

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

COMMENTARY NUMBER 424
February CPI, PPI, Real Retail Sales, Industrial Production

March 16, 2012

February CPI Was Shy of Reflecting Full Impact of Gasoline Prices

February's Consumer Inflation: 2.9% (CPI-U), 3.1% (CPI-W), 10.5% (SGS)

Real Retail Sales Monthly Gain Was Not Statistically Meaningful

Volatile Monthly Production Numbers Sputtered And Stalled Once Again

PLEASE NOTE: The next regular Commentary is scheduled for Friday, March 23rd, covering February housing starts and new and existing home sales.

Best wishes to all — John Williams

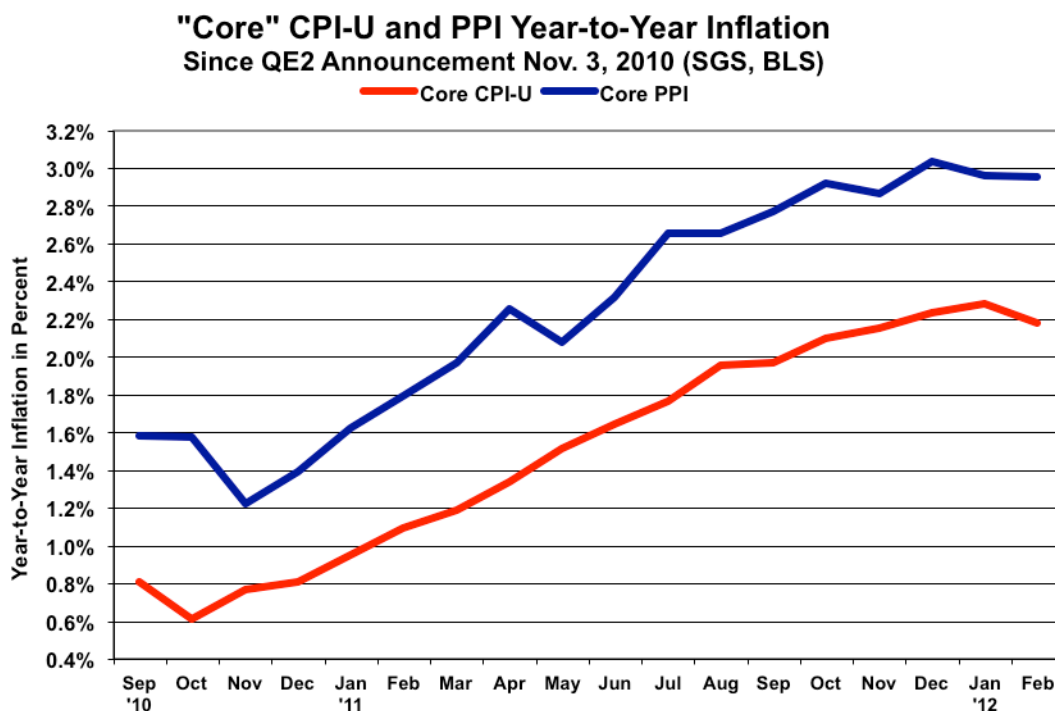
Opening Comments and Executive Summary. Inflationary pressures continue, while official economic reporting shows intermittent indications of stalling. Current inflation levels have been reached due largely to the Federal Reserve's dollar-debasement policies of recent years, along with supplemental upside pressures, at present, from heightened political tensions in the Middle East. February industrial production was unchanged on a monthly basis, while the monthly gain in February retail sales was not statistically meaningful, adjusted for inflation.

Inflation. With oil and gasoline prices pressured by market concerns over Middle Eastern political stability, monthly consumer inflation jumped in February and stabilized in the three-plus percentage range on a year-to-year basis. Nonetheless, the Bureau of Labor Statistics (BLS) was somewhat shy in tabulating the February jump in unadjusted gasoline prices (4.9% versus 5.8% as reported by the Department of Energy), which, combined with unusually soft seasonal adjustments to gas prices, left the headline CPI-U monthly inflation at 0.4%, instead of what would have been at least 0.5% otherwise.

The current level of inflation, however, stands where it is due primarily to the effects of the Federal Reserve's efforts to debase the dollar, which, in turn, spiked global oil prices into the \$100 per barrel range. The effects of the dollar-debasement and oil-price-spiking policies not only had direct inflationary impact on energy-related prices, but also—in the period following QE2—had an accelerating upside impact on inflation throughout the broad economy, as indicated by rising “core” inflation (net of food and energy inflation).

While the Fed and Wall Street like to tout “core” inflation, since rising food and energy prices can be ignored, protracted higher oil prices—in particular—eventually work their way into the broad economy and create inflation issues that are tough to ignore and for the Fed to contain.

The following graph reflects year-to-year “core” inflation as reported for both the CPI-U and PPI, since the onset of QE2. The annual CPI-U “core” inflation rate for February softened slightly, after 15 straight months of higher annual inflation.



The inflation ahead very much will be tied to the exchange rate value of the dollar, which should be hit heavily by eventual dollar dumping in the global markets. That event could be triggered by the Fed's next effort at easing, which likely will be aimed at propping the banking system, under the guise of trying to boost economic activity. The U.S. Treasury/Administration and the Fed will use whatever lending, spending, guarantees and money creation that are needed, in order to prevent a systyemic collapse, much as was seen in 2008.

