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

COMMENTARY NUMBER 489
November CPI, Industrial Production

December 14, 2012

Real Retail Sales Still Signal Recession

Storm's Impact on November Retail and Production Activity May Have Been Positive, But Any Gains Are Temporary, And Major Revisions Are Likely

Time for the Government to Come Clean on the C-CPI-U

QE3 Expansion Promises Rising Inflation Ahead

November Year-to-Year Inflation: 1.8% (CPI-U), 1.7% (CPI-W), 9.4% (SGS)

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, December 21st, covering November new orders for durable goods, housing starts and existing home sales, the third estimate (second revision) to third-quarter GDP, and the November PCE deflator.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Economic activity reflected in November 2012 retail sales and industrial production purportedly saw some pick-up from recovery effects following Hurricane Sandy, particularly in both the sales and production of automobiles, and other big-ticket items, where items destroyed by the storm were being replaced.

While that well may be the case, the gains here are temporary, with continuing structural problems in consumer liquidity preventing sustainable economic growth, as explored later in these *Opening Comments*. Reporting difficulties also likely still beset the quality of both the retail sales and industrial production surveying, and that means that significant revisions to currently reported data are likely in the months ahead.

On the inflation front, a sharp decline in gasoline prices caused declines in the headline monthly consumer inflation numbers for November, with a commensurate slowing in year-to-year consumer inflation. Core inflation (net of food and energy prices) remained relatively strong, still reflecting the impact of high oil prices within the broad economy. As the Fed's expanded QE3 fully kicks in, global financial-market response most likely will hit the dollar hard, pushing oil and gasoline prices higher, once again.

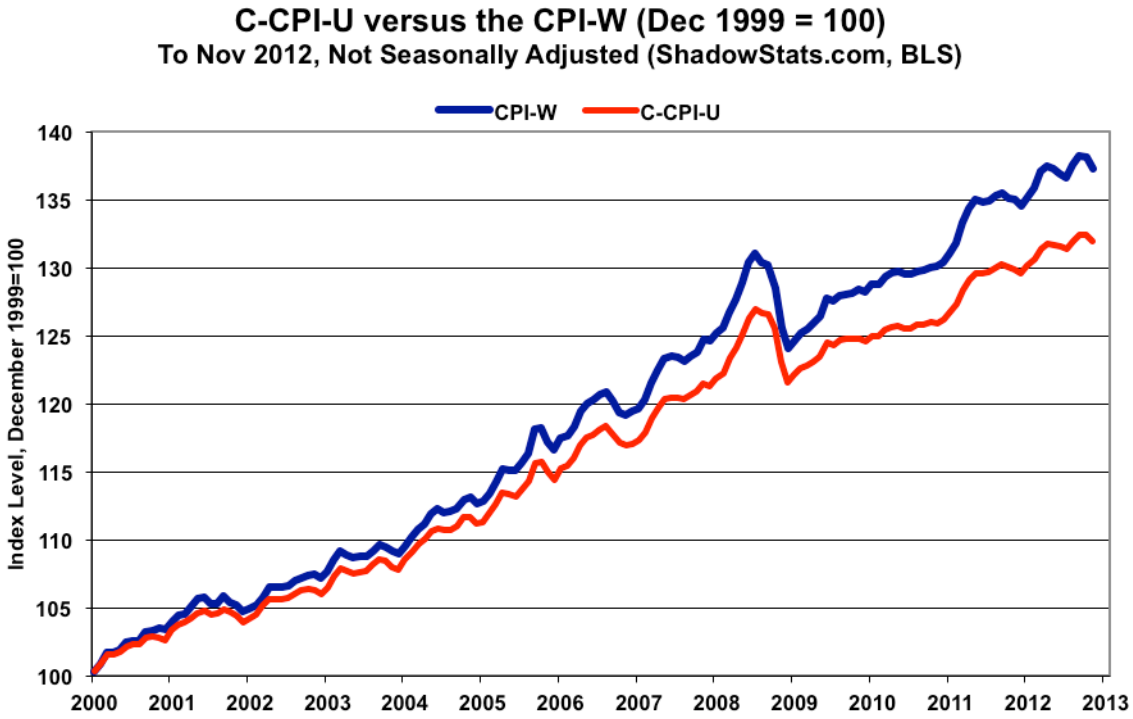
As the miscreants in Washington negotiate solutions to the "fiscal-cliff" and debt-ceiling crises, trial balloons have been floated that agreement has been reached to use a new CPI measure—the C-CPI-U, which tends to understate inflation even more than the CPI-U—as way of deceptively reducing cost-of-living adjustments to Social Security, etc. Not too surprisingly, public reaction appears to be turning increasingly negative, as the concept gets broader exposure in the popular press.

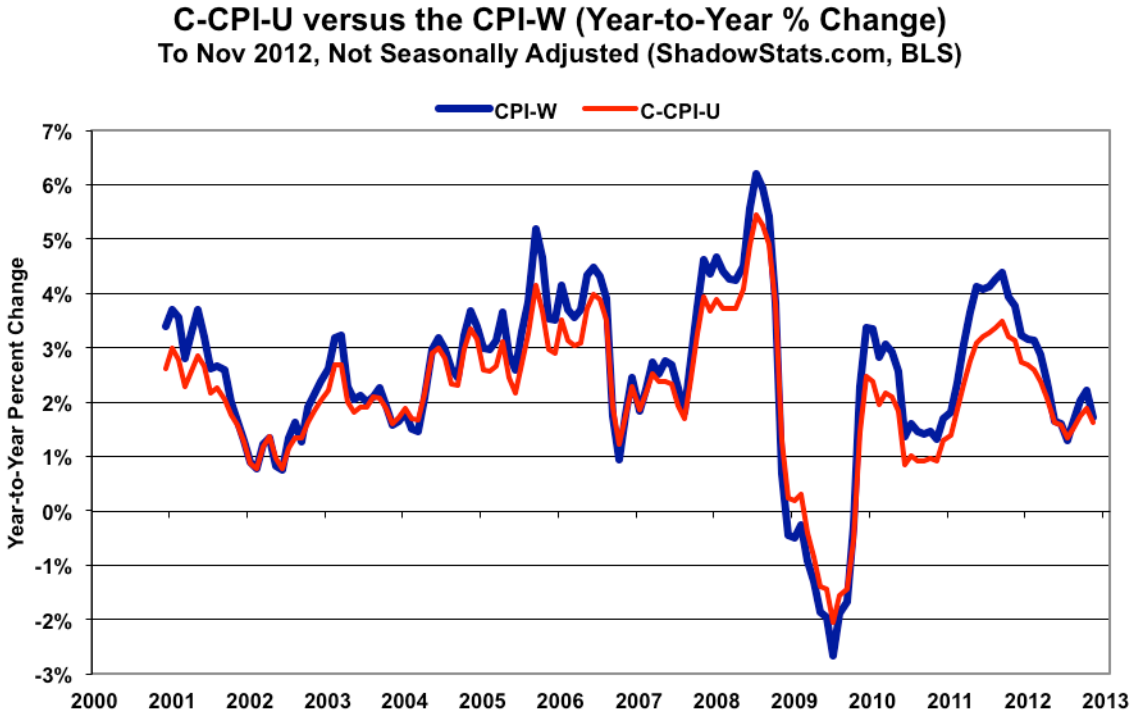
Public Furor Mounts Over Proposed Use of the C-CPI-U to Short-Change Social Security Recipients on Their Cost of Living Adjustments. The chain-weighted CPI-U (C-CPI-U) is the fully substitution-based inflation series that is under serious consideration by those in Congress and the White House as a replacement for the CPI, with the goal of cutting Social Security cost-of-living adjustments (COLA) by stealth. A fully-substitution-based inflation index used in COLA calculations would reflect lower inflation than would the CPI-U or CPI-W (used for Social Security), resulting in fraudulently- and artificially-reduced cost-of-living adjustments to social programs, retirement funds, etc.

If the people controlling the U.S. government were honest, they simply would tell the COLA recipients that payments were being cut as part of the effort to balance the budget. Yet, no one in Washington has the political courage to suggest such a thing, openly, hence the regular deception that so often surfaces in the headline budget bargaining. Aside from reducing Social Security COLA artificially, the C-CPI-U has other issues, such as being revised annually for two years, unlike the unadjusted CPI-U and CPI-W, which never are revised. If inflation estimates were revised lower, would the government try to take back earlier payment adjustments, or retroactively to increase payments in the event of upside revisions?

The following two graphs plot the comparative levels and annual inflation rates of the C-CPI-U and the CPI-W (used in Social Security COLA calculations). If the C-CPI-U had been used since its inception, in lieu of the CPI-W for COLA calculations, the ensuing annual cost of living adjustments would have averaged 13% less in each year, than they would have been otherwise.

Reducing COLA by artificially reducing CPI reporting is not new. Had the politicians not pursued similar policies successfully in the 1980s and 1990s, Social Security payments would be more than double current levels. Assuming the budget negotiations continue to embrace this terribly-misleading concept, this area will be addressed soon in an updated version of the *Public Commentary on Inflation Measurement*, which otherwise explains why individuals do not want to use a substitution-based index for COLA, instead of the fixed-basket-of-goods index that was in full use several decades ago.



