

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

COMMENTARY NUMBER 501
December 2012 and Annual Trade Balance, Consumer Credit

February 8, 2013

**Little Changed for the Year, 2012 U.S. Merchandise Trade Deficit
Still Reflected Cumulative Loss of 6.6 Million Jobs**

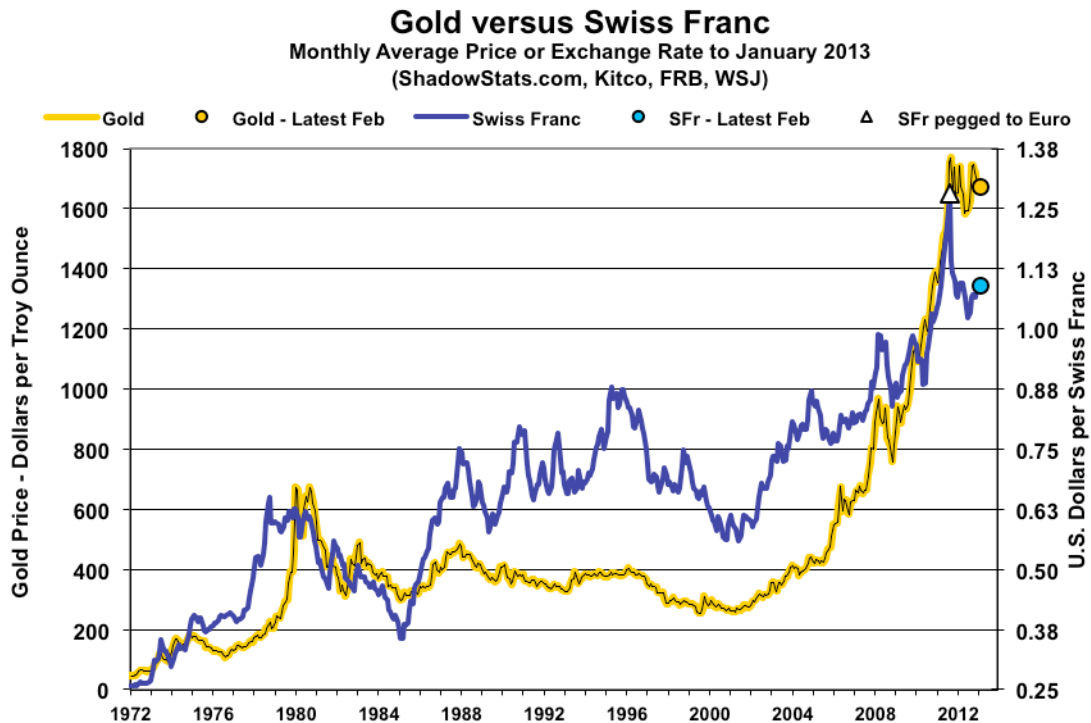
**December Trade Reporting Suggested Upside Contribution to
First Revision of Fourth-Quarter GDP**

New ShadowStats Graph of Consumer Credit Outstanding

PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, February 13th, covering January 2013 retail sales, with a subsequent Commentary on Friday, February 15th, covering January industrial production.

Best wishes to all — John Williams

Opening Comments and Executive Summary. Probably the most significant, underlying factor that helps to drive the long-range foreign-exchange rate value of the U.S. dollar is the relative trade balance of the United States. In the post World War II era, the U.S. trade position first fell into net deficit in 1971. By the late-1970s, widening annual trade shortfalls had become perpetual, as had the resulting structural deterioration in the U.S. economy and the foreign-exchange weakness of U.S. dollar. The dollar's post-1970 weakness is shown in the accompanying graph of the price of gold versus the Swiss franc, where the movement in both series reflects the dollar weakness and resulting inflation problems.