PPI. The February 2012 PPI gained 0.36% month-to-month (0.10% in January) and 3.27% year-to-year (4.07% in January).

CPI. The February 2012 CPI-U gained 0.41% month-to-month (0.21% in January) and 2.87% year-to-year (2.93% in January). The annual inflation rate indicated by the SGS-Alternate Consumer Inflation Measure (1980-based) held at about 10.5% in February, the same as in January.

Industrial Production and Real Retail Sales. February's industrial production measure was unchanged per headline reporting (up by 0.02%), but January's similar headline number of "unchanged" (up by 0.03%) revised to a 0.37% gain. Previous months' weather distortions had depressed reporting, but those issues appears to have been worked through, with the February number likely now overstated a little.

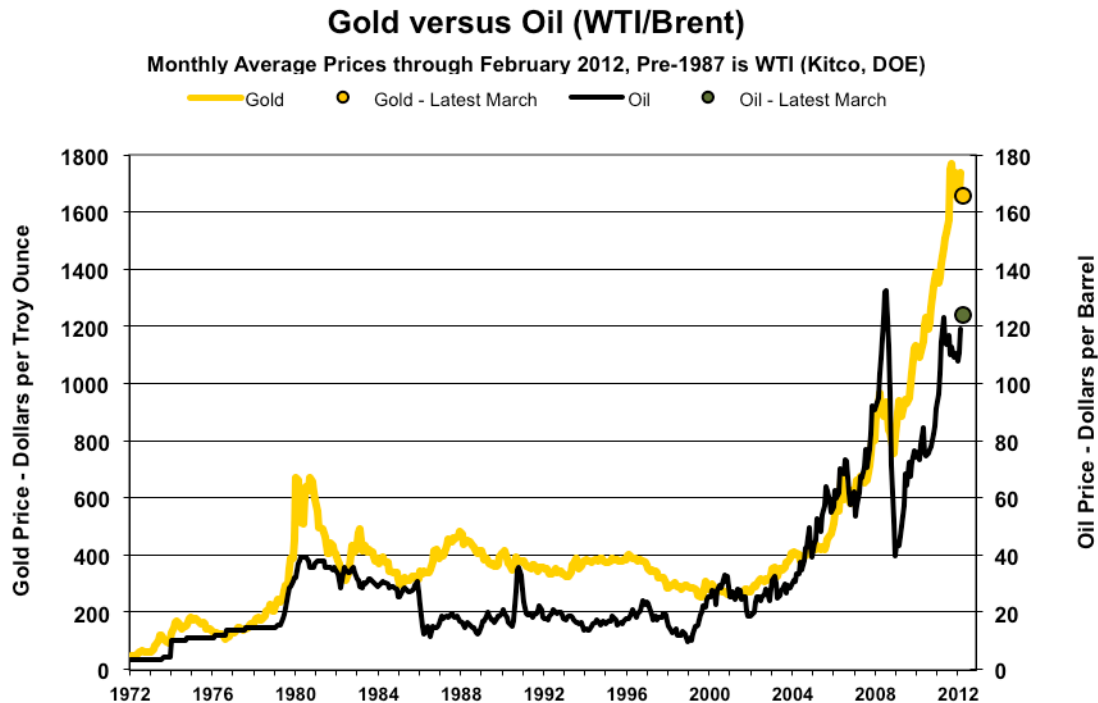
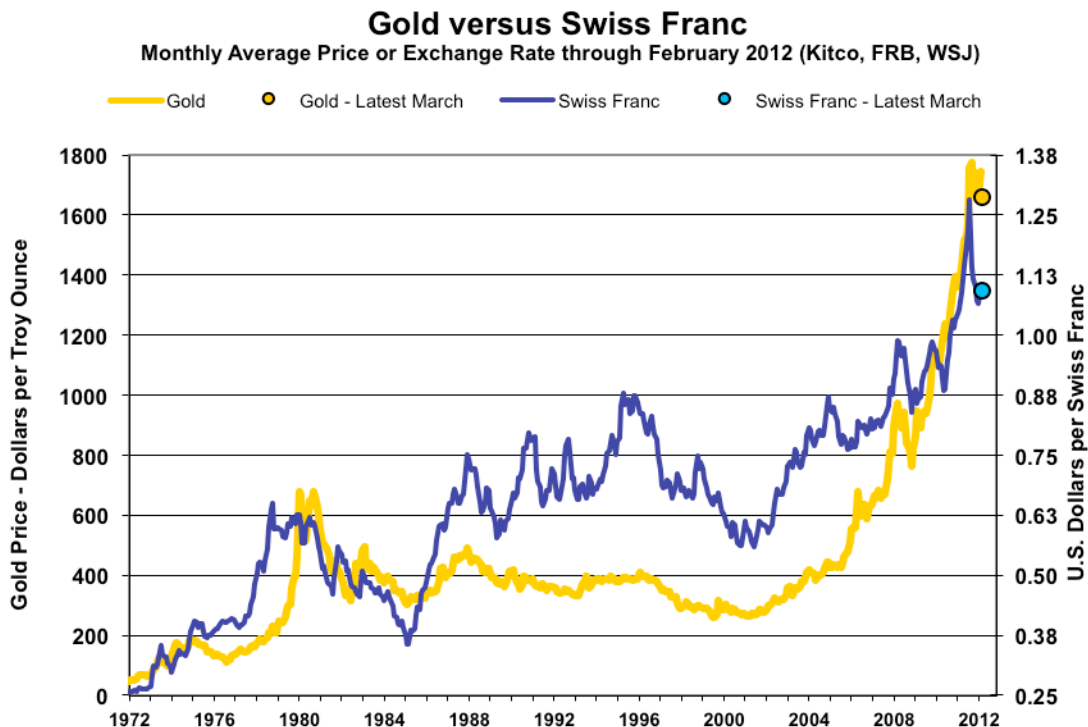
Net of CPI-U inflation, the 0.65% month-to-month gain in February retail sales and the 0.42% gain in January were not statistically meaningful. In nominal terms, the monthly gains respectively were reported at 1.06% and 0.62%.

