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October Trade Balance

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October Trade Deficit Suggests Positive Contribution to Fourth-Quarter GDP

**Nonmonetary Gold Trade Patterns
Are Not Easily Tied to Gold Price Variations**

PLEASE NOTE: The next regular Commentary is scheduled for Tuesday, December 13th, covering November retail sales. That will be followed by a Commentary on Friday, December 16th, covering the November CPI, PPI and industrial production.

Hyperinflation 2012 (updated Hyperinflation Report) is planned for the second week of January 2012, accommodating the delayed publication of the 2011 Financial Report of the United States Government.

Along with today's newsletter, we begin posting a [schedule](#) for Commentaries planned in the month ahead. A link to that schedule always is available at [www.shadowstats](http://www.shadowstats.com) in the left-hand column, at the top of the Latest Newsletter Commentaries.

—Best wishes to all for a most joyous holiday season! John Williams

Opening Comments and Executive Summary. In a week otherwise light in major economic reporting, today's (December 9th) reporting of the October 2011 trade deficit added little to the broad economic outlook. The deficit narrowed to \$43.5 billion in October, from a revised \$44.2 billion in September, but

that was in the context of six months worth of revisions. Against the original \$43.1 billion trade shortfall in September, the October deficit widened slightly. Imports fell more than exports, thanks to declining physical oil imports and declining oil prices. Net of oil imports, the trade deficit widened.

Nonetheless, given the Bureau of Economic Analysis (BEA) use of the trade data in its GDP estimates, the October number is suggestive of a positive trade contribution to the initial guesstimate of fourth-quarter GDP next month.

The broad economic and inflation outlooks have not changed, but they will be updated in next Friday's (December 16th) *Commentary*, when the major economic and inflation data for November are in place.

Hyperinflation Watch—Outside Timing of 2014 Remains. Since the publication of the [Hyperinflation Special Report \(2011\)](#) back in March, the hyperinflation outlook has not changed, but events—suggestive of accelerating movement towards a near-term dollar and inflation catastrophe—have been unfolding. Outside timing for the hyperinflation crisis remains 2014. These issues have been discussed and explored in various *Commentaries*, but they will be fully reviewed and updated in *Hyperinflation 2012*, which is planned for the second week of January. It will cover details of the delayed *2011 Financial Report of the U.S. Government*, which is due for release on December 23rd, per latest advice.

Reiterating Key Points of the Prior Hyperinflation Watch. An annual GAAP-based U.S. federal deficit running greater than five-trillion dollars is beyond control and containment within the sphere of the politicians controlling the White House and Congress (see [Commentary No. 400](#)), and underlying economic reality remains an ongoing protracted and deepening economic catastrophe (see [Commentary No. 401](#)). The lack of political will in Washington to address the mortal threats to the U.S. financial system and economy effectively killed any remaining global confidence in the U.S. dollar by early August 2011, and the domestic and global markets have been highly unstable—in extreme turmoil—ever since. A new dollar-selling panic, and crisis reactions actions by the Fed, easily could bring the pending hyperinflation threat rapidly to a head.

The economic collapse that began in 2006 or 2007 is ongoing and is worse than popularly is recognized. With no relief in sight for the structural income and credit problems facing consumers, there is no near-term prospect for broad economic recovery in the United States. An ongoing economic downturn has severely negative implications for the projected U.S. federal budget deficit, for projected U.S. Treasury funding needs and for banking-system stress tests and systemic stability. It also promises a volatile political environment coming into the 2012 election, where pocket-book issues historically have dominated national election results more than any other single issue.

There remain no happy solutions available here to remedy the crises, only tools—devil's choices—for the Fed and the U.S. government to buy a little extra time. Domestic systemic instabilities, and possibly instabilities outside the United States, make substantial, expanded “easing” actions of some form likely by the Federal Reserve, sooner rather than later. From the Fed's standpoint, keeping the banking system afloat remains its primary concern, not expanding the economy or containing inflation. The ultimate cost in propping the system, however, remains inflation.