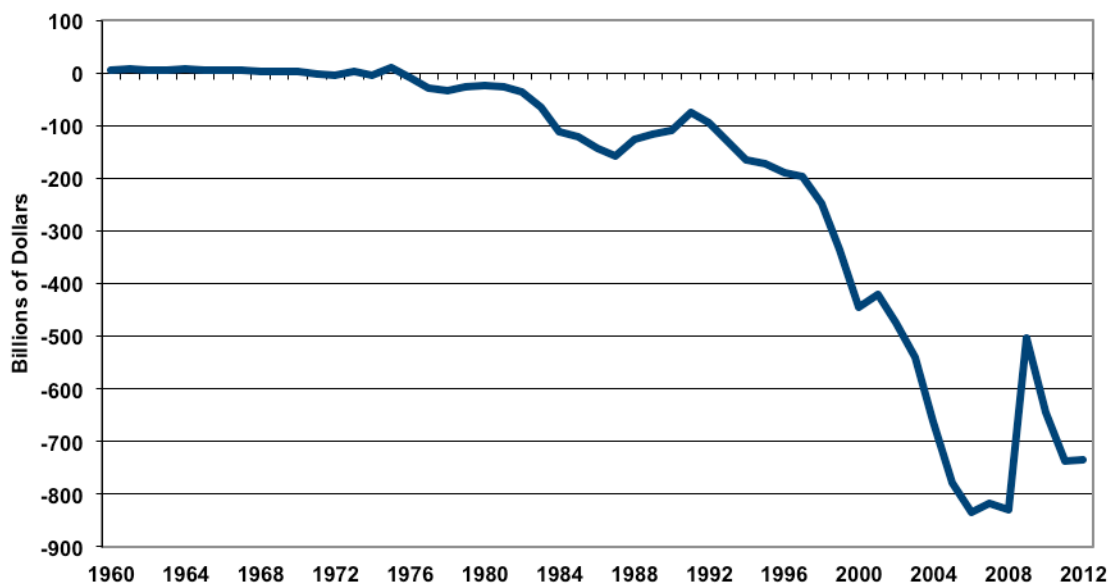
Other fundamentals underlying the U.S. dollar's value are grim. Beyond the trade picture, as seen in the next two graphs, key factors—relative to other major currencies—could not be much worse. Those issues include relatively low interest rates, a weakening economy and mounting political and fiscal instabilities. The Federal Reserve's expanding strategy to debase the U.S. dollar (boosting inflation); the long-range solvency issues for the U.S. government and the lack of political will to address them; and rapidly deteriorating public and global-market confidence in the U.S. government; all threaten severe and negative disruptions ahead for the U.S. currency.

Many of these issues, however, tie back to the abysmal U.S. trade picture. Consider the loss of higher paying jobs to low-wage offshore competition, which has been a major contributing factor to the structural income problems currently besetting U.S. consumers. The effects from that have helped to drive the ongoing domestic systemic-solvency and economic crises, as is discussed more fully in [Hyperinflation 2012](#) and [No. 485: Special Commentary](#).