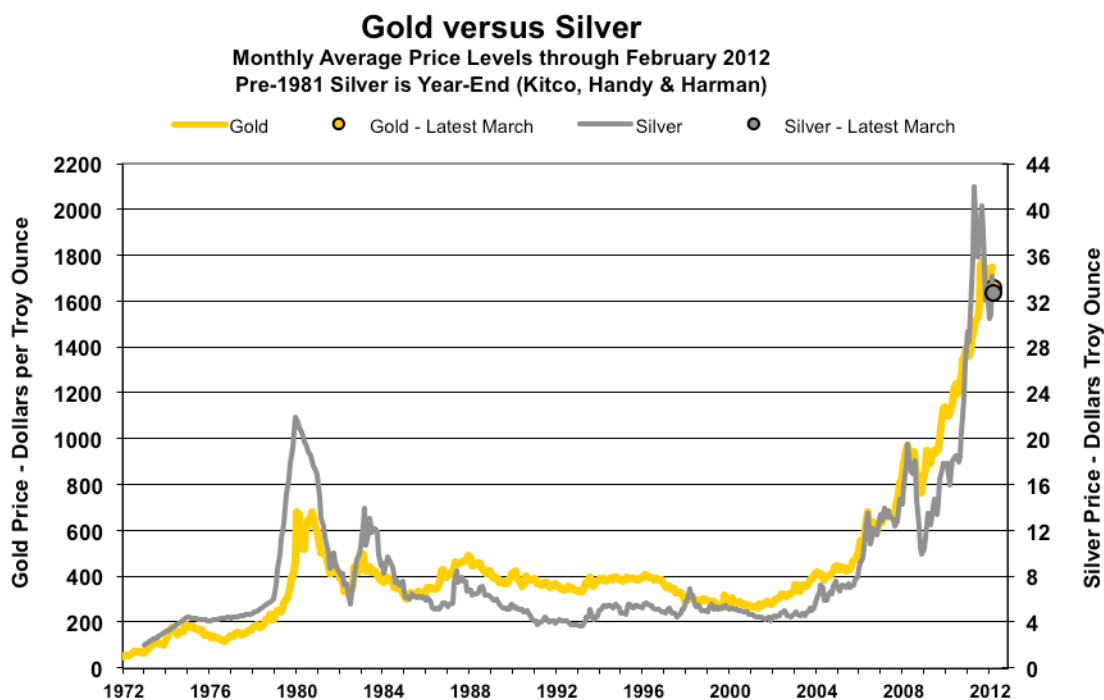
Both the production and retail sales series face near-term benchmark revisions that likely will show the economy of the last several years to have been weaker than previously reported.

Updated U.S. Treasury Receipts of Payroll Tax Withholdings. The latest assessment of U.S. Treasury receipts of payroll tax deposits is available at [Payroll Tax Receipts](#). Year-to-year change in tax receipts still is running below what would be expected, allowing for possible shifts in the timing of annual bonus payments and based on the growth in earnings and employment as reported by the Bureau of Labor Statistics. Unless bonuses are less than expected, or the BLS earnings and employment estimates are overstated, year-to-year change in Treasury receipts of payroll withholdings should be picking up in the weeks ahead.

Hyperinflation Watch. Irrespective of any intervening economic, inflation and financial-market developments, the broad economic, inflation and hyperinflation outlooks discussed in [Hyperinflation 2012](#) of January 25th are not changed.

The regular gold graphs, which are published each month along with the CPI analysis, follow. Market conditions remain unstable and highly volatile, and the precious metals and stronger major currencies remain the primary hedges against the coming U.S. dollar calamity. Recent upside pressure on oil prices primarily reflects supply concerns tied to political instabilities in the Middle East, but those pressures have built upon the upside shift in oil prices that was triggered by the Fed's policies (*i.e.* QE2) aimed at debasing the U.S. dollar.





REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (February 2012)

Gasoline Price Inflation Was Understated in the February CPI. Per better-quality reporting out of the Department of Energy (DOE), unadjusted gasoline prices rose by more than was reported by the Bureau of Labor Statistics (BLS) in the February CPI. Separately, for the third straight month, irregular seasonal-adjustment patterns also muted adjusted gasoline-price inflation as well as aggregate adjusted CPI-U reporting. The nature of CPI seasonal adjustments, however, is that they get revised only once per year, instead of every month as is done in the concurrent seasonal adjustments of payroll employment and retail sales. Accordingly, whatever is short-changed by the CPI seasonals in one month should be restored fully in a later month.