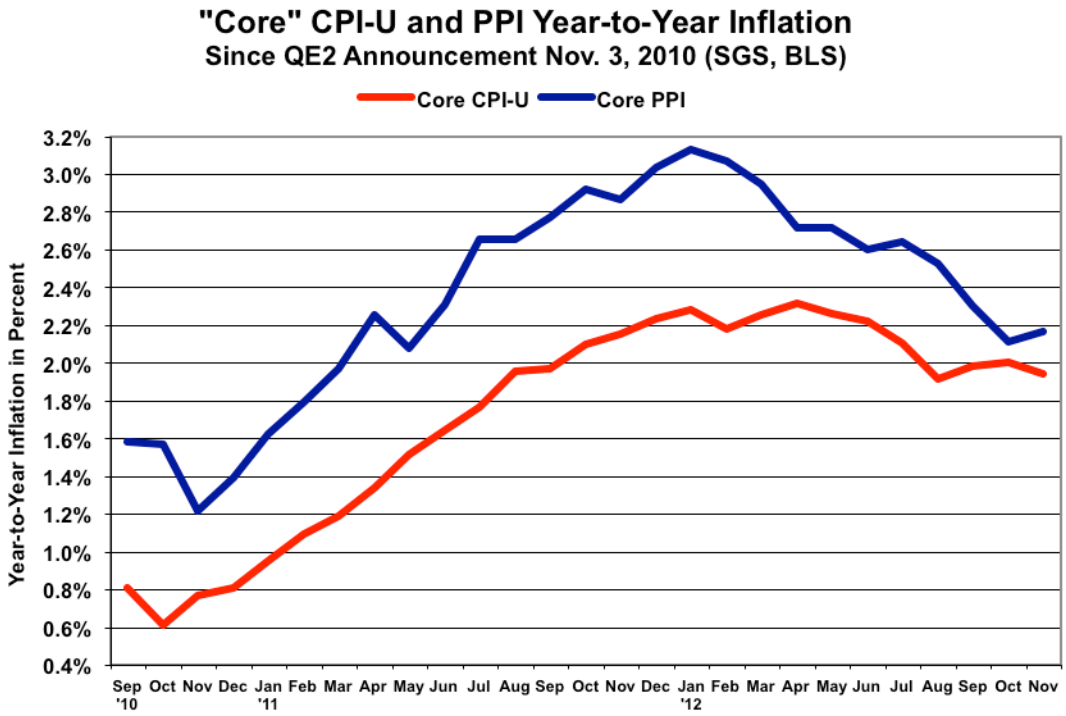


Monthly Inflation Declines and Annual Inflation Slows, Tied to Declining Gasoline Prices. Headline November CPI-U monthly inflation declined by 0.31% for the month, in the context of declining gasoline prices. Annual inflation softened, as well, with year-to-year November CPI-U inflation at 1.76%, down from 2.16% in October. Parallel moves were seen in the other series with CPI-W down by 0.46% for the month and annual inflation slowing to 1.70% in November, from 2.21% in October. Adjusted to pre-Clinton (1990) methodology, annual SGS-Alternate CPI inflation eased back to 5.2% in November, from 5.6% in October, while the 1980-based measure came in at 9.4% in November, versus 9.8% in October. The downside violence to these numbers from falling gasoline prices appears to have run its course.

Core Inflation. Inflationary pressures—from still broadly higher oil prices—continue to spread in the general 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. Despite repeated protestations to the contrary, by more than one Federal Reserve chairman, high oil prices have significant, longer-range inflationary impact on the broad economy, as mirrored in rising core inflation. While core inflation is net of direct energy inflation, the impact of oil prices permeates all economic sectors, including transportation costs of goods, services and people, and as the basis for many chemicals, pharmaceuticals, plastics, fertilizer, etc. Persistently high oil prices, as seen recently, lead to persistently high inflation in the core numbers.

Based on likely market reaction to the expansion of QE3, new inflationary impact should surface shortly in terms of weakness in the U.S. dollar and in higher dollar-denominated oil prices.

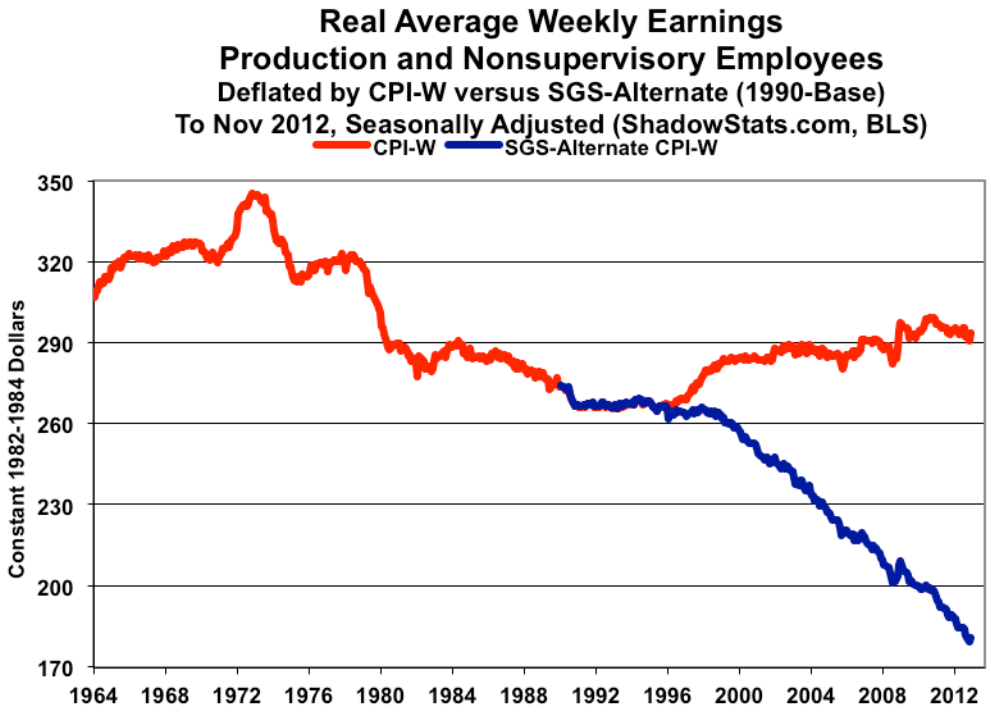
As reflected in the graph, November 2012 year-to-year CPI-U core inflation moved minimally lower to 1.94%, from 2.00% in October. In contrast, the PPI annual core inflation moved somewhat higher in November, to 2.17%, from 2.11% in October.



Consumer Liquidity Constraints Continue Unabated. As discussed in *Special Commentary (No. 485)* and *Hyperinflation 2012*, the major structural constraint on broad economic activity remains the impaired liquidity of consumers. With a general lack of inflation-adjusted growth in consumer income, and the inability of the consumer to expand his or her credit, so as to be able to make up the shortfall in living standards, the chances for sustainable growth in retail sales or in the broad economy—as reflected in industrial production—remain nil for the foreseeable future.

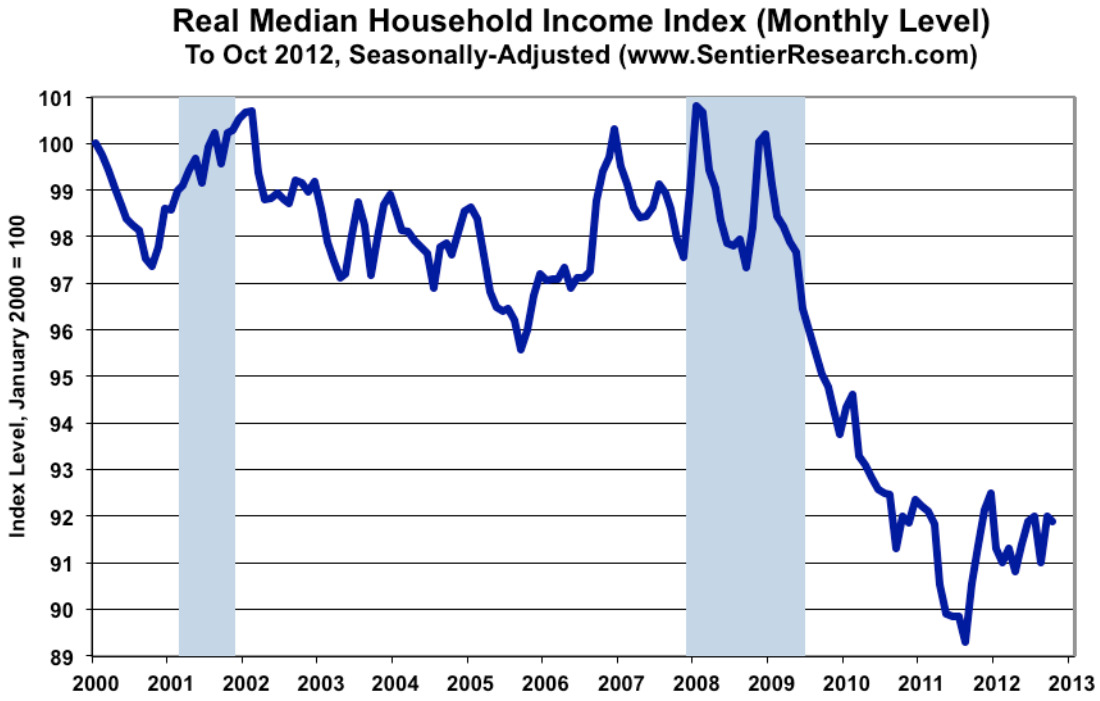
All of the following graphs are updated from the *Special Commentary*, except for the median real household income plot (courtesy of www.SentierResearch.com), where there has not been a subsequent data release.

