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

COMMENTARY NUMBER 470
August CPI, PPI, Retail Sales, Industrial Production

September 14, 2012

Fed Easing Aimed at Propping Banking System, Not Boosting Economy

CPI and PPI Headline Inflation Highest Since June 2009

Headline CPI Held at 0.6%, Instead of 1.0%, Due to Intervention Analysis?

August Year-to-Year Inflation: 1.7% (CPI-U), 1.7% (CPI-W), 9.3% (SGS)

Retail Sales Showing Consistent Pattern of Overstated Headline Activity Being Revised Lower in Following Month

Monthly Production and Real Earnings Turn Down

PLEASE NOTE: The next regular Commentary *is scheduled for Wednesday, September 19th, covering August housing starts and existing home sales.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. While the prospects for hyperinflation and the general outlook on the economic and systemic-solvency crises are unchanged, general circumstances have continued to advance towards the ultimate demise of the dollar. The most recent development was yesterday's (Septembers 13th) announcement by the Federal Open Market Committee (FOMC) of a new, open-ended round of Federal Reserve quantitative easing (QE3).

The stated rationale for the easing action was to stimulate economic activity. As usual, though, the Federal Reserve's actions appear aimed at propping up the banking system, using the weak economy as politically-expedient cover. Since the panic of 2008, none of the actions taken by the Fed or the U.S. government have succeeded in turning around the economic or systemic-solvency crises, and nothing the Fed is doing here will boost economic activity.

The Fed will be buying $40 billion per month of mortgage-backed securities (MBS), "To ensure a stronger economic recovery and to help ensure that inflation, over time, is at the [presumably higher than current inflation] rate most consistent with [the Committee's] dual mandate [of maximum employment and price stability]." The FOMC statement added that, "If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases [presumably U.S. Treasury securities], and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability."

The U.S. labor market likely is going to deteriorate in the months ahead, and the economists at the Federal Reserve Board, including Fed Chairman Bernanke, are good enough masters of the dismal science to know that. There is little the U.S. central bank can do to boost the economy, other than possibly pursuing the unthinkable act of raising interest rates. Higher interest rates generate interest income for savers, and the higher rates provide banks with adequate profit margin to cover riskier loans and to expand lending.

Faced with nothing but devil's choices, the Fed has opted to try buying more time, kicking the proverbial can down the road, once more. This time, however, the road is near its end, and that kicked can easily could come bouncing back off a barrier at the end of the road. Yesterday's actions are likely to lead to heavy global dumping of the U.S. dollar and dollar-denominated paper assets.

Further, with the new easing guidelines put out by the FOMC, negative employment reports now may become major triggers for selling of the U.S. dollar and otherwise for extreme financial market turmoil and volatility. Significant loss of exchange-rate value of the U.S. currency will have the effect of pushing domestic inflation much higher, and of setting the early conditions for a hyperinflation.

As financial conditions deteriorate, short-lived interventions in the markets and attempts and controlling prices and capital flows are probable, but that activity is doomed to failure against massive market forces.

The forecast for hyperinflation remains with an outside timing of 2014. The time is at hand, however, for a full review of the hyperinflation outlook, which will be published in the next couple of weeks.

[The following economic data are covered more fully in the *Reporting Detail* section.]

Resurgent Inflation. The respective 0.6% and 1.7% jumps in the headline CPI-U and PPI inflation were the largest monthly inflation increases in more than three years, since June of 2009. The recent surge in gasoline prices was the major contributing factor, but unusual seasonal adjustments appear to have reduced the CPI-U number from what would have been roughly 1.0%, if seasonal adjustments similar to those of August 2011 were used. At work here likely is "intervention analysis," which the BLS can use at its discretion to alter adjustments to what it deems to be aberrant pricing patterns.

CPI. The headline August CPI-U rose by 0.60%, versus a 0.05% increase (unchanged rounded to one decimal point) in July. August 2012 unadjusted year-to-year CPI-U inflation increased to 1.69%, from 1.41% in July.

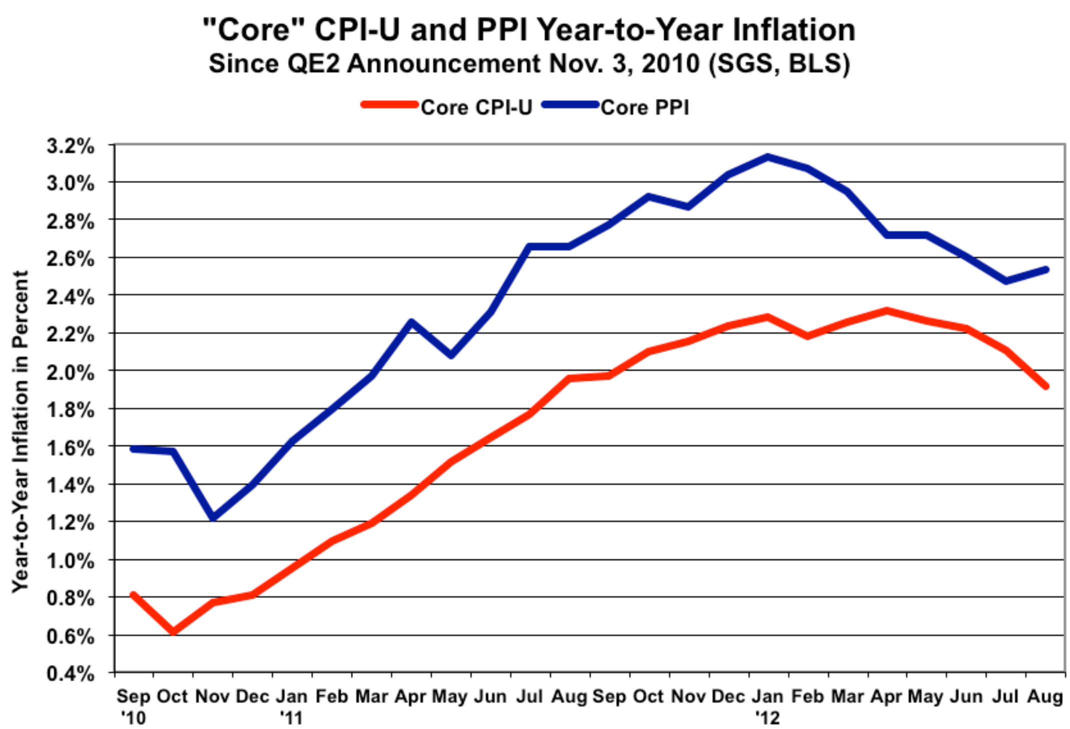
Headline CPI-W rose by 0.74% for the month, versus a 0.05% gain (unchanged at the first decimal point) in July. Unadjusted, August 2012 year-to-year CPI-W inflation was 1.67%, versus 1.29% in July.

Adjusted to pre-Clinton (1990) methodology, annual SGS-Alternate CPI inflation was roughly 5.2% in August 2012, versus 4.9% in July, while the 1980-based measure was about 9.3% in August, versus 9.0% in July.

PPI. The headline August finished-goods producer price index (PPI) rose by 1.66%, following a monthly gain of 0.26% in July. Unadjusted and year-to-year, August's total finished goods PPI annual inflation rebounded to 1.98%, from 0.52% in July.

Core Inflation. The inflationary pressures from high oil prices have continued to spread in the broad economy, as shown in the accompanying graph, which has tracked the impact of QE2 on "core" inflation, inflation net of direct food and energy inflation. High oil prices, however, still have significant, longer-range inflationary impact on the general economy. Based on early market reaction to QE3, new inflationary impact is likely to surface in the core numbers of the months ahead.

The August 2012 year-to-year CPI-U core inflation was 1.91%, versus 2.10% in July. In contrast, the PPI annual core inflation turned somewhat higher in August, to 2.53%, from 2.47% in July.



