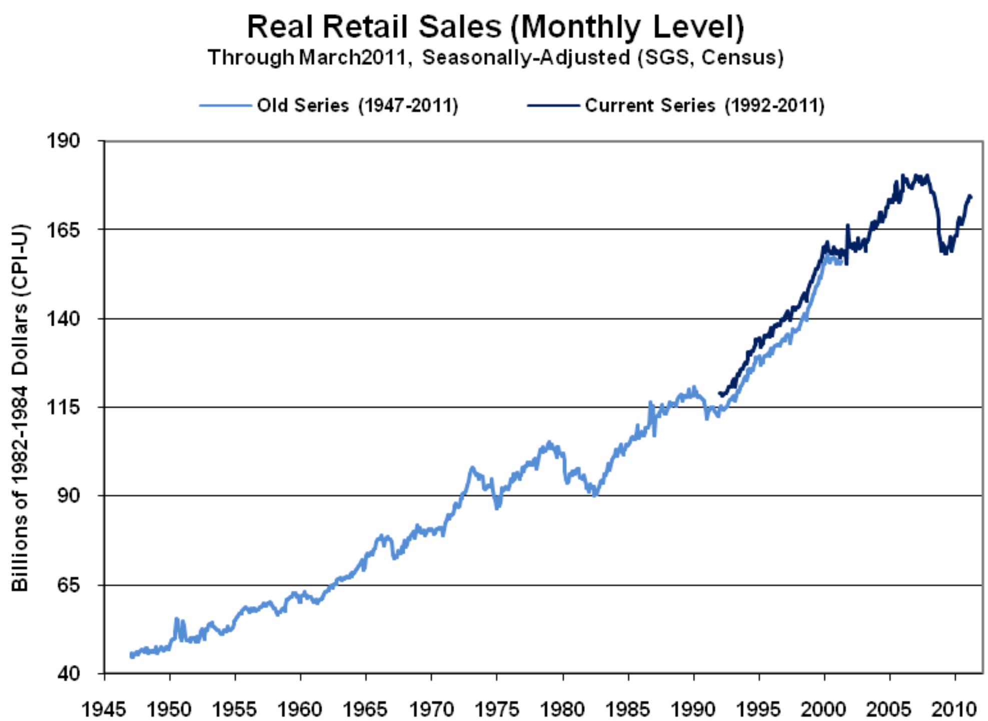
***Nominal (Not-Adjusted-for-Inflation) Retail Sales*.** Wednesday's (April 13th) March 2011 retail sales report—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.39% (up 0.57% net of prior-period revisions) +/- 0.6% (95% confidence interval), versus a revised 1.08% February monthly gain (previously an increase of 0.97%).

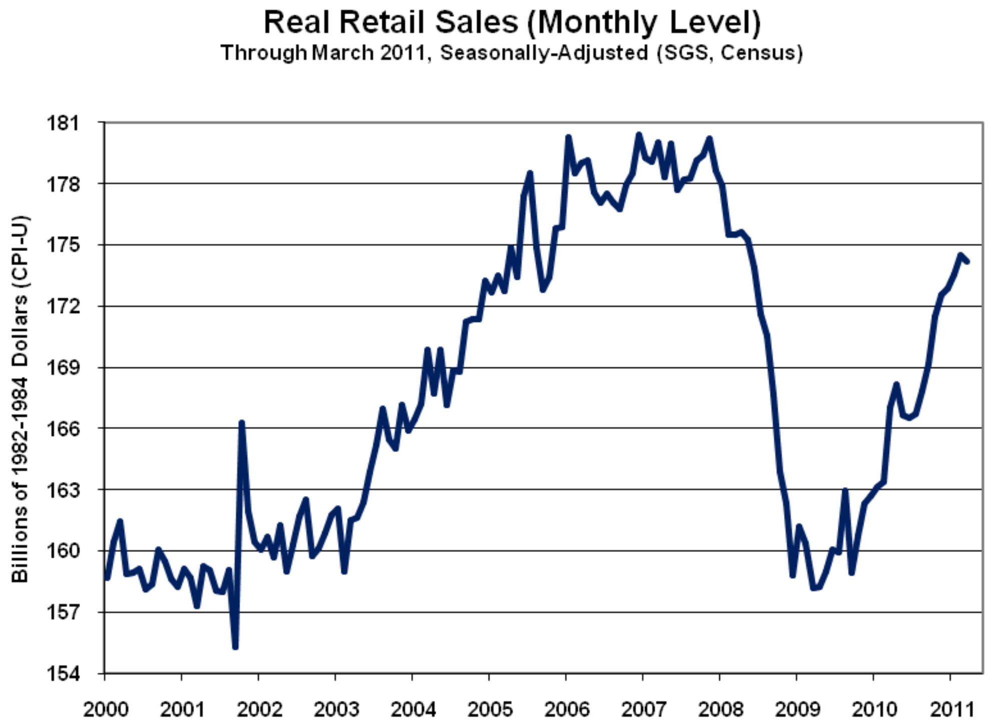
On a year-to-year basis, March 2011 retail sales were reported up by 7.10% from March 2010, versus a revised year-to-year February 2011 gain of 9.10% (previously 8.87%).