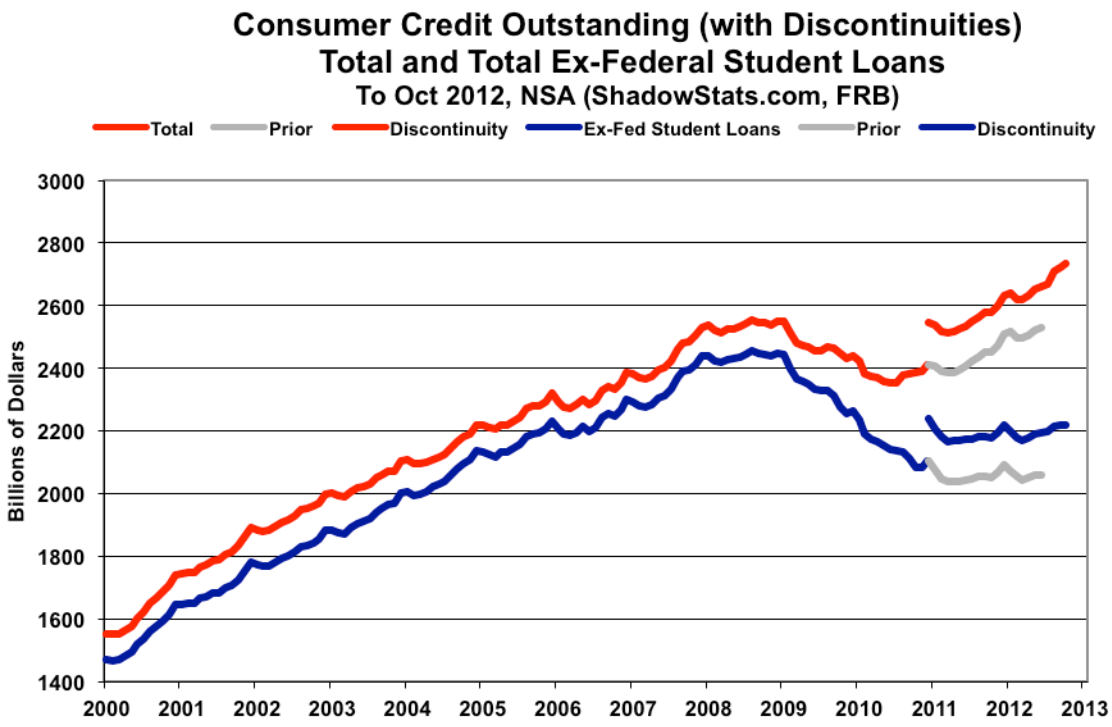
In the graph of real (inflation-adjusted) average weekly earnings for production and nonsupervisory employees, as deflated by the official CPI-W, average earnings have been trending lower since mid-2010, with irregular monthly volatility. Nonetheless, earnings never recovered their pre-1975 recession high, thanks largely to the loss of higher paying production jobs to offshore competition.

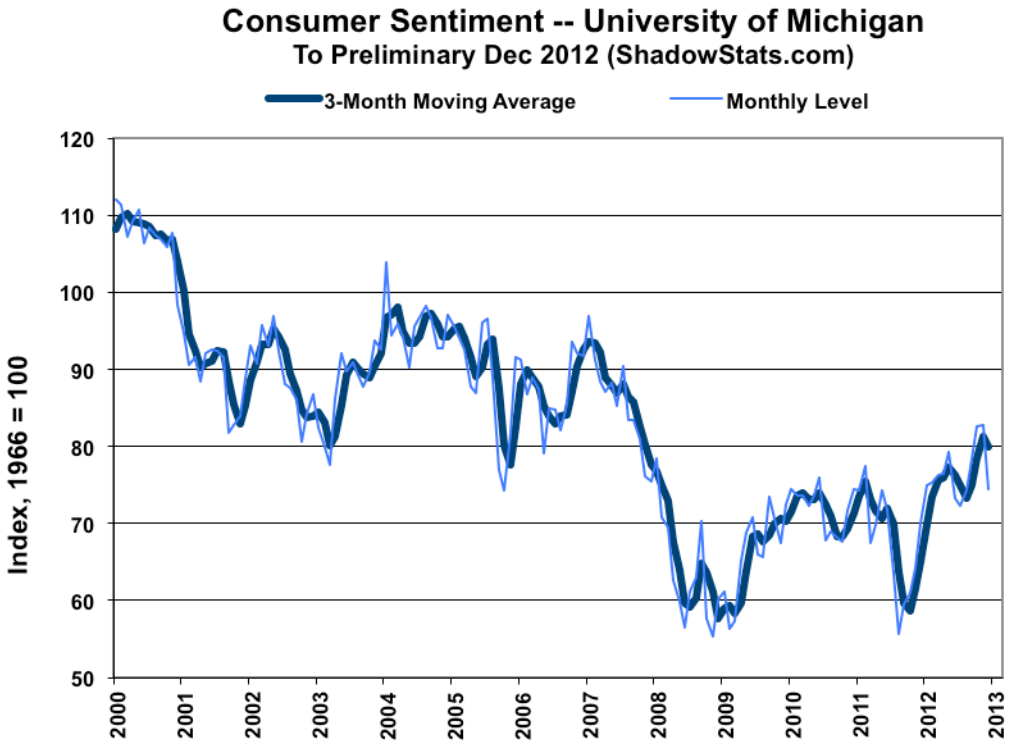


The same series deflated by the SGS-Alternate consumer inflation measure (1990-based), which reflects slightly more than three-percentage-point higher annual inflation than the CPI-W, shows real average weekly earnings generally to have been in a general downtrend since the early-1970s.

Allowing for normal volatility, the next graph of real median household income shows that measure to be at its lowest level in decades, having been in a tailspin since the official recession formally ended in June of 2009. As seen in the second graph following, consumer credit outstanding continues to show no post-recession growth, whatsoever, except for the government's lending of student loans. The "discontinuity" reflects an incomplete and inconsistent revision to the numbers by the Federal Reserve.


Real Median Household Income Index (Monthly Level)
To Oct 2012, Seasonally-Adjusted (www.SentierResearch.com)
Index Level, January 2000 = 100
101
100
99
98
97
96
95
94
93
92
91
90
89
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013


Consumer Credit Outstanding (with Discontinuities)
Total and Total Ex-Federal Student Loans
To Oct 2012, NSA (ShadowStats.com, FRB)
Total
Prior
Discontinuity
Ex-Fed Student Loans
Prior
Discontinuity
Billions of Dollars
3000
2800
2600
2400
2200
2000
1800
1600
1400
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013

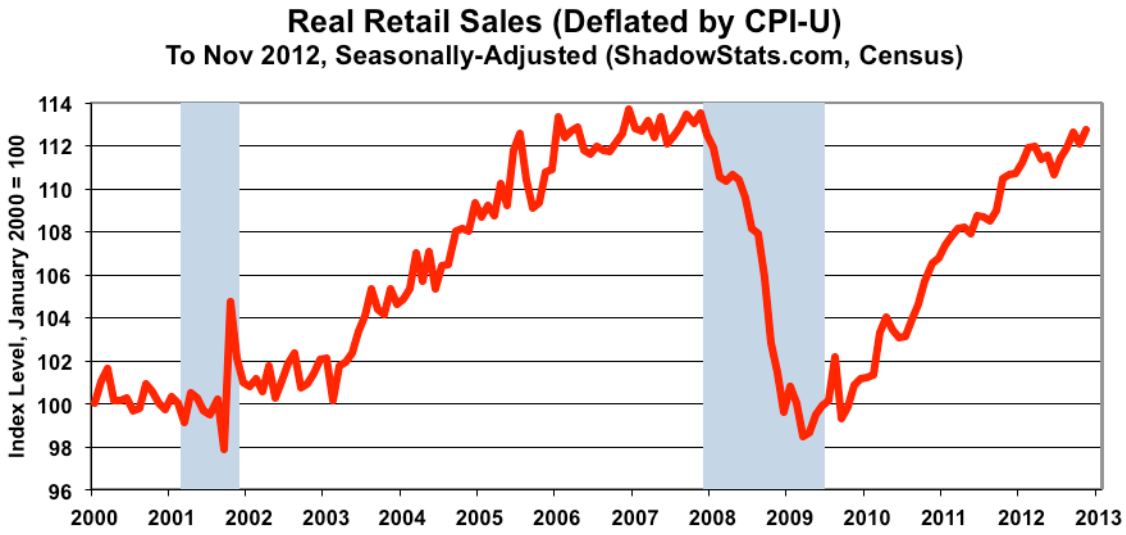


Not only does the consumer lack the real income and credit wherewithal to support sustained economic growth, the preceding graph of consumer sentiment (similar in pattern to consumer confidence) shows the consumer in a batten-down-the-hatches mode. Allowing for the regular volatility of the series, sentiment remains at levels generally not seen outside of recessions. The consumer, who accounts for more than 70% of the GDP, has not and simply cannot support the hoped-for economic recovery

November Retail Sales and Industrial Production. Both series likely are meaningfully distorted, with unusual activity, reporting and surveying issues created by Hurricane Sandy making landfall in central New Jersey at the end of October. Accordingly, the monthly numbers just published are not particularly meaningful and subject to major revisions in the months ahead.