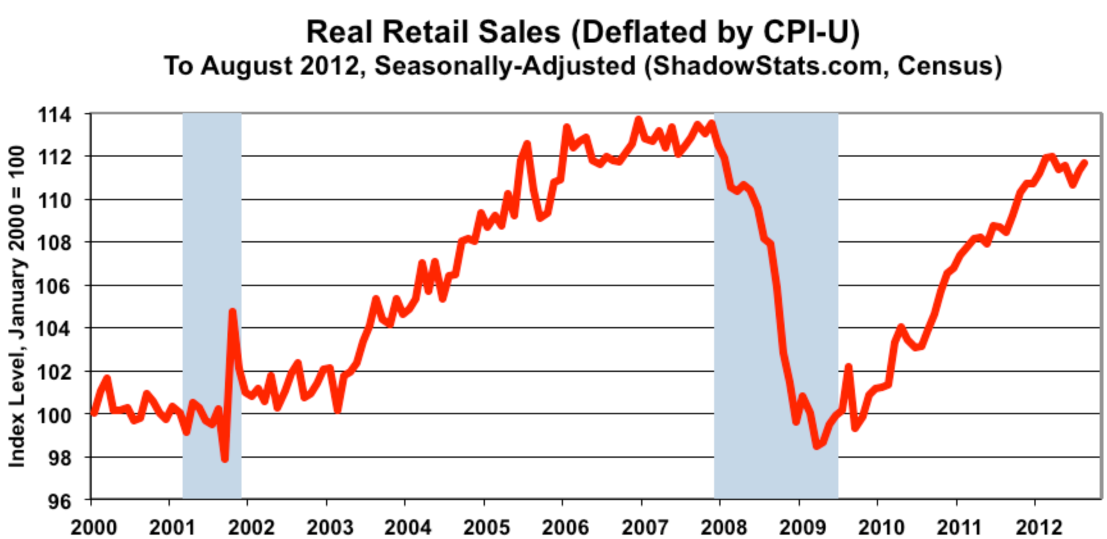
Retail Sales. The Census Bureau likely overstated the August 2012 retail sales activity in today's reporting. The headline monthly gain of 0.89% (up by 0.69% before prior-period revisions) in August was against a revised 0.63% (previously a 0.81%) gain in July. Year-to-year growth in August sales was 4.67%, versus a 3.89% (previously a 4.12%) increase in July.

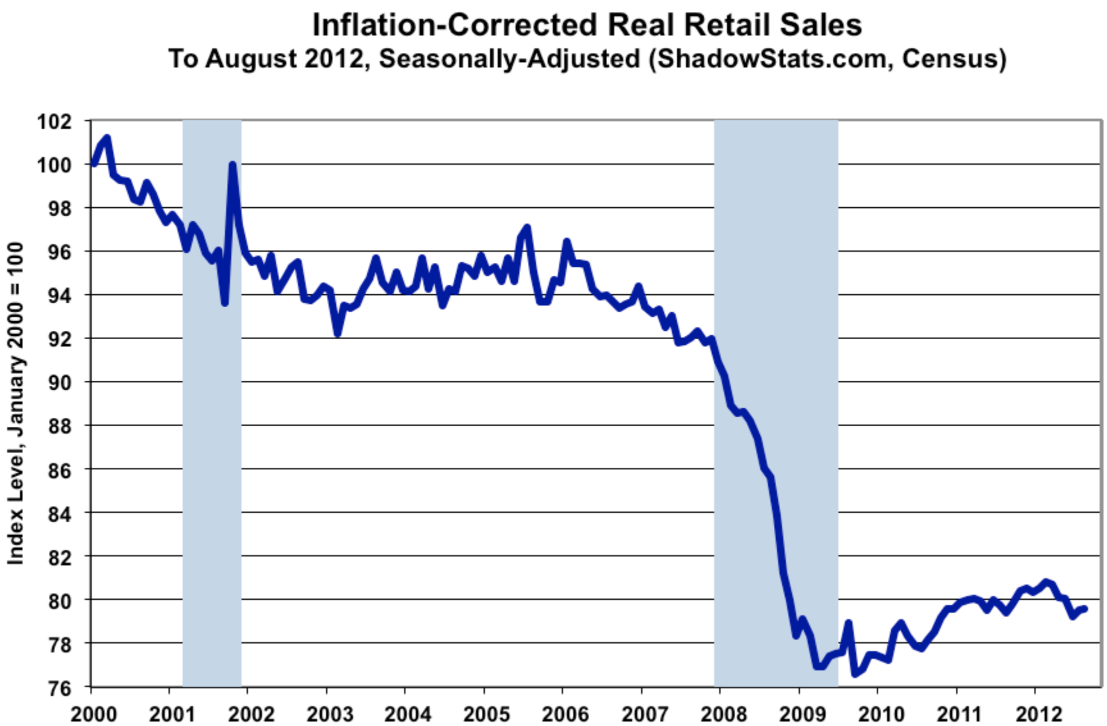
There are two major issues here. First, for the fourth straight month—for the entire period following the downside annual benchmark revisions to the retail sales series on April 30th—each month's reporting has been revised lower with the next month's report. The problem here is tied to unrealistic upside assumptions in the retail sales surveying process and to major distortions in the concurrent-seasonal-factor process. Second, the bulk of the monthly gain was accounted for by inflation.

Real (Inflation-Adjusted) Retail Sales. Based on the August CPI-U, inflation- and seasonally-adjusted August 2012 retail sales rose by 0.28% for the month, where, before inflation-adjustment (nominal basis), the current number was up by 0.89%. July real retail sales were revised to a 0.59% (previously 0.76%) monthly gain, where the nominal monthly gain in July was 0.63%. On a year-to-year basis, August real retail sales rose at an annual pace of 2.93%, versus a revised 2.44% (previously 2.66%) in July.

The chances for sustainable, real (inflation-adjusted) gains in retail sales remain nil, where the consumer lacks adequate income growth and credit availability to fund ongoing increases in real consumption. Various consumer liquidity issues were discussed recently in *Commentary No. 469*.

Inflation-Corrected Retail Sales. The first graph following reflects real retail sales as reported by the St Louis Fed and as deflated by the CPI-U. The CPI-U, however, understates inflation (see the *Public Comment on Inflation*) with the effect of overstating the inflation-adjusted growth.





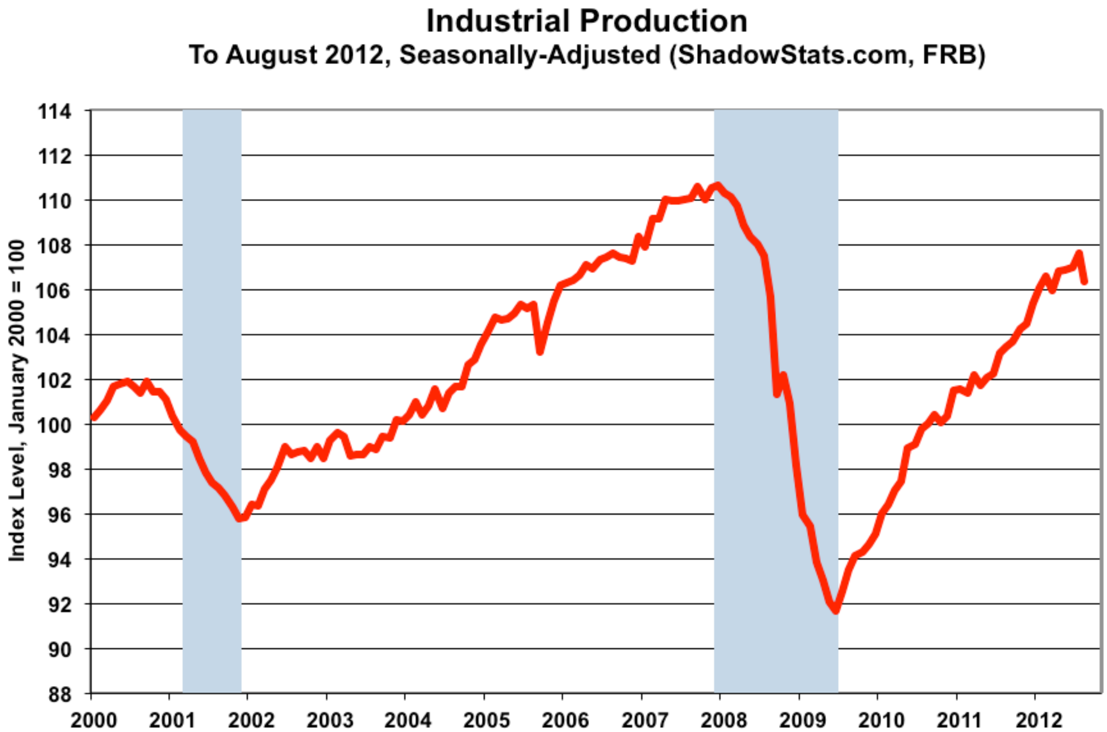
The "inflation-corrected" numbers in the second graph use the SGS-Alternate Inflation Measure (1990-Base) for deflation, instead of the CPI-U. As discussed in *Hyperinflation 2012* and *Special Commentary No. 445*, with the higher inflation of the SGS measure, the revamped numbers suggest a topping out process in a series that has been bottom-bouncing along a low-level plateau of economic activity in the period following the economic collapse.

