

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

COMMENTARY NUMBER 495
December CPI, Real Retail Sales, Real Earnings, Production

January 17, 2013

**Official Quarterly Production Growth Rates for Second-Half 2012
Were Weakest Since Recession Trough in 2009**

**Corrected for Understated Inflation, Real Retail Sales and Production Show
Post-2009 Stagnation Turned into Contraction in Second- or Third-Quarter 2012**

December Year-to-Year Inflation: 1.7% (CPI-U), 1.7% (CPI-W), 9.4% (ShadowStats)

**December Housing Starts Gain Still Not Statistically Significant
Despite Some Boost from Hurricane Damage**

PLEASE NOTE: Later today (January 17th), the U.S. Treasury will release its GAAP-based 2012 Financial Statement of the United States Government. A Special Commentary analyzing the details of government's financial condition will follow as soon as practicable thereafter.

The next regular Commentary is scheduled for Friday, January 25th, covering December existing- and new-home sales.

Best wishes to all — John Williams

Opening Comments and Executive Summary. Despite upside contributions to December 2012 activity in retail sales, industrial production and housing starts, from the repair and replacement of damaged or

destroyed property and the disruption to business by Hurricane Sandy, fundamental underlying economic activity continued to falter or to signal pending economic downturn in the latest monthly reporting. This was true both in terms of official reporting, and in terms of ShadowStats-corrected numbers.

As discussed in [Commentary No. 493](#) and [Special Commentary \(No. 485\)](#), structural liquidity issues tied to contracting real (inflation-adjusted) consumer income, and to lack of expansion in consumer credit, continue to prevent sustainable real growth in broad economic activity, let alone personal consumption (more than 70% of GDP) and retail sales.

There has been no actual economic recovery since the official recession hit bottom in June 2009, and there is no economic recovery pending. The official, full recovery reflected in GDP reporting is but a statistical illusion. The use of too-low inflation in deflating the popular economic series—adjusting them for the effects of inflation—results in overstated inflation-adjusted growth. Versions of current retail sales and industrial production reporting, corrected for this inflation understatement, already are in quarter-to-quarter contraction, as explored later in these *Opening Comments*.

Even as reported officially, though, growth rates in both the real retail-sales and industrial-production series are suggestive of a renewed formal downturn in economic activity, an event that should gain eventual official recognition as the second-leg of a double-dip recession.

Year-to-year growth in December 2012 real retail sales remained at a low level that would provide a reliable signal of pending recession, during normal economic times. Further, annualized quarterly growth rates in industrial production were at post-2007 recession lows in third- and fourth-quarter 2012. Outside of formal recession, these levels were last seen in the two quarters leading into the 2007 recession.

On the inflation front, December CPI-U was unchanged month-to-month, with declining gasoline and other energy prices being offset by rising food prices and core inflation. Reflecting the formal lack of inflation in December, real average weekly earnings gained 0.3% for the month, which was well within the bounds of normal volatility for the series, as discussed in the *Reporting Detail* section. Growth in real earnings has been virtually nil for the last decade, using the official CPI-W, but it has been continually negative, when deflated using the ShadowStats-Alternate Inflation measure (1990-based).

December 2012 Inflation Reporting. Buffeted by highly volatile gasoline prices, year-to-year CPI-U inflation ranged in 2012 from 2.93% in January to 1.41% in July, closing out 2012 at 1.74%. Detail of a full variety of monthly, quarterly and annual inflation measures is covered in the *Reporting Detail* section.

The recent decline in gasoline prices appears to have run its course. Likely downside turmoil for the U.S. dollar in the months ahead should spike oil prices and consumer inflation in the year ahead, in addition to creating other problems.

Following are comparative year-to-year inflation rates as of December 2012 versus December 2011, the CPI-U: 1.74% versus 2.96%, CPI-W: 1.68% versus 3.21%, C-CPI-U: 1.58% versus 2.73%, ShadowStats (1990-based): 5.2% versus 6.3%, ShadowStats (1980-based): 9.4% versus 10.6%.

Definitions of the various series are included in the *Reporting Detail* section.

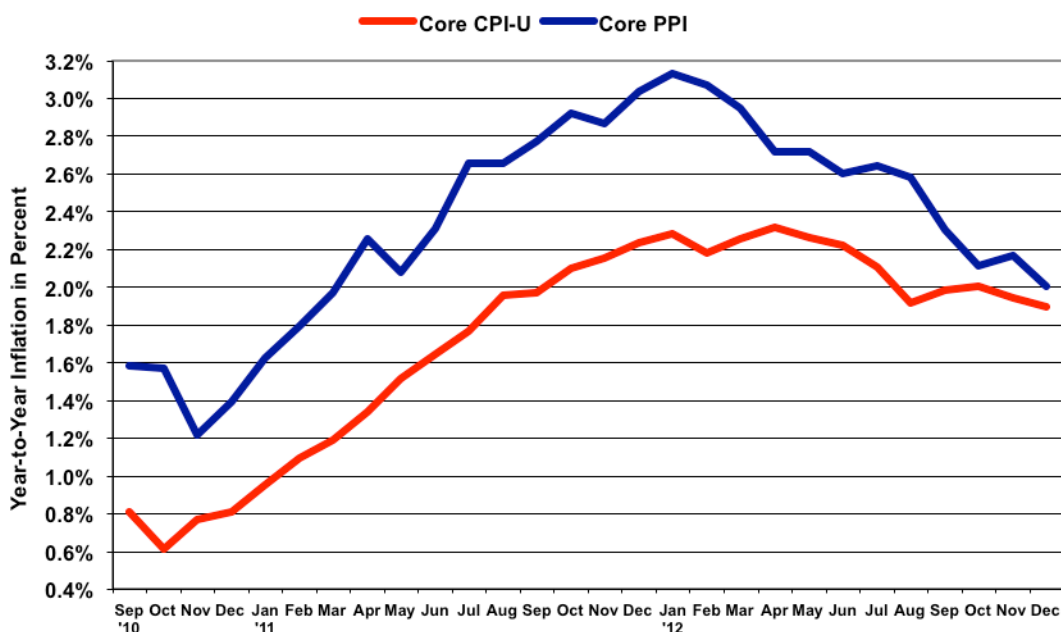
Core Inflation. *Graph 1* shows the ongoing pattern of annual growth in “core” inflation, which is general inflation net of food and energy inflation. The December 2012 year-to-year CPI-U core inflation rate

slowed minimally to 1.89%, from 1.94% in November. The PPI annual core inflation also turned lower in December, to 2.00% from 2.17% in November.

The December 2012 CPI-U core rate, however, still was well above the core inflation of 0.61%, in November 2010, when Federal Reserve Chairman Bernanke introduced QE2 in a successful bid to debase the U.S. dollar, with the effect of spiking oil prices. The recent promise of expansion in QE3 should create some renewed upside pressures here, when the Fed's monetization of U.S. Treasuries gets fully underway. The still relatively high core annual inflation numbers for both the CPI-U and PPI reflect the ongoing impact of higher energy prices in the broad economy.

Graph 1

**"Core" CPI-U and PPI Year-to-Year Inflation
Since QE2 Announcement Nov. 3, 2010 (SGS, BLS)**



December Retail Sales and Industrial Production. Both the retail sales and production series continue to reflect some impact from the late-October 2012 superstorm. Nonetheless, as discussed earlier, both series are suggesting a looming, renewed downturn in formal broad-economic reporting. As shown in the accompanying graphs corrected for the use of understated inflation rates used in the economic deflation process, a renewed downturn—following an extended period of low-level stagnation—actually began in second- or third-quarter 2012.

Real Retail Sales. With CPI-U inflation contracting by 0.02% in December 2012, real (inflation-adjusted) December retail sales rose by 0.53%, instead of the 0.51% nominal (not adjusted for inflation) monthly gain. Real retail sales monthly growth in November revised to 0.70%. Year-to-year real growth was

2.93% in December, versus a revised 2.27% in November. These annual growth rates still are at levels that would signal pending recession during normal economic times.

As shown *Graph 2*, official real retail sales reporting, at least temporarily, has regained its pre-recession level. That pattern does hold, however, if the series is corrected for understated inflation.

As shown in *Graph 3* of real retail sales activity, corrected for inflation understatement, sales actually contracted at respective 5.0% and 0.5% annualized quarterly rates in second- and third-quarter 2012, and was virtually flat, up by an annualized 0.2%, in fourth-quarter 2012.

Corrected Retail Sales. *Graph 2* 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 *Graph 3* use the ShadowStats-Alternate Inflation Measure (1990-Base) for deflation. As discussed in [Hyperinflation 2012](#) and [Special Commentary \(No. 485\)](#), with the higher inflation of the ShadowStats measure, the revamped numbers show a pattern of plunge and stagnation. The recent topping-out process now has reverted to renewed decline, as of second-quarter 2012, in a series that has been bottom-bouncing along a low-level plateau of economic activity following the economic collapse of 2006 into 2009. The two retail sales charts are indexed to a consistent scale.

Industrial Production. With utility usage purportedly depressed by unseasonably warm December weather, December production rose by 0.26% for the month, versus a revised 1.04% storm-recovery in November. Year-to-year, December production slowed to 2.25%, versus a revised 2.86% in November.