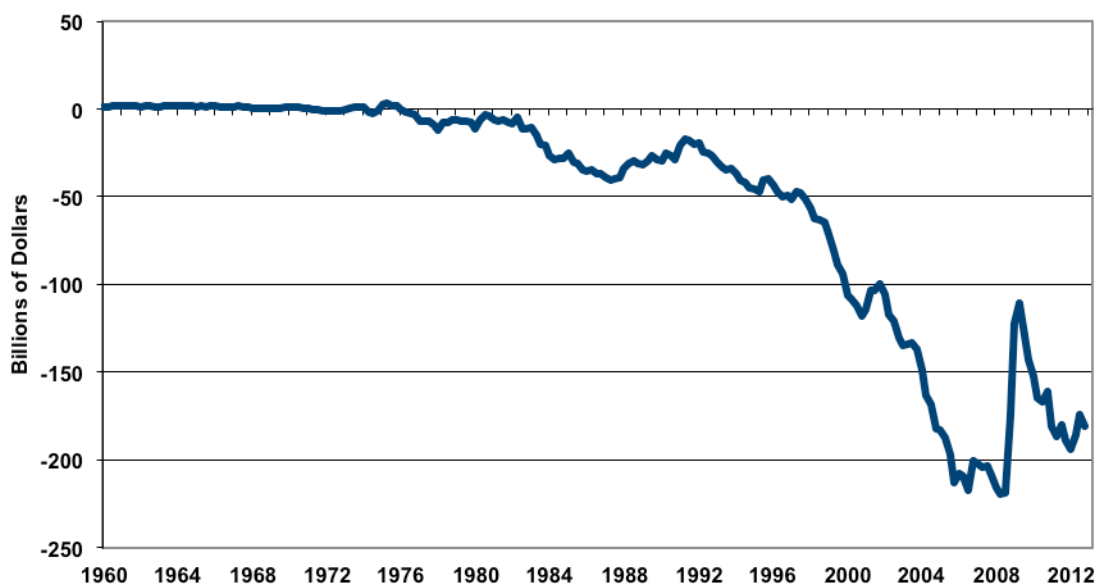
2012 U.S. Trade Deficit. Today's (February 8th) publication of the December 2012 and annual 2012 trade data show the annual trade shortfall holding near its worst levels. Other than for the continued effects of gyrations in oil prices since the 2008 financial crisis, the trade deficit has seen regular deterioration since the 1970s. The nominal (not-inflation-adjusted) series is most closely tied to dollar movement. The more excess dollars that are pumped into the global markets, the weaker will be the U.S. currency. With the annual merchandise trade deficit holding just shy of \$730 billion (customs basis) in both 2011 and 2012, it is worth remembering that the current annual shortfall is worth roughly 6.6 million jobs that have been lost to global competition over the years, because of bad domestic trade policies.

The following graphs are on a balance of payments basis, consistent with nominal GDP estimates.

U.S. Merchandise Trade Balance (Annual Level)
Through 2012, Balance of Payments Basis
(Sources: ShadowStats.com, Census Bureau, BEA)



U.S. Merchandise Trade Balance (Quarterly Level)
To 4q2012, BOP, Seasonally-Adjusted (ShadowStats,Census)



Much of the U.S. trade deterioration during the last four decades has been due to domestic trade and other policies that have driven U.S. manufacturing offshore. The following table (deficits are on a customs or census basis—see *Reporting Detail* section for definitions) shows the top six annual U.S. trade deficits by trading partner. The deficits with China, Japan, Germany and Saudi Arabia all grew markedly in 2012. The deficit with NAFTA (specifically Mexico and Canada), however, narrowed by 5.9% for the year.

**U.S. 2012 Annual Merchandise Trade Deficit by Country
(Excess of \$30 Billion)**

| 2012 Rank | 2011 Rank | Country/Group | 2012 Deficit \$ Billion | 2011 Deficit \$ Billion | Related Trade Group |
|-----------|-----------|---------------|----------------------------|----------------------------|---------------------|
| | | Total World | 727.9 | 727.4 | |
| | | ---- | ---- | ---- | |
| 1 | 1 | China | 315.1 | 295.4 | |
| 2 | 3 | Japan | 76.3 | 63.2 | |
| 3 | 2 | Mexico | 61.3 | 64.5 | NAFTA |
| 4 | 4 | Germany | 59.7 | 49.5 | EURO |
| 5 | 6 | Saudi Arabia | 37.5 | 33.6 | OPEC |
| 6 | 5 | Canada | 31.8 | 34.5 | NAFTA |
| | | ---- | ---- | ---- | |
| | | EURO Area | 99.9 | 89.0 | |
| | | OPEC | 98.9 | 126.9 | |
| | | NAFTA | 93.1 | 98.9 | |

Sources: ShadowStats.com, U.S. Census Bureau

While the U.S. trade deficit with NAFTA (the trade group including the United States, Canada and Mexico) was a reduced \$93.1 billion in 2012, that trade agreement has been particularly destructive to U.S. production and employment.