Notes on Different Measures of the Consumer Price Index

The Consumer Price Index (CPI) is the broadest inflation measure published by the 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.*

CPI-U. The BLS reported today (March 16th) that the headline, seasonally-adjusted CPI-U for February 2012 jumped by 0.41% (up by 0.44% unadjusted) for the month. That followed a gain of 0.21% (0.44% unadjusted) in January.

The BLS reported a not-seasonally-adjusted 4.9% monthly gain in gasoline prices, versus a 5.8% monthly gain indicated by the more comprehensive surveying of the DOE. That difference, combined with what would have been seen with consistent seasonal-adjustments to gasoline prices, would have added a tenth of a percentage point to the headline 0.4% monthly gain in the CPI-U, showing instead a gain of 0.5%.

As with reporting in December and January, the February 2012 CPI reflected seasonal adjustment factors that were sharply at variance with the adjustments used the year before and, at best, the differences suggest systemic instability that throws into question the significance of the adjusted month-to-month headline numbers. In February 2012 reporting, an unadjusted 4.9% monthly gain in gasoline (again, that was gain 5.8% per the DOE) became 6.0% after seasonal adjustment. In February 2011 an unadjusted gain of 2.2% was adjusted to a 4.7% monthly increase.

After 15 straight months of rising “core” CPI-U inflation (net of food and energy inflation), the February annual CPI-U “core” inflation notched lower on an annual basis to 2.18% from 2.28%. Such, however, remained well elevated from where it was (0.61% in November 2010), when Mr. Bernanke introduced QE2 in a successful effort to debase the dollar, with the effect of spiking oil prices. The “core” annual

inflation numbers for both the CPI-U and PPI reflect the ongoing impact of higher energy prices in the broad economy (see the graph and comments in the *Opening Comments and Executive Summary*).

February 2012's unadjusted year-to-year CPI-U inflation eased slightly to 2.87%, from 2.93% in January.

Year-to-year total CPI-U inflation would increase or decrease in next month's March 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.53% gain in the adjusted monthly level reported for March 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for March 2012, the difference in March's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from February 2012's reported annual inflation rate of 2.87%.

CPI-W. The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose by 0.49% (up by 0.49% unadjusted) in February 2012, versus a gain of 0.21% (0.47% unadjusted) in January.

Unadjusted, February 2012's year-to-year CPI-W inflation was 3.12%, little changed from the 3.15% reported for January.

C-CPI-U. Year-to-year inflation in the February 2012 C-CPI-U eased to 2.58% from a revised 2.69% (previously 2.60%) in January, and from a revised 2.73% (previously 2.77%) in December 2011.

The chain-weighted CPI-U is the fully substitution-based series that gets touted as a CPI replacement by inflation apologists and by those who oppose use of the existing CPI-U and CPI-W, including a number of politicians looking to cut deficit spending by using the C-CPI-U to reduce Social Security annual cost of living (COLA) adjustments artificially. The series is reported only on an unadjusted basis and is revised annually for the prior two years, unlike the unadjusted CPI-U, which never is revised except for outright calculation errors.

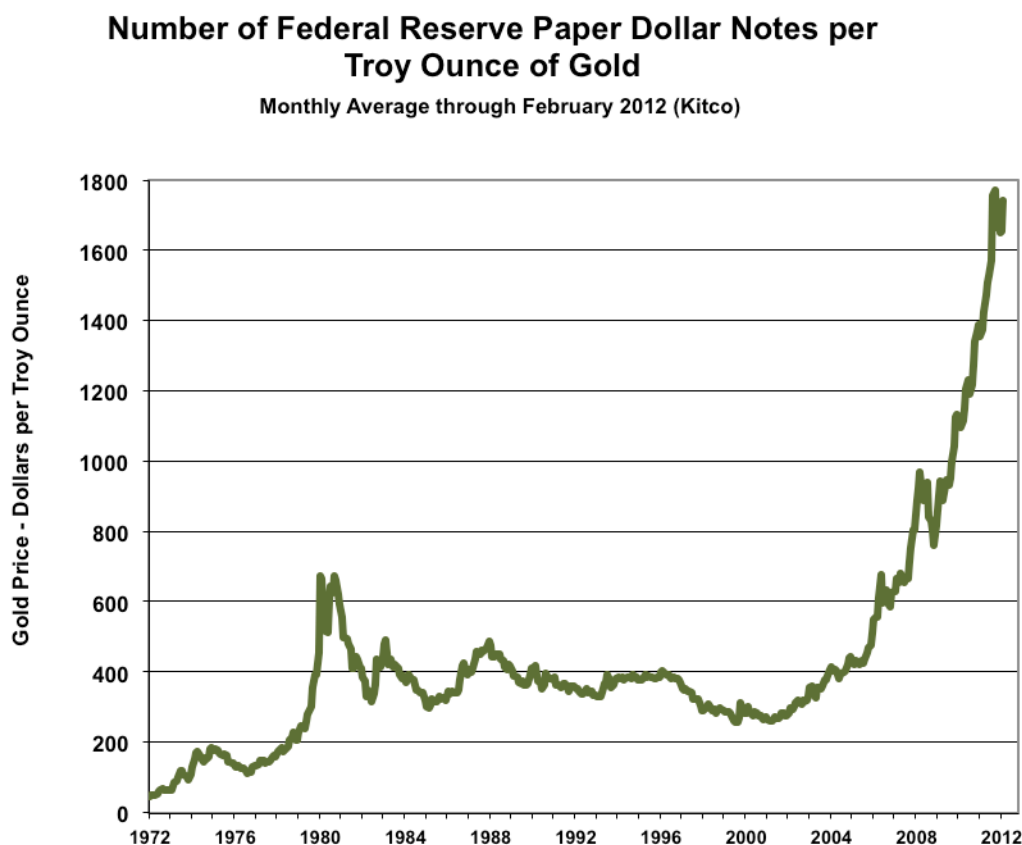
Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 6.2% in February 2012, versus 6.3% in January 2012. The SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, remained at about 10.5% (10.45% for those using the extra digit) in February 2012, against January's 10.5%.

