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

COMMENTARY NUMBER 418
January Retail Sales and Industrial Production

February 15, 2012

Retail Sales "Growth" Remains Statistically Insignificant and Reliant on Price Increases

Slowing Annual Growth Evident in Both Sales and Production

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, February 17th, covering January housing starts, real retail sales, CPI and PPI.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Perhaps confirming somewhat the overly-optimistic nature of the hype surrounding the release of January's poor-quality labor data, reporting of both January retail sales and industrial production disappointed market expectations. The monthly gain in retail sales was not statistically significant and otherwise was accounted for largely by price increases, not by increased physical volume of goods and services. January's headline industrial production was unchanged.

Despite downside revisions to prior retail sales reporting and an upside revision to December production, year-to-year growth in both series has slowed markedly, consistent with patterns that traditionally would lead into official recession. Net of realistic inflation effects, though, both series still have been showing ongoing bottom-bouncing, following the plunge in economic activity seen from 2007 into 2009 (see *Hyperinflation 2012*).

Where January retail sales indicated declining auto sales, but January production showed surging auto assemblies, an involuntary inventory build-up—already indicated as the primary force behind estimated fourth-quarter GDP growth—may be continuing. Traditionally, inventory excesses are adjusted by corrective reductions in production activity.

Nonetheless, recent reporting of month-to-month change in most economic data (including payrolls, retail sales and industrial production) remains of questionable quality, due to extreme distortions in the standard seasonal adjustment process. These distortions are a direct result of the extraordinary depth and length of the current downturn, unprecedented in its scope of disruption to modern, or post-World War II era, economic reporting. Friday's (February 17th) *Commentary*, following the January housing and inflation releases, will review more fully the latest economic and inflation background.

Retail Sales. In the context of downside revisions, particularly to December and November data, January sales rose by 0.4% for the month (0.2% net of prior-period revisions). The reporting confidence interval around January growth included the possibilities of no growth or contraction. Not adjusted for inflation, January's annual growth slowed to 5.8% from 6.2% in December.

The reported level of monthly growth was close enough to expected January CPI inflation so as likely to be negligible after inflation adjustment. Adjusting for gasoline and food sales, "core" retail sales rose by 0.1%, instead of the official 0.4%.

Industrial Production. January production was unchanged from December, with year-to-year change easing to 3.35% in January, versus 3.58% in December. December's monthly production gain, however, was revised to 1.0% from an initial 0.4%, likely reflecting early data gathering difficulties. Despite unseasonably-mild winter weather dampening utility usage and the aggregate production index, production of consumer goods was down by 0.1% for the month.

Hyperinflation Watch. Beyond the monthly retail and production numbers updated in today's *Commentary*, the hyperinflation outlook just was updated fully in *Hyperinflation 2012*. The economic and inflation outlooks remain unchanged, but they will be reviewed in the next regular *Commentary*.

REPORTING DETAIL

RETAIL SALES (January 2012)

Once Again, January Retail Sales Gain Was Not Statistically Meaningful and Likely Was All from Rising Prices. As has been the case in eight of the last nine months, the monthly change in January 2012 retail sales was not statistically meaningful, and it likely was flat-to-minus, adjusted for official CPI inflation, as has been the case in four of the last seven months. The evidence here continues to be for a bottom-bouncing economy.

Where the purported month-to-month January retail sales gain was 0.4%, seasonally adjusted, it was a contraction of 21.4% not seasonally adjusted. A very slight variance in seasonal adjustments here makes the difference between monthly gain or contraction, and the seasonal factors simply are not that accurate. The concurrent seasonal-factor issues and broader distortions seen otherwise in seasonal-adjustment factors and sampling methodologies, as discussed in *Hyperinflation 2012*, continue. The stability of the seasonal-adjustment process and sampling methods have been disrupted severely by the unprecedented depth and length of the current economic downturn in the post-World War II era (the period of modern economic reporting).

Under such circumstances, where the markets effectively are flying blind as to actual economic activity, consideration of broad underlying fundamentals is essential. Consumer income and credit remain structurally impaired and continue to signal economic deterioration, not recovery, with the broad economy remaining in serious trouble.

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Yesterday's (February 14th) report on January 2012 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.38% (up by 0.20% before prior-period revisions) +/- 0.6% (95% confidence interval). January's increase followed a revised flat December reading—a gain of 0.02% at the second decimal point—previously reported as a 0.09% gain. The numbers are heavily modeled and include generally overly optimistic underlying assumptions at this stage of reporting. New and used automobile sales were guesstimated to have fallen by 1.3% for the month. Despite already existing industry reporting, the Census Bureau is unable to estimate new car sales in its "advance" report.

Continuing to show a slowing trend in year-to-year change, January 2012 retail sales were reported up by 5.84%, versus the revised year-to-year December 2011 gain of 6.22% (previously reported at 6.45%).

The annual benchmark revisions to retail sales will be published on April 30th. As most commonly happens, the revamped data likely will show downside revisions to retail sales of recent years, as overly-optimistic underlying assumptions get replaced by actual data.