In terms of bad trade policies related to U.S. economic health, NAFTA stands out. Initially, the U.S. had a small surplus with Mexico and Canada, but that has turned into a meaningful deficit that remained close to \$100 billion in 2011. Irrespective of any politically-hyped jobs creation that surrounded the NAFTA deal, U.S. economic activity has suffered a net decline, and a loss in employment of roughly 900,000 jobs, thanks to the regional “free trade” pact.

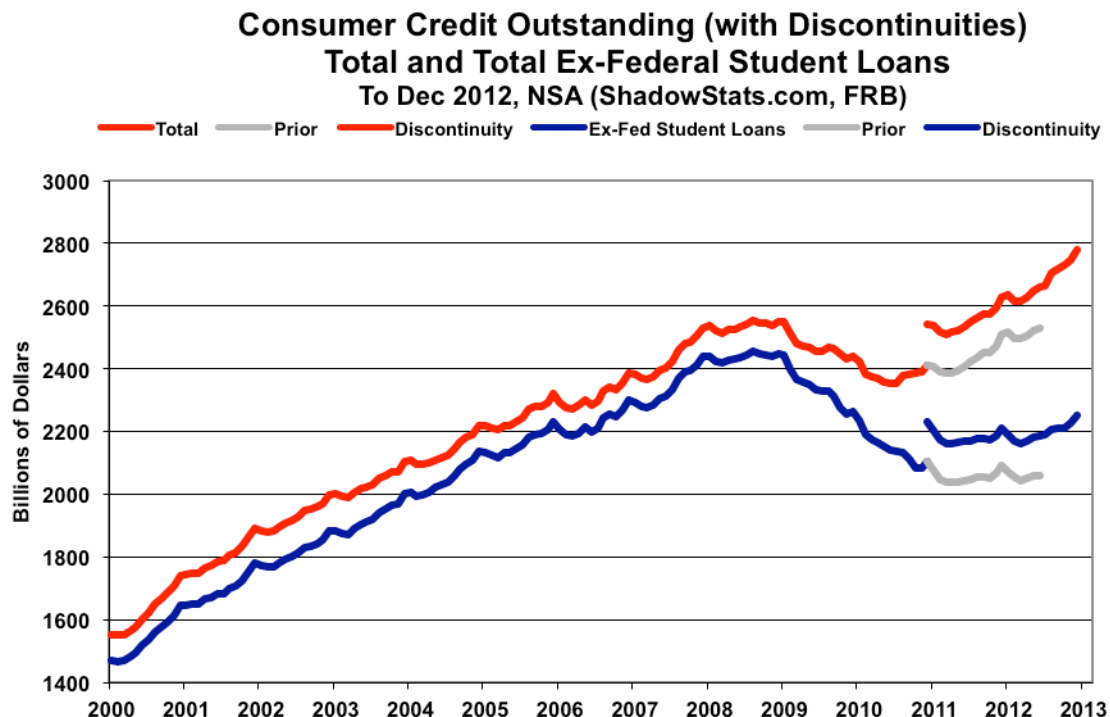
Monthly December 2013 Trade Reporting. The monthly trade deficit narrowed sharply in December, both before and after adjustment for inflation. As a result, a better-than-expected, full-quarter inflation-adjusted trade shortfall suggested an upside contribution to the looming February 28th first-revision to fourth-quarter 2012 GDP. There will be other factors that contribute to the GDP revision, but, by itself,

