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

COMMENTARY NUMBER 436
March Trade Balance, Consumer Credit, April PPI

May 11, 2012

Trade Deficit Deterioration Suggests Downside Pressure on GDP Revision

PPI Contraction Due to Seasonal-Factor Suppression of Higher Energy Prices

Net of Federal Student Loans, Consumer Credit Is Near Cycle Low

Gold Remains Key Hedge Against Oncoming Troubles

PLEASE NOTE: The next regular Commentary *is scheduled for Tuesday, May 15th. It will cover the April CPI, retail sales and real earnings; the* Public Comment on Inflation Measurement *will be published as an adjunct to that* Commentary. *A* Commentary *on Wednesday, May 16th, will cover April industrial production and housing starts, while a* Commentary *on Friday, May 18th, will examine the annual benchmark revision to new orders for durable goods.*

Best wishes to all — John Williams

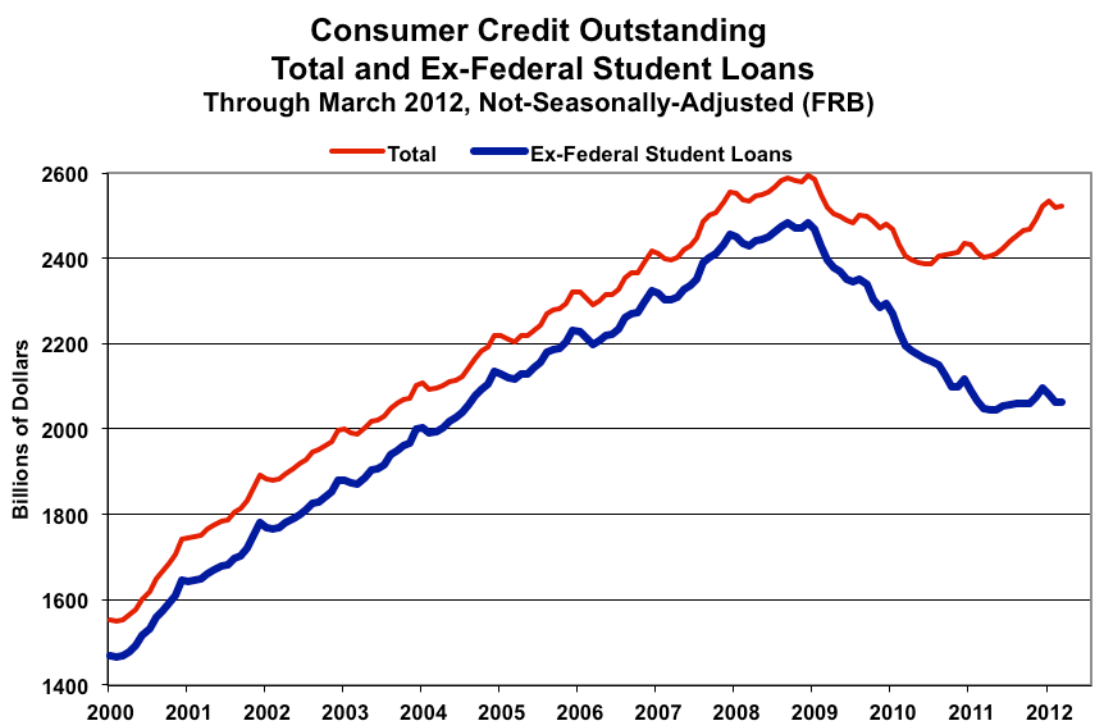
Opening Comments and Executive Summary. This week's reporting showed a deteriorating trade deficit, a decline in wholesale inflation and—contrary to the popular financial media hype—an unhappy circumstance in consumer credit. The week also saw some political changes in Europe, along with growing concerns over renewed recession and continuing sovereign-solvency issues in the same region.

These concerns also apply or will apply to the United States, where the country faces an unusual election year. At present, there is negligible chance of a post-election U.S. government that would address national solvency issues any more seriously than has been pursued by those currently controlling the White House and Congress. The U.S. already is in "another" recession, too, or more appropriately, the nation never recovered from the initial 2006 to 2009 collapse (see *Special Commentary No. 426*).

If indeed the message from the European elections were, as purported, a general rejection of austerity programs, then there is a practical message for U.S. politicians facing reelection not to bring the fiscal condition of the United States into balance.

Economic Data. With next week's heavy economic calendar, including the CPI, retail sales, industrial production and housing starts, the related *Commentaries* will offer a broader review of the economic and inflation circumstances than does today's relatively brief missive.

Consumer Credit Outstanding. The Federal Reserve released March consumer credit outstanding data on May 7th. The numbers shown in the following graph are not-seasonally-adjusted, simply because the Fed does not publish seasonally-adjusted data on federal student loans. The only "recovery" in total consumer credit outstanding (the top red line) since the economic collapse has been in an extraordinary surge of student loans from the federal government. Net of the student loans, more-traditional consumer credit outstanding (the bottom blue line) has been stagnating near its cycle low.