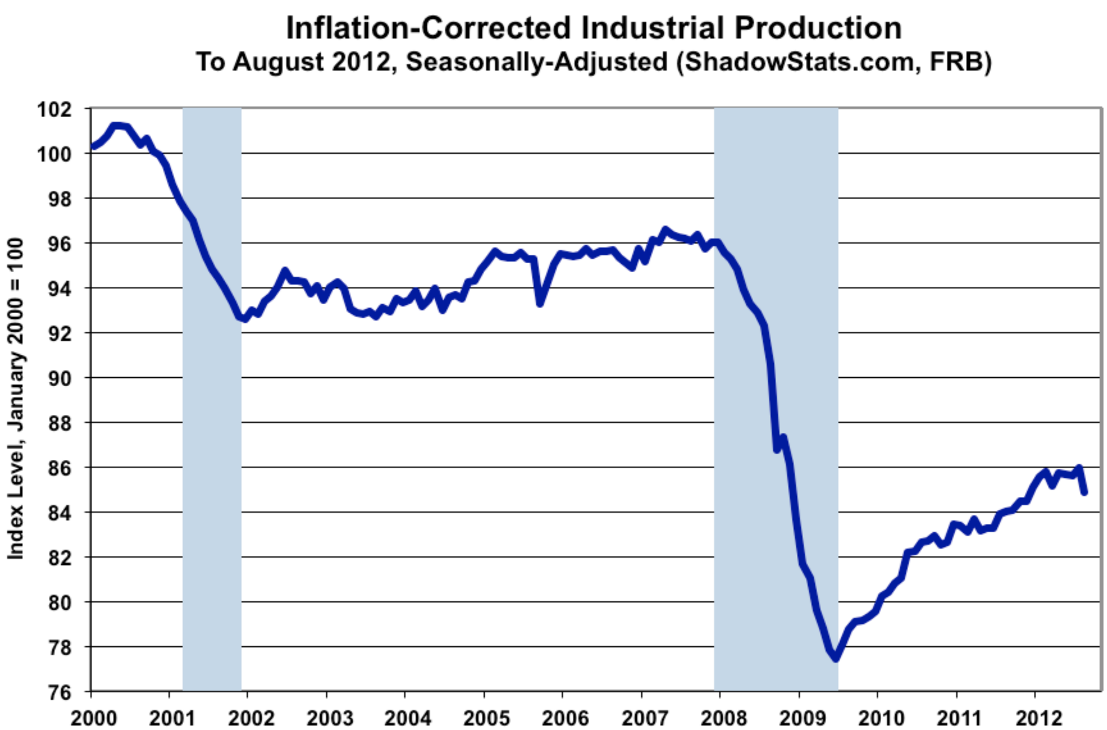
These two charts are indexed to a consistent scale, and they update *Graphs 28* and *29* in *Special Commentary No. 445*.

Industrial Production. Headline August 2012 industrial production showed a monthly decline of 1.16% (down by 1.24% before prior-period revisions), versus a revised 0.54% (previously 0.65%) monthly gain in July. Year-to-year growth in August production slowed sharply to 2.80%, from a revised 4.29% (previously 4.37%) in July.

The monthly production downturn encompassed a 0.7% drop in manufacturing (automobile manufacturers working off excess inventories), a 1.8% decline in mining (oil platforms shut down for Hurricane Isaac), and a 3.6% decline in utilities output (catch up from prior-period weather distortions).

The following graphs update *Graphs 30* and *31* in *Special Commentary 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 August 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 August 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—Federal Reserve Update. As discussed in the *Opening Comments*, the general outlook is unchanged, but general circumstances have continued to advance towards the ultimate demise of the dollar, as seen with the announcement of QE3. The hyperinflation prediction remains in place with an outside timing of 2014. The hyperinflation outlook will be reviewed and updated fully in a *Special Commentary* in the next couple of weeks. The following summary of the broad outlook has been updated, primarily with the material on QE3.

The detail in Special Commentary No. 445 *(June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That* Special Commentary *supplemented* Hyperinflation 2012 *(January 25th), which remains the primary missive detailing the hyperinflation story. Those reports are suggested as background reading for new subscribers.*

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

In contrast to the 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 has 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. Indeed, common experience suggests that the economy has not recovered. 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, as discussed in *Commentary No. 467*, *Special Commentary No. 445*, and *Public Comment on Inflation*.

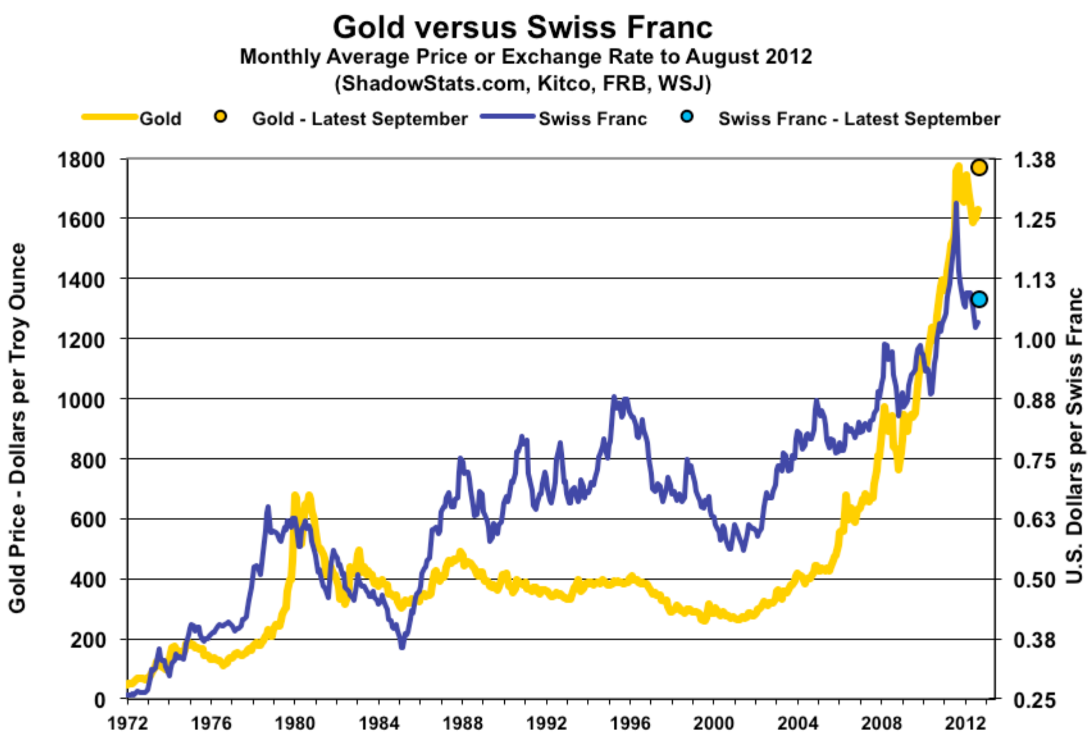
The long-term fiscal solvency issues of the United States—where GAAP-based accounting shows annual deficits running in the $5 trillion range—are not being addressed, and the politicians currently running the government lack the political will to address those issues. That circumstance initially suggested 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.