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 neither reflects the constant-standard-of-living concept nor measures adequately most of what consumers view as out-of-pocket expenditures. 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 the September 5, 2011 historic-high gold price of \$1,895.00 per troy ounce (London afternoon fix), and despite the multi-decade-high silver

price of \$48.70 per troy ounce (London fix of April 28, 2011), gold and silver prices have yet to re-hit their 1980 historic levels, adjusted for inflation. The earlier all-time high of \$850.00 (London afternoon fix, per Kitco.com) of January 21, 1980 would be \$2,487 per troy ounce, based on February 2012 CPI-U-adjusted dollars, \$9,074 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), although approached in 2011, still has not been hit since 1980, including in terms of inflation-adjusted dollars. Based on February 2012 CPI-U inflation, the 1980 silver price peak would be \$145 per troy ounce and would be \$528 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

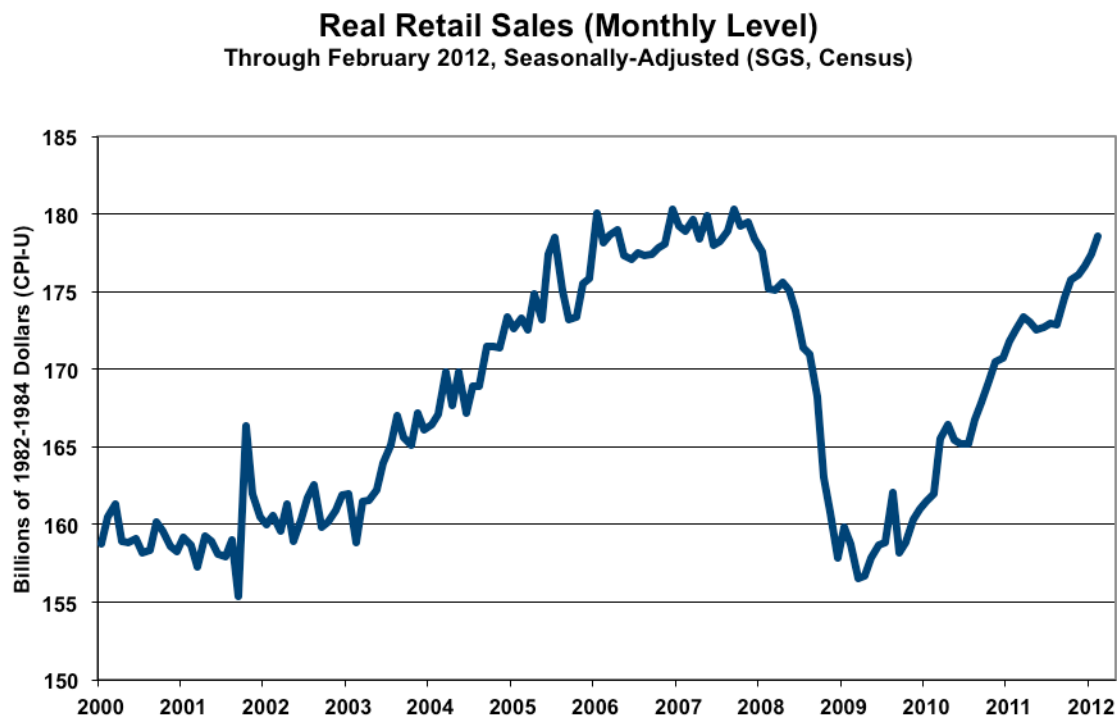


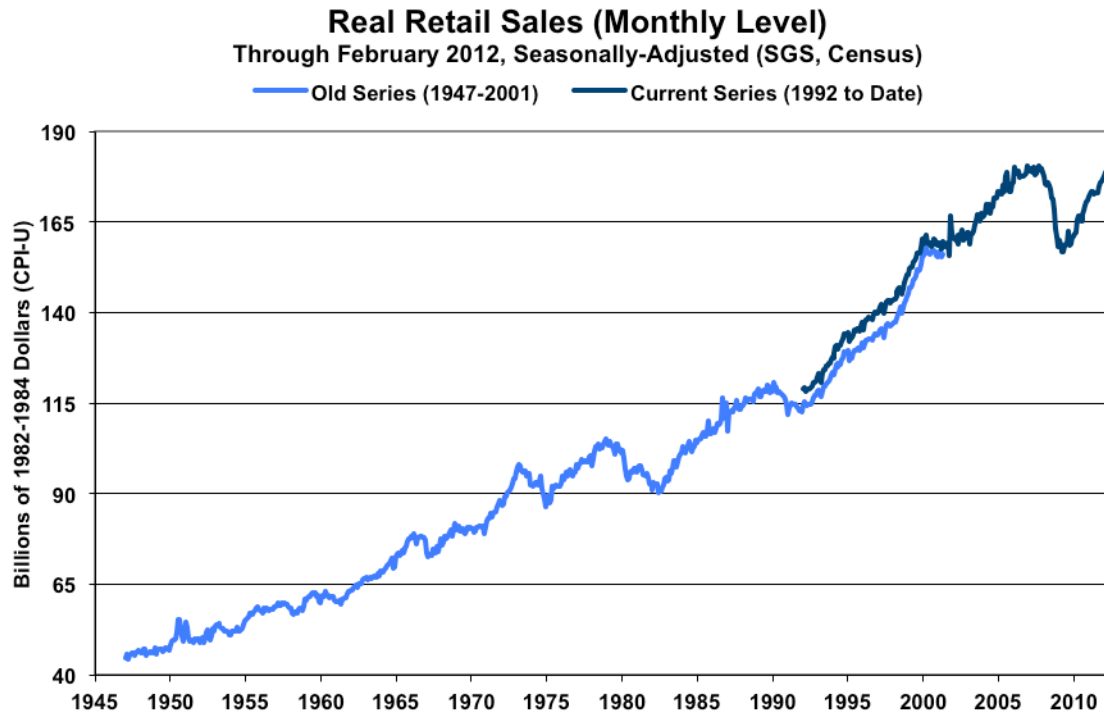
As shown in Table 1 on page 50 of [Hyperinflation 2012](#), over the decades, the increases in gold and silver prices have compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, while they effectively have compensated fully for the loss of purchasing power of the dollar based on the SGS-Alternate Consumer Price Measure (1980 Methodologies Base).

Real (Inflation-Adjusted) Retail Sales. Based on the February 2012 CPI-U reporting, inflation- and seasonally-adjusted February 2012 retail sales rose by 0.65% for the month, where, before inflation-adjustment, the current number was up by 1.06% (see [Commentary No. 423](#) for details of the nominal reporting). January real retail sales revised to a 0.42% (initially a 0.17%) gain, where the nominal (not-adjusted-for-inflation) number revised to a 0.62% (previously a 0.38%) increase. Net of the increases in retail prices, the implied recent monthly gains in the physical volume of goods and services sold have not been statistically meaningful.

February's real retail sales rose at a year-to-year pace of 3.49%, versus a revised 3.24% (previously 2.83%) gain in January.

The ongoing “recovery” in real retail sales is reflected in the following graphs, which show the latest monthly levels of CPI- and seasonally-adjusted activity. The first graph shows close historical detail for the period beginning in 2000; the second shows the same data in historical context since World War II. These data will be subject to an annual benchmark revision (due April 30th), which likely will show a revised weaker history for the series than currently is reported.