The root source of current global systemic instabilities primarily 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 ongoing crises in the euro-area from triggering a systemic collapse in the United States. That precedent was established in 2008. 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 remain extremely volatile and unstable. Underlying the various market upheavals fundamentally is the deepening crisis of confidence in the U.S. dollar and in the long-term doubts of U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of any ongoing 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, again, remain the fundamental, long-range hedges against what lies ahead.

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

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. A fully updated *Hyperinflation Report* is planned in later this month, shortly after the December 15th scheduled publication of the 2011 GAAP-based financial statements for the U.S. government.

REPORTING DETAIL

U.S. TRADE BALANCE (October 2011)

October Trade Deficit Narrowed in the Context of Revised, Wider Prior-Period Deficits. With the monthly trade deficits since March 2011 now worse than they were in last month's reporting, and given ongoing distortions in the seasonal factors used in estimating monthly changes, the narrowing in October's monthly trade shortfall likely was not meaningful.

That said, the way the Bureau of Economic Analysis (BEA) uses these data in its GDP calculations, and the October deficit is suggestive of positive contribution to next month's "advance" estimate of fourth-quarter GDP reporting from the trade account.

Going forward, though, underlying fundamentals still indicate an ongoing deterioration in the U.S. trade balance.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The BEA and the Census Bureau reported today (December 9th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for October 2011, on a balance of payments basis, narrowed to \$43.5 billion from a revised \$44.2 billion (previously \$43.1 billion) in September. Such was in the context of revised monthly trade estimates for second- and third-quarter 2011 showing larger deficits than previously reported, with the six months-ended September showing an annualized deficit of \$563.8 billion versus prior reporting of \$557.3 billion. Before prior-period revisions, the October deficit widened slightly by \$0.3 billion.

As has become the standard caution, heavy distortions appear to be playing out in seasonal adjustments, much as has been seen in other economic releases, such as retail sales, where the headline number reflects month-to-month change. As has been discussed frequently (see the [Hyperinflation Special Report \(2011\)](#) for example), the extraordinary length and depth of the business downturn have disrupted regular seasonality patterns. Accordingly, the markets still should not be relying heavily on the accuracy of monthly headline data, at present.

Against the revised September numbers, the reported seasonally-adjusted October trade balance reflected declines in both exports and imports, with the pace of fall-off in imports faster than that for exports. The seasonally-adjusted drop in oil imports more than accounted for the full decline in imports, as well as for the full narrowing of the seasonally-adjusted monthly trade deficit.

Crude Oil and Energy-Related Petroleum Products. For the month of October 2011, the not-seasonally-adjusted average price of imported oil eased to \$98.84 per barrel, down from \$101.02 in September, but up from \$74.21 in October 2010. In terms of not-seasonally-adjusted physical oil imports, October 2011 volume averaged 8.490 million barrels per day, down from 9.338 million in September 2011, but up from 8.135 million in October 2010. Again, seasonally-adjusted, oil imports declined by more than enough to determine the direction of both the monthly swing in aggregate imports as well as in the total trade deficit.

Nonmonetary Gold. Several subscribers queried the nature of a reported surge in September's nonmonetary gold exports that appeared to be more than what might be expected based solely on changes in the price of gold. First, the reported data were on a census basis and possibly were far short of reflecting the scope of actual monthly transactions. Second, due to the vagaries of the timing of U.S. Customs' paperwork flows, definitional issues as to what is included in the census-based category, and timing of the actual transactions at the commodity-level detail, a meaningful relationship between the volatility of daily or monthly gold prices and the valuation of reported nonmonetary gold imports and exports would not be likely, and it cannot be determined from the monthly trade data.

The headline trade deficit is reported on a balance of payments (BOP) basis, but detail at the commodity level, such as nonmonetary gold, is available only on a census basis. The headline trade number (balance of payments basis) includes gold transactions between private entities and central banks, with gold held by the central banks, but the detail at the census level reflects only the gold that actually leaves Customs territory.

The Department of Commerce offers these definitions of the trade balance accounting methods it uses:

“Census Basis - Represents the difference between U.S. total exports based on F.A.S. values and U.S. general imports based on Customs import values. This balance corresponds to a measurement of the international payments or credit flows resulting from the physical movement of goods between the U.S. and foreign countries.”