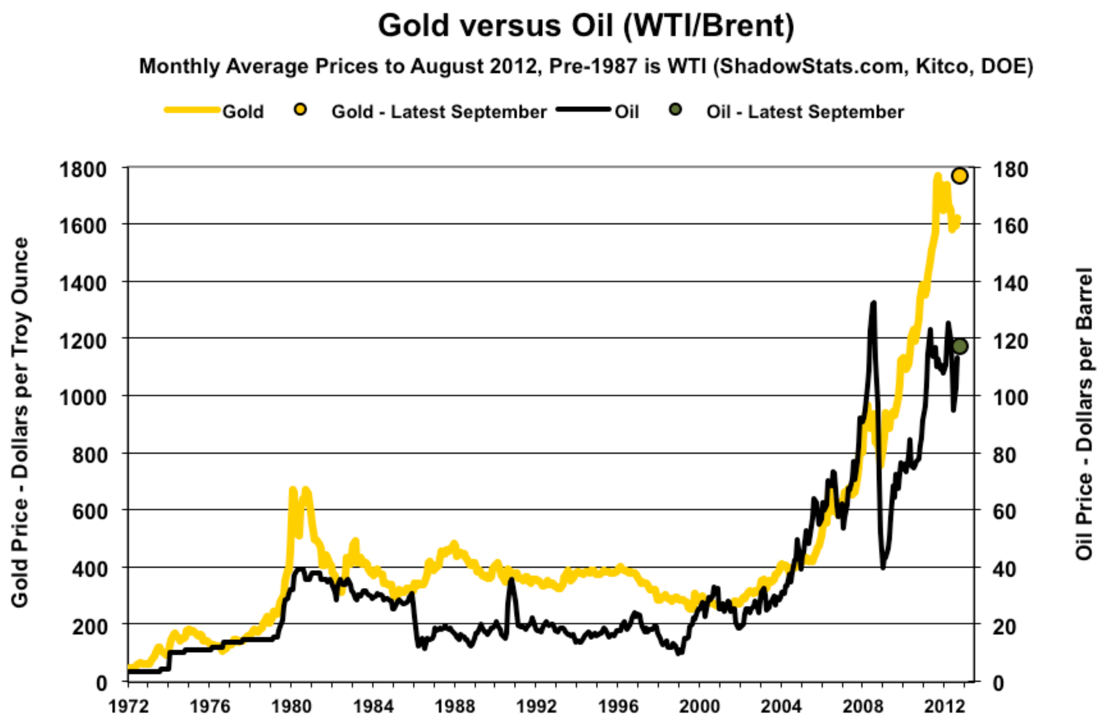
Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions, and the most recent readings on income variance suggest that the worst is yet to be seen, as discussed in *Commentary No. 469*.

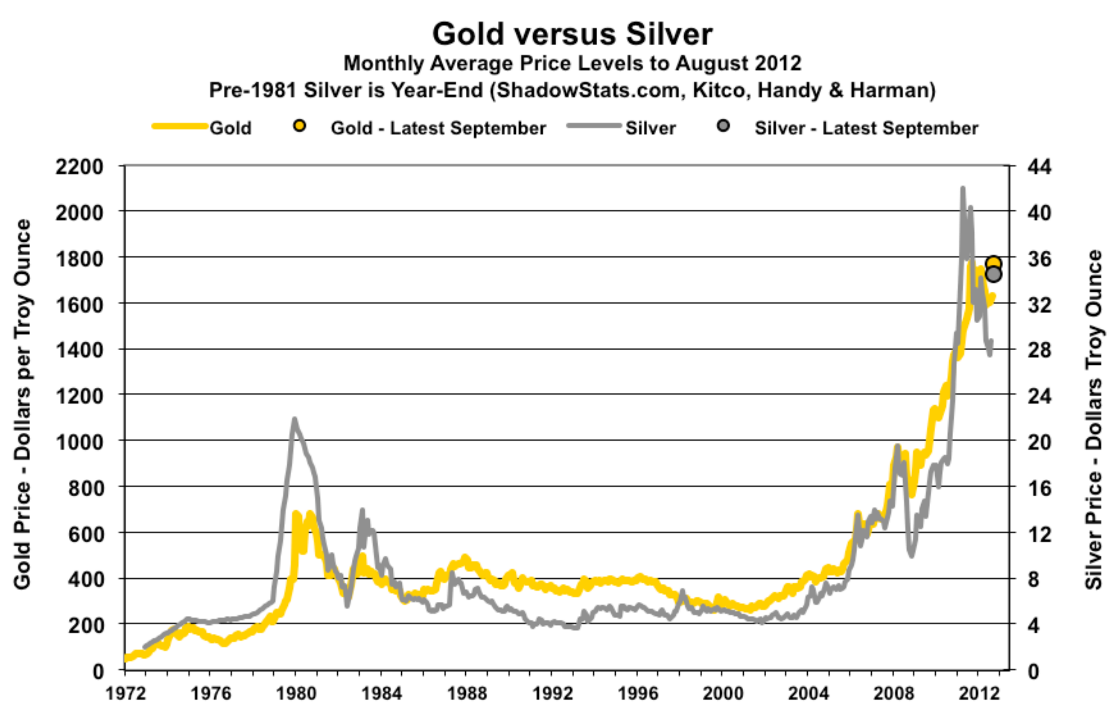
With the economy weak enough to provide political cover for further Federal Reserve accommodation to the still-struggling banking system, QE3 was introduced on September 13th. That action effectively provided for open-ended monetization of U.S. Treasury debt at the Fed's discretion. The mechanism for eventual full debasement of the dollar now is in place, and it likely will come into full play, as needed to support the banking system and as needed to assure "successful" auctions of Treasury debt.

QE3 likely will lead to a massive dollar-selling crisis, and that will begin the process of a rapid upturn in domestic consumer inflation. A near-term dollar-selling crisis is now of a much greater risk, post-QE3. Separately, though, a dollar-selling crisis could begin at any time, triggered by various economic, sovereign-solvency or political issues. With the new guidelines for QE3, even negative employment reports could trigger massive dollar selling.

Gold Graphs. Following are the graphs of Gold versus the Swiss franc, oil and silver that regularly are published in the monthly CPI *Commentary*. The dollar continues to be propped artificially against the Swiss franc. Even so, the currency and precious metals markets have begun to respond to the dollar debasement inherent in the QE3 just announced by the FOMC. Escalating political tensions in the Middle East and other supply concerns have been moving oil prices higher, and that process should accelerate as the U.S. dollar weakens against the stronger, major Western currencies. 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 wealth and assets.




Gold versus Oil (WTI/Brent)
Monthly Average Prices to August 2012, Pre-1987 is WTI (ShadowStats.com, Kitco, DOE)
Gold
Gold - Latest September
Oil
Oil - Latest September
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 August 2012
Pre-1981 Silver is Year-End (ShadowStats.com, Kitco, Handy & Harman)
Gold
Gold - Latest September
Silver
Silver - Latest September
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

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REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (August 2012)

August Headline CPI Inflation Contained by "Intervention Analysis?" As discussed in the *Opening Comments and Executive Summary* and in the *CPI-U* section below, an unusual variation in seasonal factor patterns (likely BLS "intervention analysis") in August 2012 cut the headline CPI-U inflation rate to 0.6% instead of what otherwise would have been about 1.0%. As reported, the monthly CPI-U inflation was the highest since June 2009. At 1.0%, CPI-U inflation would have been at the highest reading since June of 2008, a month with a jump in gasoline prices similar to that seen in August 2012.