Real (Inflation-Adjusted) Retail Sales. Details on real retail sales for January 2012 will be published in the Friday, February 17th, *Commentary*, along with details from the January 2012 CPI-U release. Where January CPI-U inflation likely will be positive (see *Week Ahead*), official January CPI-U inflation has the potential again to offset fully the nominal (not adjusted for inflation) sales gain.

***Core Retail Sales*.** In January 2012 retail sales reporting, both gasoline stations and groceries stores showed increases in monthly 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: January 2012 versus December 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was up by 0.10%, versus an official gain of 0.38%.

Version II: January 2012 versus December 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations—was up by 0.08%, versus an official gain of 0.38%.

INDEX OF INDUSTRIAL PRODUCTION (January 2012)

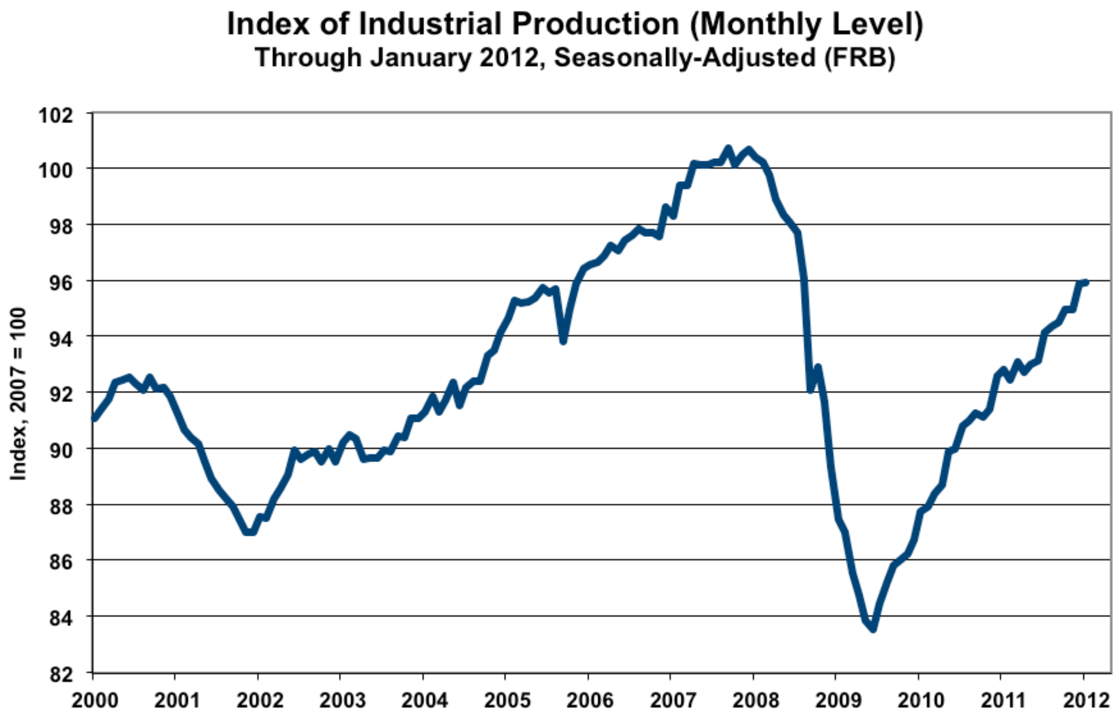
Industrial Production "Unchanged" in January. In the context of the usual six months worth of revisions, today's (February 15th) Federal Reserve Board release of seasonally-adjusted January 2012 industrial production was unchanged month-to-month versus December. At the second decimal point, though, January production was 0.03% higher (up 0.64% net of prior-period revisions) versus December's level. In turn, December showed a revised gain 0.98% (previously 0.44%) versus November. As with December, the January number was depressed by relatively low utility usage that resulted from unseasonably warm weather. The upside revision to December production was unusual in its broad scope, and that is suggestive of the Fed having some data gathering problems.