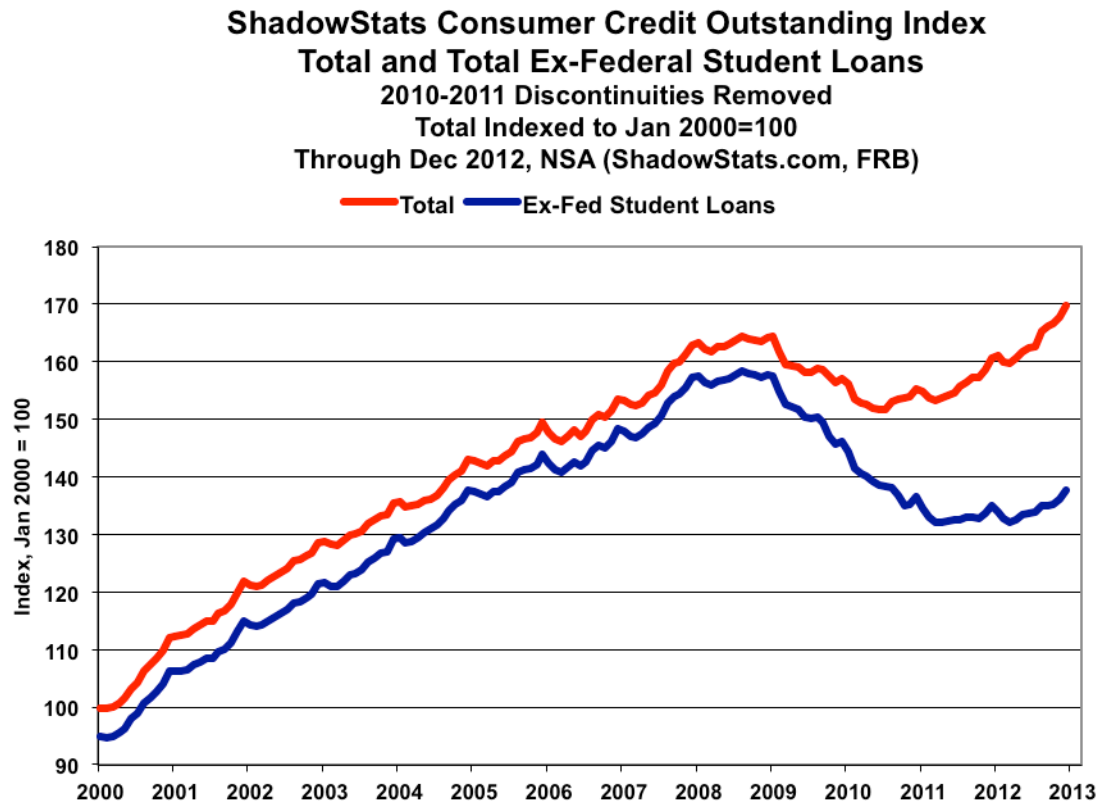
the new trade reporting for fourth-quarter 2012 is enough to push the initial, small contraction in headline GDP into a revised small expansion.

Before inflation adjustment, the deficit narrowing easily could have reflected trade-flow and paperwork disruptions from Hurricane Sandy, although it will take several months to resolve that issue. The headline December 2012 monthly deficit narrowed to \$38.5 billion, from a revised \$48.6 in November, and from \$51.7 billion in December 2011. The monthly trade improvement reflected a sharp decline in imports, versus a strong gain in exports. More than half the monthly deficit reduction was accounted for by a sharp decline in monthly oil imports.

[More-complete detail on the December and annual trade data are found in the Reporting Detail section.]

Introduction of the ShadowStats Consumer Credit Outstanding Graph. Since the Federal Reserve has not addressed the discontinuities in its reporting of consumer credit outstanding, an estimation has been made by ShadowStats so that the existing series can be plotted and viewed, without a break for discontinuity. The discontinuity developed when the Fed surveyed a new universe for its credit series, and found that levels in that universe were higher than had been estimated previously in the old universe. The nature of the revisions, however, showed that activity in the two universes tended to move together, proportionately. The Fed, however, has not adjusted the historical data for the changes, as shown in the first graph. The existing historical data simply were inconsistent with and disjointed from the new series.





