

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

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September Retail Sales, August Trade Deficit

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The Great Downturn Deepens as Household Incomes Collapse
September Retail Sales Gain Exaggerated by Poor-Quality Seasonal Adjustments
Trade Deficit Still Suggests A Positive Contribution to Third-Quarter GDP

PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, October 19th. It will cover September CPI, PPI, housing starts, real retail sales and industrial production.

—Best wishes to all, John Williams

Opening Comments and Executive Summary. Fundamental factors that drive U.S. consumption show the broad economy still to be in decline, with no near-term chance of the prospective economic recovery that regularly gets hyped by Wall Street. Structural problems tied to the lack of real (inflation-adjusted) consumer income growth, and to restricted credit availability, remain at the core of the economic problems, as discussed in the [*Hyperinflation Special Report \(2011\)*](#).

Household Income Collapse. On the consumer income front, household income is continuing to collapse, per a just-released [private study](#) by Gordon Green and John Coder. Green and Coder, respectively, were the former Chiefs of the Governments Division and of the Income Statistics Branch at the U.S. Census Bureau, and, at one time, produced the government's annual poverty survey, from which

I pull details on annual household income (see [Commentary No. 389](#)). The new study was publicized in an October 9th *New York Times* story: “Recession Officially Over, U.S. Incomes Kept Falling.”

Using raw data available from the Census Bureau’s Current Population Survey (the unemployment survey used by the Bureau of Labor Statistics), Green and Croder concluded that monthly median household income, adjusted for CPI-U inflation, fell by 9.8% from the official beginning of the recession in December 2007 through June 2011. This is near-depression territory (see the definitions section of the [Hyperinflation Special Report \(2011\)](#)). Further, the collapse in household income accelerated after the purported end of the recession in June 2009, suggesting that the recession never really ended.

Per Green and Croder, “Real [adjusted for inflation] median annual household income has fallen significantly more during the economic recovery period from June 2009 to June 2011 than during the recession lasting from December 2007 to June 2009. During the recession, real median annual household income fell by 3.2 percent, from \$55,309 in December 2007 to \$53,518 in June 2009. During the economic recovery, real median annual household income fell by an additional 6.7 percent, from \$53,518 in June 2009 to \$49,909 in June 2011.”

The declines in real median household income in all mentioned periods were greater than the appropriate CPI inflation, which means that the median household incomes also declined in nominal terms (not adjusted for inflation). The latest reading on real median household income appears to be at the low of the cycle, and, as deflated by the CPI-U, should be at the lowest level seen since before 1970, based on the Census Bureau’s historical annual series.

Growth in real consumption and real GDP cannot be sustained without sustained growth in real income. Short-term consumption growth, however, can be borrowed from the future—through debt expansion—assuming consumers have the ability and willingness to take on new debt.

Credit and Confidence. On the consumer credit front, the Fed’s reporting of August 2011 consumer credit outstanding showed a 1.9% increase versus the third-quarter 2010 level. That also is less than the official annual increase in consumer inflation of 3.8% (CPI-U) to 4.3% (CPI-W) in August. Net of consumer debt held by the federal government, however, nominal August consumer credit was down by 3.1% over the same period. The banks still are not lending, and without credit expansion available to the consumer to make up for the shortfall in his or her living standards, real consumption and GDP again have no prospects for sustainable expansion.

As to consumer confidence, both the Conference Board’s confidence measure and the University of Michigan’s sentiment measure remain deep in territory usually not seen outside of historical recessions (except for the current period, where, again, the 2007 recession really never ended).

Retail Sales. Despite all the factors hampering consumer activity, headline September retail sales rose by 1.1% in the month. Even after inflation adjustment, that should remain in positive territory. The monthly changes here are warped by poor-quality seasonal adjustments. The sales gain here would have been roughly 0.5%, based on 2010 adjustments. The underlying fundamentals, as discussed above, do not support any form of near-term consumer recovery, and real contractions in monthly retail sales should be common in the key holiday-shopping-season months ahead.