That said, a 0.27% nominal (not-adjusted-for-inflation) increase in November 2012 retail sales became a 0.58% monthly increase after inflation adjustment, where the inflation rate was a contraction of 0.31%. Real growth in October had been a monthly contraction of 0.34%. The November reporting reflected a pick-up in auto sales, which could have been storm related, with replacement vehicles being purchased to replace those destroyed in the storm.

In like manner, November industrial production bounced back, up by 1.05% for the month, following a 0.67% decline in October. The November gain purportedly reflected a rebound from plant shutdowns during the storm, with strong new growth in auto production. Again both these series are not reliable, at the moment. Yet, year-to-year change for both series remained unusually low, suggestive of patterns that tend to lead the onset of a recession during normal economic times. Standard graphs of these series are published in the *Reporting Detail* section. Graphs corrected for poor-quality deflation, however, follow.

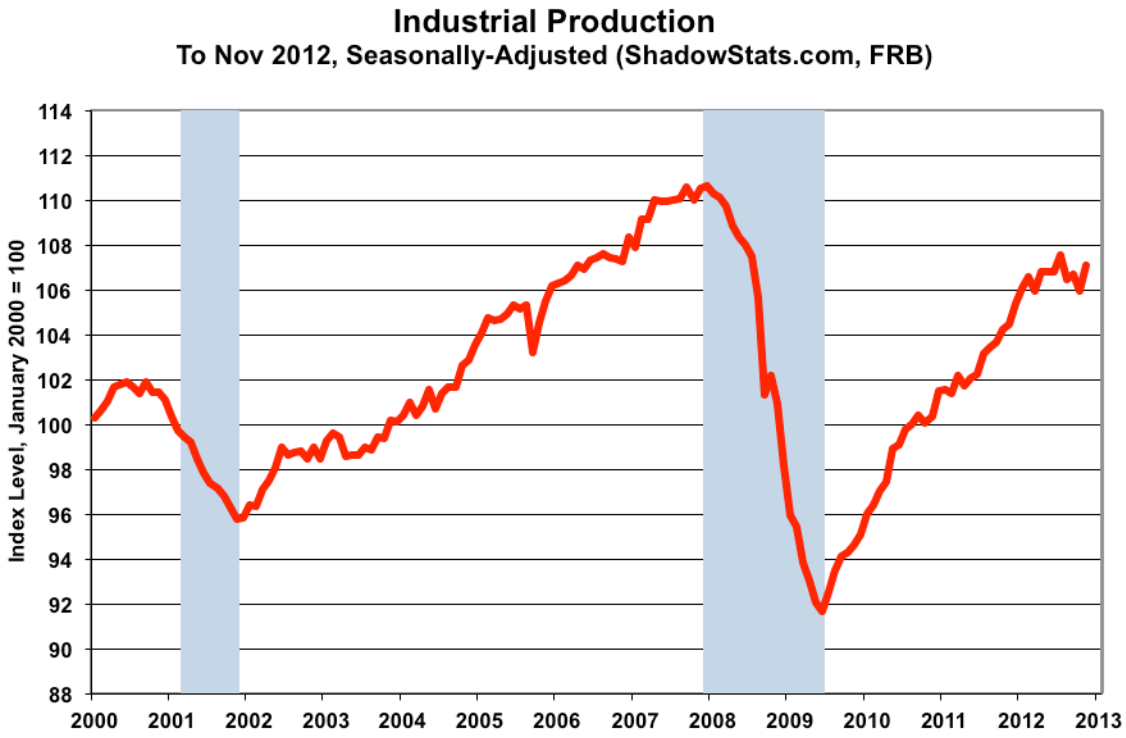


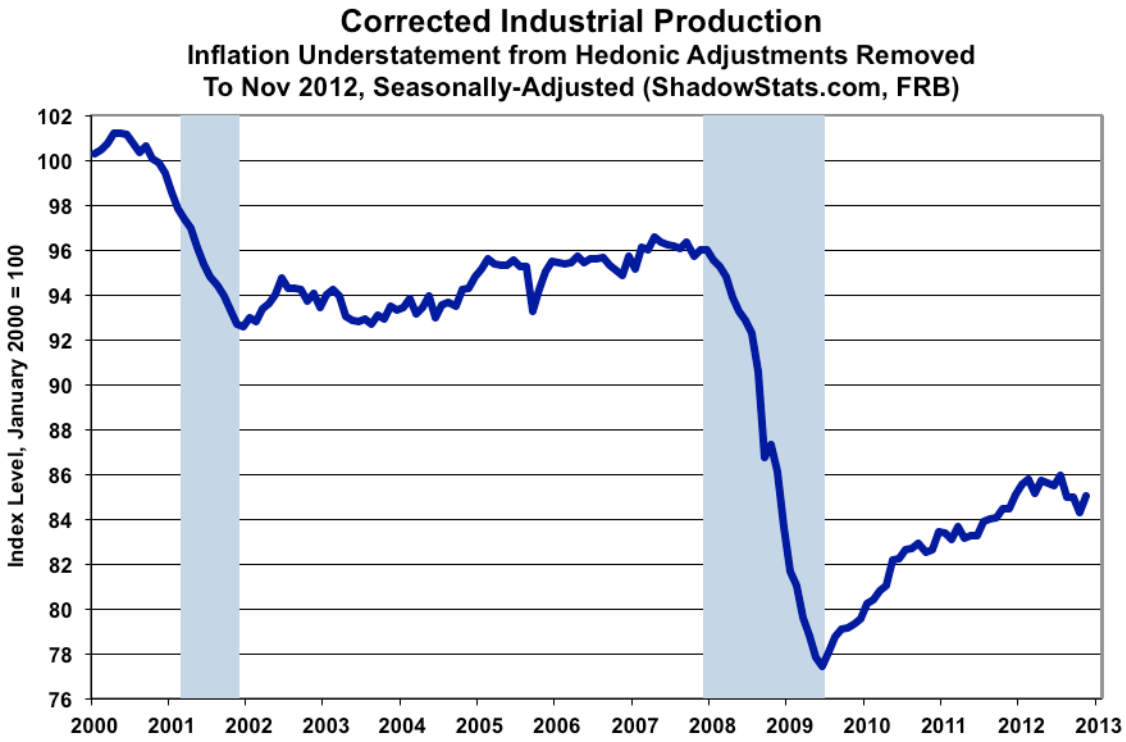
Corrected Retail Sales. The first graph preceding reflects real retail sales as reported by the St. Louis Fed and as deflated by the CPI-U. The CPI-U, however, understates inflation (see the *Public Comment on Inflation*), with the effect of overstating the inflation-adjusted growth.

Instead of being deflated by the CPI-U, the "corrected" real retail numbers in the second graph above use ShadowStats.com's SGS-Alternate Inflation Measure (1990-Base) for deflation. As discussed in *Hyperinflation 2012* and *Special Commentary (No. 485)*, with the higher inflation of the SGS measure, the revamped numbers show a pattern of plunge and stagnation. The recent topping-out process now has reverted to renewed decline, in a series that has been bottom-bouncing along a low-level plateau of economic activity, in the period following the economic collapse of 2006 into 2009. The two charts are indexed to a consistent scale.

Corrected Industrial Production. Where hedonic quality adjustments are used to understate inflation used in calculating components of industrial production, the two graphs following address that issue. The first graph reflects official industrial production reporting, indexed to January 2000 = 100, instead of the Fed's index that is set at 2007 = 100. The 2000 indexing is used to provide for some consistency in this series of revamped graphics. The second graph is a corrected version of the first, with the estimated hedonic-inflation adjustments backed-out of the official deflator.

The "corrected" graph does show some growth in the period following the official June 2009 near-term trough in production activity. Yet, the upturn is far shy of the full recovery reported in the GDP. Production levels have not regained pre-recession highs, but, instead, have entered a period of renewed contraction.





[More complete details on consumer inflation, industrial production, real retail sales and average weekly earnings are found in the* Reporting Detail *section.]

