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

COMMENTARY NUMBER 455
June Retail Sales

July 16, 2012

Second-Quarter Retail Sales Contraction Was First Since the "Recession"

Renewed Downturn in Business Activity Picks Up Momentum

PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Tuesday, July 17th, covering June CPI and industrial production. A subsequent* Commentary *on Wednesday, July 18th, will cover June housing starts.*

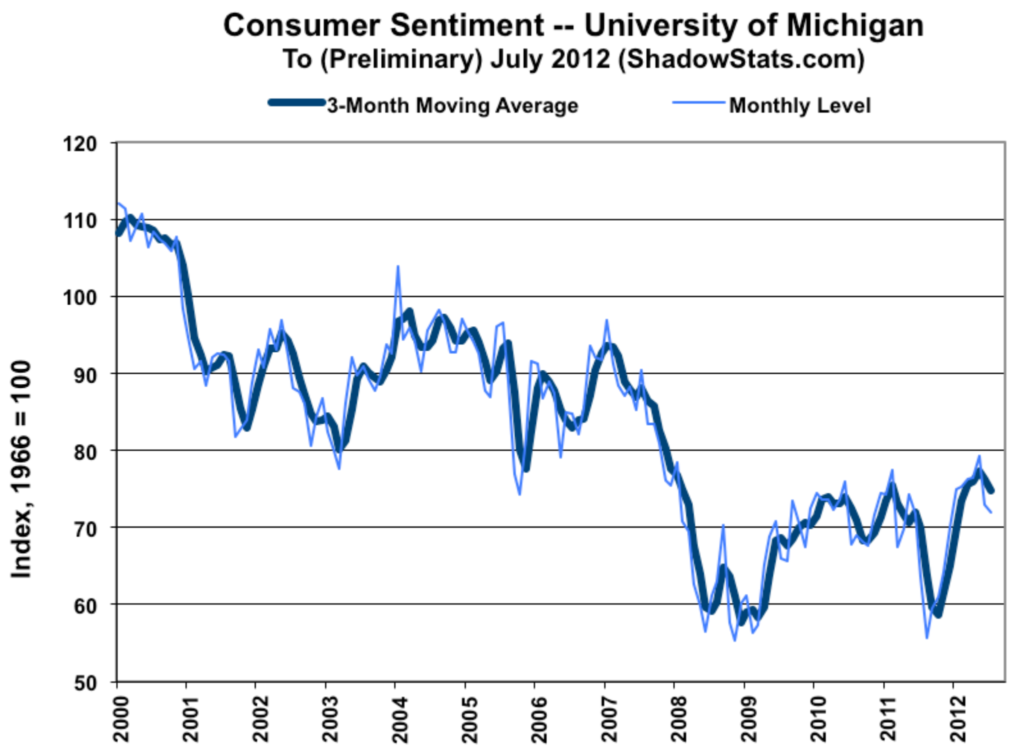
Best wishes to all — John Williams

Opening Comments and Executive Summary. Renewed economic contraction has started to show up in the reporting of major economic series. Headline June retail sales declined by 0.5% versus May, in the context of earlier monthly contractions in and downside revisions to the April and May estimates. As a result, second-quarter 2012 retail sales contracted at a quarterly rate of 0.20% (an annualized rate of 0.78% for those enamored of GDP reporting style).

That was the first quarterly downturn in nominal retail sales—before inflation adjustment, as rung up on cash registers—since first-quarter 2009, during the official 2007/2009 recession. Allowing for likely June CPI reporting, an outright quarterly contraction in real (inflation-adjusted) sales also is likely for the second-quarter. The last quarterly contraction in real retail sales was at the end of the formal recession, in second-quarter 2009.

Year-to-year June 2012 retail sales growth also slowed markedly to 3.8%, from a downwardly revised 5.1% in May. In normal economic times, June's annual growth rate, net of likely inflation, would be close to signaling a pending recession.

In other reporting since the last *Commentary*, the University of Michigan published its early-month estimate of July consumer sentiment, which fell for the second month. Due to an extremely limited sampling base, this number is not too meaningful, but it is included here as potential indicator of consumer activity in July.



A general review of the latest economic indicators, and an outlook for the GDP annual revisions due for release on July 27th, will be included in the July 18th *Commentary*.

Hyperinflation Watch. The general outlook remains unchanged, with the broad outlook discussed in detail in the links in the following note. Official reporting shows a plunge in economic activity from fourth-quarter 2007 to second-quarter 2009, with an ensuing upturn in activity that led to a full recovery as of third-quarter 2011. In contrast, I contend the economy began turning down in 2006, plunging in

2008 into 2009 and subsequently stagnating—bottom-bouncing—at a low level of activity ever since. There has been no recovery, and the economic downturn is intensifying anew.

The official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP. Use of understated inflation in such a manner results in overstated economic growth.

The long-term fiscal solvency issues of the United States—where GAAP-based accounting shows annual deficits running in the $5 trillion range—are not being addressed, and the politicians currently running the government lack the political will to address those issues. That circumstance initially suggested a hyperinflation crisis by the end of this decade, but the systemic-solvency crisis of 2008 accelerated the process, indicating a hyperinflation problem by no later than the end of 2014.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions. With the economy weak enough to provide cover for further Fed accommodation to the still-struggling banking system, the next easing by the Fed likely will trigger a massive dollar selling crisis and begin the process of a rapid upturn in domestic consumer inflation.