Trade Deficit. The August trade deficit was unchanged versus July, but with July now showing a wider deficit in revision. The net narrowing in the quarterly deficit initially suggested by the July report now is

smaller, but the effect still should be the same. The net export account likely will make a positive contribution to the “advance” third-quarter GDP estimate due for release on October 27th.

An update on the broad outlook for inflation and the economy will be included in the *Commentary* scheduled for October 19th.

Hyperinflation Watch—Outlook Unchanged. The U.S. economy continues to falter. With the added pressures of systemic-solvency stresses, the domestic and global financial markets and financial system remain extremely unstable.

Repeated from the prior *Commentaries*, there are no happy solutions available here to remedy the economic and systemic-solvency crises, only tools—devil’s choices—for the Fed and the U.S. government to buy a little extra time. From the Fed’s standpoint, keeping the banking system afloat remains its primary concern, although needs for economic growth and contained inflation will be given as the rationale behind any overt change in policy. The ultimate cost in propping the system, however, remains inflation. The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the [Hyperinflation Special Report \(2011\)](#) and in recent *Commentaries*, continue to unfold with outlooks that remain unchanged.

The root source of current global systemic instabilities largely has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent a euro-area crisis from triggering a systemic collapse in the United States. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

The financial markets still are roiled by deepening crises of confidence in the U.S. dollar and in the long-term outlook for U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of any further near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold, the stronger currencies and precious metals remain the fundamental hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets could start at anytime, with little or no further warning. With a U.S. government unwilling to balance or even to address its uncontainable fiscal condition; with the federal government and Federal Reserve standing ready to prevent a systemic collapse, so long as it is possible to print and spend whatever money is needed; and with the U.S. dollar at risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.

REPORTING DETAIL

RETAIL SALES (September 2011)

September Retail Sales Boosted by Poor-Quality Seasonal Factors. With anything close to stable monthly seasonal adjustments relative to last year, September's 1.1% adjusted monthly sales gain would have been around 0.5%. The concurrent seasonal factor issues, and broader distortions seen otherwise in current seasonal factors, as discussed in [Commentary No. 393](#) and in the [Hyperinflation Special Report \(2011\)](#), continue. The stability of the seasonal-adjustment process has been disrupted by the unprecedented depth and length of the current economic downturn in the post-World War II era (the period of modern economic reporting).

As a result, monthly changes being reported in series such as payroll employment and new orders for durable goods—in addition to the retail sales series—remain within the realm of statistical meaninglessness. Distorted monthly reporting in these and other key series, leave the markets effectively flying blind as to actual underlying economic activity. In such circumstances, looking at broad underlying fundamentals may be useful. As discussed in the *Opening Comments and Executive Summary*, the underlying consumer fundamentals continue to signal economic deterioration, not recovery. The broad economy remains in serious trouble.

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Today's (October 14th) report on September 2011 retail sales—issued by the Census Bureau—indicated a statistically-significant, seasonally-adjusted monthly gain of 1.13% (up by 1.53% before prior-period revisions) +/- 0.6% (95% confidence interval). September's jump was against a revised 0.28% (previously 0.04%) monthly increase in August. The July monthly gain also was revised higher, to 0.42% from 0.27% in last month's reporting.

On a year-to-year basis, September 2011 retail sales were reported up by 7.94%, versus the revised year-to-year August 2011 gain of 7.53% (previously 7.16%).

Real (Inflation-Adjusted) Retail Sales. Details on real retail sales for September will be published in the October 19th *Commentary*, along with details on the September 2011 CPI-U release. While September CPI-U inflation likely increased (see *Week Ahead*), the gain should be well below 1.1%. As a result, real retail sales for September most likely will show a month-to-month gain. Despite the upside revisions to August and July's nominal monthly gains, though, both months continue to show monthly real contractions, with August now down by 0.09% (previously down by 0.33%) and July down by 0.07% (previously down by 0.23%).

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 preference for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

Version I: September 2011 versus August 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was up by 1.3%, versus an official gain of 1.1%.

Version II: September 2011 versus August 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations—was up by 1.0%, versus an official gain of 1.1%.