HYPERINFLATION WATCH

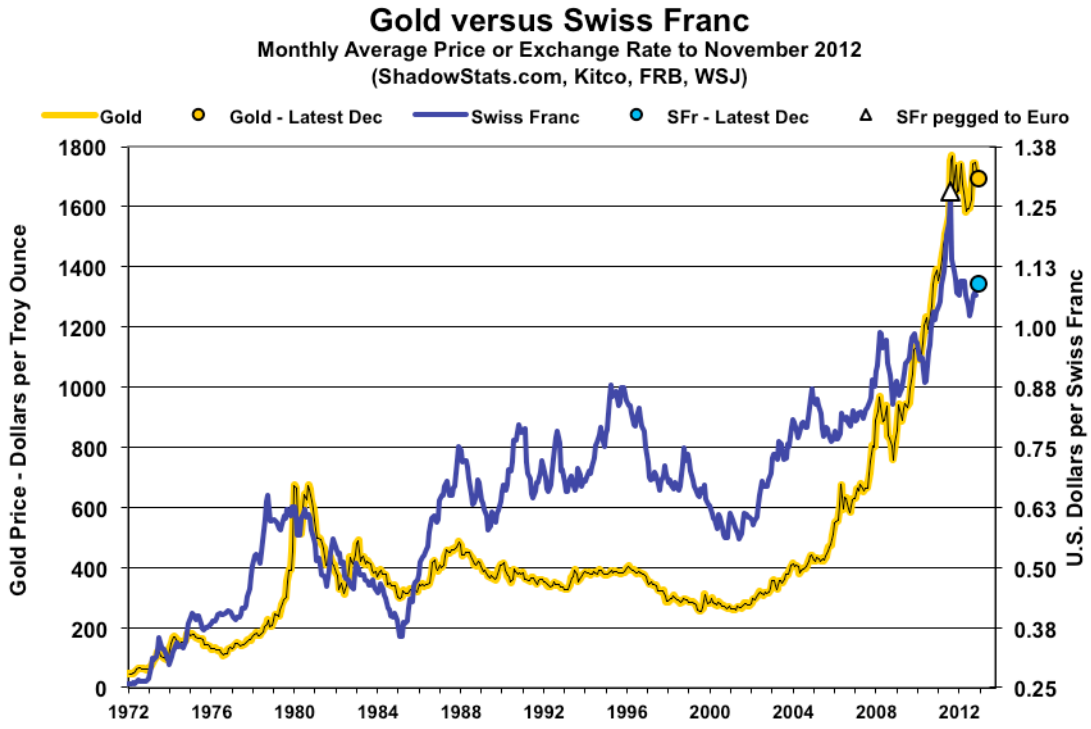
Special Commentary (No. 485), published on November 27th, updated *Hyperinflation 2012* and the broad outlooks for the economy and inflation, as well as for systemic stability and the U.S. dollar. No recent economic releases, and certainly no advertised negotiating activity by Washington politicians on the "fiscal cliff" and debt ceiling expansion, have altered those outlooks. The expansion of QE3 by the Fed, on December 12th, however, continued the regular unfolding of events that eventually will trigger a hyperinflation, as discussed in *Commentary No. 488*.

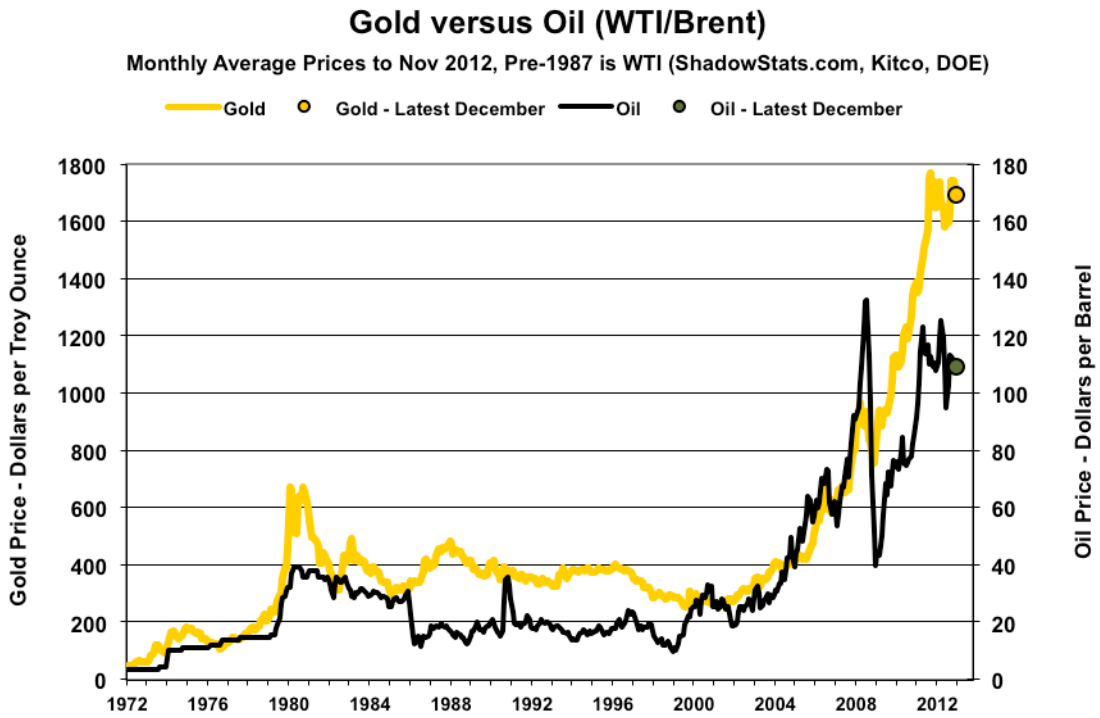
The Fed's activity can be viewed as a signal of deepening problems in the banking system. As discussed by Mr. Bernanke, the Fed can do little to stimulate the economy, but it can create inflation. Nonetheless, the move here was to prop-up the banking system. Direct monetization of Treasury debt will tend to savage the U.S. dollar's exchange rate, boost oil and gasoline prices, boost money supply growth and domestic U.S. inflation. Those issues, however, could be exacerbated rapidly by significant problems out

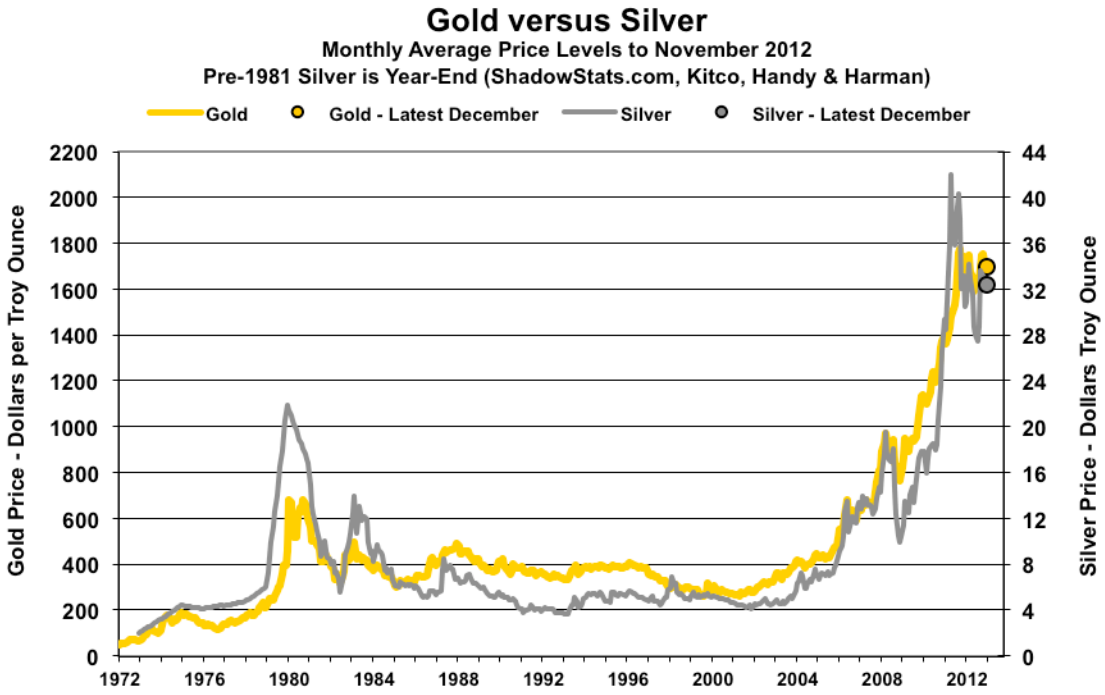
of the government negotiations to handle the "fiscal cliff" and debt ceiling (see *Commentary No. 488* for further detail).

For new subscribers, as well as for those who otherwise are not familiar with the hyperinflation report or the recent special commentary, linked above, those documents are suggested as background reading on the financial turmoil and currency upheaval facing the United States in the next year or two.

Gold Graphs. Following are the usual graphs of the price of gold, versus the Swiss franc, oil prices and silver prices. Despite what appears to be covert, but still rather obvious intervention aimed at killing a fundamental rally in the price of gold, the underlying fundamentals against the dollar could not be much worse. Accordingly, it would not be surprising to see some upside movement in the price of each of the plotted instruments or commodities in the not-so-distant future.







REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (November 2012)

Falling Gasoline Prices Hit November's Consumer Inflation Readings. The Bureau of Labor Statistics (BLS) reported a month-to-month decline, and lower inflation year-to-year, for consumer prices in November 2012. With headline monthly inflation down by 0.3% for the month, annual CPI-U inflation eased to 1.8% in November, from 2.2% in October. Those patterns primarily reflected declining gasoline prices, which subsequently have stabilized, at least on a seasonally-adjusted basis, so far, in December.

With the expansion of QE3 into the Federal Reserve's direct purchasing and monetization of U.S. Treasury securities, downside pressure on the exchange rate value of the U.S. dollar is likely in the months ahead, along with related relative spikes in the price of oil and gasoline, which, in turn, should begin to accelerate an upside pace in consumer inflation (see *Commentary No. 488*).

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.* Since it is fully substitution based, the series tends to reflect lower inflation than the other CPI measures. Accordingly, the C-CPI-U is the "new inflation" measure being considered by Congress and the White House as a tool for reducing Social Security cost-of-living adjustments by stealth.

*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.* There are two measures, where the first is based on reporting methodologies in place as of 1980, and the second is based on reporting methodologies in place as of 1990.

