John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 464
July CPI, Real Retail Sales, Industrial Production

August 15, 2012

U. S. Dollar versus Euro

Irregular Seasonal Factors Depressed Headline CPI by Two-Tenths of a Percentage Point

July Year-to-Year Inflation: 1.4% (CPI-U), 1.3% (CPI-W), 9.0% (SGS)

Real Retail Sales and Earnings Showed Deteriorating Economy

July Production Boost Reflected Excess Auto Inventory Building

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PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Thursday, August 16th, covering housing starts.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. July's headline CPI number was weak and the headline industrial production number was strong, but those patterns should reverse sharply in the months ahead. Adjusted for inflation, both retail sales and average weekly earnings continued their patterns of topping out or downtrending stagnation. The economic outlook continues to be for an ongoing period of protracted bottom-bouncing and renewed downturn in business activity. Recent economic reporting will be reviewed in tomorrow's (August 16th) *Commentary*. In the *Hyperinflation Watch*, the relationship between the U.S. dollar and the euro are touched upon, both in the context of long-term fundamentals, and in the context of currency manipulations by the Swiss National Bank. Also in the *Hyperinflation Watch*, although the general outlook has not changed, the text summarizing it has been refreshed.

GDP Revision on August 29th. As discussed in the retail sales and real retail sales *Reporting Detail* of yesterday (*Commentary No. 463*) and today, irrespective of the monthly gain reported for July sales, retail sales activity was revised lower for the second-quarter by enough to place downside pressure on the pending August 29th first-revision to second-quarter 2012 GDP. Some offsetting upside pressure on the GDP revision should come from June trade reporting, as discussed in *Commentary No. 462*.

CPI Reporting. The headline inflation estimate of "unchanged" (up by 0.05%) for July was depressed by two-tenths of a percentage point, due to unusual seasonal-factor adjustments to gasoline prices. July traditionally has seasonal adjustments that boost adjusted gasoline inflation, reversing deflating trends of the months before. For example, those seasonals turned an unadjusted monthly decline of 1.5% in July 2011 gasoline prices into a seasonally-adjusted monthly gain of 4.7%.

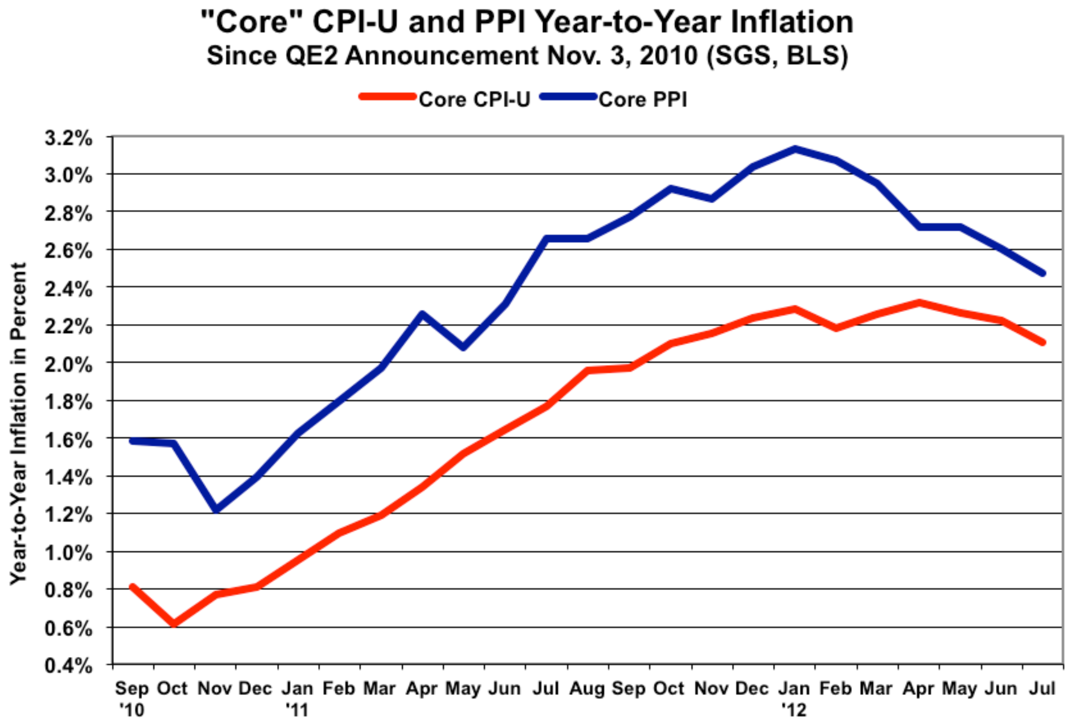
Despite a near-10% jump in gasoline prices in the last four-to-five weeks, unadjusted average gasoline prices fell by 2.7% in July, versus June, per the Department of Energy. That is the same pace of decline that the Bureau of Labor Statistics (BLS) estimated today for the not-seasonally-adjusted month-to-month change in July gasoline prices.

Instead of the traditional upswing, a much weaker adjustment turned the 2.7% decline to a gain of 0.3%, instead of something that should have been around 3.5%. Had the regular adjustment patterns from last year been repeated, headline July CPI-U gain would have been at 0.24%, instead of at 0.05% (rounding to unchanged with one decimal point).

Unlike the employment and unemployment series, though, the CPI is not adjusted on a concurrent basis, where the seasonal factors are revised each month. As a result, one might expect a catch-up adjustment in the reporting of August CPI. Not only should gasoline prices be up by at least 7.0% on an unadjusted basis, but also seasonal adjustments should boost the gain. In August 2011, an unadjusted decline of 0.5% in gasoline prices was seasonally-adjusted into a 1.9% gain. Even without a catch-up from July's underreporting, gasoline prices should contribute at least 0.3% monthly inflation to the August number.

July Detail. Unadjusted, year-to-year inflation eased in July 2012, with the July CPI-U at 1.41% annual growth, down from 1.66% in June, with July CPI-W at 1.29%, down from 1.58% in June, with the July C-CPI-U at 1.32% versus 1.56% in June, and with the July SGS Alternate CPI Measure (1980 Base) at 9.0% versus 9.3% in June.

"Core" inflation—net of food and energy inflation—remained relatively strong, with year-to-year change at 2.10% in July, versus 2.22% in June and versus the cycle high of 2.31% seen in April at 2.31%. The inflationary pressures from high oil prices have continued to spread in the broad economy, as shown in the accompanying graph.