With the August numbers dominated by higher energy costs, the annual inflation rates also rose with the jump in the headline numbers, with the year-to-year CPI-U inflation increasing to 1.7% in August from 1.4% in July.

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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.*

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CPI-U. The BLS reported today (September 14th) that the headline, seasonally-adjusted CPI-U for August 2012 rose by 0.60%. On an not-seasonally-adjusted basis, it was up for the month by 0.56%. That followed an adjusted July monthly increase of 0.05% (unchanged rounded to one decimal point); the unadjusted July measure was down for the month by 0.16%.

Of particular import, seasonal adjustments appear to have been altered significantly for gasoline prices, likely with the BLS's "intervention analysis" that sometimes is used to change or eliminate seasonal adjustments to price changes deemed aberrant by the BLS. Unadjusted monthly average gasoline prices rose by 7.2% per the BLS in August, versus the 8.1% estimated by the Department of Energy in its more comprehensive surveying. Seasonally-adjusted, August's gasoline prices gained 9.0% for the month, versus the unadjusted 7.2%. Consider, though, that the August 2011 seasonal-adjustment factors changed an unadjusted 6.8% monthly decline into a 1.9% gain. The BLS likely used its "intervention analysis" to mute some of the seasonal-adjustment impact. If August 2012 had been adjusted in the same manner as 2011, the headline August 2012 monthly inflation would have been about 1.0%.

August 2012 unadjusted year-to-year CPI-U inflation increased to 1.69%, from 1.41% in July.

Year-to-year total CPI-U inflation would increase or decrease in next month's September 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.27% gain in the adjusted monthly level reported for September 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2012, the difference in September's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from the August 2012 annual inflation rate of 1.69%.

After 17 of the last 21 months showed rising year-to-year, or annual, "core" CPI-U inflation (net of food and energy inflation), the August 2012 year-to-year core rate of 1.91%, continued to back-off from April's cycle-high of 2.31%, July had slowed to 2.10%. In contrast, the PPI annual core inflation turned somewhat higher in August, to 2.53%, from 2.47% in July.

The August CPI 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 introduction of QE3 should reflect some renewed upside pressures here. 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)*.

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 0.74% and was up by 0.66%, unadjusted, for August. That was against a 0.05% gain (unchanged at the first decimal point) in July, which was down by 0.21%, unadjusted.

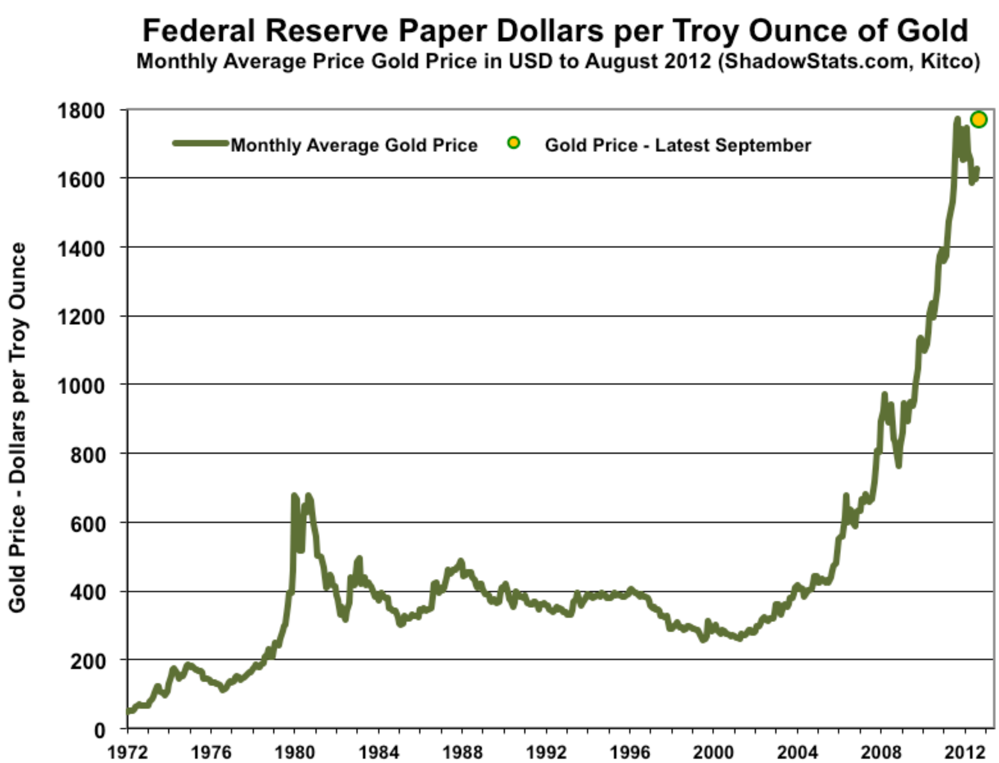
Unadjusted, August 2012 year-to-year CPI-W inflation was 1.67%, versus 1.29% in July.

C-CPI-U. Year-to-year inflation for the August 2012 C-CPI-U was 1.51%, versus 1.32% in July.

Note: 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 5.2% in August 2012, versus 4.9% in July. The SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was about 9.3% (9.33% for those using the extra digit) in August 2012, versus 9.0% in July.

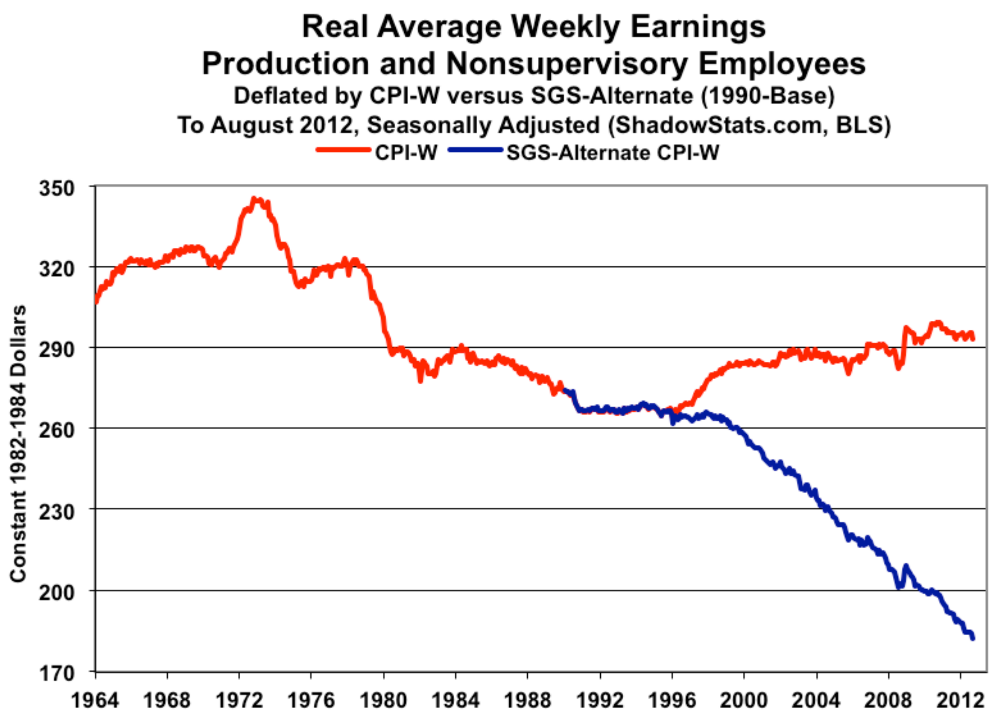
Note: The SGS-Alternate Consumer Inflation Measure adjusts on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made by the BLS (the series is not recalculated). Over the decades, the BLS has altered the meaning of the CPI from being a measure 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 $2,517 per troy ounce, based on August 2012 CPI-U-adjusted dollars, and $9,445 per troy ounce based on August 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 August 2012 CPI-U inflation, the 1980 silver-price peak would be $146 per troy ounce and would be $549 per troy ounce in terms of August 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).