CPI-U. The BLS reported today (December 14th) that the headline, seasonally-adjusted CPI-U for November 2012 declined by 0.31% (down by 0.47% unadjusted) for the month. That followed a monthly increase in October of 0.15% (a rounded 0.1%). Unadjusted, the monthly October CPI-U was virtually flat, down by 0.04%.

A decline in gasoline prices was muted minimally by seasonal adjustments. Unadjusted monthly-average gasoline prices declined by 7.7% in November, per the BLS (down by 7.6% per the more-comprehensive surveying of the Department of Energy). Seasonal-adjustments narrowed the price decline to 7.4%. Suggesting a shift in 2012's seasonal adjustments, an unadjusted 1.1% monthly decline in November 2011 gasoline prices, became a 2.4% decline after seasonal adjustment.

Unadjusted, November 2012 year-to-year CPI-U inflation softened to 1.76%, versus 2.16% in October.

Year-to-year, CPI-U inflation would increase or decrease in next month's December 2012 reporting, dependent on the seasonally-adjusted monthly change, versus an unchanged level in the adjusted monthly reporting for December 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for December 2012, the difference in December's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the November 2012 annual inflation rate of 1.76%.

Nineteen of the last twenty-four months have shown rising year-to-year, or annual, "core" CPI-U inflation (net of food and energy inflation), with the November 2012 year-to-year core rate slowing minimally to 1.94%, from 2.00% in October. In contrast, the PPI annual core inflation turned minimally higher in November, to 2.17% from 2.11% in October.

The November CPI-U 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 recent expansion of QE3 should create some renewed upside pressures here, shortly, as the Fed's monetization of U.S. Treasuries gets fully underway. The core annual inflation numbers for both the CPI-U and PPI reflected 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, fell by 0.46% (down by 0.60% unadjusted), following a seasonally-adjusted headline gain in October of 0.13% (down by 0.09% unadjusted) for the month.

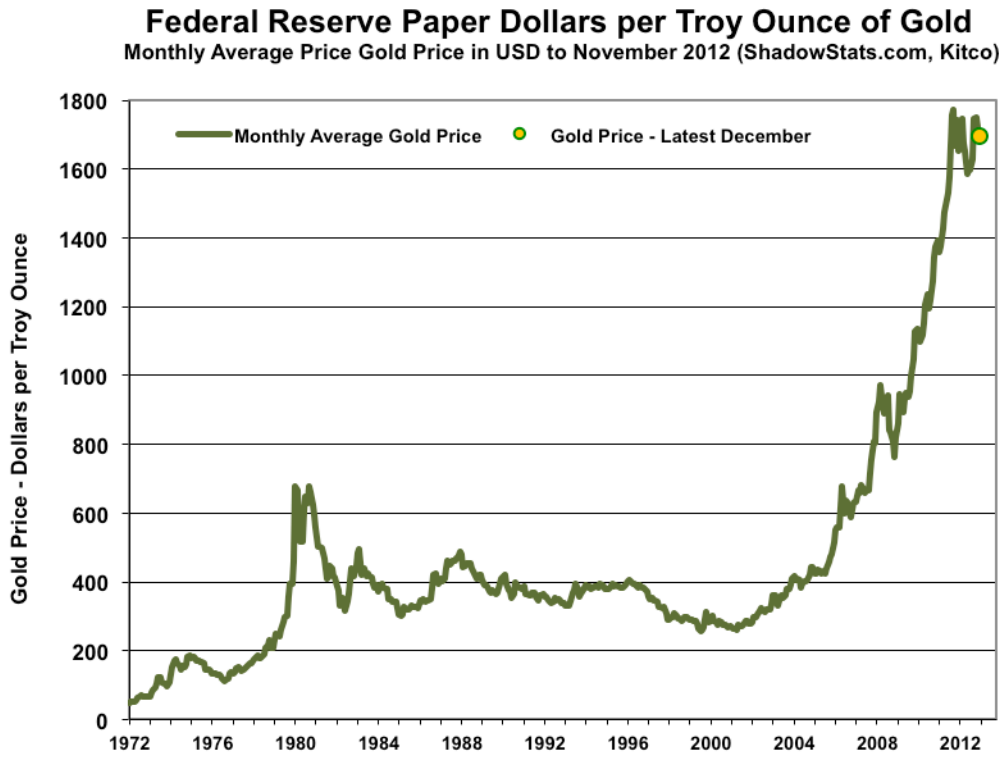
Unadjusted, November 2012 year-to-year CPI-W inflation was 1.70%, versus 2.21% in October.

C-CPI-U. Year-to-year inflation for the November 2012 C-CPI-U was 1.61%, versus 1.87% in October.

The chain-weighted CPI-U is the fully substitution-based series that openly is being discussed (purportedly agreed to) by the President and Congress as a way to reduce cost-of-living payments for Social Security, etc., by stealth. This outright fraud on the public has not been receiving good press, as trial balloons have been floated. Successful similar efforts at deceptive inflation reporting, in the past several decades, account for why today's headline CPI inflation numbers are so understated (see the brief discussion in the *Opening Comments* section and the *Public Commentary on Inflation Measurement*).

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990-based) methodologies, annual CPI inflation was roughly 5.2% in November 2012, versus 5.6% in October. The SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was about 9.4% (9.41% for those using the extra digit) in October 2012, versus 9.8% in October.

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) for gold on January 21, 1980 would be $2,515 per troy ounce, based on November 2012 CPI-U-adjusted dollars, and $9,521 per troy ounce, based on November 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 November 2012 CPI-U inflation, the 1980 silver-price peak would be $146 per troy ounce and would be $554 per troy ounce in terms of November 2012 SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

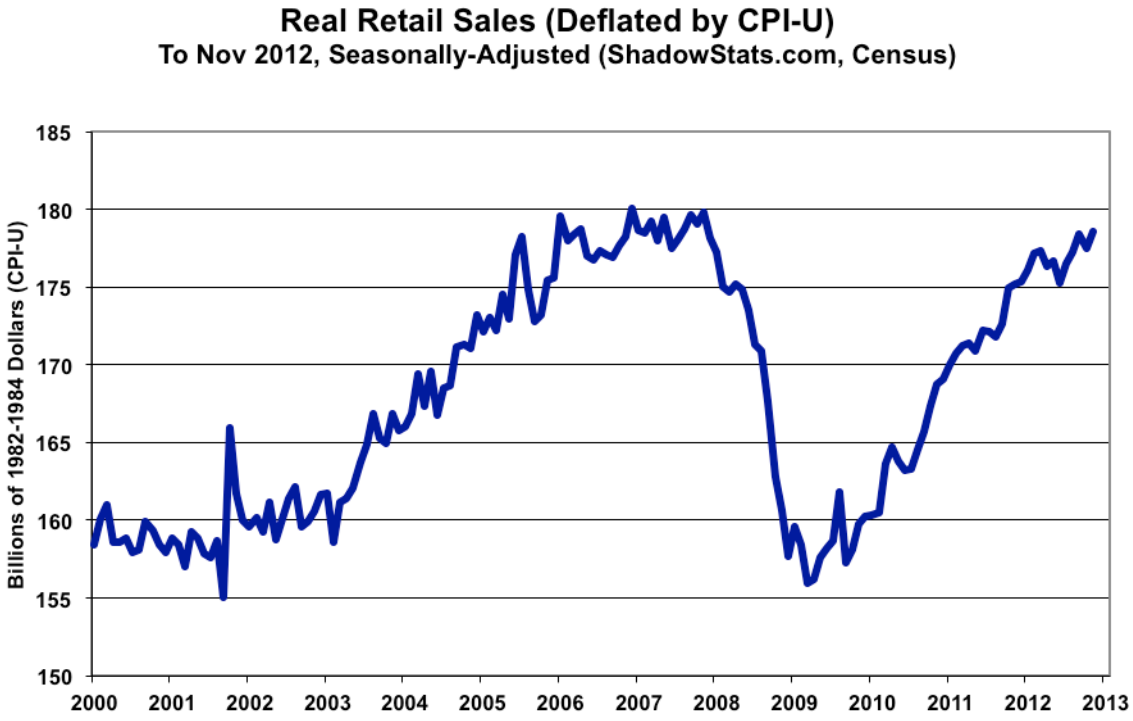
As shown in Table 1 on page 50 of *Hyperinflation 2012*, and as updated in Table III on page 40 of *Special Commentary (No. 485)*, over the decades, the increases in gold and silver prices have compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, 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).