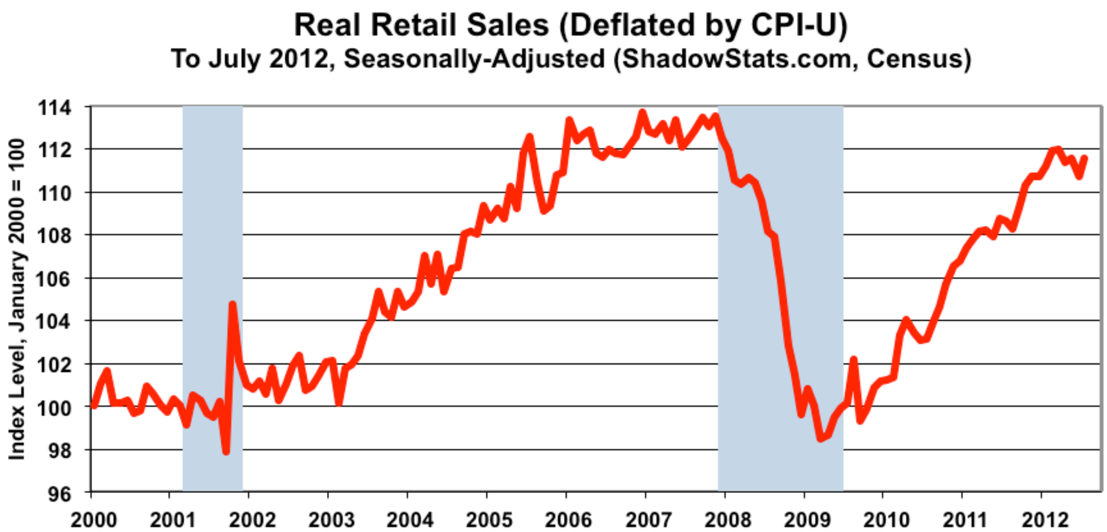


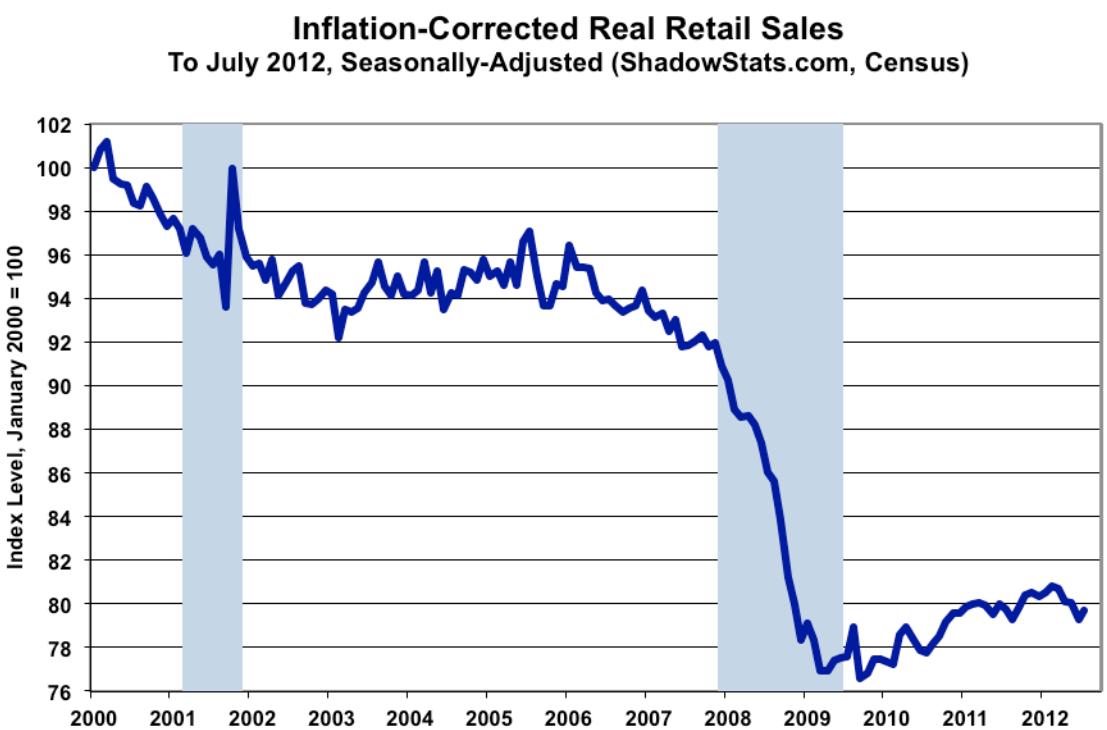
Real Retail Sales. Adjusted for inflation, the gain in July retail sales was shy of recovering the revised estimate of the sales volume lost in June. Based on July CPI-U reporting, inflation- and seasonally-adjusted July 2012 retail sales rose by 0.76%, versus a revised 0.77% (previously 0.52%) monthly decline in June. The seasonally-adjusted, annualized quarter-to-quarter change in real retail sales for second-quarter 2012 revised to a contraction of 1.73% from a 1.52% decline, suggestive of downside pressure on the upcoming GDP revision.

On a year-to-year basis, July real retail sales rose at an annual pace of 2.66%, versus a revised 1.81% (previously 2.06%) in June, levels that would generate a reliable signal of pending recession in normal economic times.

Inflation-Corrected Retail Sales. The recent pattern of retail sales activity remains negative in the updated "inflation-corrected" real retail sales graph that follows.

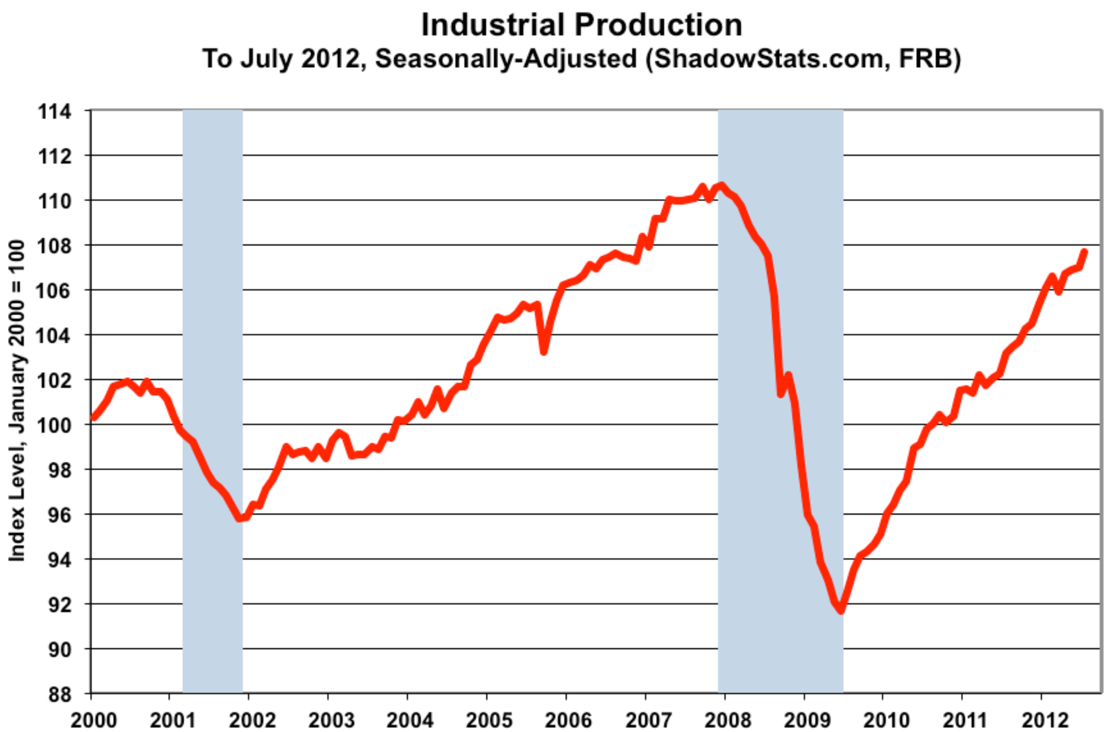
The following charts are indexed to a consistent scale and they update *Graphs 28* and *29* in *Special Commentary No. 445*. The first graph reflects the reported real retail sales, but that series is deflated by the CPI-U, which understates inflation (see the *Public Comment on Inflation*). The downturn in sales also is reflected in the second graph of real retail sales, which is "inflation-corrected." The inflation-corrected numbers use the SGS-Alternate Inflation Measure (1990-Base) for deflation, instead of the CPI-U. As discussed in *Hyperinflation 2012* and *Special Commentary No. 445*, deflation by too-low an inflation number (such as the CPI-U) results in overstated real growth.