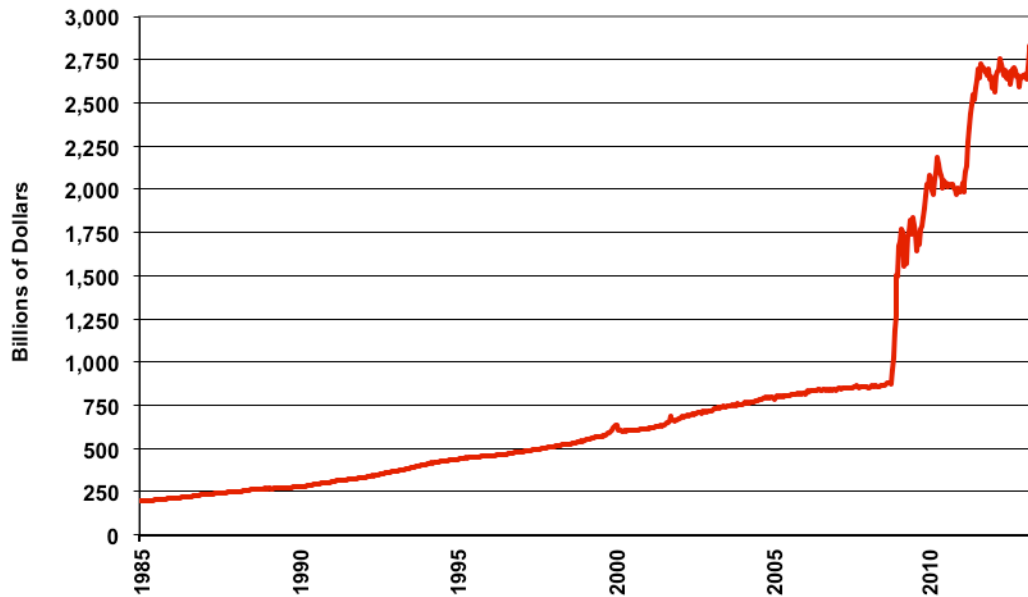
The old series has been adjusted by ShadowStats to the upside, on a proportionate basis, as suggested by the revisions, so that rough comparisons can be made. The new total credit outstanding series also has been indexed to January 2000 = 100, eliminating issues in terms of dollar levels, as shown in the second graph. The series adjusted for federally-owned student loans remains proportionate to the total numbers, as previously indicated.

In both graphs, the highly touted recent growth in total consumer credit outstanding—a factor viewed by some as a recovery in consumer liquidity and confidence—has been due solely to the extraordinary growth in federally-owned student loans, not in terms of bank lending that normally would help to stimulate retail sales and other consumption (see the *Week Ahead* section).

HYPERINFLATION WATCH—MONETARY BASE

Monetary Base Continues to Expand. The monetary base, which is currency in circulation (part of M1 money supply) plus bank reserves (not part of the money supply), has continued to shoot up in response to the Federal Reserve's expanded QE3. That is shown in the monetary-base graphs following, which are updated through February 6th. Where the Fed monetizes U.S. Treasury securities, that adds directly to the broad money supply, and it contributes to selling pressure against the U.S. dollar. Movement in both money supply growth and dollar selling should accelerate in the weeks and months ahead.

St. Louis Fed Adjusted Monetary Base
Bi-Weekly through February 6, 2013, SA, St. Louis Fed



St. Louis Fed Adjusted Monetary Base
Yr/Yr %, Bi-Weekly through Feb 6, 2013, SA, SGS, St. Louis Fed



Hyperinflation Outlook: Updated Summary. This brief summary of the outlook for current economic activity, systemic solvency and inflation/hyperinflation is intended particularly 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.

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. The basics have not changed here, other than events keep moving towards the circumstance of a domestic hyperinflation by the end of 2014. Accordingly, the time is near for publishing a fully updated hyperinflation report, and a March timing on that is likely.

The economic and systemic solvency crises of the last eight years continue. There never was an actual recovery following the economic downturn that began in 2006 and collapsed into 2008 and 2009. What followed was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012. The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series. Nonetheless, the renewed downturn likely will gain recognition as the second-dip in a double- or multiple-dip recession.

What continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 panic and near-collapse of the system at the time. All the extraordinary actions and interventions bought a little time, but they did not resolve the various crises. That the crises continue can be seen in deteriorating economic activity and in the panicked actions by the Federal Reserve, where it proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise.