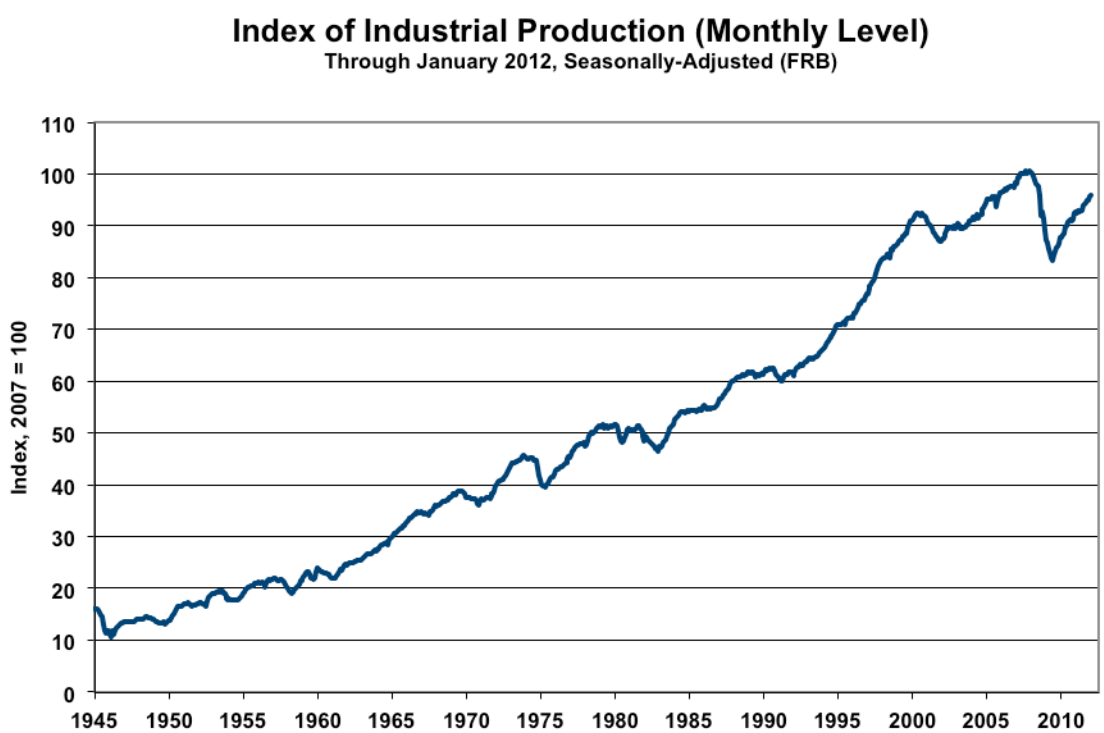
Despite the utility distortions, reported production of consumer goods fell by 0.1% in January, despite a 5.8% jump in automobile production. In the unlikely event that there is any reporting consistency with the declining auto sales reported in the retail sales data, the implication here would be for an unwanted build-up of inventories, which usually is addressed by a corrective reduction in production.

Year-to-year growth in January 2012 production slowed to 3.35% from a revised 3.58% (previously 2.95%) in December, and was the weakest reading since the series' recent relative peak annual growth of 7.75% in June 2010. The year-to-year contraction of 14.83% seen in June 2009, at the end of second-quarter 2009, was the steepest annual decline in production growth since the shutdown of war-time production following World War II.

Annual benchmark revisions to industrial production will be published on March 30th. As most commonly happens, the revamped data likely will show downside revisions to production in recent years, as overly-optimistic underlying assumptions get replaced by actual data.

Also keep in mind that a portion of industrial production (largely high tech, such as computers) is estimated by deflating nominal (not-adjusted-for-inflation) numbers with inflation measures of a nature similar to those used in the GDP estimates. Where those inflation estimates are understated, the resulting inflation-adjusted production growth is overstated, as is discussed in and graphed in *Hyperinflation 2012*.


Index of Industrial Production (Monthly Level)
Through January 2012, 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
2012


Index of Industrial Production (Monthly Level)
Through January 2012, 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

The "recovery" in industrial production is reflected in the preceding graphs. Both graphs show the monthly level of the production index. The first of these shows close historical detail for the period beginning in 2000, the second shows the same data in historical context since World War II.

Week Ahead. Adjusting to the stronger-than-expected reporting of January's labor data, consensus expectations for recent and upcoming economic releases appear to have been boosted, setting up potential downside surprises for near-term economic reporting, given much-weaker underlying economic reality.

Accordingly, recognition of an intensifying double-dip recession as well as an escalating inflation problem remains sporadic. The political system would like to see the issues disappear until after the election; the media does its best to avoid publicizing unhappy economic news; and the financial markets will do their best to avoid recognition of the problems for as long as possible, 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.

Residential Construction (January 2012). Housing starts are due for release on Thursday, February 16th. Expectations appear to have been boosted by the labor data, and perhaps by expectations of a seasonal-adjustment boost resulting from unseasonably-mild winter weather in many areas of the country. To the extent there is a gain, it should not be statistically significant, with the bottom-bouncing pattern of recent years continuing.

Producer Price Index—PPI (January 2012). The January PPI is due for release on Thursday, February 16th. With higher oil prices and likely minimal distortion from oil-price seasonal adjustments, and with spreading inflation outside the energy area, monthly inflation in this regularly-volatile series should be on the strong-side of market expectations.

Consumer Price Index—CPI (January 2012). Due for release on Friday, February 17th, the January CPI-U also could see an upside surprise to consensus estimates (0.3% per MarketWatch.com). Gasoline prices rose month-to-month by 3.4% in January 2012, versus December, per the Department of Energy, and seasonal-adjustment distortions to gasoline prices should be minimal for January. Inflationary pressures also likely continued to spread outside the energy area.

Year-to-year total CPI-U inflation would increase or decrease in January 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.40% gain in the adjusted monthly level reported for January 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2012, the difference in January's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from December 2011's reported annual inflation rate of 2.96%. For example, a 0.4% gain in the January 2012 CPI would leave annual inflation near 3.0%.