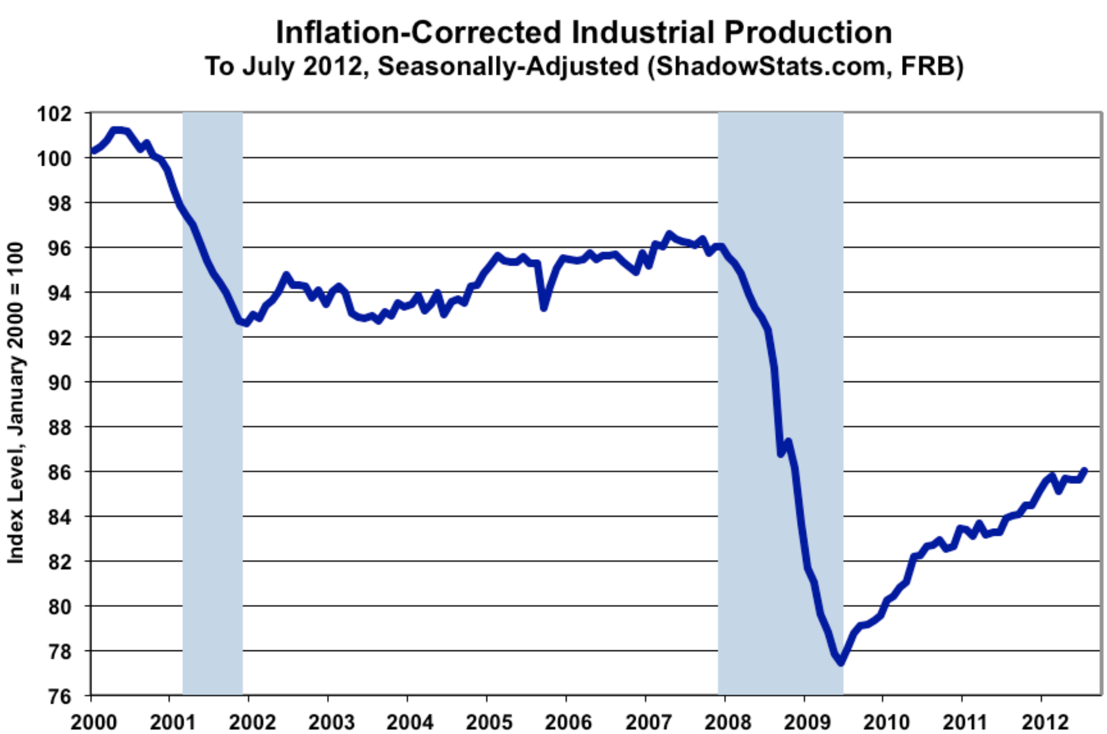




Industrial Production. The headline July production gain was 0.65%, versus 0.13% (previously 0.43%) in June. The July gain largely was accounted for by excess inventory building in the auto industry. Year-to-year growth for July 2012 production was 4.37%, versus a 4.66% (previously 4.68%) gain in June.

The following graphs update *Graphs 30* and *31* in *Special Report No. 445*. The first reflects official industrial production, indexed to January 2000 = 100. The second graph is an inflation-corrected version of the first, with estimated hedonic inflation adjustments backed-out.


Industrial Production
To July 2012, Seasonally-Adjusted (ShadowStats.com, FRB)
Index Level, January 2000 = 100
114
112
110
108
106
104
102
100
98
96
94
92
90
88
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012


Inflation-Corrected Industrial Production
To July 2012, Seasonally-Adjusted (ShadowStats.com, FRB)
Index Level, January 2000 = 100
102
100
98
96
94
92
90
88
86
84
82
80
78
76
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

Hyperinflation Watch—Euro versus U.S. Dollar. The instabilities in the euro area continue, as do the sovereign-solvency games being played. My betting still favors some form of a break-up for the euro, but anything is possible. The currency arrangement never faced long-range stability, and chances for more-coordinated fiscal policies, or chances of member states giving up their sovereignty, never have seemed realistic. Whatever currency ends with up linked with the German mark will dominate the European arena, and, as discussed earlier, it likely will be Germany that determines the ultimate fate of the euro.

That said, the longer-term solvency issues facing the United States remain much more severe than anything that could come out of the existing euro circumstance. Currency fears are misplaced and somewhat rigged. At some point in the not-too-distant future, the global markets likely will turn on the U.S. dollar with a vengeance, dumping dollar-denominated paper assets, forcing Mr. Bernanke's hand in pumping liquidity into the markets and banking system. Renewed Fed "easing" also would be a likely trigger for a dollar-dumping crisis. In either event, the United States would see rapidly mounting inflationary pressures as a result.

In the rigged arena, for nearly a year, the Swiss National Bank (SNB) has been intervening heavily to depress the Swiss franc versus the euro and the U.S. dollar; it has been propping up the euro and U.S. dollar, artificially. As discussed in the August 8th *Financial Times* article "Swiss foreign currency reserves swell on efforts to defend the franc," Swiss foreign exchange reserves were reported at a record high SFr 406 billion as of July 2012, up by 71% since April.

Normally, "defending" a currency refers to fighting off sellers, not buyers. There are a number of benefits to having a strong currency, beginning with the ability to buy at relatively low cost in the rest of the world. The primary concern for having a strong currency is fear of damaging exports, but that damage usually ends being much less than expected, particularly where the exported goods are manufactured as opposed to being pure commodities. History has shown an amazing creativity and resiliency among affected exporters and importers.

It is doubtful that the Swiss are looking to destroy the franc. Propping up losing currencies itself rapidly becomes a losing proposition, and the growing level of foreign-exchange reserves suggests that the SNB already is feeling some discomfort. I still look for the SNB intervention to be short-lived.

General Outlook. *General circumstances have not changed, but the text in this section has been refreshed. The detail in* Special Report No. 445 *(June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That* Special Report *supplemented* Hyperinflation 2012 *(January 25th), which remains the primary* Commentary *detailing the hyperinflation story. The following text is the same as provided in recent* Commentaries.

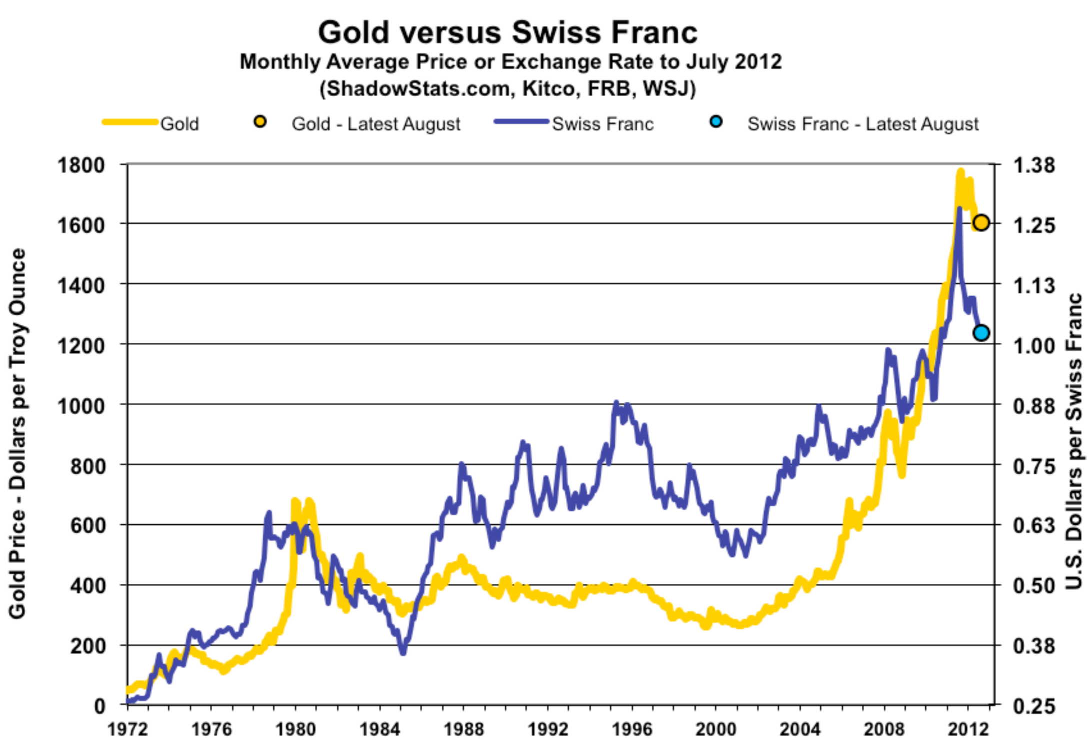
Official GDP reporting shows plunging economic activity from fourth-quarter 2007 to second-quarter 2009, with an ensuing upturn in activity that led to a full recovery as of fourth-quarter 2011, and that "recovery" has continued through second-quarter 2012 GDP reporting.