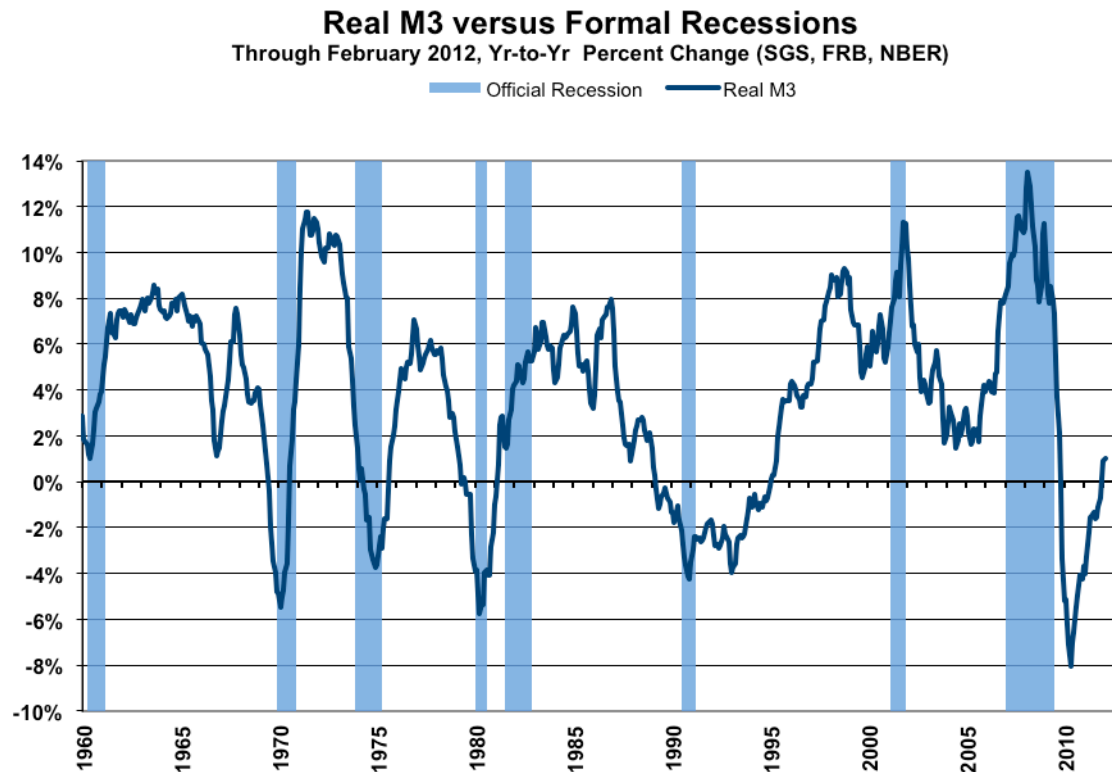


Using the SGS Alternate-CPI Inflation estimates for deflation of the retail series would not reflect an ongoing rise in activity for the last year or so, but rather an ongoing pattern of bottom-bouncing, as shown and discussed in [Hyperinflation 2012](#) (see Graph 27, page 44). It has been my preference here and wherever otherwise possible, to use the official estimates (the series here is as calculated by the St. Louis Fed), since that eliminates a level of argument over what is being reported. As official consumer inflation picks up further, and as overall retail sales suffer from the ongoing consumer liquidity squeeze, these data should turn down meaningfully in what eventually will become a formal double-dip recession.

There has been no change in the underlying fundamentals. There is nothing that would support a sustainable turnaround in retail sales, personal consumption or in general economic activity. There is no recovery, just general bottom-bouncing. Accordingly, real retail sales levels in the months ahead should become increasingly negative (see the household and disposable income comments and the liquidity issues also discussed in [Hyperinflation 2012](#) and updates to same in [Commentary No. 422](#)).

Real Money Supply M3. The signal for a double-dip or ongoing recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), discussed in the [Hyperinflation 2012](#), remains in place and continues, despite real annual M3 growth having turned to the upside. Based on the February 2012 CPI-U report and the latest February SGS-Ongoing M3 Estimate, the annual growth in real M3 for February 2012 was 1.0%, versus a revised 0.9% (previously 1.0%) gain estimated for January. As with the nominal series, the pick-up in annual growth appeared to stall 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. Breaking into positive territory does not generate a meaningful signal one way or the other for the broad economy. 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. Weaknesses in a number of series continued in 2011, and in February 2012 reporting, with a renewed downturn likely to be obvious to most observers in the year ahead, eventually leading to recognition of a double-dip recession.



PRODUCER PRICE INDEX—PPI (February 2012)

February's PPI Showed Persistent Inflation Beyond Headline Oil and Gasoline Issues. As reported yesterday, March 15th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for February 2012 rose by 0.36% (up by 0.42% unadjusted) following an adjusted 0.10% (0.31% unadjusted) monthly increase in January.

Unadjusted and year-to-year, February 2012's total finished goods PPI inflation eased to 3.27% from 4.07% in January. The relatively high level of annual PPI inflation generally still reflects ongoing impact of the Fed's dollar-debasement policies, not surging economic demand. Annual changes, however, now

are softening some as they go against the year-ago period when Mr. Bernanke was running QE2 and meeting with early success in debasing the U.S. Dollar and generating an increase in oil prices.

The seasonally-adjusted monthly “core” PPI—net of food and energy—increased by 0.17% (by 0.17% unadjusted) in February, versus a 0.44% (0.50% unadjusted) gain in January, reflecting the still-spreading impact of higher oil costs throughout the broad economy. Year-to-year “core” finished goods inflation held at 3.0% (unadjusted) for the third straight month (February 2012 at 2.95%, January at 2.96%, and December 2011 at 3.00%). A comparison with “core” CPI-U is graphed in the *Opening Comments and Executive Summary*.

Intermediate and Crude Goods. On a monthly basis, seasonally-adjusted February intermediate goods prices rose by 0.7%, following a 0.4% decline in January, with February crude goods prices up by 0.4%, following a 1.5% gain in January. Year-to-year inflation in unadjusted February intermediate goods was 3.3%, versus 4.2% in January, with February’s annual inflation in crude goods at 0.7%, versus 4.5% in January.

INDEX OF INDUSTRIAL PRODUCTION (February 2012)

Monthly Industrial Production Stalled Again. Today’s (March 16th) Federal Reserve Board release of seasonally-adjusted February 2012 industrial production was unchanged month-to-month versus January, but as with a similar initial reporting for January 2012, that was in the context of prior-period revisions. At the second decimal point, February production was 0.02% higher (up by 0.28% net of prior-period revisions. In turn, January showed a revised gain of 0.37% (previously 0.03%) versus December.