The Census Bureau continues to play games with the monthly seasonal factors and revisions to year-ago data, where only a limited number of the revisions are published. That leaves the monthly data in the published historical series inconsistent, month-over-month, for the last several years. Shifting patterns of seasonals can shift adjusted growth from earlier periods into the current reporting, without the earlier revisions being published. Ongoing distortions basically are from the same concurrent seasonal-factor adjustment problems (unprecedented business-cycle effects overwhelming the traditional seasonal patterns of activity) and sampling issues (companies out business that no longer are reporting, but still are being counted) with sales or employees on payrolls. These should be among the issues adjusted in the upcoming benchmark revision.

Real (Inflation-Adjusted) Retail Sales. Based on the March 2011 CPI-U reporting, inflation- and seasonally-adjusted monthly March 2011 retail sales fell by 0.16%, where, before inflation adjustment, the current number was up by 0.39%. Real February sales revised to an increase of 0.53% (initially a 0.42% gain).

March real retail sales rose at a year-to-year pace of 4.29%, slowing from a revised 6.79% (previously 6.57%) annual gain reported for February.





The "recovery" in real retail sales is reflected in the preceding graphs. Both graphs show the monthly level of the seasonally-adjusted activity. The first graph shows the data in historical context since World War II. The second graph shows the same numbers in clearer detail for the current period beginning in 2000.

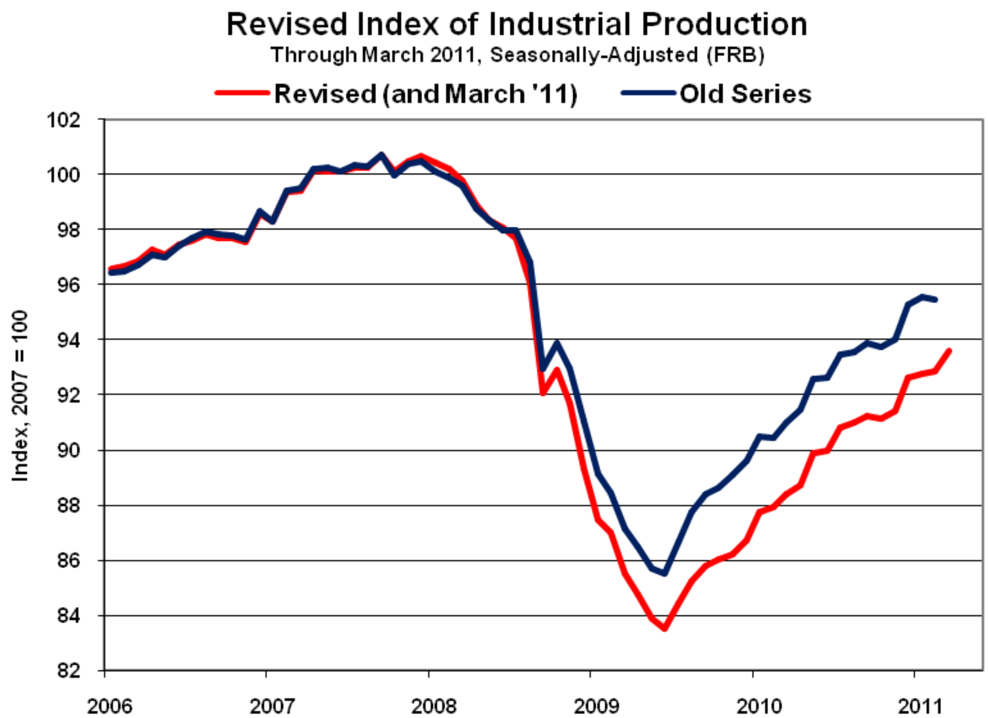
Since November 2008, monthly real retail sales (CPI-U deflated) have been fluctuating around an average of $164.9 billion (the deflated March number was $174.2 billion). With the likely benchmark revisions, the series should be topping out. There has been no change in underlying fundamentals that would 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 should turn increasingly negative.