A general review of inflation and systemic-liquidity conditions and of near-term economic activity will be included, respectively, in the *Commentaries* on July 17th and 18th.

Note: The broad out outlooks on the economy, systemic solvency and inflation—described in the following linked missives—are unchanged. Special Report No. 445 *(June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. The* Special Report *supplemented* Hyperinflation 2012 *(January 25th), which remains the primary* Commentary *detailing the hyperinflation story.*

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REPORTING DETAIL

RETAIL SALES (June 2012)

Latest Reporting Pulls Retail Sales into Quarterly Contraction, Both Before and After Adjustment for Inflation. In nominal terms (not adjusted for inflation), second-quarter 2012 retail sales contracted at a quarter-to-quarter rate of 0.20% (an annualized rate of 0.78%). That was the first quarterly downturn in nominal retail sales since first-quarter 2009, during the formally-recognized 2007/2009 recession. Allowing for likely June CPI reporting, the first quarterly contraction in real (inflation-adjusted) retail sales since the end of the formal recession in second-quarter 2009 is likely.

Note: The stability of the seasonal-adjustment process (particularly the concurrent seasonal-adjustment process used with retail sales) 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 may be flying blind as to actual economic activity, consideration of broad underlying fundamentals is essential. Consumer income and credit remain structurally impaired, as discussed in Hyperinflation 2012 *and* Special Report No. 445*. Those factors continue to signal economic deterioration, not recovery, with the broad economy remaining in serious trouble.*

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Today's (July 16th) report on June 2012 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly decline of 0.48% (a drop of 0.76% before prior-period revisions) +/- 0.6% (all confidence intervals are at the 95% level). June's decline followed an unrevised monthly May decline of 0.17%, although the seasonally-adjusted May level of sales revised lower by 0.28%.

Year-to-year June 2012 retail sales growth slowed to 3.77% +/- 0.8%, where year-to-year growth for May was revised lower to 5.14% (previously reported as a gain of 5.30%). In normal economic times, the June annual growth rate, net of likely inflation, would be close to signaling a pending recession.

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: June 2012 versus May 2012 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—was down by 0.38%, versus an official decline of 0.48%.

Version II: June 2012 versus May 2012 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—was down by 0.29%, versus an official decline of 0.48%.

Real (Inflation-Adjusted) Retail Sales. Real June retail sales will be assessed along with the release of the June 2012 CPI-U reporting tomorrow, Tuesday, July 17th. The CPI-U is used in deflating the nominal retail sales series. With a small decline likely in the headline June CPI-U, the nominal decline reported in this morning's retail sales could be mitigated a bit, but real retail sales nevertheless should show both month-to-month and quarter-to-quarter contractions.

As official consumer inflation picks up again, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze, the downturn in these data should accelerate and lead eventually to recognition of a formal double-dip recession.

As discussed in Special Report No. 445, there have been no changes in the underlying fundamentals. There have been no shifts in underlying activity that would support a sustainable turnaround in retail sales, personal consumption or in general economic activity. Where in recent years there has been no recovery, just general bottom-bouncing, real retail sales now appear to have entered a period of renewed contraction.

Week Ahead. *Market recognition of an intensifying double-dip recession has started to take a stronger hold, at the moment, while recognition of a mounting inflation threat remains sparse. 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 or to put a happy spin on the numbers; 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 (June 2012). The release by the Bureau of Labor Statistics of the June 2012 CPI numbers is scheduled for tomorrow, Tuesday, July 17th. With unadjusted gasoline prices down 5.1% for the month (per the Department of Energy), the headline June CPI-U likely will show a small contraction, even with a pending reversal to first-half 2012 seasonal-adjustment pressures that have suppressed gasoline inflation numbers. Still, consensus expectations appear to be for a small increase in the headline CPI-U. Any upside surprises likely would come from higher food prices and from relatively strong "core" inflation.

As noted in *Commentary No. 447*, the regular, artificial depression of adjusted gasoline prices in the first-half of the year is due for a sharp reversal. In June, seasonal adjustments for gasoline prices usually move towards neutral, turning much less negative in impact. In July, seasonal adjustments flip and turn strongly positive, boosting reported headline gasoline price inflation and often turning actual price declines into adjusted increases. Accordingly, headline monthly CPI inflation should turn to the upside by July 2012 reporting.

Year-to-year total CPI-U inflation would increase or decrease in June 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.09% gain in the adjusted monthly level reported for June 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for June 2012, the difference in June's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from the May 2012 annual inflation rate of 1.70%. For example, if the headline CPI-U were unchanged in June, year-to-year inflation should come in around 1.6%.

Industrial Production (June 2012). Also due for release tomorrow, Tuesday, July 17th, by the Federal Reserve, the headline industrial production number likely will be flat or contract again in June 2012, following the 0.1% monthly decline initially reported for May. Working-off of excess inventories should continue to impair near-term production activity, with results that likely will be weaker than market expectations.

Residential Construction (June 2012). June housing starts detail is due for release on Wednesday, July 18th, by the Census Bureau. Following a 75% plunge in activity from 2006 through 2008, the ensuing four-year pattern of housing starts stagnation—at an historically low level of activity—likely did not change in June. As has become the standard circumstance, any reported monthly gain likely would not be statistically significant.