Outside of the official 2007 to 2009 recession period, which began from the peak of economic activity in fourth-quarter 2007, and ended in the trough of activity seen in second-quarter 2009, annualized quarterly growth in industrial production has not been slower than the 0.4% and 1.0% growth rates seen respectively in third- and fourth quarter 2012. The last two non-recession quarters that were that weak were the respective 1.0% and 0.6% annualized growth rates of third- and fourth-quarter 2007, leading into the recession.

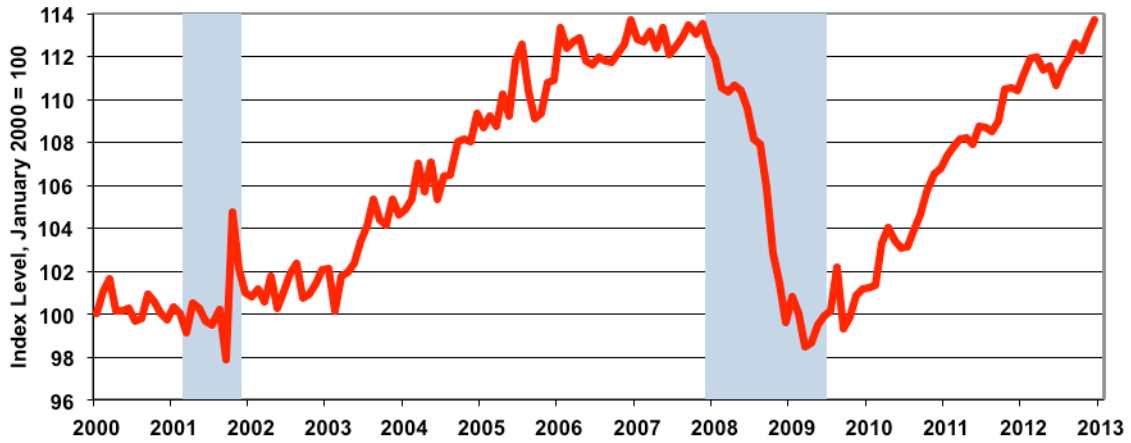
As shown in *Graph 5* of industrial production activity, corrected for inflation understatement, the industrial production series actually contracted at respective 1.4% and 0.8% annualized quarterly rates in third- and fourth-quarter 2012.

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. *Graph 4* 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. *Graph 5* is a corrected version of the *Graph 4*, 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 quarterly contraction, as of third-quarter 2012.

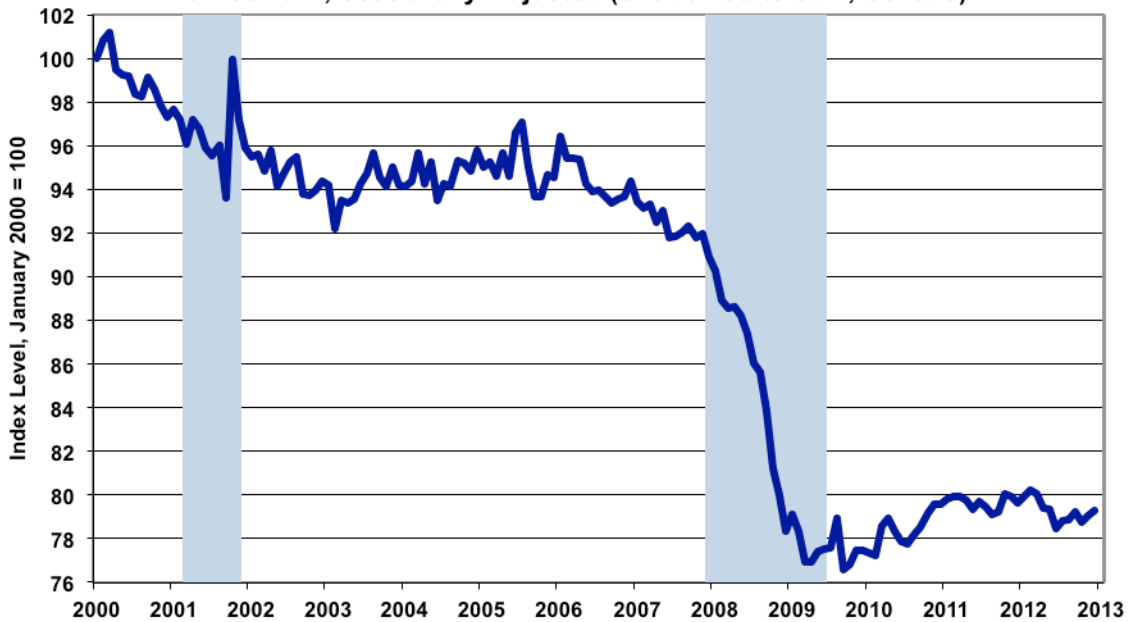
Graph 2

Real Retail Sales (Deflated by CPI-U)
To Dec 2012, Seasonally-Adjusted (ShadowStats.com, Census)

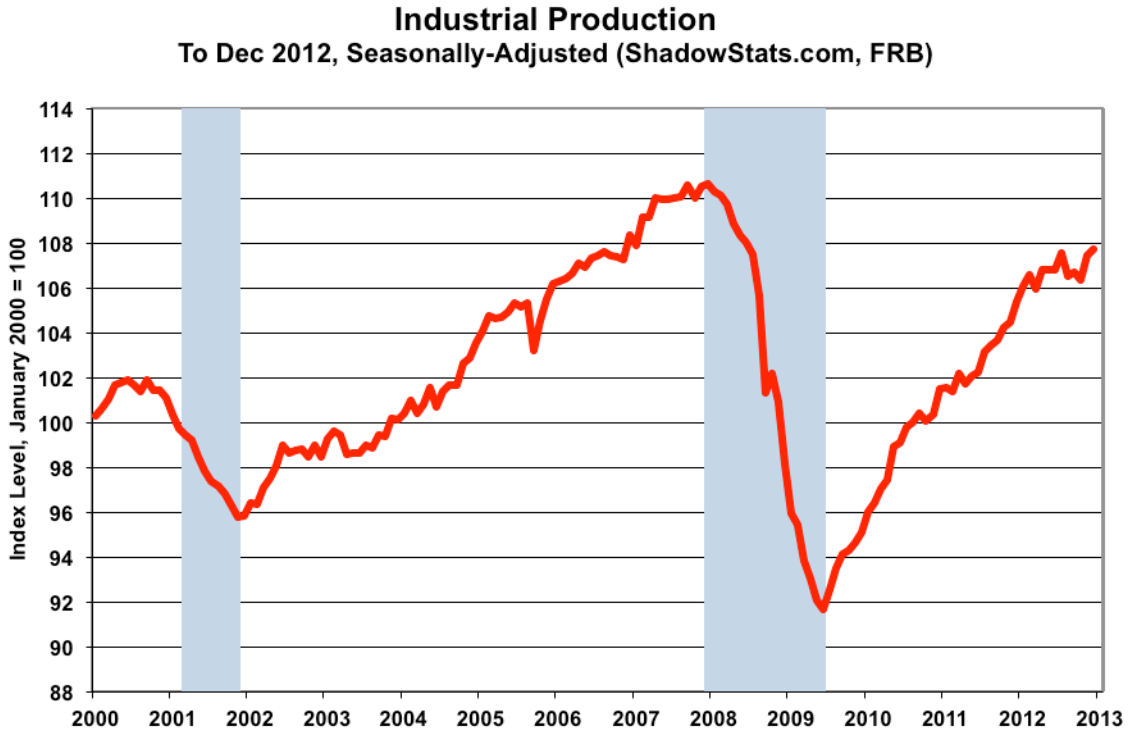


Graph 3

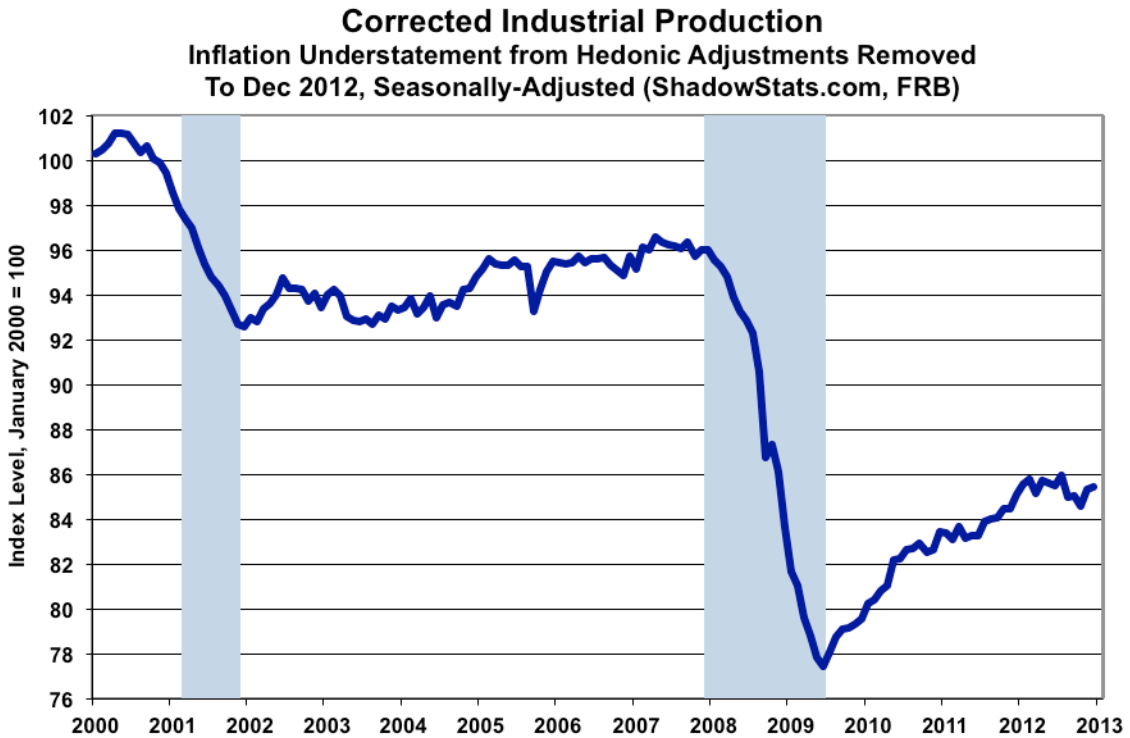
Corrected Real Retail Sales
Deflated by ShadowStats-Alternate CPI (1990-Base)
To Dec 2012, Seasonally-Adjusted (ShadowStats.com, Census)