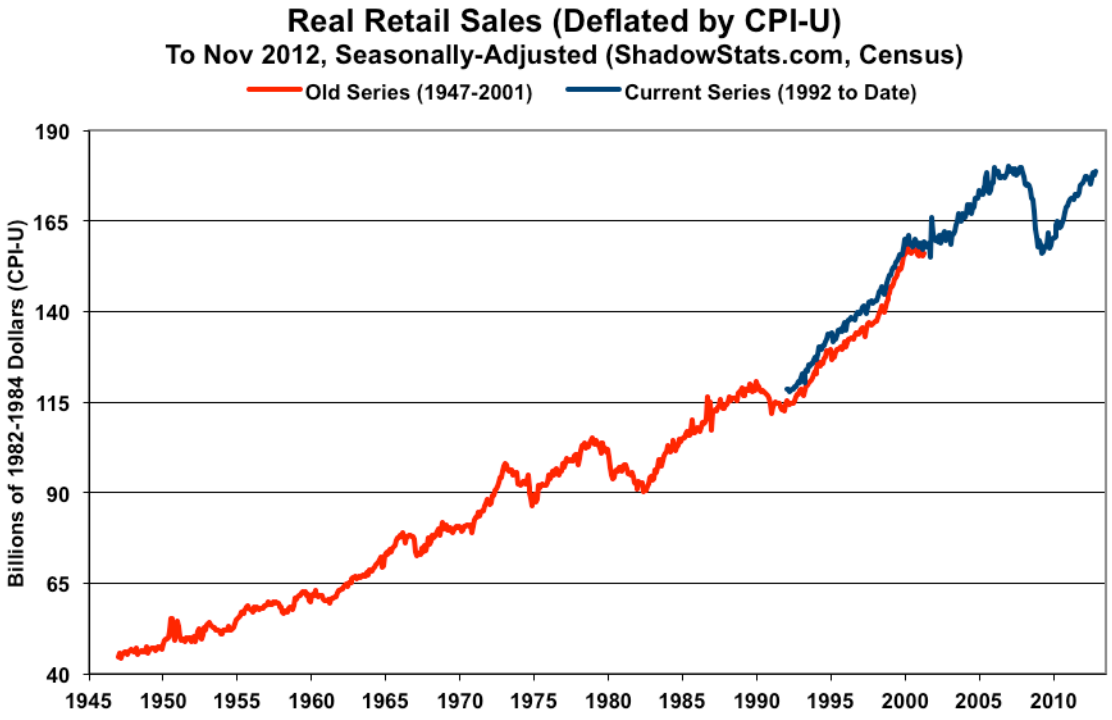
Real (Inflation-Adjusted) Retail Sales. As discussed with the nominal (not-adjusted-for-inflation) retail reporting for November 2012 in *Commentary No. 488*, the November sales survey likely included heavy distortions from the impact of Hurricane Sandy. As a result, significant monthly volatility and revisions should be seen in the months ahead. Much of the month-specific impact may never be knowable, but the reporting eventually will balance out. One element that appears to have been storm-related was a boost in automobile sales, likely replacing a significant number of vehicles that were destroyed during the storm. This same factor appears to be at work in a sudden pick-up in November automobile production. Gains here will be actual, but short-lived, barring a major shift in underlying consumer fundamentals.

Based on today's, December 14th, November CPI-U estimate, inflation- and seasonally-adjusted November 2012 retail sales rose by 0.58% month-to-month, reflecting the combination of the nominal monthly gain of 0.27% and a contraction in monthly CPI-U inflation of 0.31%. Real October sales reflected a revised 0.34% (previously 0.45%) monthly decline, versus a revised nominal October decline of 0.34% (previously 0.31%).

Year-to-year, November 2012 real retail sales rose at an annual pace of 1.90%, versus a revised 1.49% (previously 1.61%) in October. October annual growth had dropped to a level that would generate a reliable signal of pending recession—during more-normal economic times—and the November annual growth rate continued to hold in that range. In the current circumstance, those signals could be viewed as indicating a pending intensification of the downturn.

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


Real Retail Sales (Deflated by CPI-U)
To Nov 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
2013


Real Retail Sales (Deflated by CPI-U)
To Nov 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 recent pattern of sales activity turns increasingly negative in the updated "corrected" real retail sales graph shown in the *Opening Comments and Executive Summary* section. The corrected real 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. 485)*, deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating economic growth.

As also discussed in the *Opening Comments and Executive Summary* section, there has been no change in the underlying consumer-liquidity 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 resumes its upturn, 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, and again in *Commentary No. 469*—these data should continue trending meaningfully lower, in what eventually will become a formal double-dip recession.

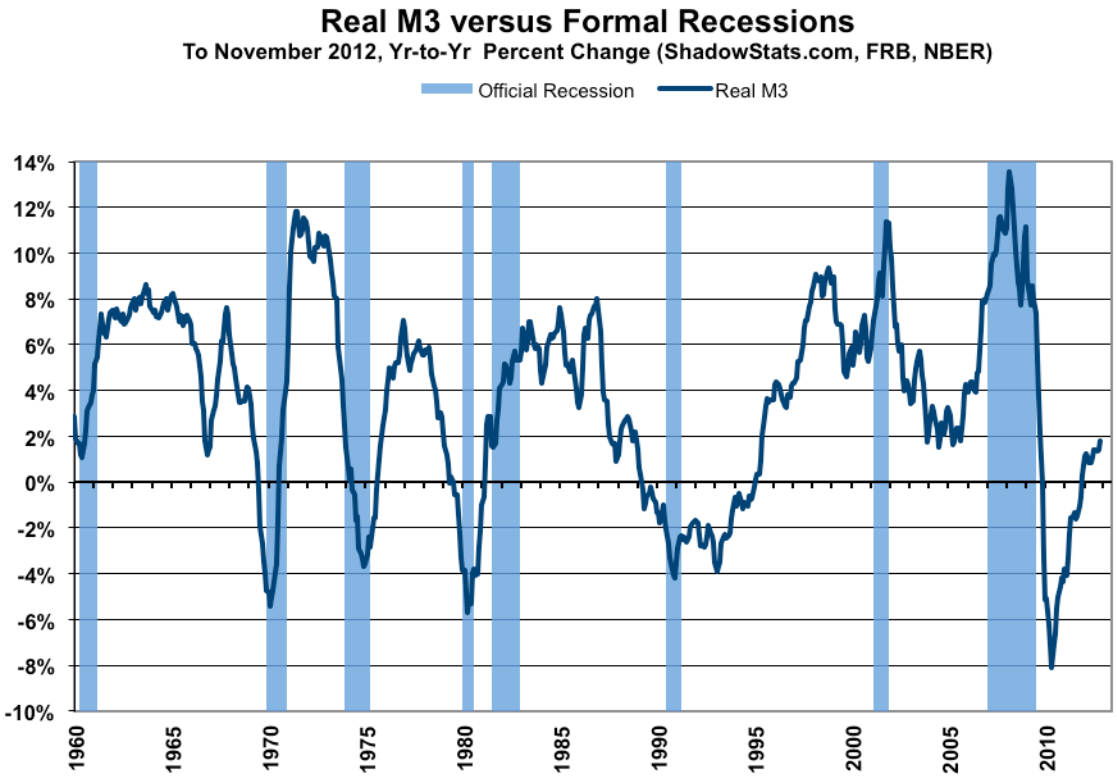
Real (Inflation-Adjusted) Earnings. Coincident with today's (December 14th) CPI release for November 2012, the BLS published real (inflation-adjusted) average weekly earnings for November 2012. The production and nonsupervisory employees series showed that seasonally-adjusted, real average weekly earnings (deflated by the CPI-W) jumped by 0.9% month-to-month in November, reflecting primarily a 0.5% monthly decline in the CPI-W, and a gain in nominal (not-adjusted-for-inflation) earnings otherwise of 0.4%. The month-to-month decline in October real earnings was revised to 0.4% (previously a 0.5% drop), accompanied by an upside revision of 0.1% to the level of October's real earnings estimate.

Unadjusted and year-to-year, November 2012 real earnings fell by 0.4%, versus a revised 2.6% (previously 2.7%) year-to-year decline in October. Both the monthly and annual fluctuations in this series are irregular, with current reporting well within the normal bounds of volatility.

The regular graph of real average weekly earnings of production and nonsupervisory employees series is included in the *Opening Comments and Executive Summary* section.

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 November 2012 CPI-U report and the latest SGS-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for November 2012 was 1.8%, versus 1.4% in October. The entire difference was in the decline of the annual inflation rate in the November CPI-U.

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, even though there had been no upturn since the economy hit bottom in mid-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 more obvious, and that eventually should lead to official recognition of a double-dip recession. Reality remains that the economic collapse into 2009 was followed by a plateau of low-level economic activity or stagnation—no upturn or recovery, no end to the official 2007 recession—and the downturn ahead remains nothing more than a continuation and re-intensification of the downturn that began in 2006.

INDEX OF INDUSTRIAL PRODUCTION (November 2012)