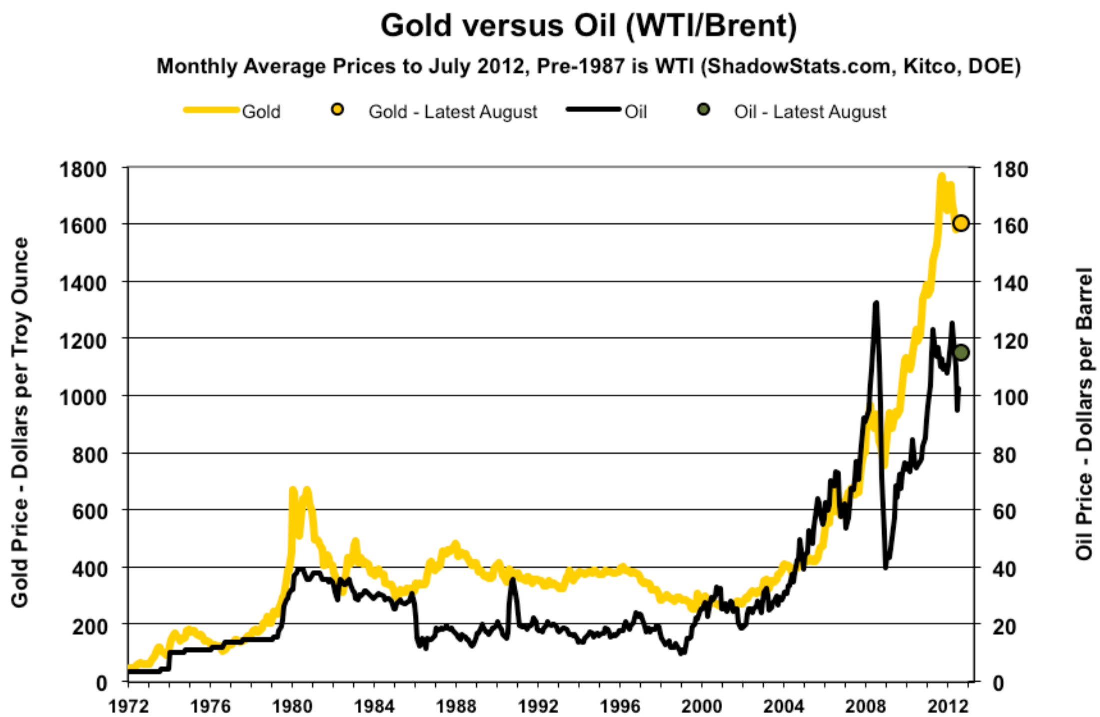
In contrast to GDP reporting—and in line with patterns seen in better-quality economic series—I contend that the economy began turning down in 2006, plunging in 2008 into 2009 and subsequently stagnating—bottom-bouncing—at a low level of activity, ever since. There has been no recovery since mid-2009, and the economic downturn now is intensifying once again. The renewed slowdown is evident in the current reporting of nearly all major economic series. Not one of those series shows a pattern of activity that confirms the recovery evident in the GDP series.

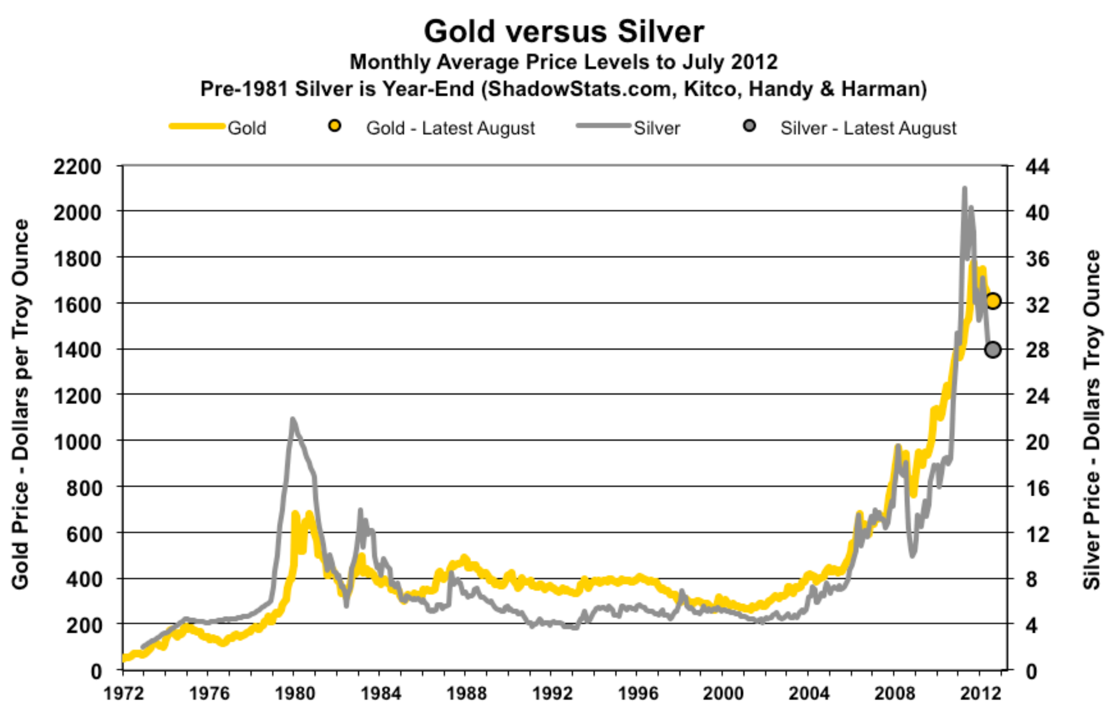
Federal Reserve Chairman Ben Bernanke recently observed that broad aggregate measures of the U.S. economy, such as GDP, do not appear to be reflecting the common experience of the general public. General experience suggests that the economy has not recovered. As shown in *Commentary No. 459*, the official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP, which overstates deflated economic growth (see also *Special Report No. 445*).

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 federal government and Federal Reserve actions—in response to the systemic-solvency crisis of 2008—accelerated the process, indicating a hyperinflation problem by no later than the end of 2014. The continuing economic downturn is intensifying the fiscal- and systemic-solvency problems, and public awareness of this should grow rapidly in the months ahead.

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—and it should follow as needed to support the banking system—likely will lead to a massive dollar-selling crisis, and that will begin the process of a rapid upturn in domestic consumer inflation. A dollar-selling crisis, however, could begin at any time, triggered by any number of economic, sovereign-solvency or political issues.