Graph 4



Graph 5



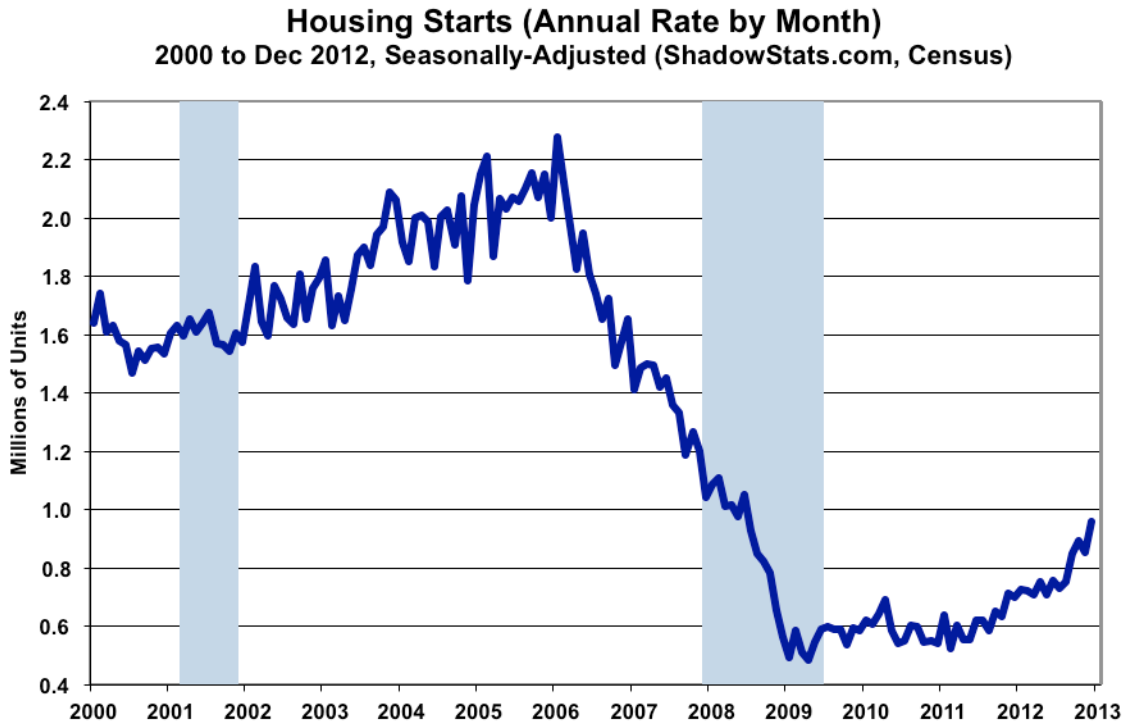
December Housing Starts. The headline 12.1% monthly gain in December 2012 housing starts followed a revised and more-severe 4.3% decline for November. December housing starts showed double-digit monthly percentage gains in all regions except the South. Where some of the 21.4% seasonally-adjusted gain in the Northeast likely reflected some rebuilding from Hurricane Sandy, much of that reconstruction still could be in the quarter or two ahead. Nonetheless, none of the monthly measures of housing starts gains in December were statistically significant.

On a quarterly basis, housing starts gained at an accelerated annualized pace of 81.5% pace in fourth-quarter 2012, versus a 22.3% annualized gain in the third-quarter, which should provide some upside pressure on the January 30th advance estimate for fourth-quarter 2012 GDP growth.

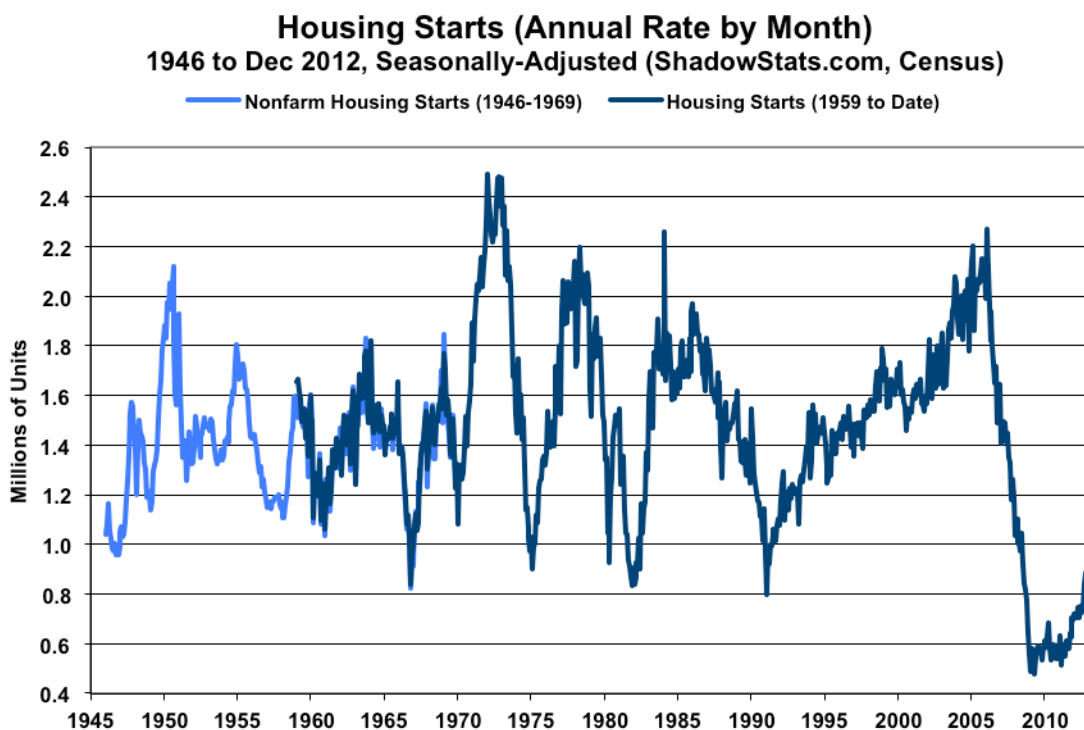
As reported, the December 2012 number was 58% below the January 2006 series high. This series remains particularly volatile and tends to suffer large monthly revisions, as well as irregular monthly distortions from a host of other factors, as discussed in [Hyperinflation 2012](#) and [No. 485: Special Commentary](#).

Graph 6 shows official industry reporting of the monthly seasonally-adjusted, annualized millions of housing starts, with detail since 2000. *Graph 7* includes the same data, but also shows the history since World War II, including a predecessor series to current headline reporting.

Graph 6



Graph 7



[For reference clarity between sections, graphs are numbered in the Opening Comments and Executive Summary. More complete details on reporting of December inflation, real retail sales, real average weekly earnings, housing starts and industrial production are found in the Reporting Detail section, along with various other unnumbered graphics unique to each of those sections.]

HYPERINFLATION WATCH

Hyperinflation Outlook: Background. The following text is largely as written for the prior and other recent *Commentaries*. It is intended for new subscribers, as well as for those who otherwise are not familiar with the hyperinflation report or the recent special commentary, linked below. Those documents are suggested as background reading on the financial turmoil and currency upheaval facing the United States in the next year or two. This section will be revised fully in the upcoming *Special Report* analyzing the January 17th release of the GAAP-based *2012 Financial Statement of the United States Government*.

The November 27, 2012 [Special Commentary \(No. 485\)](#) updated [Hyperinflation 2012](#) and the broad outlooks for the economy and inflation, as well as for systemic stability and the U.S. dollar. These remain the two primary articles outlining current conditions and the background to the hyperinflation forecast.

Subsequent to that *Special Commentary*, neither new economic data nor fiscal developments have altered the outlooks. The expansion of QE3 by the Fed, on December 12th, and the ongoing unwillingness and political inability of the current government to address the longer-range U.S. sovereign-solvency issues only have continued the regular unfolding of events that eventually will trigger a hyperinflation, as discussed in [Commentary No. 491](#).