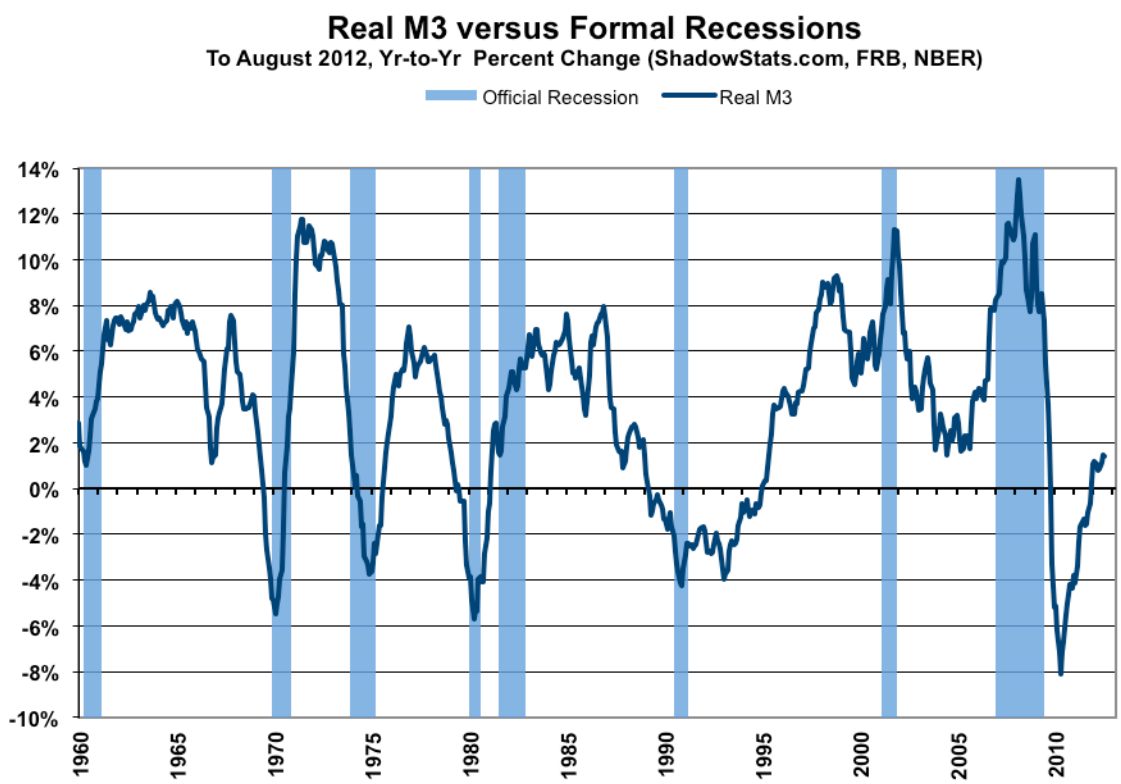
Real Earnings. Coincident with today's (September 14th) CPI releases for August 2012, the BLS published real (inflation-adjusted) average weekly earnings for August 2012.

For all employees on private nonfarm payrolls, seasonally-adjusted, real average weekly earnings (deflated by the CPI-U) fell by 0.6% month-to-month in August (no growth before inflation adjustment), versus a revised 0.2% contraction (previously unchanged) in July (down by a revised 0.3% before inflation adjustment, which previously had been a 0.1% gain). Year-to-year, real earnings were up by 0.3% in August, versus a revised 0.3% (previously 0.6%) gain in July.

For August 2012, the production and nonsupervisory employees series showed real average weekly earnings (deflated by the CPI-W) were down by 0.8% for the month (unchanged before inflation adjustment), versus un unrevised 0.1% gain (up by 0.1% before inflation-adjustment) in July. Year-to-year, real earnings fell by 0.1% in August, versus a unrevised annual decline of 0.1% in July.

The production and nonsupervisory employees series is the only one with meaningful historical data, and is shown in the preceding 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 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 following graph—based on the August 2012 CPI-U report and the latest SGS-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for August 2012 was 1.4%, versus 1.5% in July, with higher inflation more than offsetting an uptick in nominal (not-adjusted-for-inflation) annual M3 growth.



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, and that eventually should lead to recognition of a double-dip recession.

PRODUCER PRICE INDEX—PPI (August 2012)

Wholesale Inflation Has Its Biggest Jump in Three Years. As reported yesterday, August 13th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for August 2012 rose by 1.66% (a gain of 1.24% unadjusted), following a monthly gain of 0.26% (a gain of 0.16% unadjusted) in July. August's monthly inflation was the highest since June 2009.

The rounded 1.7% seasonally-adjusted gain in reported monthly inflation for August was accounted for by an adjusted 6.4% (unadjusted 4.2%) month-to-month surge in finished energy goods, plus an adjusted 0.9% (unadjusted 0.9%) gain in food prices, and by an adjusted 0.2% (unadjusted 0.2%) gain in "core" inflation.

"Core" inflation is net of food and energy inflation. The concept of core inflation as a realistic measure of inflation is nonsensical, where food and energy account for 41.4% of the finished goods PPI (24.6% of the CPI-U, 27.6% of the CPI-W). Even Mr. Bernanke, core-inflation's primary advocate, purportedly consumes food and energy.

The core measure, however, is useful as an indication of how energy prices (in particular) are impacting the broad economy. Indeed, reflecting the ongoing broad impact of high oil prices throughout the general economy, the seasonally-adjusted monthly core PPI increased by 0.22% (0.16% unadjusted) in August, versus an adjusted gain of 0.44% (0.28% unadjusted) in July. Year-to-year, unadjusted core finished goods inflation picked up to 2.53% in August, from 2.47% in July. A comparison of core PPI with core CPI-U is graphed in the *Opening Comments and Executive Summary*.

Unadjusted and year-to-year, August's total finished goods PPI rebounded to a gain of 1.98%, versus 0.52% in July. Nonetheless, annual change in the PPI has weakened from a 7.08% near-term peak seen in July 2011, after which the annual numbers began going against a year-ago period where Mr. Bernanke was running QE2 and meeting with early success in debasing the U.S. Dollar and generating an increase in oil prices.

Intermediate and Crude Goods. On a monthly basis, seasonally-adjusted August intermediate goods prices rose by 1.1%, following a 0.9% decline in July, with August crude goods prices up by 5.8%, versus 1.8% increase in July.

Year-to-year inflation in unadjusted August intermediate goods fell by 1.1%, after a 2.6% decline in July. Year-to-year inflation in August crude goods was down 3.5%, following a decline of 9.6% in June. The recent rebound in oil prices slowly is working its way into the PPI reporting, on top of rising food prices.

RETAIL SALES (August 2012)

Headline Retail Sales Growth Has Been Overstated Every Month. On April 30th, the Census Bureau published its annual benchmark revisions to the retail sales series. Historical retail sales levels were revised lower through the then latest reporting of March 2012. In every month since the benchmark revision, the reported headline change has been revised to the downside in the next month's reporting. April 2012 was reported initially with a 0.14% increase; that revised in the next reporting to a 0.22% decline. May was reported initially with a 0.17% decline; that revised in the next reporting to a 0.19% decline. June was reported initially with a 0.48% decline; that revised in the next reporting to a 0.73% decline. July was reported initially with a 0.81% increase; that revised in today's reporting (September 14th) to a 0.63% gain.