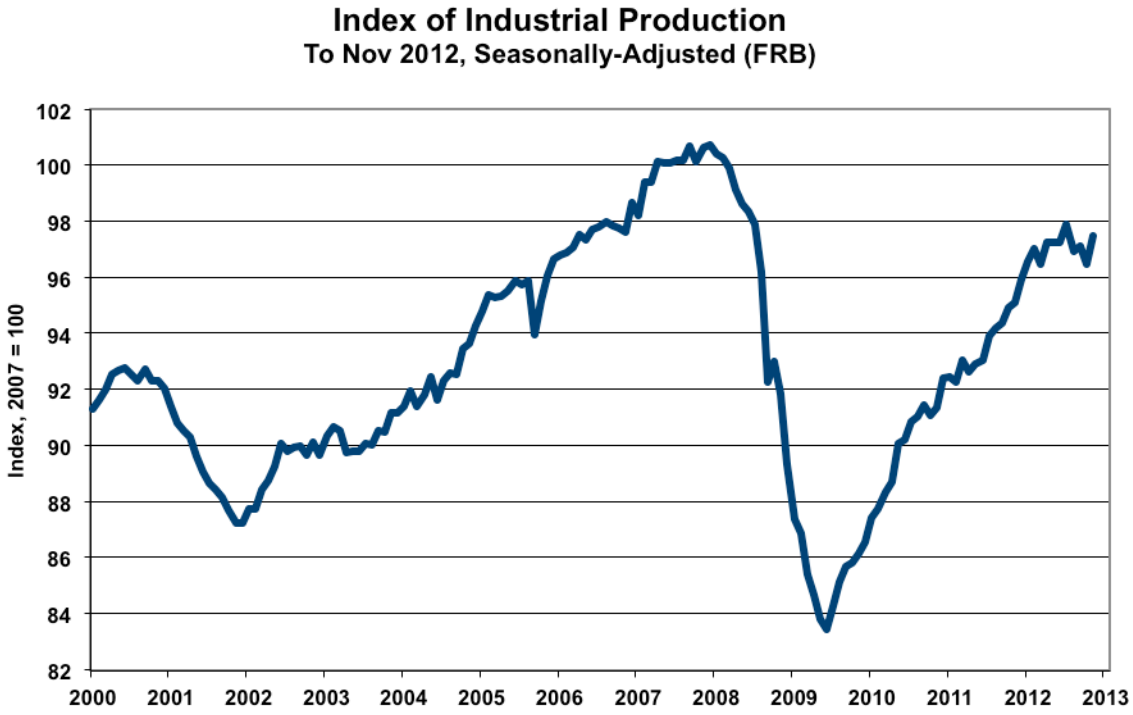
November Production Boosted by Hurricane After-Effects; Reporting Remains Unstable. This morning's (December 14th) release by the Federal Reserve Board of seasonally-adjusted November 2012 industrial production showed a headline monthly gain of 1.05% (up by 0.95% before prior-period revisions), versus a revised deepening of October's month-to-month contraction to 0.67%, versus an initial decline reported as down by 0.43%.

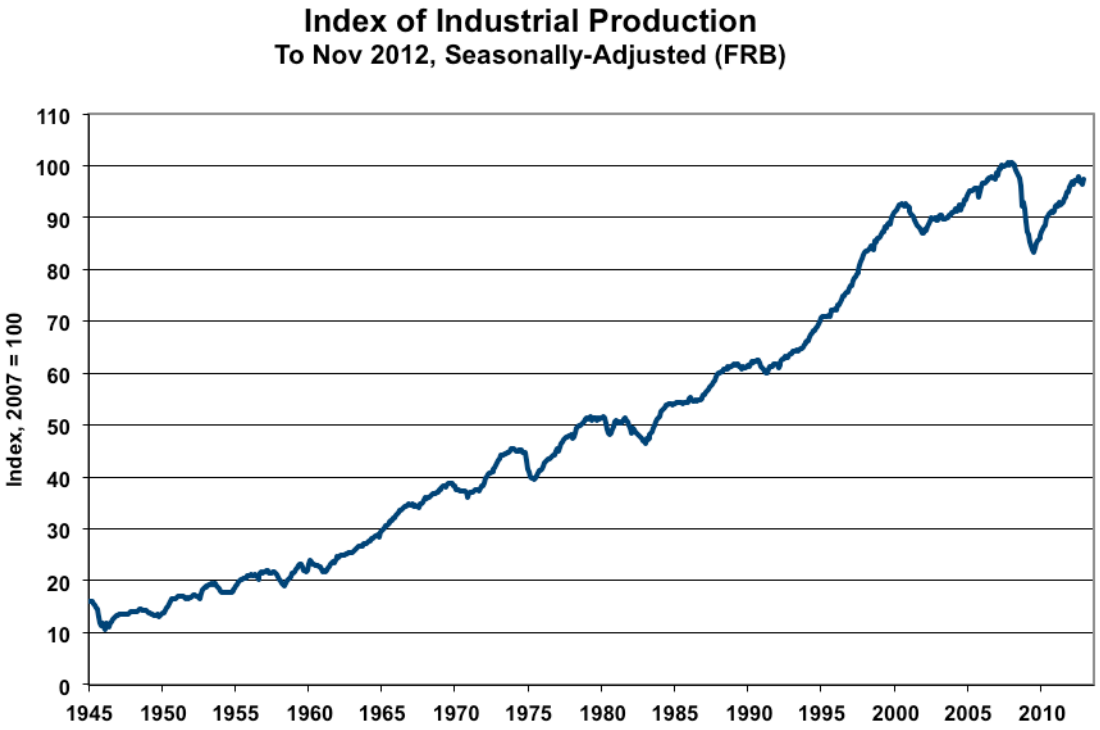
As with retail sales, this series still likely is suffering from hurricane-related distortions, and major series volatility and revisions should loom as a result. The Fed touts the November monthly gain as recovery from the storm-related shutdown of production activity in October. The Fed initially estimated that Hurricane Sandy had been destructive enough in three days to reduce aggregate national activity by something shy of 1.0% for the entire month of October. The heavily-touted rebound in monthly automobile production likely was related to sales of automobiles that were replacing vehicles otherwise

destroyed in the storm. As with retail sales, however, any post-disaster gains will be fleeting, unless there is a strong turnaround in underlying fundamental drivers of business activity, such as household income.

Year-to-year growth for November 2012 production was estimated at a still-traditionally-low level of 2.51%, up from a revised 1.64% (previously 1.74%) in October. Other than for October 2012, November's annual growth was the weakest showing since February 2010, well off the recent relative peak annual growth of the series at 8.13%, in June 2010 (going against the official June 2009 trough of the economic collapse). Indeed, 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 to have topped out, trending lower in recent reporting. The corrected production series is graphed in the *Opening Comments and Executive Summary* section. Please note that index base for the corrected graphs is January 2000 = 100, instead of the Federal Reserve's official 2007 = 100, used in the graphs here.

Week Ahead. Beyond the temporary effects of the post-Hurricane Sandy environment, and in anticipation of the impact of the expanded QE3 program in currency markets, reporting generally should show higher-than-expected inflation and indicate 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.

Significant reporting-quality problems continue with most widely followed series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments, distortions that have been induced by the still-ongoing economic turmoil of the last five years. The recent economic collapse has been without precedent in the post-World War II era of modern economic reporting. These distortions have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series. In any event, where numbers are too far removed from common experience, they tend to be viewed by the public with extreme skepticism.

Still, recognition of an intensifying double-dip recession continues to gain, while recognition of a mounting inflation threat has been rekindled by recent Fed monetary policies. The political system would like to see the issues disappear; 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.

Residential Construction (November 2012). Detail on November housing starts is due for release on Wednesday, December 19th, by the Census Bureau. November reporting could begin to see some upturn from post-storm reconstruction efforts, but with some offsetting construction delays likely from the storm's early impact, and often otherwise inclement weather along the damaged East Coast, the biggest upside impacts likely will be seen in later months.

Pending storm-related gains will tend to be temporary, in the wake of the 75% collapse in activity from 2006 through 2008, and the ensuing four-year pattern of housing starts stagnation at an historically low level of activity continues, unless the circumstance is affected by a fundamental upturn in consumer and banking liquidity conditions. Chances are good that any reported monthly gain for November still will not be statistically significant.

Existing Home Sales (November 2012). November existing home sales are due for release on Thursday, December 20th, from the National Association of Realtors, (the new home sales report from the Census Bureau is not due for release until Thursday, December 27th). Entrenched patterns of stagnation likely have continued in both series, and the pending monthly results are not likely to be statistically-significant.

Gross Domestic Product—GDP (Third-Quarter 2012, Third-Estimate, Second-Revision). The third-estimate and second-revision of third-quarter 2012 GDP is due for release by the Bureau of Economic Analysis (BEA) on Thursday, December 20th. The revision here likely will be no more than statistical noise.

Underlying reality remains in the direction of much weaker than the previously-reported headline growth, but revisions in that direction will have to wait until the annual revisions in July 2013. Whatever is reported, the new number most certainly still will not be statistically significant, with the GDP series remaining the most worthless, the most heavily politicized and the most misleading of any major government economic statistical release.

Personal Consumption Expenditure (PCE) Deflator (November 2012). The BEA is scheduled to release the November 2012 PCE deflator on Friday, December 21st. The Federal Reserve's purported inflation target should move somewhat lower, holding below the targeted 2.0% year-to-year inflation rate, moving in tandem with the slowing of the November annual inflation numbers in today's (December 14th) CPI reporting. Nonetheless, as discussed previously, the current concept of an inflation target serves only as pablum for the financial markets, not as a defining priority that drives Fed policy. This will be discussed in the related *Commentary*, along with the latest waffling by Mr. Bernanke on what the Fed really means by an inflation target (i.e., a projected "core" PCE deflator a year down the road).

New Orders for Durables Goods (November 2012). The initial estimate for November 2012 new orders for durable goods now is scheduled tentatively for release on Friday, December 21st, by the Commerce Department, based on Commerce's presumption that Monday, December 24th will be a federal holiday.

Despite the sharp and irregular volatility in commercial aircraft orders, new orders have been trending lower, contracting quarter-to-quarter for third-quarter 2012. That trend likely will continue, even though a given month's results may not fall outside the bounds of normal variability.

In terms of the potential inflation contribution to the monthly and annual change in new orders, the seasonally-adjusted, month-to-month change in the November 2012 PPI finished goods capital equipment index was an increase of 0.2%, with year-to-year unadjusted inflation at 1.5%. Due to hedonic-quality adjustments to this portion of the PPI series, however, as with the GDP numbers, those inflation data understate inflation reality and correspondingly overstate inflation-adjusted growth by perhaps two-percentage points per year.