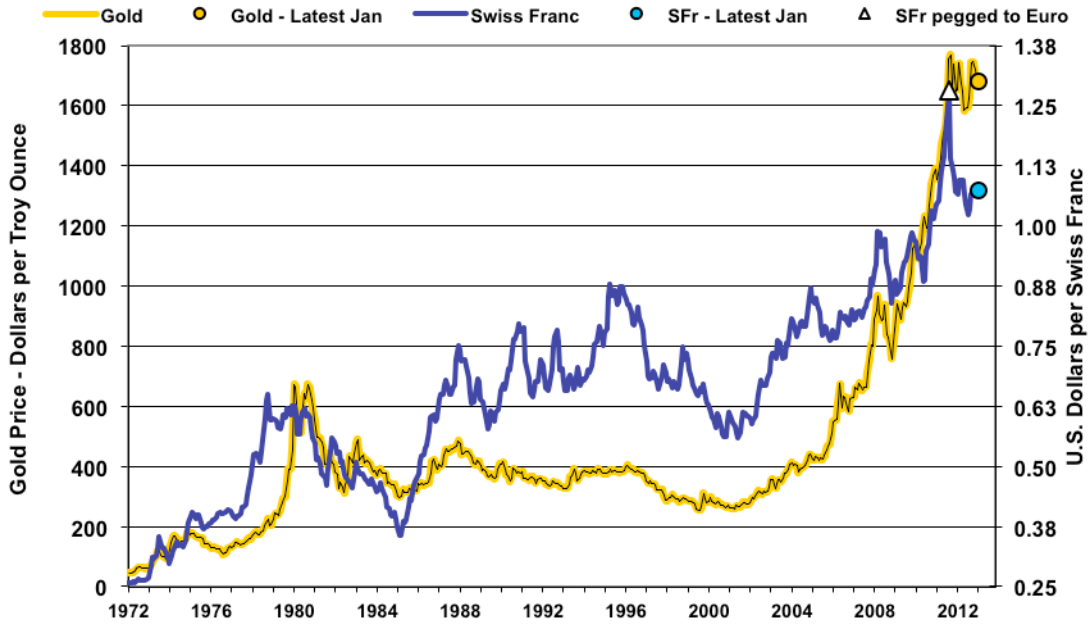
The Fed's latest actions can be viewed as a signal of deepening problems in the banking system. As discussed by Mr. Bernanke, the Fed can do little to stimulate the economy, but it can create inflation. Nonetheless, the Fed's move here was to prop-up the banking system and to provide back-up liquidity to the U.S. Treasury in the months ahead. 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.

Complicating and exacerbating those issues is the failure of the government to make any serious effort at bringing the nation's extreme and dangerous fiscal conditions into balance, or to move to address the Treasury's debt ceiling on a timely basis. Despite a two-month "sequestration" delay, the temporary "fiscal-cliff" avoidance may buy the politicians in Washington only a week or two. Market tranquility likely will not last much longer than that, against what should be increasingly evident as disgruntled global markets beginning to move against the U.S. dollar.

Monthly Gold Graphs. Following are the graphs of gold prices versus the Swiss franc, oil prices and silver prices that usually accompany the *Commentary* on the monthly CPI release. Shy of direct market intervention and short-lived jawboning—both factors appear to have been in play in the last month—the pending political negotiations on containing U.S. fiscal excesses and on raising the debt ceiling are much more likely than not to push the value of the U.S. dollar lower, versus all of the items tracked in these graphs. Global markets increasingly should move to avoid holding the U.S. dollar.

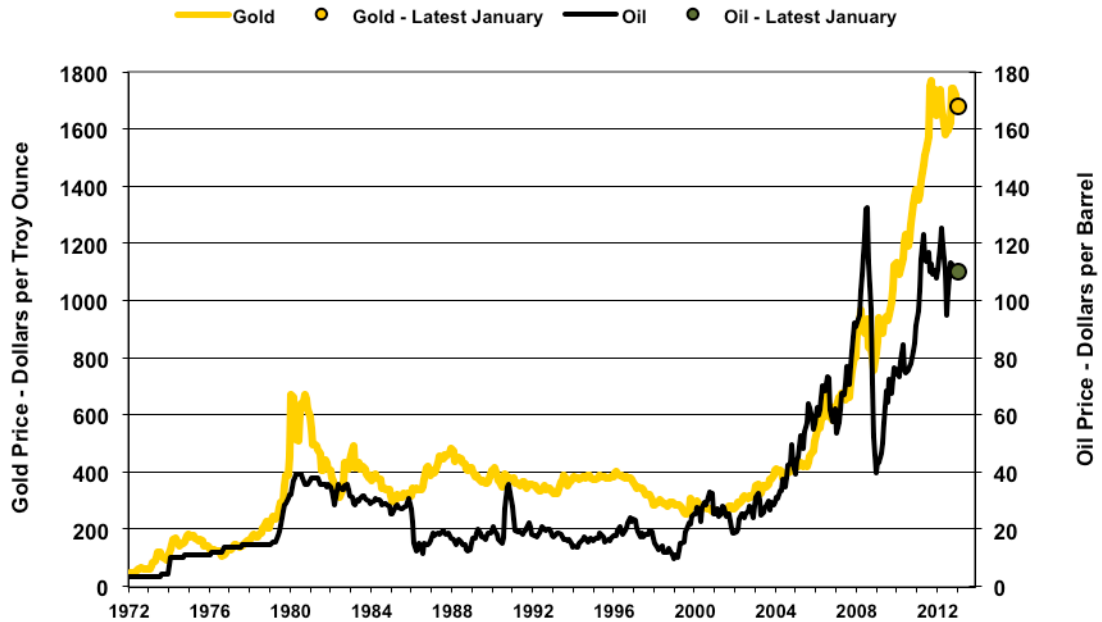
Gold versus Swiss Franc

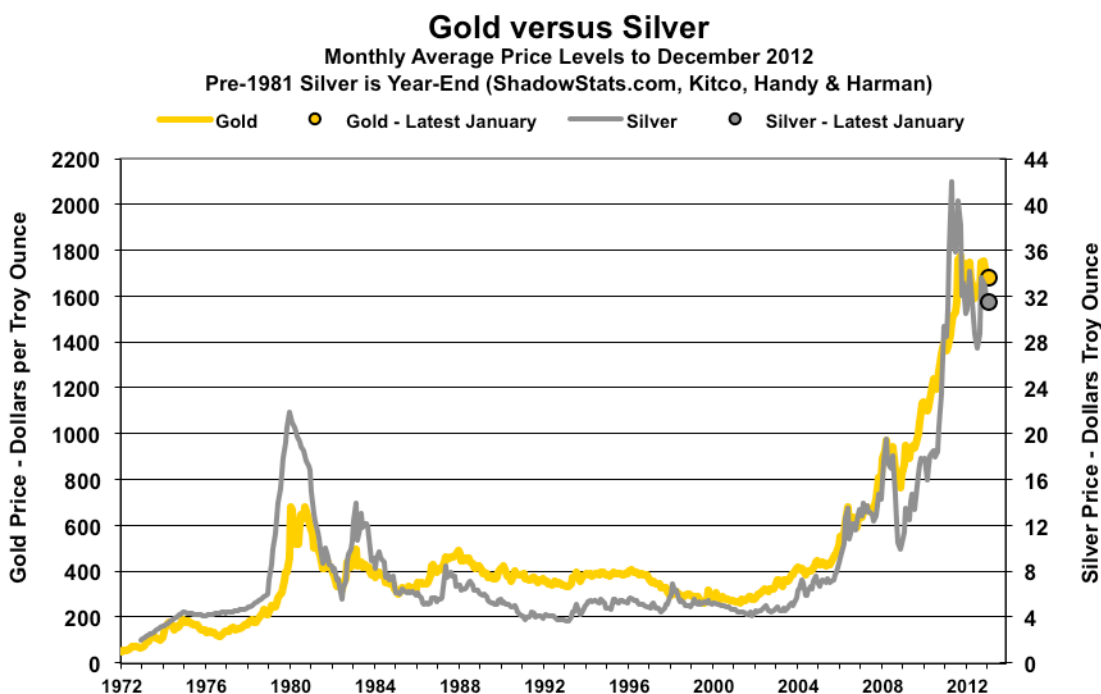
Monthly Average Price or Exchange Rate to December 2012
(ShadowStats.com, Kitco, FRB, WSJ)



Gold versus Oil (WTI/Brent)

Monthly Average Prices to Dec 2012, Pre-1987 is WTI (ShadowStats.com, Kitco, DOE)





REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (December 2012)

Monthly Consumer Inflation Was Reported as Flat in December. The Bureau of Labor Statistics (BLS) reported an unchanged pace of inflation in December 2012, versus November, despite the ongoing temporary decline in seasonally-adjusted gasoline prices. The decline in gasoline and other energy prices was offset by an increase in food inflation (contrary to the PPI reporting) and core inflation. Year-to-year CPI-U inflation declined to 1.7% from 1.8% in November, but that was due primarily to rounding issues; the actual change was insignificant, with annual growth dropping from 1.76% in November to 1.74% in December.

With the promised expansion of QE3 into the Federal Reserve’s direct purchasing and monetization of U.S. Treasury securities, and with renewed turmoil pending in budget and debt-ceiling negotiations, 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.

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 **ShadowStats 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 yesterday (January 16th) that the headline, seasonally-adjusted CPI-U for December 2012 was “unchanged” versus November. Seasonally adjusted, December inflation actually was lower using the second decimal point in the monthly growth rate, down by 0.02% (down by 0.23% unadjusted). That followed an adjusted monthly decline of 0.31% (down by 0.47% unadjusted) for November.