Core Retail Sales. Assuming that the bulk of non-seasonal variability in food and gasoline sales is in pricing, instead of demand, "core" retail sales—consistent with the Federal Reserve's predilection for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

Version I: March 2011 versus February 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was up by 0.1% versus an official aggregate gain of 0.4%.

Version II: March 2011 versus February 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations—was a gain of 0.1% versus the aggregate gain of 0.4%.

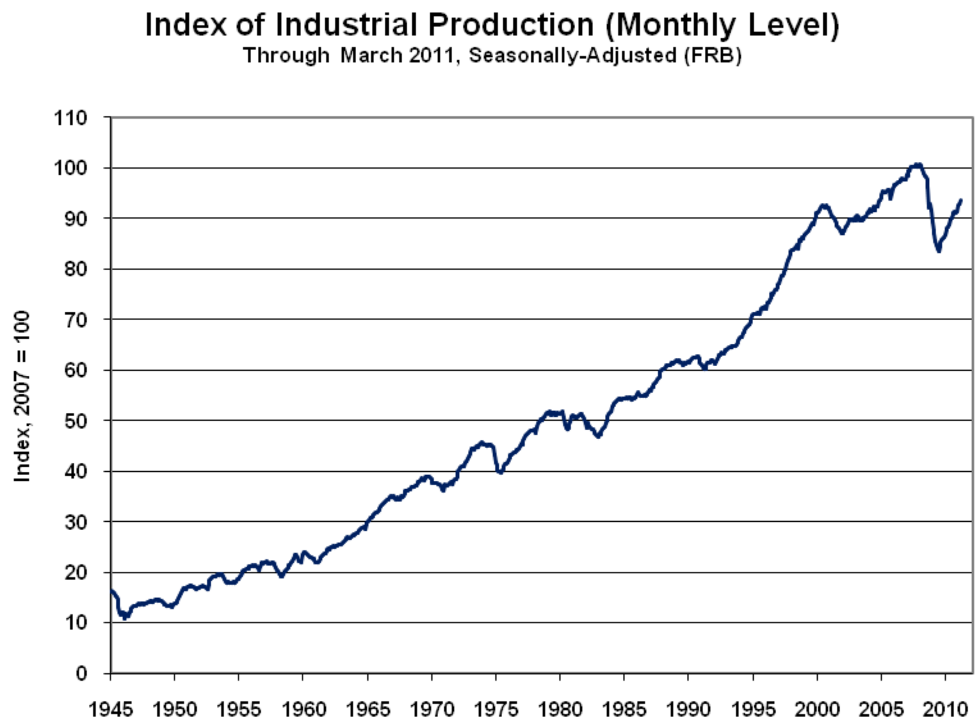
March Industrial Production Gained for Month, With Overall Level Reduced Significantly by the Benchmark Revisions. Current reporting is in an environment of restated economic history that shows much weaker economic activity in recent years than reported initially (see *Commentary No. 360*).