The Fed's current liquidity actions also can be viewed as a signal of deepening problems in the banking system. As Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Nonetheless, the Fed's easing moves have been an ongoing effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury.

Despite the near-term political hype that Congress will come up with a plan to balance the budget in a ten-year time frame, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of current negotiations. Ongoing economic woes assure that the usual budget forecasts—based on overly-optimistic economic projections—will fall far short of fiscal balance and propriety. Furthermore, chances remain nil for the government addressing the GAAP-based deficit that hit \$6.6 trillion in 2012, instead of the popularly followed, official cash-based accounting deficit in 2012 of \$1.1 trillion, as discussed in [No. 500: Special Commentary](#).

Efforts at delaying meaningful fiscal action, and at briefly postponing conflict over the Treasury's debt ceiling, have bought the politicians in Washington minimal time in the global financial markets, but the patience in the global markets is near exhaustion. The continuing unwillingness and political inability of the current government to address seriously the longer-range U.S. sovereign-solvency issues, only pushes along the regular unfolding of events that eventually will trigger a domestic hyperinflation, as discussed in [Commentary No. 491](#). The unfolding fiscal collapse, in combination with the Fed's direct monetization of Treasury debt, will tend to savage the U.S. dollar's exchange rate, to boost oil and gasoline prices, and to boost money supply growth and domestic U.S. inflation. Market tranquility likely will not last much

longer, despite the tactics of delay by the politicians and obfuscation by the Federal Reserve. This should become increasingly evident as the disgruntled global markets begin to move against the U.S. dollar. A dollar selling panic is likely this year, with its effects and aftershocks setting hyperinflation into action in 2014.

REPORTING DETAIL

U.S. TRADE BALANCE (December 2012, Annual Data)

Annual 2012 Merchandise Trade Deficit Basically Was Unchanged from 2011. On a balance of payments (BOP) basis—where the Bureau of Economic Analysis (BEA) adjusts customs-based data to make the trade numbers consistent with the theoretical constructs in GDP reporting—the annual U.S. merchandise trade deficit narrowed slightly to \$735.7 billion in 2012, from \$738.4 billion in 2011. The annual and quarterly details for that series are graphed in the *Opening Comments* section.

On a census or customs basis—where the detail reflects data compiled from documents collected by the Customs Service—the deficit widened minimally to \$727.9 billion in 2012, versus \$727.4 billion in 2011. Where freight costs are on a C.I.F. basis (cost, insurance, freight), instead of the F.A.S. (free along side ship) basis used with the BOP accounting, the annual deficit widened to \$788.1 billion in 2012, versus \$738.4 billion in 2011.

Adjusted for GDP-style inflation (2005 chained dollars) and on a census basis, the 2012 merchandise deficit narrowed to \$568.3 billion versus \$574.7 billion. While that is not a large annual differential, it does suggest that the net-export account in real (inflation-adjusted GDP) will have added some overall growth to 2012 GDP, versus 2011 GDP.

Adding in the relatively meaningless surplus reported from the services sector, the annual goods and services deficit, on a nominal (not-inflation-adjusted) balance of payments basis, narrowed to \$540.4 billion in 2012, from \$559.9 billion in 2011. The only basic trade measure here that has meaning, though, is the dominant merchandise trade side, which is in deficit, where the numbers are backed by a paper trail. The relatively-minor services-sector surplus detail largely is generated by overly-optimistic guesswork.

Narrowing of December Trade Deficit Could Reflect Hurricane Distortions and Should Boost GDP Revision. The December 2012 trade deficit narrowed sharply, month-to-month, beyond market expectations, both before (nominal) and after (real) adjustment for inflation. This easily could reflect distortions—catch-up or otherwise—from the disruptions of Hurricane Sandy to the flow of goods and

trade-related paperwork through the ports of New York, Newark and surrounding areas. It will take several months, though, to resolve that issue.