Gold versus Oil (WTI/Brent)
Monthly Average Prices to July 2012, Pre-1987 is WTI (ShadowStats.com, Kitco, DOE)
Gold
Gold - Latest August
Oil
Oil - Latest August
Gold Price - Dollars per Troy Ounce
Oil Price - Dollars per Barrel
0
200
400
600
800
1000
1200
1400
1600
1800
0
20
40
60
80
100
120
140
160
180
1972
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012


Gold versus Silver
Monthly Average Price Levels to July 2012
Pre-1981 Silver is Year-End (ShadowStats.com, Kitco, Handy & Harman)
Gold
Gold - Latest August
Silver
Silver - Latest August
Gold Price - Dollars per Troy Ounce
Silver Price - Dollars Troy Ounce
0
200
400
600
800
1000
1200
1400
1600
1800
2000
2200
0
4
8
12
16
20
24
28
32
36
40
44
1972
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012

Gold Graphs. The preceding are the usual graphs of Gold versus the Swiss franc, oil and silver. The dollar continues to be propped artificially against the Swiss franc, but, as discussed above, that should be short-lived. Political tensions in the Middle East and other supply concerns have been moving oil prices higher. The precious metals remain primary stores of wealth. As the ultimate long-term hedges against the dollar-debasement ahead, physical gold and silver enable investors to preserve the purchasing power and liquidity of their paper assets.

REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (July 2012)

July Headline CPI Inflation Appears to Have Been Understated by the Use of Unusual Seasonal Adjustments. As discussed in the *Opening Comments and Executive Summary*, the usual sharp reversal of seasonal-adjustment patterns to gasoline prices at this time of year—from depressing to boosting adjusted gasoline prices—did not take place fully. Had the regular adjustment patterns from last year been repeated, headline July CPI-U would have been at 0.24% instead of 0.05% (rounding to unchanged with one decimal point). Unlike the employment and unemployment series, though, the CPI is not adjusted on a concurrent basis, where the seasonal factors are revised each month. As a result, I would expect a catch-up adjustment in the reporting of August CPI. Not only should gasoline prices be up by at least 7.0%, but also seasonal adjustments should boost the gain. In August 2011, an unadjusted decline of 0.5% in gasoline prices was seasonally-adjusted into a 1.9% gain. Even without a catch-up from July, gasoline prices should contribute at least three-tenths of a percentage point to August's headline inflation.

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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 (August 15th) that the headline, seasonally-adjusted CPI-U for July 2012 rose by 0.05% (unchanged rounded to one decimal point) and was down for the month by 0.16%, unadjusted. That followed an adjusted June monthly increase of 0.04% (unchanged rounded to one decimal point), which was down for the month by 0.15%, unadjusted.

The BLS estimated a not-seasonally-adjusted 2.7% monthly decline in July gasoline prices, the same as indicated by the more-comprehensive monthly surveying of the Department of Energy. As discussed in the *Opening Comments and Executive Summary*, however, the traditional shift in seasonal-adjustment patterns—reversing in July the muting impact of seasonal-adjustments on gasoline prices in the first half of the year—largely disappeared, knocking two-tenths of a percentage point off what the monthly CPI headline inflation rate would have been otherwise.

After 17 of the last 20 months showed rising annual "core" CPI-U inflation (net of food and energy inflation), the July 2012 year-to-year core rate of 2.10% continued to back-off from April's cycle-high of 2.31%, June had slowed minimally to 2.22%. The July core rate still was well above the core inflation of 0.61%, in November 2010, when Mr. Bernanke introduced QE2 in a successful bid to debase the U.S. 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)*.

July 2012 unadjusted year-to-year CPI-U inflation slowed to 1.41% from 1.66% in June.

Year-to-year total CPI-U inflation would increase or decrease in next month's August 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.33% gain in the adjusted monthly level reported for August 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for August 2012, the difference in August's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from the July 2012 annual inflation rate of 1.41%.

CPI-W. The headline seasonally-adjusted CPI-W, which is a narrower series and has greater weighting for gasoline than does the CPI-U, rose by 0.05% (unchanged at the first decimal point) and was down by 0.21%, unadjusted, for July. That was against an adjusted monthly headline decline in June of 0.01% (unchanged at the first decimal point), which was down by 0.25%, unadjusted, for the month.

Unadjusted, July 2012 year-to-year CPI-W inflation was 1.29%, versus 1.58% in June.

C-CPI-U. Year-to-year inflation for the June 2012 C-CPI-U was 1.32%, versus 1.56% in June.

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.

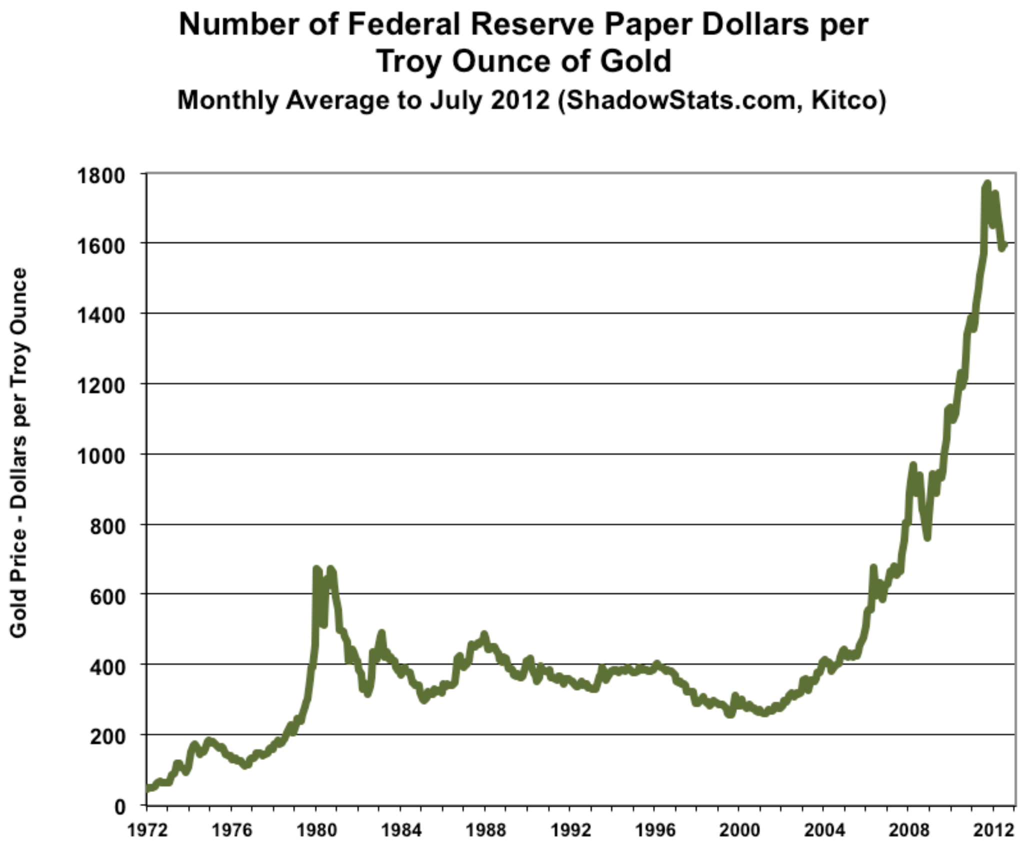
Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 4.9% in July 2012, versus 5.0% in June. The SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was about 9.0% (9.02% for those using the extra digit) in July 2012, versus 9.3% in June.

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. (See the *Public Commentary on Inflation Measurement* for further detail.)