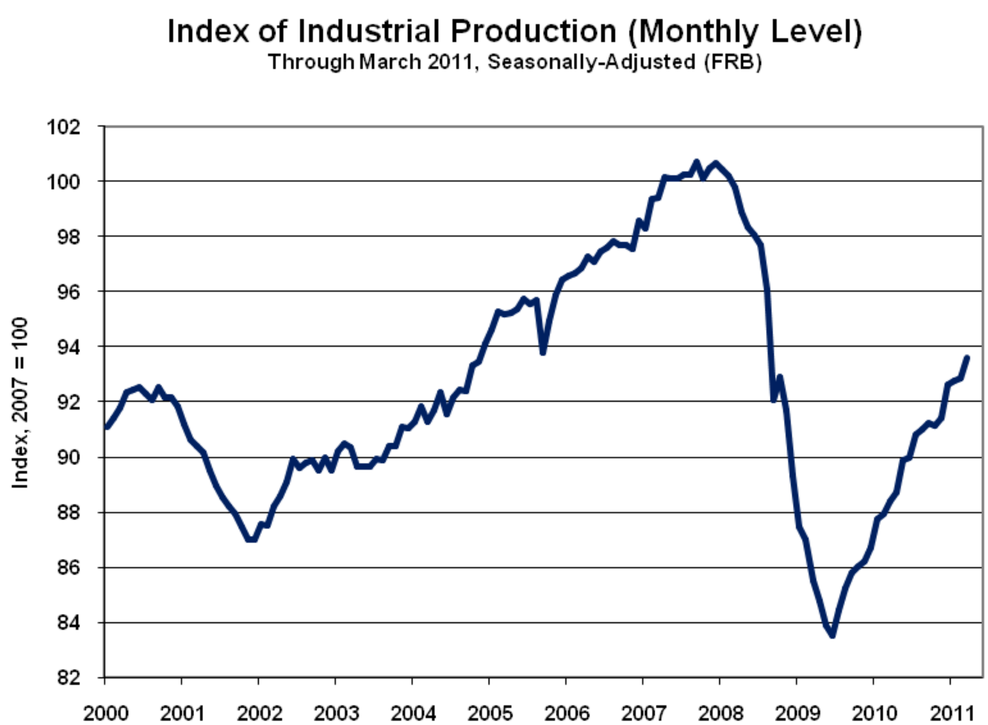


In the context of the revised historical data, this morning's (April 15th) Federal Reserve Board release of seasonally-adjusted March 2011 industrial production showed a monthly gain of 0.80%, following a 0.07% increase in February. Year-to-year change in March 2011 production was 5.88%, up from a 5.61% gain in February. The year-to-year contraction of 14.86% seen in June 2009 was the steepest annual decline in production growth since the shutdown of war-time production following World War II.

The "recovery" in industrial production is reflected in the following graphs. Both graphs show the monthly level of the production index. The first graph shows the data in the historical context since World War II. The second graph shows the same numbers in clearer detail for the current period beginning in 2000, including the benchmark revision and the March 2011 release.

For the last 29 months, the production index has averaged 88.54, around which the series has been fluctuating, although it consistently still has been moving higher in recent months. The March reading is at 93.59.


Index of Industrial Production (Monthly Level)
Through March 2011, Seasonally-Adjusted (FRB)
Index, 2007 = 100
110
100
90
80
70
60
50
40
30
20
10
0
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


Index of Industrial Production (Monthly Level)
Through March 2011, Seasonally-Adjusted (FRB)
Index, 2007 = 100
102
100
98
96
94
92
90
88
86
84
82
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011

Hyperinflation Watch—QE2/QE3. As noted in the prior *Commentary No. 362*, near-term inflation and monetary circumstances generally have continued to deteriorate in line with expectations detailed in the *Hyperinflation Special Report (2011)*, with risks continuing to mount for the near-term development of the early stages of a hyperinflation. I also suggested that, "Much weaker-than-expected economic data should be seen in the months ahead. Not only are the implications here horrendous for U.S. fiscal conditions, but the Federal Reserve likely will expand its rapidly expiring QE2 (broad money supply still has shown no major impact from QE2), or introduce QE3. In turn, this should intensify U.S. dollar selling as well as U.S. consumer inflationary pressures."

Several subscribers asked for some clarification on the Fed's likely actions. As indicated in prior writings, although the Fed officially credits its QE2 program to continued lackluster growth in economic activity and to no "core" inflation, the Fed's real concern remains in the realm of banking-system solvency. The continued weakness in broad money supply activity is suggestive of ongoing systemic solvency issues. Accordingly, until broad money growth and bank lending pick-up sharply, the "QE" programs likely will continue, although they still likely will be explained away as being necessary to combat the weak economy.

As to whether the Fed will play politics with a brief pause in the "QE" programs remains to be seen, but I would doubt there will much, if any break, given the ongoing systemic solvency crisis being juggled by the U.S. central bank. Weakness in the dollar likely will continue, in any event, given the rapid deterioration of global perceptions of U.S. political stability, etc.

Week Ahead. Though not yet commonly recognized, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions, benchmark or otherwise.

Residential Construction (March 2011). Release of March 2011 housing starts is scheduled for Tuesday, April 19th. This highly volatile series likely will continue to show a deepening new downturn in activity. To the extent there is an upside surprise to housing starts, any such result should lack statistical significance.