The pattern of higher headline reporting for the current month, followed by downside revisions in subsequent reporting continued in August, for the fourth consecutive month since the benchmark revision was published. This appears to be partially an artifact of the unstable concurrent-seasonal-adjustment process and also likely reflects overly optimistic assumptions being made in the survey process.

Beyond the relative boost from prior-period downside revisions, the headline gain in August retail sales largely was in prices. Net of prior-period revisions the headline August 0.9% gain was 0.7%. Beyond that, however, the bulk of the headline 0.9% jump otherwise was accounted for by a 0.6% headline gain in the August CPI-U. The gain would have been fully accounted for by higher prices if seasonal factors consistent with August 2011 had been used with the CPI (see *CPI* section).

The chances for sustainable, real (inflation-adjusted) gains in retail sales remain nil, where the consumer lacks adequate income growth and credit availability to fund ongoing increases in real consumption. Various consumer liquidity issues were just discussed in *Commentary No. 469*.

Note: The stability of the seasonal-adjustment process (particularly the concurrent seasonal-adjustment process used with retail sales) and of sampling methods has 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, also are discussed at length in Hyperinflation 2012 *and* Special Commentary 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 (September 14th) report on August 2012 retail sales—issued by the Census Bureau—indicated a statistically-significant, seasonally-adjusted monthly gain of 0.89% (up by 0.69% before prior-period revisions) +/- 0.6% (all confidence intervals are at the 95% level). August's headline gain followed a revised headline gain of 0.63% (previously a gain of 0.81%) in July.

Year-to-year August 2012 retail sales growth was 4.67% +/- 0.8%, where year-to-year growth for July was revised lower to 3.89% (previously reported as a gain of 4.12%).

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: August 2012 versus July 2012 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—was up by 0.38%, versus the official gain of 0.89%.

Version II: August 2012 versus July 2012 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—was up by 0.29%, versus the official 0.89%.

Real (Inflation-Adjusted) Retail Sales. Based on August CPI-U reporting, inflation- and seasonally-adjusted August 2012 retail sales rose by 0.28% for the month, where, before inflation-adjustment (nominal basis), the current number was up by 0.89%. July real retail sales were revised to a 0.59% (previously 0.76%) monthly gain, where the nominal monthly gain in July was revised to 0.63% (previously 0.81%).

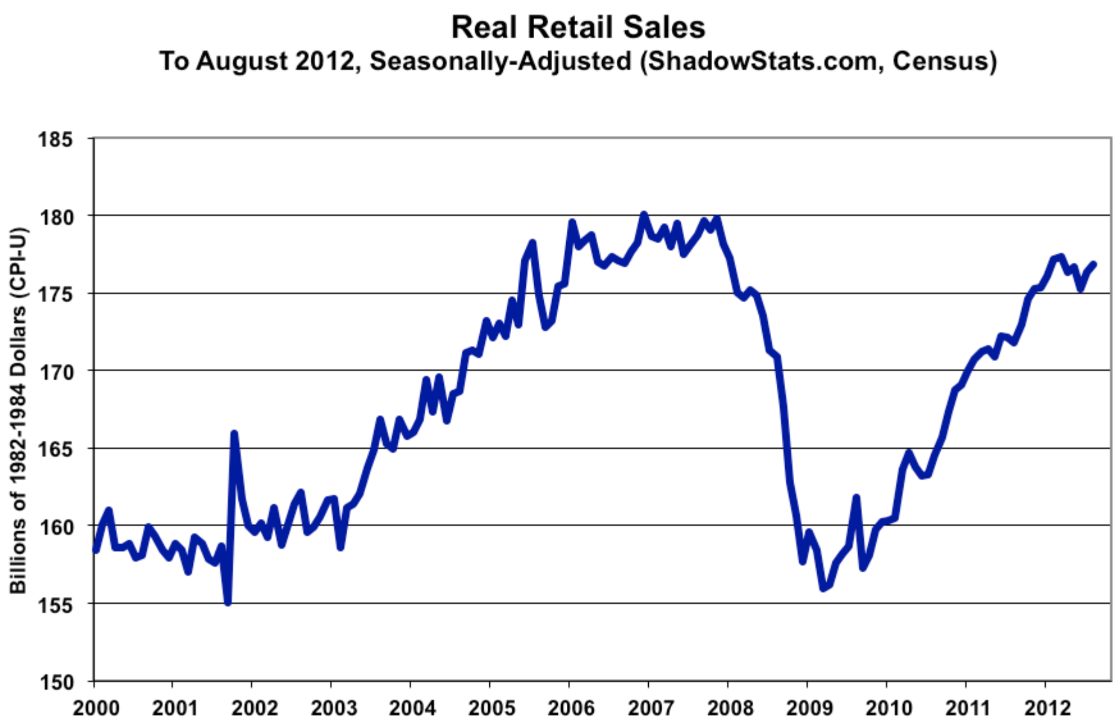
On a year-to-year basis, August real retail sales rose at an annual pace of 2.93%, versus a revised 2.44% (previously 2.66%) in July. The August annual growth is at level that would be on the brink of generating a reliable signal of pending recession in normal economic times.

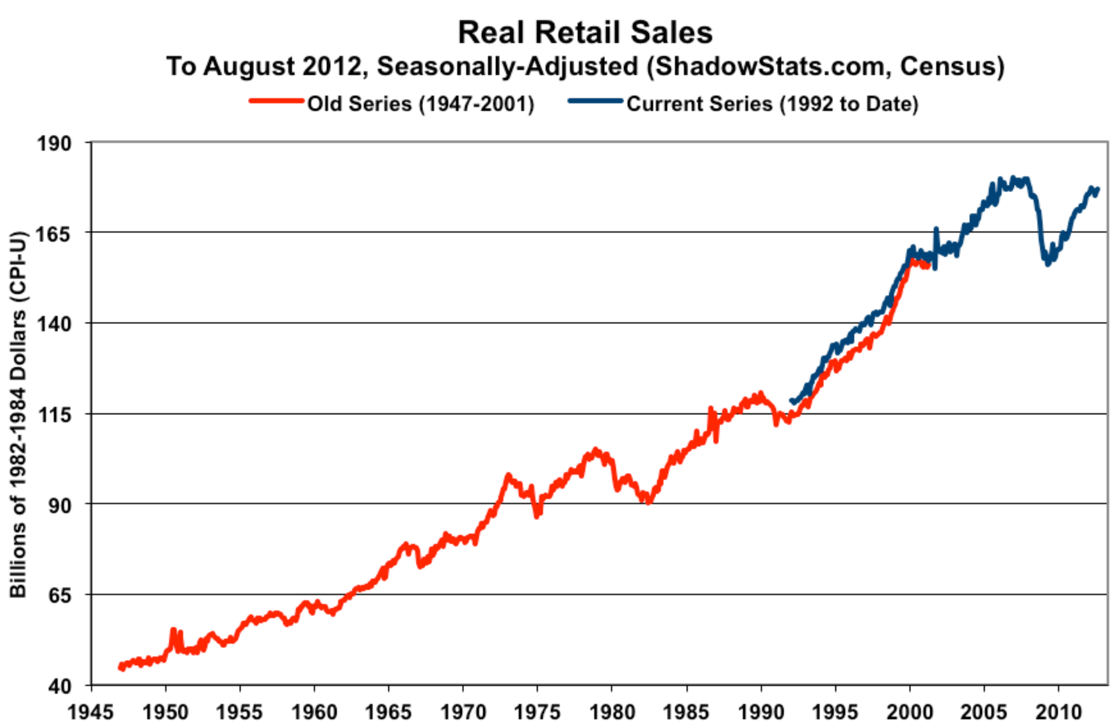
The first graph following shows real retail sales activity (deflated by the CPI-U) since 2000. The second graph shows full post-World War II detail.

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 continues to pick up, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze—as reflected partially by real earnings, discussed in the *Consumer Price Index* section and again in the most-recent *Commentary No. 469*—these data should continue trending meaningfully lower, in what eventually will become a formal double-dip recession.