With household income not keeping up with inflation, and with consumer credit growth not available to make up the shortfall in consumer living standards, there is no chance of sustainable growth in broad economic activity (see *Special Commentary No. 429*). Increasingly, that circumstance should become evident in most government economic reporting, including the May 15th release of April retail sales.

PPI. The 0.2% monthly decline in the April PPI was due entirely to seasonal factors that turned an actual gain in energy prices to the downside. Not seasonally adjusted, April PPI gained 0.3% for the month. Overstated energy inflation will come to the series in second-half 2012, as the energy seasonal factors compensate by reversing direction. Going against the early stages of the QE2-related inflation spike, a year ago, annual PPI inflation slowed to 1.9% in April 2012, from 2.8% in March.

Trade Deficit. The March trade deficit widened sharply to $51.8 billion from a revised $45.4 (previously $46.0 billion), thanks to the gains in imports outstripping the gains in exports. After inflation adjustment, the monthly deterioration remained largely intact and was enough worse than consensus to offer some negative revision pressure on the pending first revision to first-quarter GDP (May 31st).

Hyperinflation Watch—Gold Remains The Hedge. There is no change in outlook. Despite any near-term sharp swings in the prices of precious metals—high volatility has become a normal part of the gold market—gold remains the primary hedge against the looming U.S. dollar and inflation crises. In the not-too-distant future, global markets should begin to refocus on U.S. financial, economic and political instabilities, with resulting heavy selling pressure against the U.S. currency. Potential triggers of this market shift include, but are not limited to, new Fed accommodation and/or banking system problems, a particularly nasty presidential election campaign, and/or a shock economic statistic that hits the financial markets the wrong way.

Otherwise, in the context of the updated economic background published in *Special Commentary No. 426* and *Special Commentary No. 429* on consumer liquidity, and with full consideration of other economic, inflation and financial-market developments since the January 25, 2012 publication of the hyperinflation report, the broad economic, inflation and hyperinflation prospects discussed in *Hyperinflation 2012* have not changed.

REPORTING DETAIL

PRODUCER PRICE INDEX—PPI (April 2012)

Seasonal Factors Again Depressed Monthly PPI. As reported this morning, May 11th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for April 2012 declined by 0.21% (up by 0.31% unadjusted), versus an unchanged reading (up by 0.88% unadjusted) in March. The decline in reported monthly inflation was due fully to seasonal adjustments that turned a month-to-month unadjusted inflation gain of 0.9% in finished energy goods into a 1.4% contraction.

Unadjusted and year-to-year, April's total finished goods PPI inflation eased to 1.89%, from 2.80% in March. Annual change in the PPI by month has been softening as the numbers 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.

Reflecting the still broad impact of high oil prices on inflation throughout the broad economy, the seasonally-adjusted monthly "core" PPI—net of food and energy—increased by 0.17% (0.11% unadjusted), versus a 0.28% (0.26% unadjusted) gain in March. Year-to-year core finished goods inflation was 2.71% in April, against 2.89% in March. A comparison of core PPI with core CPI-U will be graphed in the May 15th *Commentary* covering the April CPI release.

Unlike the payroll and retail sales numbers, where monthly seasonal factors are revamped every month, the PPI and CPI adjustments get revised but once a year. Accordingly, seasonally-adjusted underreporting of energy-based inflation will be offset in the second-half of the year, when seasonal adjustments tend to boost reporting of energy prices.

Intermediate and Crude Goods. On a monthly basis, seasonally-adjusted April intermediate goods prices fell by 0.5%, following a 0.7% gain in March, with April crude goods prices down by 4.4%, versus a 2.5% decline in March. Year-to-year inflation in unadjusted April intermediate goods was 1.1%, versus a 2.9% gain in March. The year-to-year change in April crude goods was a decline of 7.3%, against a 0.1% increase in March. Oil prices actually declined month-to-month in April but, as with finished goods, intermediate and crude goods, inflation changes were pushed even lower by negative seasonal adjustments to energy prices.

U.S. TRADE BALANCE (March 2012)

Widening of March Trade Deficit Should Add Some Downside Pressure to Upcoming GDP Revision. Both adjusted and not adjusted for inflation, the U.S. trade deficit widened sharply in March 2012, with the monthly deterioration beyond market expectations. Accordingly, the latest numbers should contribute a negative note to the upcoming first revision of first-quarter 2012 GDP, on May 31st.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported yesterday (May 10th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for March 2012, on a balance of payments basis, widened to $51.8 billion from a revised $45.4 billion (previously $46.0 billion) in February. The March 2012 deficit also was wider than the $46.1 billion shortfall in March 2011.