TRADE BALANCE (August 2011)

August Trade Data Still Suggest A Positive Contribution to Third-Quarter GDP. The July trade deficit widened in revision, with the August number then reported as unchanged. These two months of reporting, which will be used to estimate the net-export contribution in the initial third-quarter GDP report (due for release October 27th), appear to have narrowed against first-quarter reporting, suggesting a positive contribution to the quarterly GDP number. Going forward, though, look for ongoing monthly trade deterioration.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported yesterday (October 13th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for August 2011 held at \$45.6 billion, the same level as the revised July deficit, which widened from the initial reporting of \$44.8 billion.

Against the revised July data, the August trade balance showed offsetting minimal \$0.1 billion monthly declines in both exports and imports. The import numbers reflected a decline in oil prices, but also a surge in physical oil import volume. Specifically, for the month of August 2011, the not-seasonally-adjusted average price of imported oil was \$102.62 per barrel, down from \$104.27 in July 2011, but up from \$73.47 in August 2010. In terms of not-seasonally-adjusted physical oil imports, August 2011 volume averaged 9.757 million barrels per day, up from 9.067 million in July 2011, but down from 9.905 million in August 2010.

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil price swings and other inflation (2005 chain-weighted dollars as used in reporting real GDP), the reported August merchandise trade deficit came in at \$47.0 billion, up from a revised \$46.0 (previously \$45.3) billion in July.

Based on the two months of reporting that will be used in estimating the net export component of third-quarter GDP, the annualized deficit for the third-quarter would be \$557.6 billion (previously estimated at \$543.3 billion from the initial one month's reporting). Although widened from the initial estimate, it still is narrower than the full reporting of an annualized real second-quarter 2011 merchandise deficit of \$567.4 billion. The likely estimate of a quarterly narrowing of the trade deficit would be a positive for the GDP's net export account and, accordingly, a positive contribution to the initial estimate of third-quarter GDP growth.

Week Ahead. Although still not fully acknowledged, there is both an intensifying double-dip recession and an 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.

Industrial Production (September 2011). The September 2011 industrial production release is scheduled for Monday, October 17th. The consensus estimate for the headline monthly change in September production likely will be for modest growth, above the 0.2% increase initially reported for August. Reporting risk, however, generally will be to the downside of consensus, with a flat-to-minus result, as a formal double-dip recession begins to unfold in the numbers.

Producer Price Index—PPI (September 2011). The release of the September 2011 PPI is scheduled for Tuesday, October 18th. Finished goods inflation should top a likely flat-to-minus consensus outlook, due to the effects of still-spreading broader inflationary pressures from earlier higher oil prices.

Consumer Price Index—CPI (September 2011). The release of the September 2011 CPI is scheduled for Wednesday, October 19th. Headline consumer inflation, once again, is at fair risk of topping a likely relatively soft consensus. At work here remains the continued boost to gasoline prices from seasonal adjustments (catch-up from depressed reporting of gasoline prices from earlier in the year), while further inflationary pressures from the recent Fed-induced jump in oil prices continue spreading beyond direct energy cost measures in the general, broad economy.

Specifically, in terms of retail gasoline, unadjusted prices fell on average by 0.8% in September 2011 per the Department of Energy. Suggestive of the likely seasonal-adjustment impact on 2011 reporting, an unadjusted 1.4% monthly decline in September 2010 gasoline prices was boosted to a 1.6% increase, after seasonal adjustments.

Year-to-year total CPI-U inflation would increase or decrease in September 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.16% gain in the adjusted monthly level reported for September 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2011, the difference in September's headline monthly change (or forecast of same) versus the year-ago monthly headline change should be added to or subtracted directly from August 2011's reported annual inflation rate of 3.77%. For example, if the headline CPI-U gained 0.3% in September, annual CPI-U inflation should move to about 3.9%.

Housing Starts (September 2011). September residential construction data are due for release on Wednesday, October 19th. The historic weakness in housing starts should continue, again, with an intensifying downtrend. As seen generally in the last several years, any upside movement likely will not be statistically meaningful.