“Balance of Payments (BOP) Basis - The U.S. Bureau of Economic Analysis adjusts goods totals on a Census basis to bring the data in line with the concepts and definitions used to prepare the international and national accounts [*i.e.* the GDP]. These adjustments are necessary to supplement coverage of the Census basis data, to eliminate duplication of transactions recorded elsewhere in the international accounts, and to value transactions according to a standard definition. These adjustments also allow for the goods trade totals to be summed with services trade totals for a more accurate account of U.S. total trade.”

On a BOP basis, the October deficit in goods trade (excluding services) was \$58.8 billion, versus a \$57.6 billion deficit on a census basis. The trade surplus for nonmonetary gold (census basis only) was \$2.2 billion in October versus \$3.1 billion in September. The difference on a BOP basis could be significantly different.

The Census Bureau defined the changes made to the census-basis nonmonetary gold detail to come up with the balance of payments aggregate. The BOP detail for nonmonetary is not available in the monthly reporting:

“Gold exports, nonmonetary - This *addition* [to the census basis to establish the BOP basis] is made for gold that is purchased by foreign official agencies from private dealers in the United States and held at the Federal Reserve Bank of New York. The Census data only include gold that leaves the U.S. customs territory.”

“Gold imports, nonmonetary - This *addition* [to the census basis to establish the BOP] is made for gold sold by foreign official agencies to private purchasers out of stock held at the Federal Reserve Bank of New York. The Census data only include gold that enters the U.S. customs territory.”

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 October merchandise trade deficit came in at \$44.2 billion, narrowed from a revised \$45.9 (previously \$45.4) billion in September.

Based on today’s reporting, the annualized real third-quarter 2011 trade deficit revised to \$550.2 billion (previously \$550.1 billion), which suggests no meaningful impact on the second revision to third-quarter GDP, due for release on December 22nd.

October is the first month of reporting for fourth-quarter 2011. Only October and November data will be available when the BEA makes its initial guess at fourth-quarter GDP on January 27, 2012. Based solely on the October number, an initial estimate would be for an annualized fourth-quarter real trade deficit of \$530.3 billion, roughly \$20 billion less than the current third-quarter number. Given the suggestion of a narrowing in the fourth-quarter versus third-quarter deficit, the October trade data favor a positive net-export account contribution to fourth-quarter GDP.

Week Ahead. Although receiving sporadic bursts of attention, an intensifying double-dip recession (it will be classified as a double-dip, because the first dip already has been called), as well as an escalating inflation problem still are not widely recognized. The political system would like to see the issues disappear until after the 2012 election, and the financial markets will do their best to avoid recognition of the problems that have horrendous implications for the markets and for systemic stability. Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Retail Sales (November 2011). November retail sales are due for release on Tuesday, December 13th. Given underlying weakness in consumer income and debt fundamentals, November sales should be on the weak-side of a likely strong consensus. Any pick-up in November CPI-U inflation would suggest the portion of sales increase that could be attributed simply to higher prices, as opposed to a direct increase in the physical flow of goods and services.

Producer Price Index—PPI (November 2011). The November PPI is due for release on Thursday, December 15th. A positive number is likely here, given flat to higher oil prices and a positive bias in energy-related seasonal factors. Also, the effects of higher oil prices still are spreading within broad economic activity.

Industrial Production (November 2011). November industrial production is due for release on Thursday, December 15th, and likely will be flat-to-minus for the month, net of prior period revisions. That probably will be weaker than consensus estimates.

Consumer Price Index—CPI (November 2011). The November CPI is due for release on Friday, December 16th. Given a 1.8% monthly decline in average November gasoline prices (Department of Energy), and seasonal factors that turned last November's 2.0% gain in gasoline prices into a 0.7% gain, any monthly gain in November 2011's CPI likely will come primarily from the still-spreading impact of higher energy costs in the broad economy. Reporting risk is slightly to the upside of a likely flat-to-minus consensus.

Year-to-year total CPI-U inflation would increase or decrease in November 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.12% gain in the adjusted monthly level reported for November 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for November 2011, the difference in November's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from October 2011's reported annual inflation rate of 3.53%. For example, an unchanged monthly November CPI-U would result in reported annual inflation of about 3.4%.