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 $2,503 per troy ounce, based on July 2012 CPI-U-adjusted dollars, and $9,369 per troy ounce based on July 2012 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 July 2012 CPI-U inflation, the 1980 silver-price peak would be $146 per troy ounce and would be $545 per troy ounce in terms of July 2012 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).

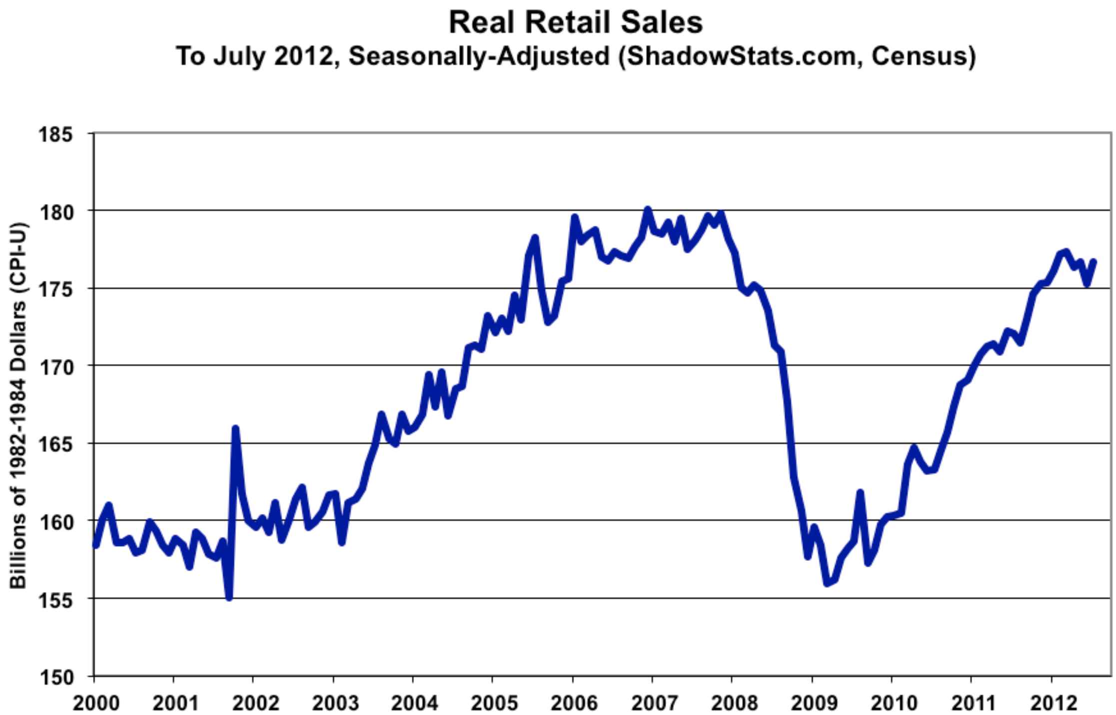


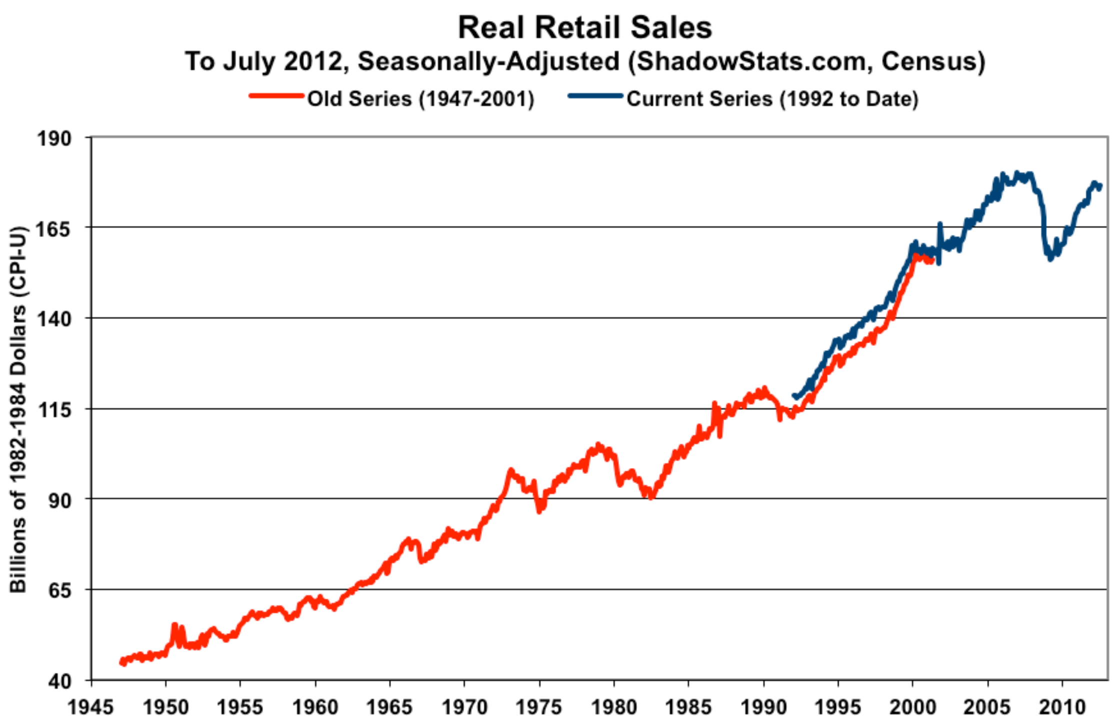
Real (Inflation-Adjusted) Retail Sales. The real monthly gain in July retail sales was shy of recovering the revised estimate of the sales volume lost in June, despite the July gain being enhanced by downside prior-period revisions and unstable patterns in the concurrent seasonal adjustment process. Based on July CPI-U reporting, inflation- and seasonally-adjusted July 2012 retail sales rose by 0.76% for the month, where, before inflation-adjustment (nominal basis), the current number was up by 0.81% (see *Commentary No. 463* for detail of the July retail sales report). June real retail sales were revised to a 0.77% (previously 0.52%) monthly decline, where the nominal monthly change in June was revised to a 0.73% (previously a 0.48%) decline.

The seasonally-adjusted, annualized quarter-to-quarter change in real retail sales for second-quarter 2012 revised to a contraction of 1.73% (previously a drop of 1.52%), versus an unrevised annualized gain of 4.14% in the first-quarter. This suggests some downside pressure on the upcoming August 29th revision to second-quarter 2012 GDP.

On a year-to-year basis, July real retail sales rose at an annual pace of 2.66%, versus a revised 1.81% (previously 2.06%) in June. These are levels that would generate a reliable signal of pending recession in normal economic times.

Even with the upside jump in July sales, the “recovery” in real retail sales clearly still is faltering, as reflected in the following monthly graphs.


Real Retail Sales
To July 2012, Seasonally-Adjusted (ShadowStats.com, Census)
Billions of 1982-1984 Dollars (CPI-U)
185
180
175
170
165
160
155
150
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012


Real Retail Sales
To July 2012, Seasonally-Adjusted (ShadowStats.com, Census)
Old Series (1947-2001)
Current Series (1992 to Date)
Billions of 1982-1984 Dollars (CPI-U)
190
165
140
115
90
65
40
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010

The first graph shows real retail sales activity (deflated by the CPI-U) since 2000. The second graph shows full post-World War II detail.

The recent pattern turns increasingly negative in the updated "inflation-corrected" real retail sales graph shown in the *Opening Comments and Executive Summary section.* The inflation-corrected numbers use the SGS-Alternate Inflation Measure (1990-Base) for deflation instead of the CPI-U. As discussed in *Hyperinflation 2012* and *Special Commentary No. 445*, deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating economic growth.