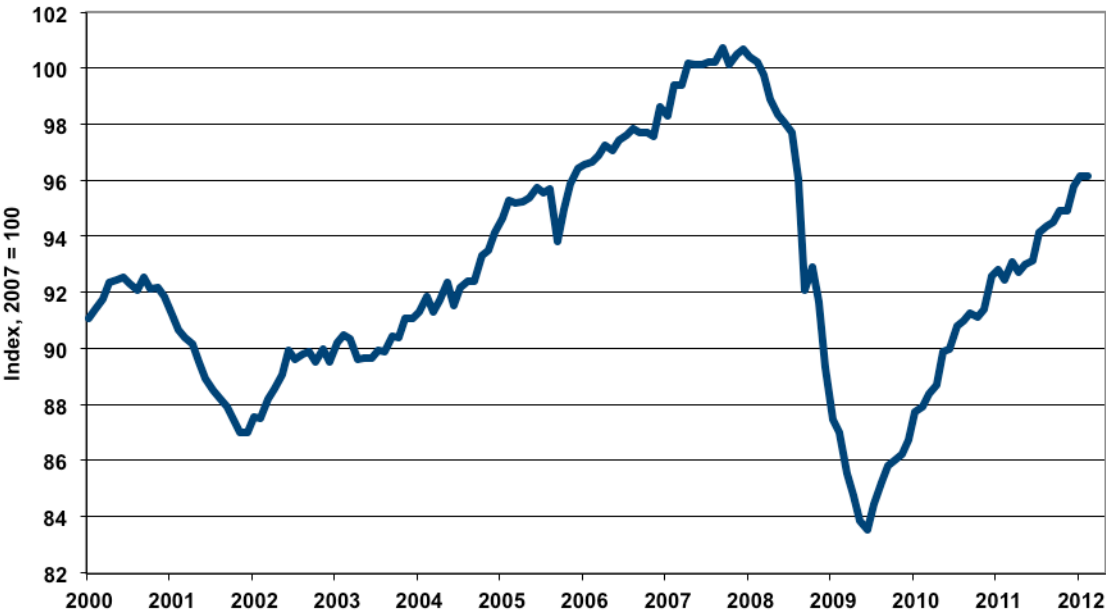
Unlike December and January production levels, which had been depressed somewhat by the effects of unseasonably warm weather on utility output, February returned to more-regular conditions, with a relative boost from more-normal utility patterns. Separately, February automobile production appears to have declined some in an effort to reduce the levels of excessive inventories.

Year-to-year growth in February 2012 production strengthened to 4.03%, from a revised 3.62% (previously 3.35%) in January, well off 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.

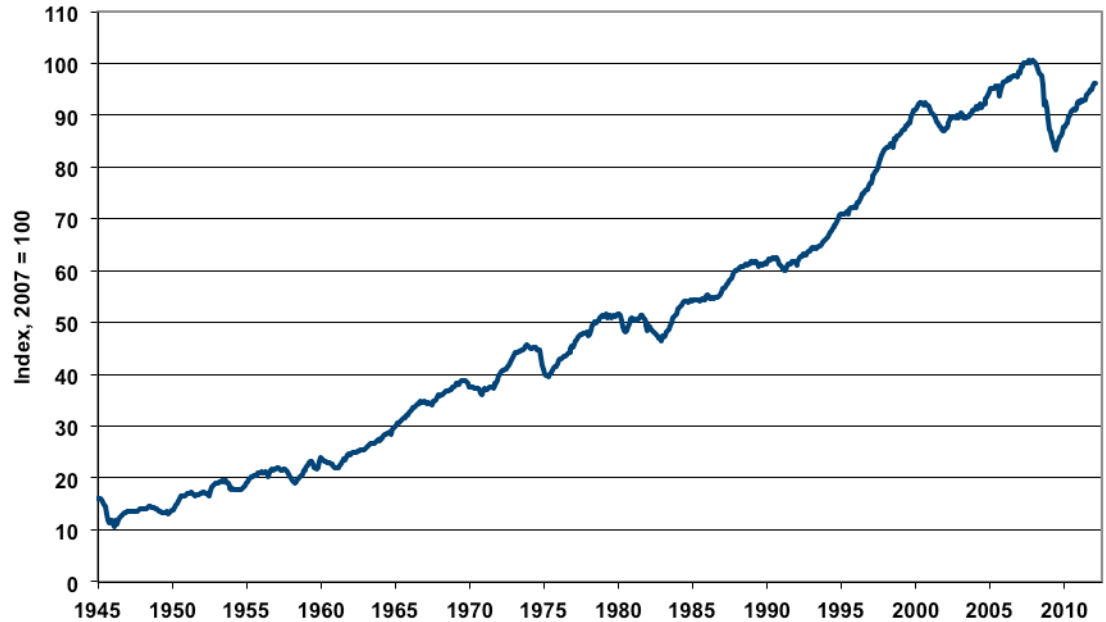
Annual benchmark revisions to industrial production will be published on March 30th. As most commonly happens, the revamped data likely will show downside revisions to production in recent years, as overly-optimistic underlying assumptions get replaced by actual data.

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 February 2012, Seasonally-Adjusted (FRB)



Index of Industrial Production (Monthly Level)
Through February 2012, Seasonally-Adjusted (FRB)



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. 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 (February 2012). The February housing starts data are scheduled for release on Tuesday, March 20th. Any weather effects likely have passed, but the extreme month-to-month volatility in apartment starts is likely to assure ongoing high volatility in the aggregate monthly number. To the extent there is a monthly gain, it should not be statistically significant, with the bottom-bouncing pattern of recent years likely to continue.

Home Sales (February 2012). The February 2012 existing home sales release is scheduled for Wednesday, March 21st, from the National Association of Realtors. New home sales data are due for release from the Census Bureau on Friday, March 23rd. For both series, entrenched patterns of bottom-bouncing likely will continue, with the new monthly results not likely to be statistically meaningful.