A decline in gasoline prices was muted partially by seasonal adjustments. Unadjusted monthly-average gasoline prices declined by 4.2% in December, per the BLS (down by 4.0% per the more-comprehensive surveying of the Department of Energy). Seasonal-adjustments narrowed the price drop to 2.1%. Rising food and “core” inflation otherwise offset the monthly decline in energy prices.

On a seasonally-adjusted quarterly basis, annualized inflation for the CPI-U was 2.05% in fourth-quarter 2012, versus 2.30% in the third-quarter, 0.75% in the second-quarter, and 2.48% in the first-quarter.

Average annual CPI-U inflation was 2.07% in 2012, versus 3.16% in 2011 and 1.64% in 2010.

Unadjusted, December 2012 year-to-year CPI-U inflation was 1.74%, little changed from 1.76% in November, except for rounding differences of 1.7% versus 1.8%. December 2011 year-to-year inflation was 2.96%, while December 2010 year-to-year inflation was 1.86%.

Year-to-year, CPI-U inflation would increase or decrease in next month's January 2013 reporting, dependent on the seasonally-adjusted monthly change, versus a reported 0.02% monthly inflation rate in January 2012. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2013, the difference in January's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the December 2012 annual inflation rate of 1.74%.

Nineteen of the last twenty-five months have shown rising year-to-year, or annual, "core" CPI-U inflation (net of food and energy inflation), with the December 2012 year-to-year core rate slowing minimally to 1.89% from 1.94% in November. The PPI annual core inflation also turned lower in December, to 2.00% from 2.17% in November.

The December 2012 CPI-U core rate still was well above the core inflation of 0.61%, in November 2010, when Federal Reserve Chairman Bernanke introduced QE2 in a successful bid to debase the U.S. dollar, with the effect of spiking oil prices. The recent promise of expansion in QE3 should create some renewed upside pressures here, 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 *Graph 1* 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, also was "unchanged" in December versus November (actually down by 0.04% adjusted, down by 0.31% unadjusted for the month). Inflation in November fell by 0.46% (down by 0.60% unadjusted).

On a seasonally-adjusted quarterly basis, annualized inflation for the CPI-W was 2.02 % in fourth-quarter 2012, versus 2.50% in the third-quarter, 0.33% in the second-quarter, and 2.66% in the first-quarter.

Average annual CPI-W inflation was 2.10% in 2012, versus 3.56% in 2011 and 2.07% in 2010.

Unadjusted, December 2012 year-to-year CPI-W inflation was 1.68%, versus 1.70% in November. December 2011 year-to-year inflation was 3.21%, while December 2010 year-to-year inflation was 1.68%.

C-CPI-U. Though unofficial for 2012, the average annual C-CPI-W inflation was 1.87%, versus 2.81% in 2011 and 1.43% in 2010.

The initial reporting of year-to-year inflation for the December 2012 C-CPI-U was 1.58%, versus 1.61% in November. December 2011 year-to-year inflation was 2.73%, while December 2010 year-to-year inflation was 1.28%.

The chain-weighted CPI-U is the fully substitution-based series that openly is being discussed (at one time 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, however, account for why today's headline CPI inflation numbers are so understated (see the discussion in [Public Commentary on Inflation Measurement](#)).

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990-based) methodologies, annual CPI inflation held at roughly 5.2% in December 2012, versus 5.2% in November 2012, but was down from 6.3% year-to-year inflation in December 2011. On an average annual basis the 2012 pre-Clinton measure showed 5.5% inflation versus 6.5% in 2011.

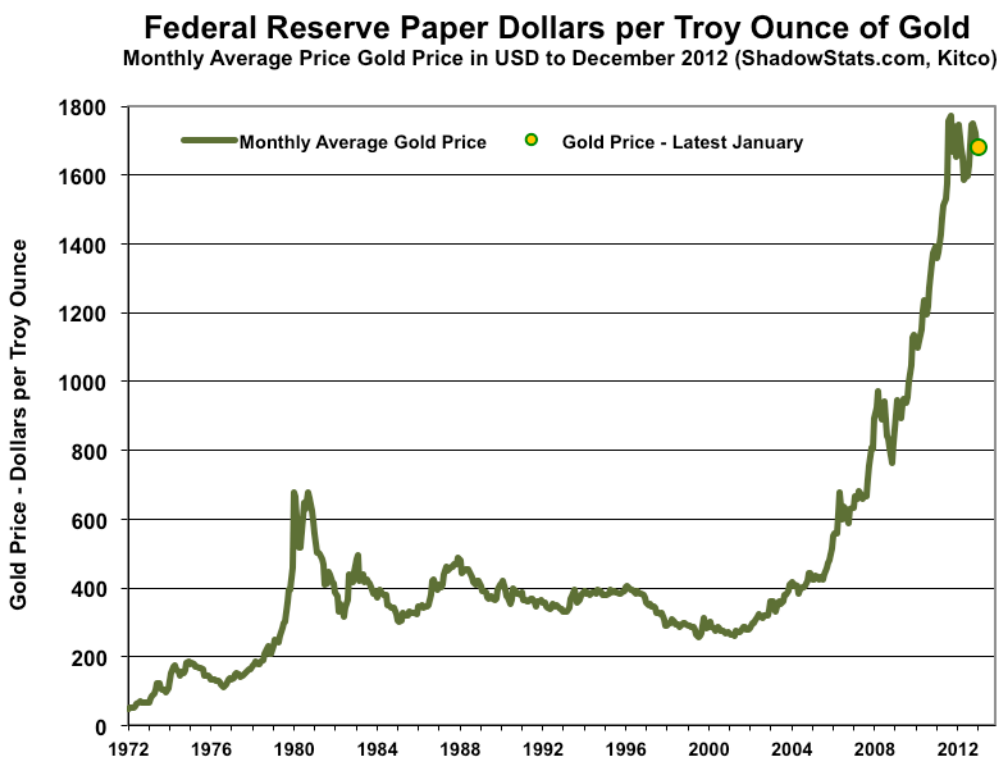
The ShadowStats-Alternate Consumer Inflation Measure (1980-Based), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, held at about 9.4% (9.36% for those using the extra digit) in December 2012, versus 9.4% November, but was down from 10.6% year-to-year inflation in December 2011. On an average annual basis, the 2012 1980-based measure showed 9.7% inflation, versus 10.7% in 2011.

Note: The ShadowStats-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 ShadowStats adjustment reflect the BLS's formal estimate of the annual impact of methodological changes; roughly two percentage points reflect changes by the BLS, where ShadowStats 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/ShadowStats 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 \$2,512 per troy ounce, based on December 2012 CPI-U-adjusted dollars, and \$9,605 per troy ounce, based on December 2012 ShadowStats-Alternate-CPI (1980-Based) 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 December 2012 CPI-U inflation, the 1980 silver-price peak would be \$146 per troy ounce and would be \$559 per troy ounce in terms of December 2012 ShadowStats-Alternate-CPI (1980-based) 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 ShadowStats-Alternate Consumer Price Measure (1980 Methodologies Base).



Real (Inflation-Adjusted) Retail Sales. As discussed with the nominal (not-adjusted-for-inflation) retail reporting for December 2012 in [Commentary No. 494](#), the December retail sales reporting included an apparent boost from sales of replacement vehicles for automobiles, etc. that were damaged in Hurricane Sandy. Separately, aside from December’s reported 0.5% sales gain lacking statistical significance, actual December sales activity was clouded by the use of unusually unstable and questionable seasonal adjustments.

Based on the January 16th December CPI-U estimate, inflation- and seasonally-adjusted December 2012 retail sales rose by 0.53% month-to-month, reflecting the combination of the nominal monthly gain of 0.51% and a contraction in monthly CPI-U inflation of 0.02%. Real November sales reflected a revised 0.70% (previously a 0.58%) monthly gain, where real sales again were boosted by a decline in reported inflation.

Year-to-year, December 2012 real retail sales rose at an annual pace of 2.93%, versus a revised 2.27% (previously 1.90%) in November. The December and revised November annual growth rates remain near levels that would generate a reliable signals of pending recession during normal economic times. In the current circumstance, those signals could be viewed as indicating a pending intensification of the general downturn.

Hitting Pre-Recession Levels. The first graph following shows the level of 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. With the December 2012 reporting, the real retail sales series effectively has recovered pre-

recession levels, the only major economic series to do so, other than the GDP, which did that a year ago and has kept rising well beyond the reported activity of retail sales or an other series, since. There is no other major economic series showing the GDP’s pattern of official, full recovery.