Real Retail Sales
To August 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 August 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

INDEX OF INDUSTRIAL PRODUCTION (August 2012)

August Production Downturn Likely Represented Efforts at Reducing Excess Auto Inventories. The 1.2% decline in August headline industrial production was the sharpest monthly downturn since the latter part of the formal 2007 to 2009 recession. The production downturn encompassed a 0.7% drop in manufacturing, a 1.8% decline in mining and 3.6% decline in output from utilities.

The manufacturing decline was dominated by reduced automobile production, where an effort at reduction in excess inventories may be underway. The manufacturing decline also was consistent with indications of reduced production in August's ISM purchasing managers survey.

The reduced mining activity partially reflected oil platform shutdowns in the Gulf of Mexico related to Hurricane Isaac, while the drop in utility output may have represented some catch up from prior-period distortions, where unseasonably hot weather had spiked utility usage.

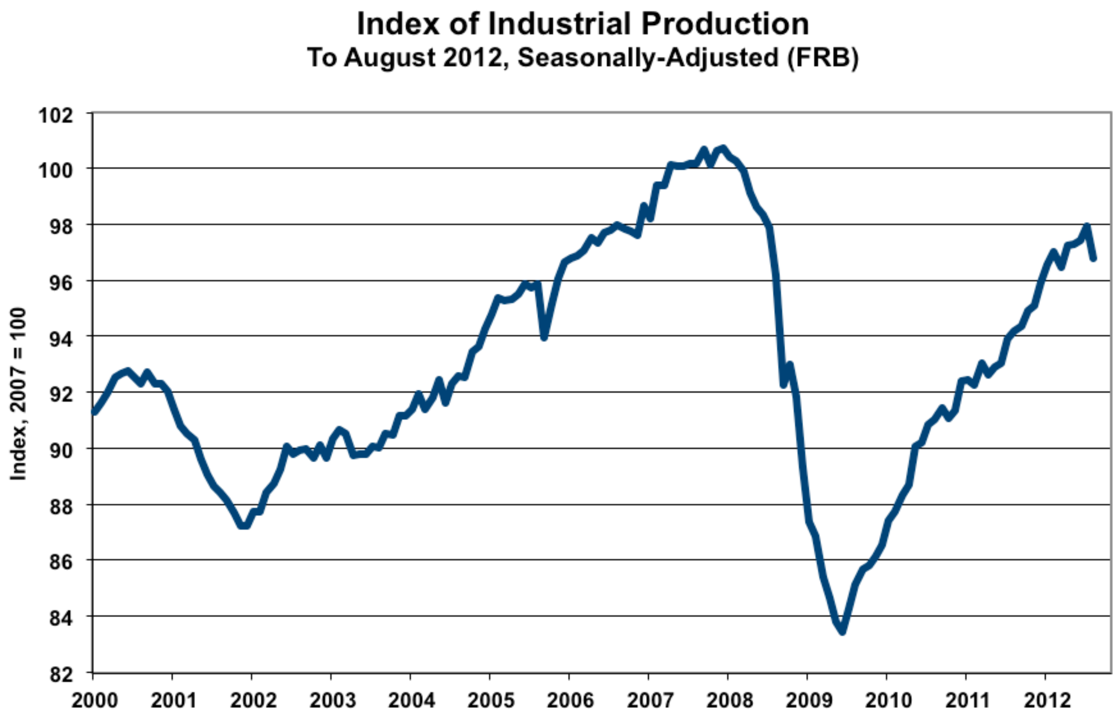
August 2012 Reporting. This morning's (September 14th) release by the Federal Reserve Board of seasonally-adjusted August 2012 industrial production showed a headline monthly decline of 1.16% (down by 1.24% before prior-period revisions), versus a revised 0.54% (previously 0.65%) monthly gain in July.

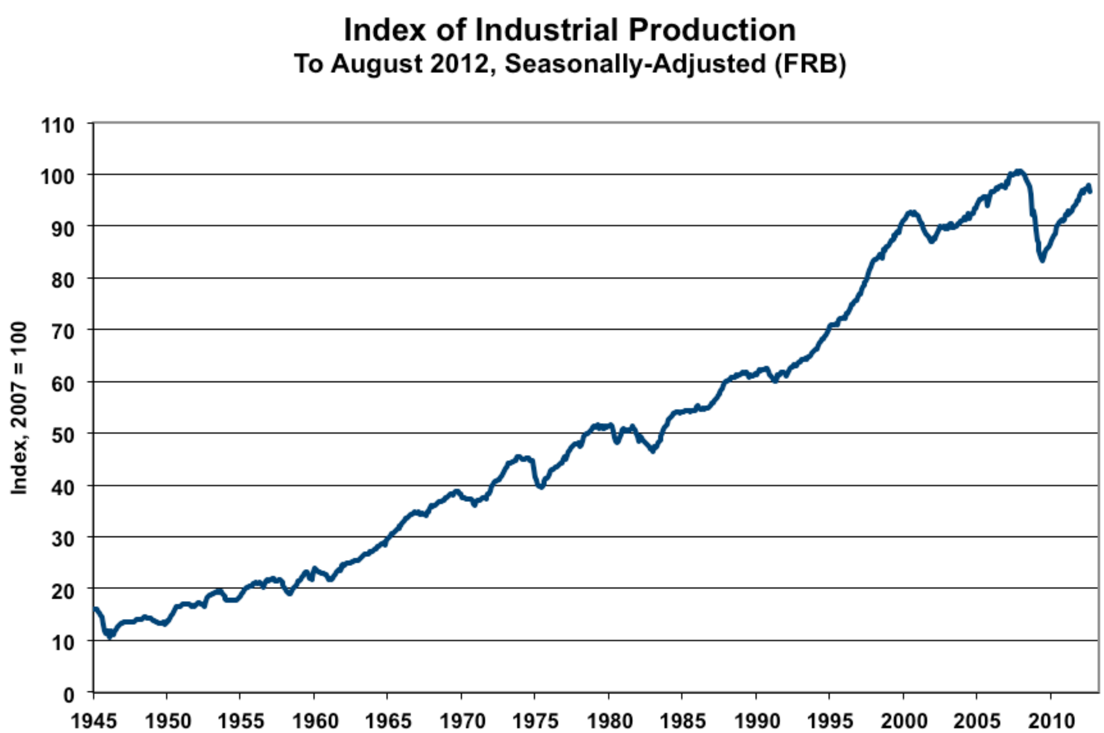
Year-to-year growth for August 2012 production slowed sharply to 2.80% from a revised 4.29% (previously 4.37%) in July. That was well off the recent relative peak annual growth of the series at 8.13%, in June 2010. The year-to-year contraction of 15.15% seen in June 2009, at the end of second-quarter 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.

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 perhaps to have topped 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 graphs here.


Index of Industrial Production
To August 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 August 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

Week Ahead. Market recognition of an intensifying double-dip recession has taken stronger hold, at the moment, while recognition of a mounting inflation threat has been rekindled a bit by recent Fed monetary policy announcements and rising headline inflation numbers. 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, otherwise, it puts a happy spin on the numbers; and the financial markets 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, as discussed in the just-updated *Hyperinflation Watch* section.

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 continue to show up in prior-period revisions.

Residential Construction (August 2012). Detail on August housing starts is due for release on Wednesday, September 19th, 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—continues, with no fundamental shift likely for August. As has become the standard circumstance, any reported monthly gain likely would not be statistically significant.

New and Existing Home Sales (August 2012). The August existing home sales release also is scheduled for Wednesday, September 19th, from the National Association of Realtors, while the August new home sales release from the Census Bureau is not scheduled until the following week, scheduled for Wednesday, September 26th. As usually is the case for both these series, entrenched patterns of stagnation likely have continued, and the new monthly results are not likely to be statistically-significant.