As a result of the narrower December deficit, however, the full-quarter of data for fourth-quarter 2012 are not as negative as the previously-incomplete data had suggested. Accordingly, these new numbers suggest upside pressure on the pending February 28th first revision to fourth-quarter GDP.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. In the context of monthly revisions for the full year of 2012, the Bureau of Economic Analysis (BEA) and the Census Bureau reported today, February 8th that the nominal, seasonally-adjusted monthly trade deficit in goods and services for December 2012, on a balance-of-payments basis, narrowed to \$38.5 billion, from a revised \$48.6 (previously \$48.7). The December 2012 deficit also narrowed sharply from \$51.7 billion in in December 2011.

The monthly trade improvement reflected a sharp decline in imports, versus a strong gain in exports. More than half the monthly deficit reduction was accounted for by a sharp decline in oil imports for the month.

Crude Oil and Energy-Related Petroleum Products. For the month of December 2012, the not-seasonally-adjusted average price of imported oil declined for the second month, dropping to \$95.16 per barrel, from \$97.45 in November 2012, and it was down from an average of \$104.16 in December 2011. Based on recent oil-market behavior, though, the pattern of declining oil prices on imported oil should reverse in the months ahead.

In terms of not-seasonally-adjusted physical oil imports, December 2012 volume averaged 7.189 million barrels per day, down from 8.100 million in November 2012 and down from 9.062 million million barrels per day in December 2011.

Other Cautions on Data Quality. *Beyond possible short-lived disruptions from weather impact, the standard caution here for the monthly detail is that heavy distortions likely also continue in the seasonal adjustments, much as has been seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. As has been discussed frequently (see [Hyperinflation 2012](#) for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not rely heavily on the accuracy of the monthly headline data.*

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil-price swings and other inflation (2005 chain-weighted dollars as used in reporting real GDP), the December 2012 merchandise trade deficit (no services) came in at \$41.1 billion, versus a revised \$51.8 (previously \$51.9) billion in November. All the monthly data were revised for the year of 2012.

With the December detail in place, the full fourth-quarter 2012 real deficit was running at an annualized pace of \$567.8 billion dollars, versus \$566.2 billion in the third-quarter. That fourth-quarter estimate is enough better than the initial guesses (based on only two months of reporting) that the net effect should be a positive contribution to the first revision to fourth-quarter 2012 GDP (due for release on February 28th). Other revisions to the monthly 2012 data do not suggest significant revisions to earlier GDP reporting, which will be addressed in July 2013.

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 reported 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 it still appears to be trying to work numerical slight-of-hand with series such as the GDP and related projections of the federal budget deficit. The media do their best to avoid publicizing unhappy economic news or, otherwise, they put a happy spin on the numbers. Pushing the politicians and media, the financial markets and related spinmeisters 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](#).

Retail Sales (January 2013). Scheduled for release on Wednesday, February 13th, by the Census Bureau, the headline January 2013 retail sales number likely will disappoint already-negative market expectations, versus an initial 0.5% gain in December that could be subject to significant downside revision. Hitting the January retail sales activity will be contracting consumer liquidity, as a variety of higher taxes take their toll on the consumer's ability to spend. Without income growth, or the ability to take on new debt (see the consumer credit outstanding detail in the *Opening Comments* section), retail sales have no basis for experiencing sustained real (inflation-adjusted) growth. Increasingly, the retail sales results will look even bleaker after adjustment for inflation. That likely will be seen as a major concern, beginning with February's reporting.

Industrial Production (January 2013). The release of detail on the January 2013 index of industrial production is scheduled for Friday, February 15th, by the Federal Reserve. The headline January production number has a fair shot of seeing an outright contraction in initial reporting—at least net of revisions—in this increasingly unstable series. Despite any inventory liquidation that took place in fourth-quarter 2012, more is needed, and restricted production would help maintain that trend in January. Reporting likely will disappoint minimally-positive market expectations, against initial reporting in December of a 0.3% monthly gain. Again, keep in mind that this series is subject to frequent and significant downside revisions.