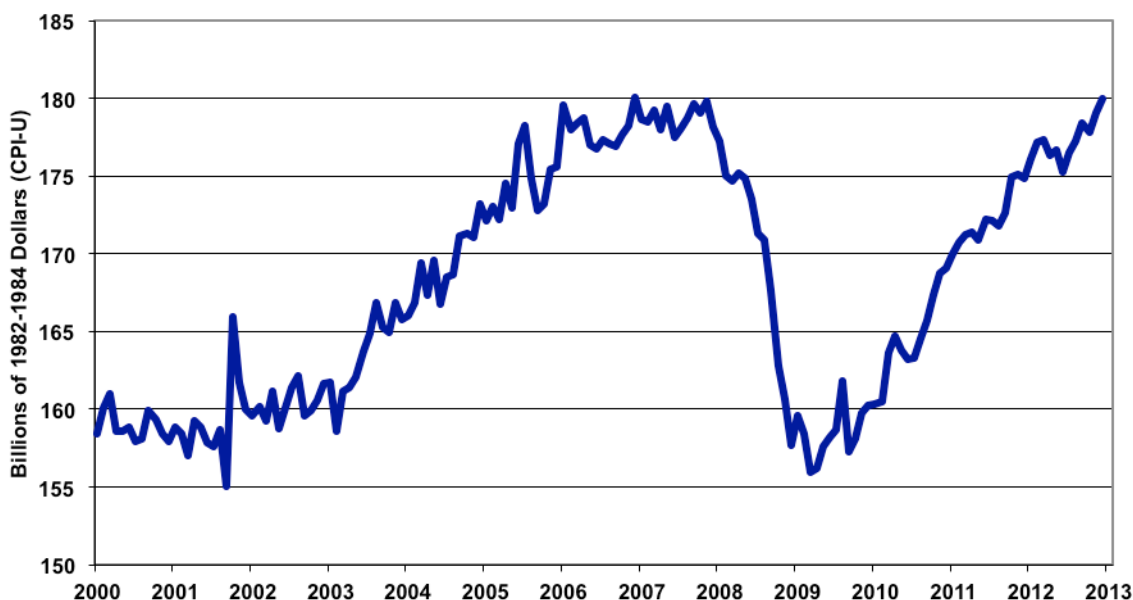
The apparent “recovery” in the real retail sales series (as well as in the GDP) is due to the understatement of the rate of inflation used in deflating retail sales and other series. As discussed more fully in [Hyperinflation 2012](#) and [Special Commentary \(No. 485\)](#), deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating inflation-adjusted economic growth.

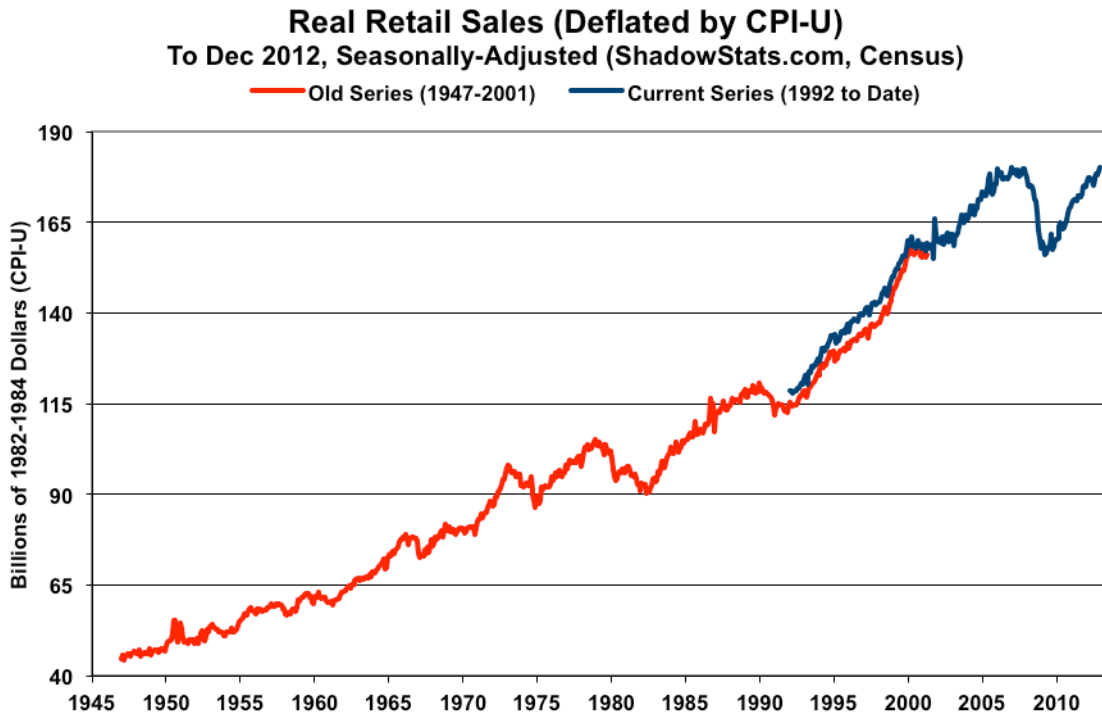
With the deflation rates corrected for understated inflation, the recent pattern of real sales activity turns increasingly negative, as shown in the latest “corrected” real retail sales graph, *Graph 3* in the *Opening Comments and Executive Summary* section. The post-2009 period of protracted stagnation ended, and a period of renewed economic contraction began in second-quarter 2012. The corrected real retail sales numbers use the ShadowStats-Alternate Inflation Measure (1990-Base) for deflation instead of the CPI-U.

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 general economic activity. There has been and is no recovery, just general bottom-bouncing that is turning down anew.

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 the *Special Commentary* linked above and in [Commentary No. 469](#)—these data should trend meaningfully lower, in what eventually will become a formal double-dip recession.

Real Retail Sales (Deflated by CPI-U)
To Dec 2012, Seasonally-Adjusted (ShadowStats.com, Census)





Real (Inflation-Adjusted) Earnings. Coincident with the CPI release for December 2012, the BLS published real (inflation-adjusted) average weekly earnings for December 2012.

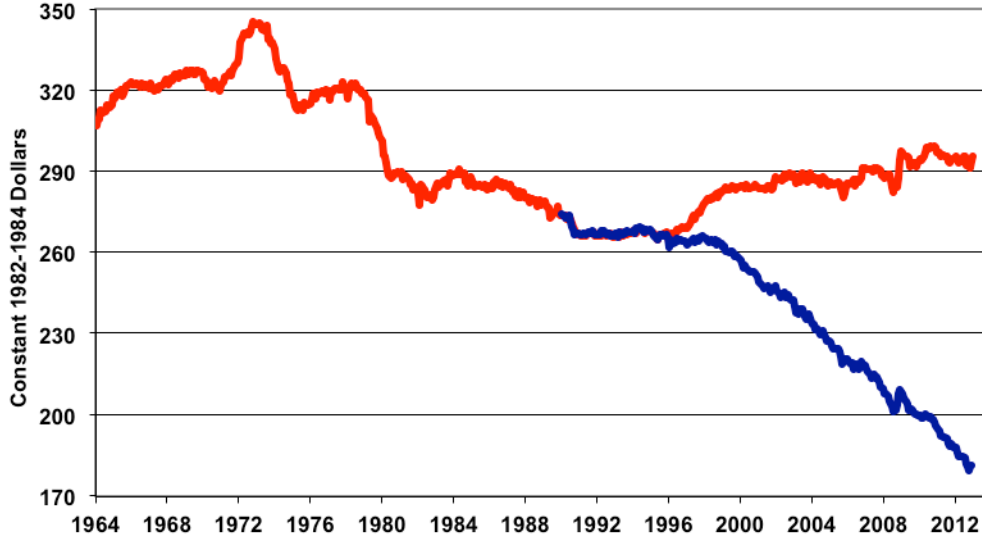
The production and nonsupervisory employees series showed that seasonally-adjusted, real average weekly earnings (deflated by the CPI-W) rose by 0.6% month-to-month in December, following a revised 1.0% (previously 0.9%) monthly gain in November. The gains here largely reflect the effects of negative monthly inflation rates in the last two months, that were dominated by a temporary drop in seasonally-adjusted gasoline prices.

Unadjusted and year-to-year, however, December real earnings were up by just 0.3%, following a revised 0.3% (previous 0.4%) annual decline in November. Both the monthly and annual fluctuations in this series are irregular, and current reporting remains well within the normal bounds of volatility, as shown in the following graph.

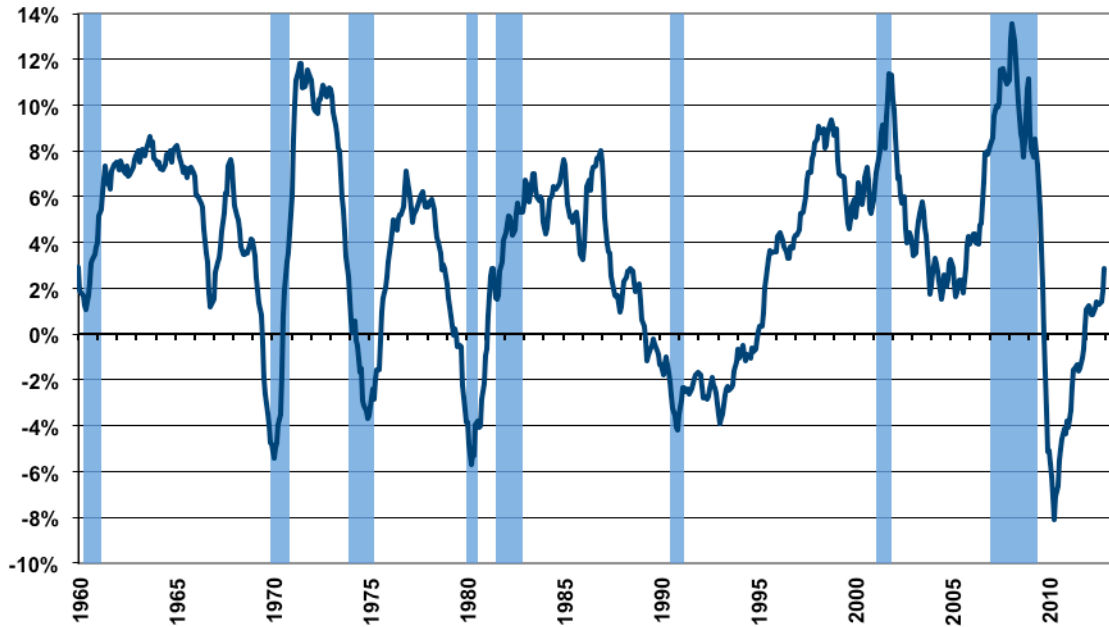
The red line reflects the earnings series as officially deflated by the BLS. As the inflation-depressing methodologies of the 1990s began to kick-in, the artificially weakened CPI-W (also used in Social Security cost-of-living adjustments) helped to prop up the reported real earnings. Official real earnings today still have not recovered their inflation-adjusted levels of the early-1970s, and, at best, have been flat for the last decade.