Against the revised February detail, the seasonally-adjusted March 2012 trade balance reflected higher levels of both exports and imports, with imports rising at more than double the pace of exports. Oil prices were higher, as was the monthly physical oil import volume, but those factors accounted for only a small portion of the seasonally-adjusted import increase, which otherwise was spread across a large number of categories.

Crude Oil and Energy-Related Petroleum Products. For the month of March 2012, the not-seasonally-adjusted average price of imported oil rose to $107.95 per barrel, from $103.63 in February 2012, and it was up from $93.76 in March 2011.

In terms of not-seasonally-adjusted physical oil imports, March 2012 volume averaged 8.738 million barrels per day, up from 7.783 million in February 2012, but down from 9.520 million in March 2011.

Caution on Data Quality. As has become the standard caution here for the monthly detail, heavy distortions likely continued in the seasonal adjustments, much as has been seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. As has been discussed frequently (see *Hyperinflation 2012* for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not be relying heavily on the accuracy of monthly headline data.

The annual benchmark revision to the trade series is scheduled for June 8th, and those revamped numbers—in combination with downside benchmark revisions to a number of other key series—should help to set the usual negative tone for the annual GDP benchmark revisions (due July 27th).

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 March merchandise trade deficit came in at $48.9 billion, versus the unrevised $44.2 billion reported for February. Monthly real data, however, were revised back to October 2011.

Based on the latest reporting and revisions, the annualized first-quarter 2012 real trade deficit—used as a base for the GDP's net export account—was at a pace of $568.8 billion, somewhat wider than the revised pace of $564.4 billion in fourth-quarter 2011. Last month, based on only two months of reporting, the first-quarter real deficit was running at a level of $559.5 billion, slightly narrower than the annualized fourth-quarter 2011 deficit at the time of $563.7.

Where last month's numbers were used as the base for the net export account in the "advance" estimate of first-quarter 2012 GDP, the swing from a slight net trade improvement to a slight net trade deterioration should have the effect of widening the first-quarter net export account deficit and of placing downside pressure on the upcoming first revision to first-quarter 2012 GDP (May 31st).

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.

Consumer Price Index—CPI (April 2012). April CPI data are due for release on Tuesday, May 15th, and the consensus forecast is for no change in the headline CPI-U, per MarketWatch.com.

Any flat-to-plus reading, however, should be due to the still-spreading effects of high oil prices, not due to higher gasoline prices, although they rose on an unadjusted basis. Per the Department of Energy, gasoline prices increased by 1.3% month-to-month in April, but seasonal adjustments likely will turn that gain into a seasonally-adjusted monthly decline. Last April, seasonal factors reduced an unadjusted monthly gain of 7.5% in gasoline prices to a gain of 3.3%.

Year-to-year CPI-U inflation would increase in April 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.38% gain in the adjusted monthly level reported for April 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for April 2012, 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 the March 2012 annual inflation rate of 2.65%. For example, consensus reporting of a flat month-to-month CPI-U would reduce the annual inflation rate to about 2.3%

Retail Sales—Nominal and Real (April 2012). Detail on nominal (not-adjusted-for-inflation) April retail sales is due for release on Tuesday, May 15th. The consensus outlook is for no change month-to-month (per MarketWatch.com), versus a 0.8% gain initially estimated for March. To the extent that any softening in the April growth rate reflects some catch-up from earlier reported gains that were overstated due to seasonal-adjustment problems, reporting could offer a downside surprise to the consensus. Real (adjusted-for-inflation) retail sales should be flat-to-minus for the month.

The underlying fundamentals here remain negative, with consumer spending constrained by lack of income growth and credit availability, and with consumer confidence holding deep within traditional recession territory.

Industrial Production (April 2012). April data on industrial production are due for release on Wednesday, May 16th. Weakness in consumer demand has led to an involuntary build-up in inventories, and early efforts at reducing that excess stock of goods was a factor in the lack of production growth reported for March. Inventory concerns also likely were a constraining factor on April production, despite indications of an early strong consensus. Accordingly, there is a fair risk of downside reporting surprise versus market expectations.

Residential Construction (April 2012). Data on April housing starts are due for release on Wednesday, May 16th. The series likely has continued its four-year pattern of stagnation at an historically low level of activity. As has been the case for some time, any reported monthly gain likely will not be statistically significant.

New Orders for Durable Goods (Benchmark Revision). The annual benchmark revision to new orders for durable goods is due for release on Friday, May 18th. The general pattern here should be one of downside revisions, as seen recently in retail sales and industrial production. Where more complete data are available, the economy in 2010 should be reported as having been weaker than estimated previously. Data subsequent to 2011 likely will be built up with the same, current overly-optimistic underlying assumptions, but growing off a weaker base.