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.

As official consumer inflation picks up again, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze—as reflected partially by real earnings, discussed in the next section—these data should turn down meaningfully in what eventually will become a formal double-dip recession.

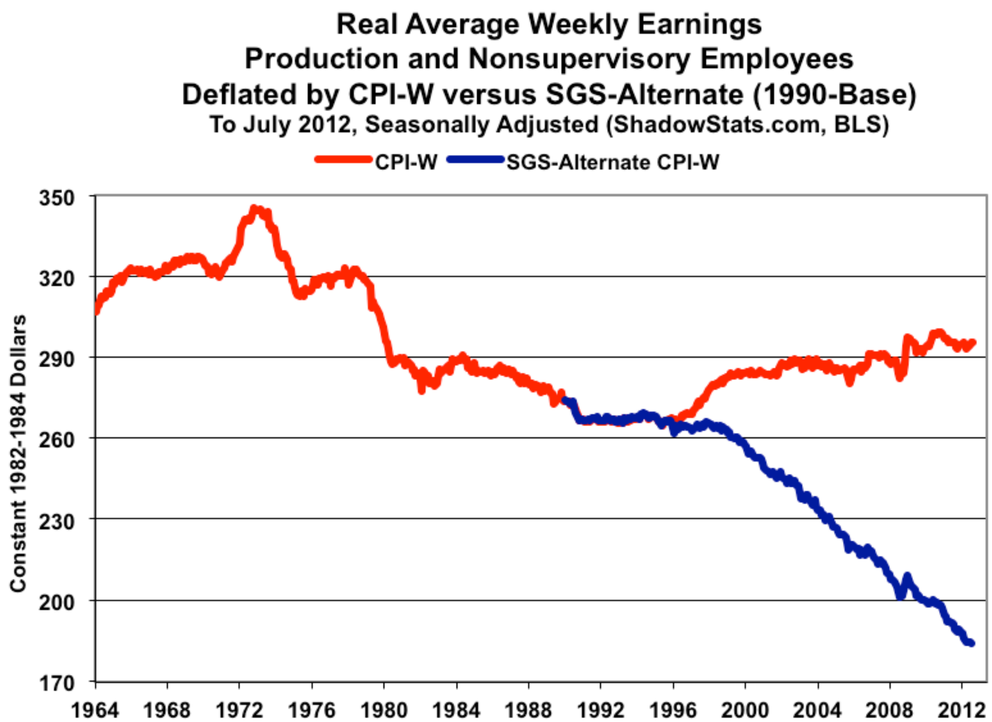
Real Earnings. Coincident with today's (August 15th) CPI releases for July 2012, the BLS published real (inflation-adjusted) average weekly earnings for July 2012.

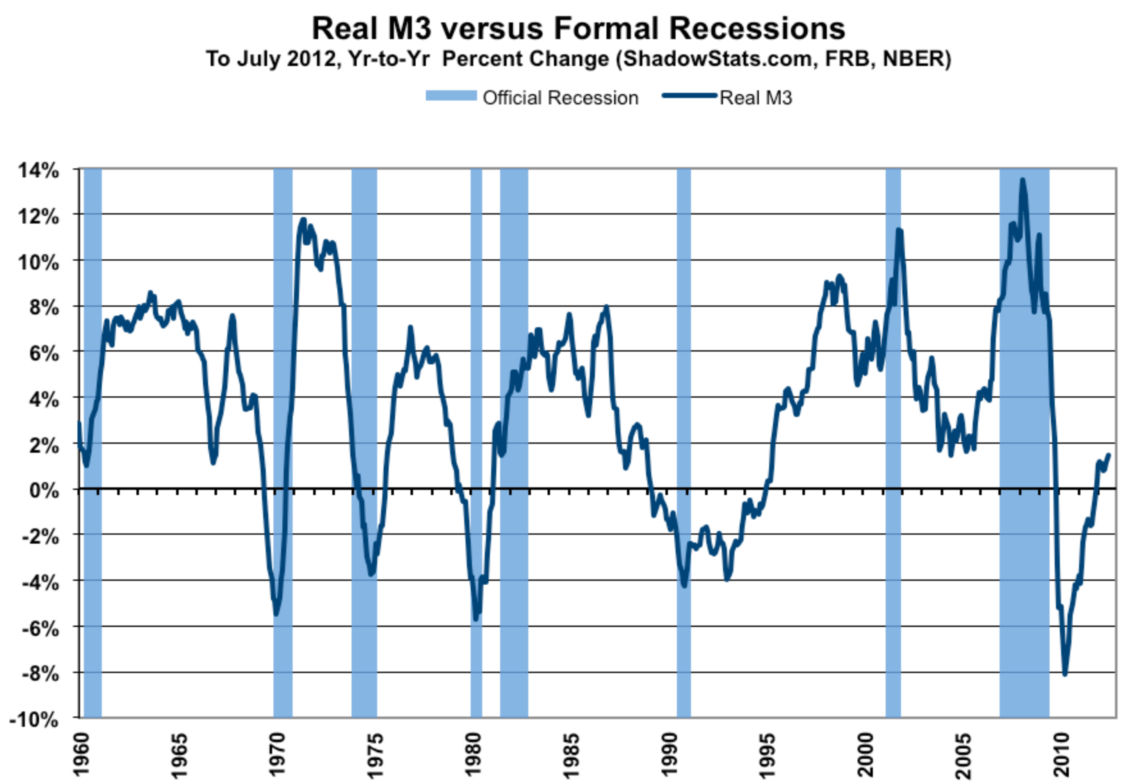
For all employees on private nonfarm payrolls, real average weekly earnings (deflated by the CPI-U) were unchanged month-to-month in July (up by 0.1% before inflation-adjustment). In June, real average earnings revised to a monthly gain of 0.6% (up by 0.6% before inflation-adjustment), where both the real and nominal gains had been estimated previously at 0.5%. Year-to-year, real earnings were up by 0.6% in July, the same gain as seen in June.

For July 2012, the production and nonsupervisory employees series showed real average weekly earnings (deflated by the CPI-W) were up by 0.1% (up by 0.1% before inflation-adjustment), versus revised real and nominal monthly gains of 0.3% (previously 0.6% for both the real and nominal numbers). Year-to-year, real earnings were unchanged in July, versus a revised 0.1% contraction (previously an annual gain of 0.2%) in June

Flat-to-minus seasonally-adjusted CPI-U and CPI-W monthly numbers have helped the recent reporting here.

The production and nonsupervisory employees series is the only one with meaningful historical data, and is shown in the following graph. The chart shows both CPI-W deflation and deflation using the SGS-Alternate Inflation Measure (1990-Base), updating *Graph 13* in *Special Commentary No. 445*.


Real Average Weekly Earnings
Production and Nonsupervisory Employees
Deflated by CPI-W versus SGS-Alternate (1990-Base)
To July 2012, Seasonally Adjusted (ShadowStats.com, BLS)
CPI-W
SGS-Alternate CPI-W
Constant 1982-1984 Dollars
350
320
290
260
230
200
170
1964 1968 1972 1976 1980 1984 1988 1992 1996 2000 2004 2008 2012


Real M3 versus Formal Recessions
To July 2012, Yr-to-Yr Percent Change (ShadowStats.com, FRB, NBER)
Official Recession
Real M3
14%
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
-8%
-10%
1960 1965 1970 1975 1980 1985 1990 1995 2000 2005 2010

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 in *Hyperinflation 2012*, remains in place and continues, despite real annual M3 growth having turned to the upside. As shown in the preceding graph—based on the July 2012 CPI-U report and the latest SGS-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for July 2012 was 1.5%, versus 1.2% in June.