Adjusted for the ShadowStats-Alternate CPI measure (1990-based), inflation-adjusted earnings have been in fairly regular decline for the last four decades, which is much closer to common experience than the pattern suggested by the CPI-W. See [Public Commentary on Inflation Measurement](#) for further detail.

**Real Average Weekly Earnings
Production and Nonsupervisory Employees**
Deflated by CPI-W versus ShadowStats-Alternate (1990-Base)
To Dec 2012, Seasonally Adjusted (ShadowStats.com, BLS)
— CPI-W — SGS-Alternate CPI-W



Real M3 versus Formal Recessions
To December 2012, Yr-to-Yr Percent Change (ShadowStats.com, FRB, NBER)
— Official Recession — Real M3



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 [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 November 2012 CPI-U report and the latest ShadowStats-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for December 2012 was 2.8%, versus 1.8% in November. The entire difference was in the increase in annual broad money growth in December.

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. Actual post-2009 economic activity has remained at low levels in protracted stagnation, as discussed in [Special Commentary \(No. 485\)](#).

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—no upturn or recovery, no end to the official 2007 recession—and the unfolding renewed downturn remains nothing more than a continuation and re-intensification of the downturn that began in 2006.

INDEX OF INDUSTRIAL PRODUCTION (December 2012)

Second-Half Industrial Production Activity Was Weakest of the “Recovery;” Looks Like the Period Leading into the Formal 2007 Recession. Outside of the official 2007 to 2009 recession period, which began from the peak of economic activity in fourth-quarter 2007, and ended in the trough of activity seen in second-quarter 2009, annualized quarterly growth in industrial production has not been slower than the 0.4% and 1.0% growth rates seen respectively in the third- and fourth quarter 2012. The last two non-recession quarters that were that weak were the 1.0% and 0.6% respective annualized growth rates of third- and fourth-quarter 2007, leading into the recession.

As shown in the graph of industrial production activity, corrected for inflation understatement (*Graph 5* in the *Opening Comments and Executive Summary* section), the industrial production series actually contracted at respective 1.4% and 0.8% annualized quarterly rates in third- and fourth-quarter 2012.

December Industrial Production. The January 16th release by the Federal Reserve Board of seasonally-adjusted December 2012 industrial production showed a headline monthly gain of 0.26% (up by 0.60% before prior-period revisions), versus a revised month-to-month gain of 1.04% (previously 1.05%) in November, and a shallower month-to-month contraction in October of 0.35% (previously a drop of 0.67%, and an initial decline of 0.43%).

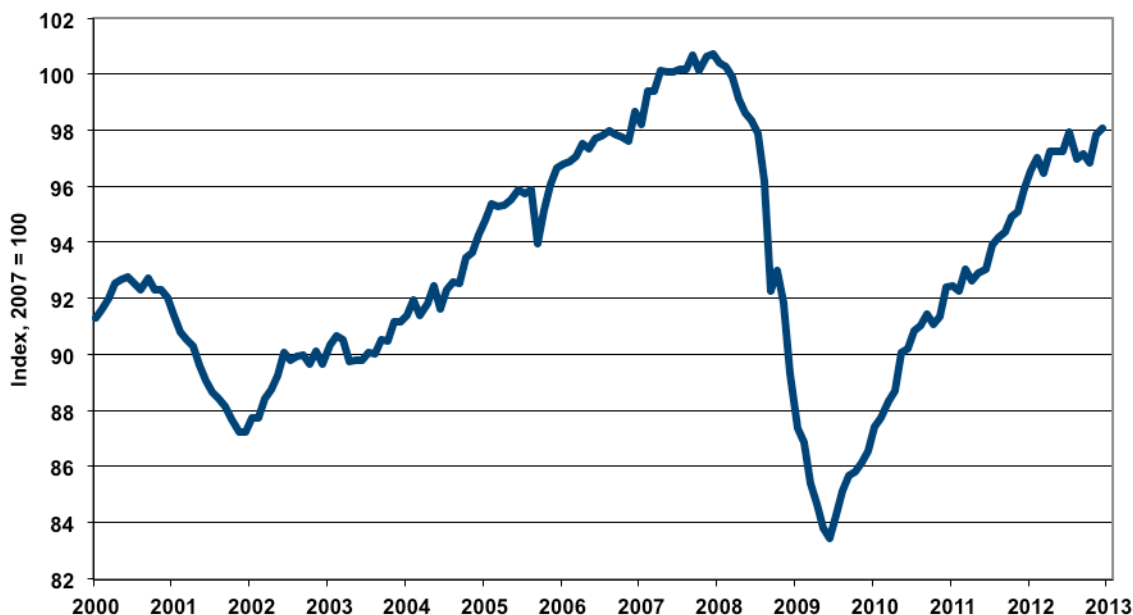
Depressing the December number was purportedly warmer than seasonable weather, which contributed to a 4.8% monthly decline in seasonally-adjusted utility usage. Separately, though, as with retail sales, this series also still is reverberating from a hurricane-related hit, where automobile and home-electronics

production likely still were seeing some replacement demand from the storm. Separately, some damaged production facilities still have not fully returned to normal operations. As with the 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.

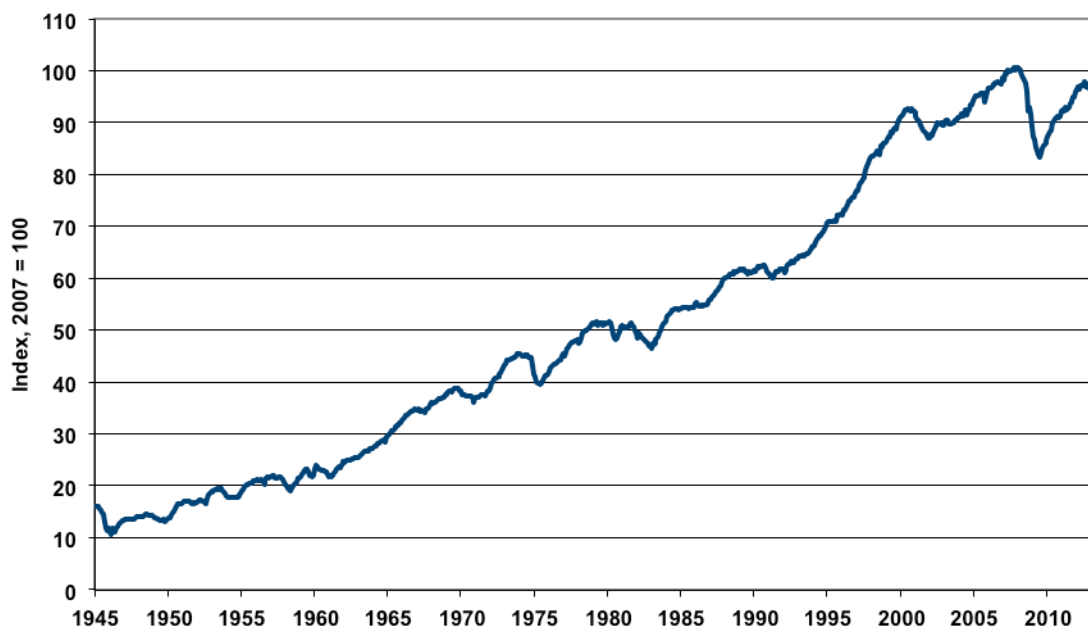
Year-to-year growth for December 2012 production was estimated at a still-traditionally-low level of 2.25%, down from a revised 2.86% (previously 2.51%) in November, and versus a revised 2.00%, (previously 1.64%, initially 1.74%) annual rate of growth in October. Other than for October 2012, December's 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. Although official production levels have moved higher since the formal June 2009 trough of the official 2007, unlike the GDP, the official series remains well shy of showing a full recovery.

**Index of Industrial Production
To Dec 2012, Seasonally-Adjusted (FRB)**



**Index of Industrial Production
To Dec 2012, Seasonally-Adjusted (FRB)**



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 since second-quarter 2012. The corrected production series, again, is shown as *Graph 5* in the *Opening Comments* section. Please note also 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.

RESIDENTIAL CONSTRUCTION (December 2012)

While Hurricane Sandy Likely Boosted Housing Starts in the Northeast, Activity in Other Sections of the U.S. Jumped as Well. December housing starts showed double-digit monthly percentage gains in all regions except the South. While some of the gain in the Northeast had to reflect rebuilding from Hurricane Sandy, much of that still could be seen in the quarter or two ahead. Nonetheless, none of the measures of monthly gains in housing starts were statistically significant.

On a quarterly basis, housing starts gained at an accelerated annualized pace of 81.5% pace in fourth-quarter 2012, versus a 22.3% annualized gain in the third-quarter, and that should provide some upside pressure on the “advance” estimate for fourth-quarter 2012 GDP growth, due for release on January 30th.

As reported, the December 2012 number was 58% below the January 2006 series high.

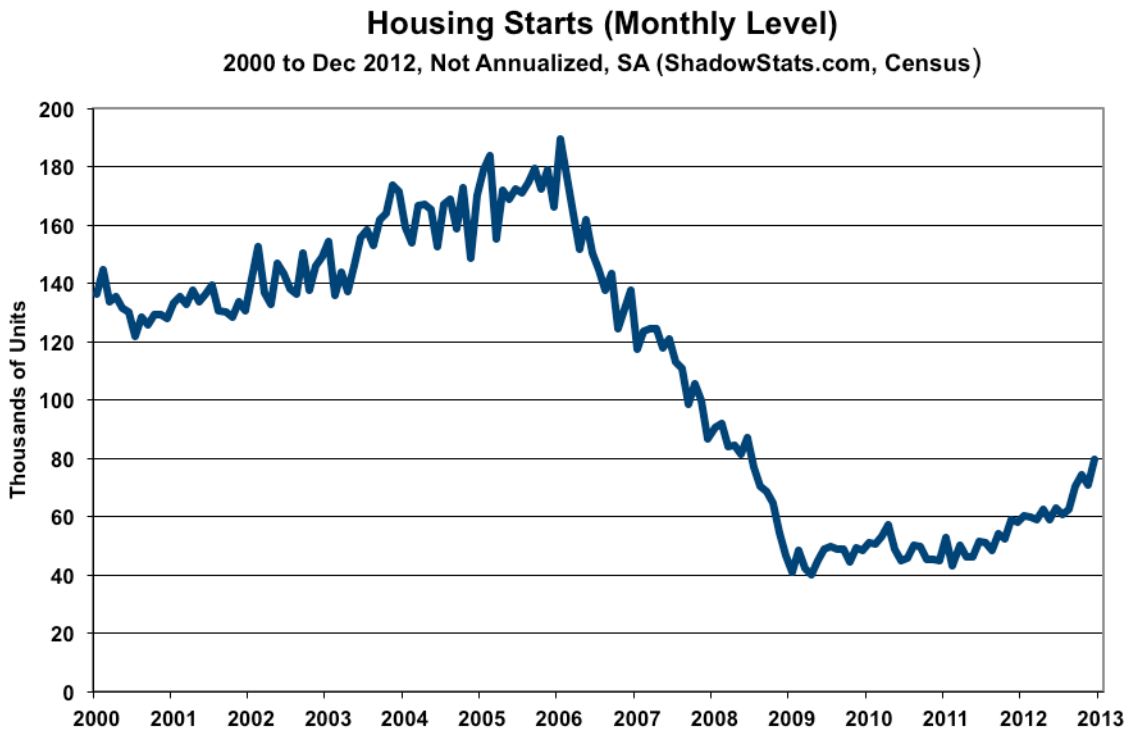
This series remains particularly volatile and tends to suffer large monthly revisions, as well as irregular monthly distortions from a host of other factors, as discussed in [Hyperinflation 2012](#) and [No. 485: Special Commentary](#).

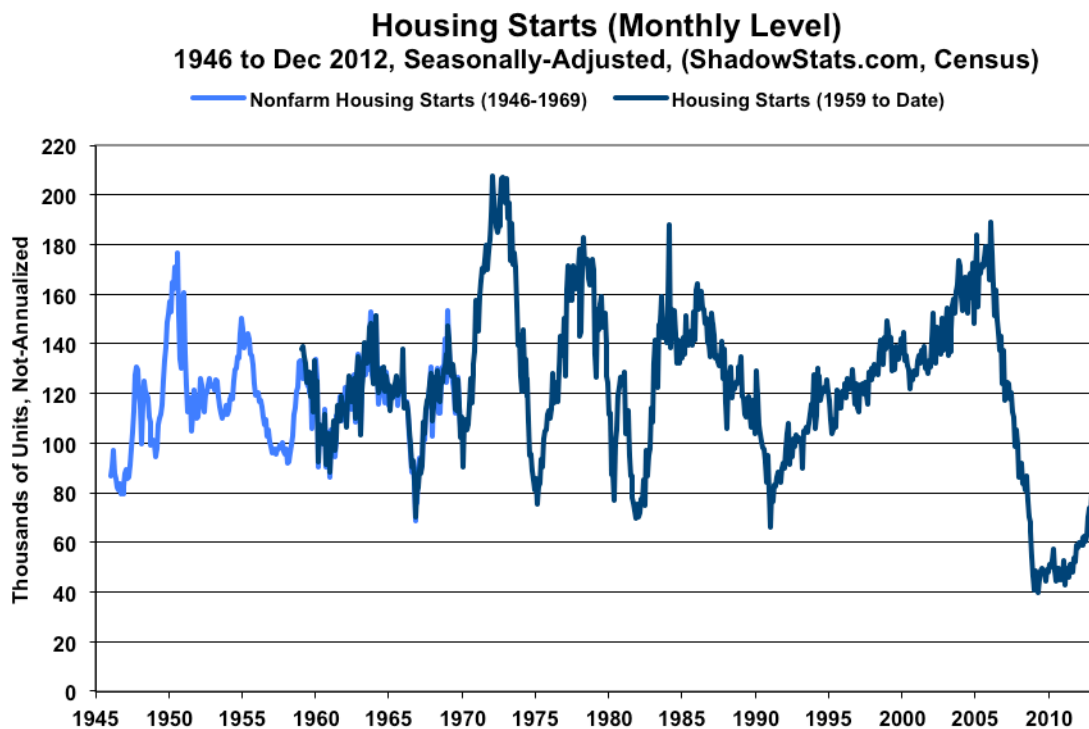
Housing Starts December 2012 Reporting. The Census Bureau reported today, January 17th, a statistically-insignificant, month-to-month headline gain in seasonally-adjusted December 2012 housing starts of 12.1% (a 10.8% gain before prior-period revisions) +/-15.6% (all confidence intervals are at the 95% level). November housing starts activity revised to a 4.3% monthly contraction (initially estimated as a decline of 3.0%).

Starts for single-unit structures in December rose by a statistically-insignificant 8.1% +/- 11.8% for the month, following a revised 3.2% (previously 4.1%) decline in November.

Activity in starts for apartment buildings (5 units or more) remained volatile, but, as usual, it was no more than statistical noise. Month-to-month, apartment building starts rose by a statistically-insignificant 23.1% +/- 40.1% in December, versus a revised 4.6% decline (previously a 1.4% gain) in November.

The year-to-year change in aggregate December 2012 housing starts was a statistically-significant increase of 36.9% +/- 25.7%, following a revised 20.2% (previously 21.6%) annual gain in November, but, again, that remains in the continued context of what has been a protracted period of low-level bottom-bouncing in a highly unstable series.





The official reporting of monthly housing starts is expressed at an annualized monthly pace, which was 954,000 for December 2012. Due to regular, extreme monthly volatility in this series, however, it is my preference to use the actual, non-annualized monthly number. The graphed patterns are the exactly same, it is just that the monthly levels tend to be a little more realistic.

The regular graphs (in annualized millions) for this series are shown as *Graphs 6* and *7* in the *Opening Comments and Executive Summary* section. The same graphs in thousands of actual starts per month are shown in the two graphs preceding. Current monthly housing starts activity is at a four-year high, well off the record monthly low seen for the present series in April 2009. Since September 2012, monthly levels of activity have notched above the levels of activity seen at the troughs of the most severe post-World War II declines in housing starts shown in the current series, or in the predecessor nonfarm housing starts series.

WEEK AHEAD

Weaker Economic and Stronger Inflation Data Are Likely. Beyond the dissipating effects of the repair, replacement and reconstruction activity generated by Hurricane Sandy, and in anticipation of the likely negative impact of expanded QE3 and the ongoing fiscal crisis/debt-ceiling negotiations on the currency markets, reporting in the months and year ahead generally should reflect higher-than-expected inflation and indicate weaker-than-expected economic results. Increasingly, previously unreported economic weakness should continue to show up in prior-period revisions.

Significant reporting-quality problems continue with most major economic series. Headline reporting issues remain 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 the Fed's monetary policies. The political system would like to see the issues disappear, and still appears to be trying to work numerical slight-of-hand with series such as the GDP; 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 [Hyperinflation 2012](#) and [No. 485: Special Commentary](#).

Existing and New-Home Sales (December 2012). December existing home sales are due for release on Tuesday, January 22nd, from the National Association of Realtors, while the December new-home sales report from the Census Bureau is due for release on Friday, January 25th. The surge in December housing starts—discussed earlier in this *Commentary*—at least partially reflected gains from replacement construction of buildings destroyed during Hurricane Sandy. Those gains should not flow through to new- or existing-home sales. In the sales area, an entrenched pattern of stagnation likely has continued in both these series, with the pending reports of monthly change not likely to be statistically-significant