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, with significant new softness in recent reporting. A renewed downturn in official data is becoming obvious to many observers, eventually leading to recognition of a double-dip recession.

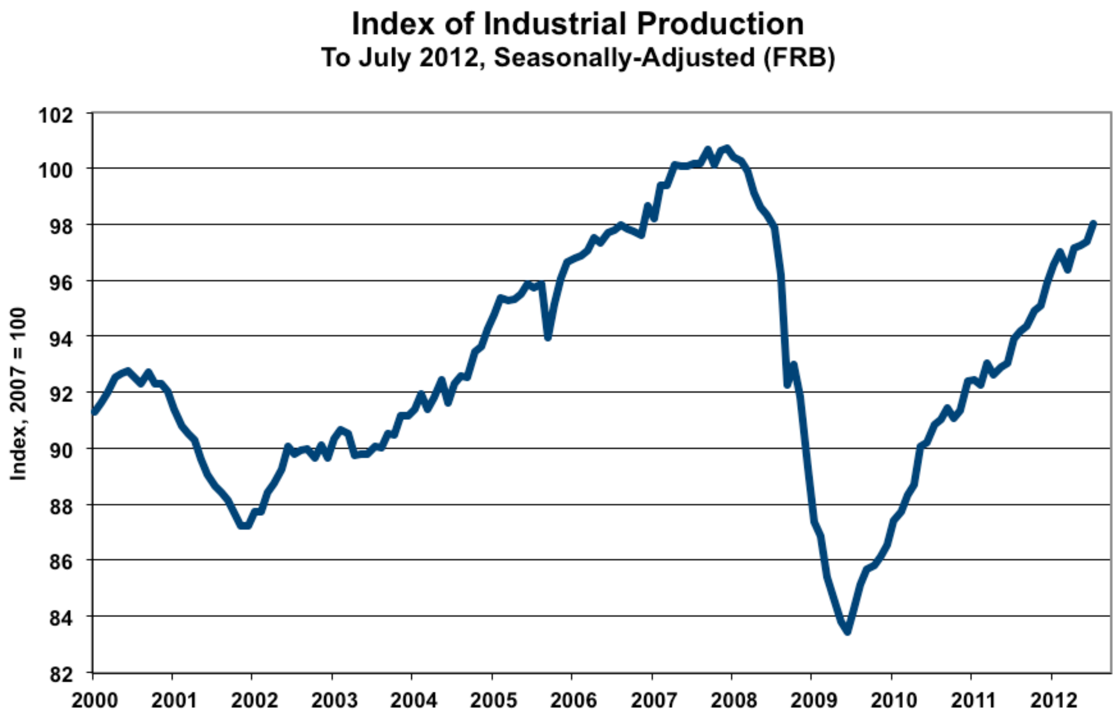
INDEX OF INDUSTRIAL PRODUCTION (July 2012)

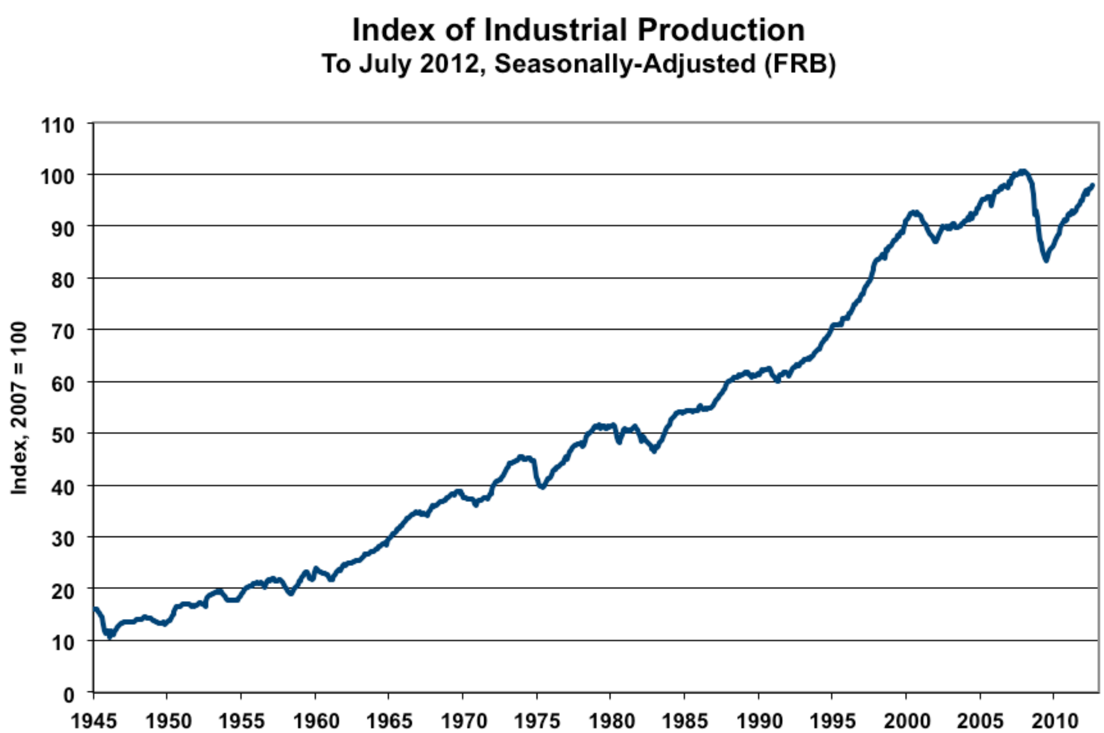
Production Revisions Remain Unstable. Unstable monthly revisions shifted some growth patterns around, but the quarterly numbers and June level were little changed, although June's monthly growth was revised sharply lower. Headline July production jumped by 0.6%, reflecting a continued build-up of excess automobile inventories, a minimal boost from utility usage covering unseasonably hot weather, and despite two consecutive readings from the ISM's purchasing managers survey suggesting that the manufacturing sector is in contraction (the ISM surveys have had some seasonal-adjustment issues, as has the industrial production series).

July 2012 Reporting. This morning's (August 15th) release by the Federal Reserve Board of seasonally-adjusted July 2012 industrial production showed a headline monthly gain of 0.65% (rounds to 0.6% at the first decimal point), the gain would have been 0.78% before prior-period revisions. Much of June's growth was thrown back into May, in revision. June production showed a downwardly revised 0.13% monthly growth, versus initial reporting of a 0.43% gain. May production showed a revised 0.11% gain, having been reported previously as a 0.23% monthly decline. Similar revisions were made with a deeper contraction than previously reported for March. Nonetheless, quarterly levels of activity were not altered meaningfully.

Year-to-year growth for July 2012 production was 4.37%, slightly below the revised annual pace of 4.66% (previously 4.68%) seen in June, and the revised 4.67% (previously 4.38%) seen in May. That still was well off the series' recent relative peak annual growth of 8.13% in June 2010. The year-to-year contraction of 15.15% 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.

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


Index of Industrial Production
To July 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
To July 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

Corrected for the understatement of inflation used in deflating portions of the industrial production index, the series has shown more of a bottom-bouncing pattern since 2009, and it appears to be topping out in recent reporting. The inflation-corrected production series is graphed in the *Opening Comments and Executive Summary* section.

Please note that index base for the inflation-corrected graphs is January 2000 = 100, instead of the official 2007 = 100 used in the preceding graphs.

Week Ahead. *Market recognition of an intensifying double-dip recession is taking a somewhat 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 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 (July 2012). Detail on July housing starts is due for release on Thursday, August 16th, 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 July. As has become the standard circumstance, any reported monthly gain likely would not be statistically significant.

