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

**COMMENTARY NUMBER 503**
**January 2013 Industrial Production**

**February 15, 2013**

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**Annual Production Growth in January Slowed to Pre-Recession Levels**

**Monthly Production Decline Was In the Context of Continued Volatile and Unstable Reporting**

**Production Benchmark Revision in March Should Show Weaker Activity Than Previously Estimated**

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*PLEASE NOTE: The next regular* Commentary *is scheduled for Wednesday, February 20th, covering January 2013 housing starts and PPI, and annual revisions to the seasonally-adjusted headline CPI data, followed by a* Commentary *on Thursday, February 21st, covering the standard releases of the January CPI, real retail sales, real earnings and existing-home sales.*

*Best wishes to all — John Williams*

**Opening Comments and Executive Summary.** The general economic outlook remains unchanged for what eventually will be recognized formally as a double-dip recession. In short-term reporting, however, an improvement in December trade data, minimal upside revisions to fourth-quarter retail sales, and today's (February 15th) upside revisions to fourth-quarter industrial production, all suggest some upside revision to the second estimate of fourth-quarter 2012 GDP headline growth on February 28th. Where the initial GDP growth estimate was for a 0.1% annualized contraction, a small positive number is likely in revision. Within a margin of error of +/- 3.5%, though, any forthcoming estimate of GDP growth would be statistically insignificant, as usually is the case in the quarterly reporting of this most-worthless of government economic series.

In the context of the upside revisions to monthly production levels in fourth-quarter 2012, the headline 0.1% monthly decline in January 2013 industrial production was not particularly meaningful, other than it was weaker than market estimates. With the latest revisions, the Federal Reserve's estimates of monthly production estimates have continued to show extreme volatility and instability in the series.

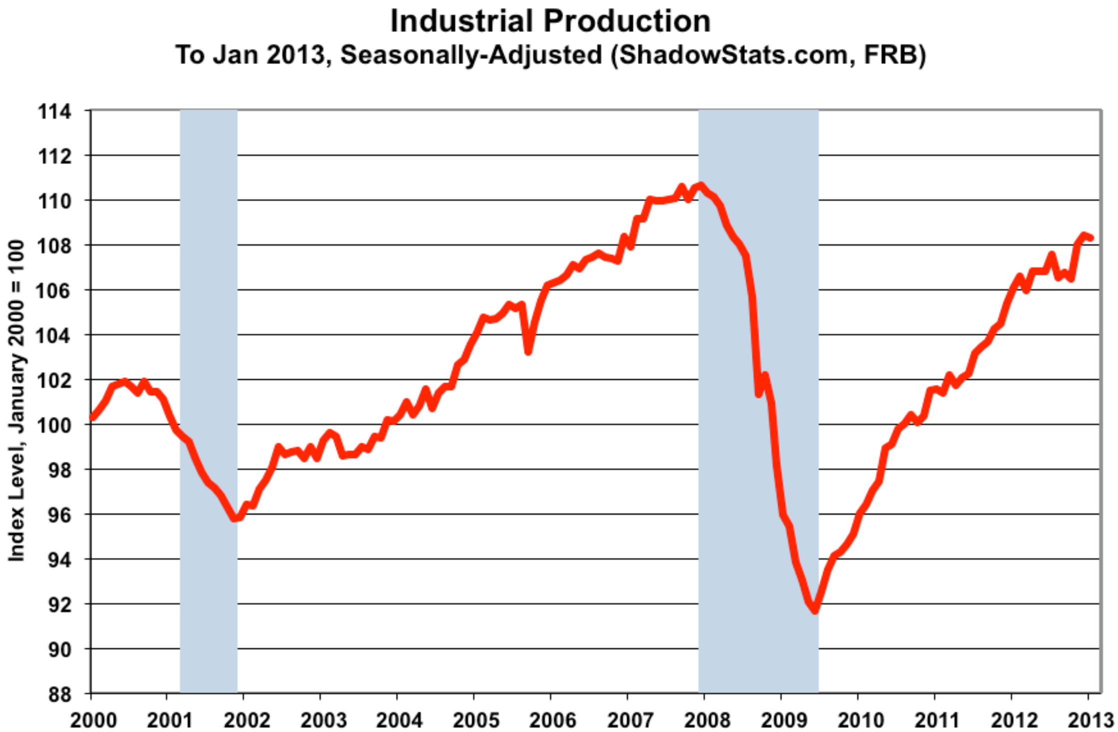
Although the headline February estimate is due for release on March 15th, annual benchmark revisions will follow just one week later, on March 22nd, when all monthly data will be revised back to 1972. While there is little hope of seeing stable monthly reporting in the nearest-term reporting, the annual revisions should show a much weaker history of production in recent years, than currently reported, particularly for 2011, and to a lesser extent in 2012, based on new and more-complete data that have not been available previously to the Federal Reserve Board. Somewhat parallel revisions should surface in a variety of other series, with the benchmarks culminating in likely downside revisions to historical GDP reporting in the July 31st annual revisions to that series.

On the inflation front—as discussed in the *Week Ahead* section—next week will see the publication of the January consumer price index (CPI) on February 21st, and the January producer price index (PPI) on February 20th. The larger headline inflation gains, however, should be evident in the next month's (February) data, where rapidly rising gasoline prices and higher oil prices will be reflected more fully, both in terms of monthly average prices and in the context of neutral-to-positive impact from monthly seasonal-factor adjustments. In January—although rising rapidly at month end—gasoline prices gained just 0.3% on average for the month, while January's seasonal factors are geared to reduce reported headline energy inflation in both the CPI and PPI. That said, both the January CPI and PPI still have fair chances of showing small headline gains.

***January Industrial Production.*** January 2013 industrial production showed a headline 0.10% monthly contraction, versus a revised 0.38% gain in December 2012. Year-to-year growth slowing to 2.10%, from a revised 2.90% in December. While the annual reading for January was the lowest since February 2010, when production was turning higher, the last time that annual production growth slowed to 2.10% was in December 2007, the month officially designated as the beginning of the 2007 recession.

The 0.1% decline in January production reflected a 0.4% drop in manufacturing (versus a revised 1.1% gain in December). Suggestive of the continuing liquidation of excessive inventories, January production of automotive products declined by 3.9% for the month. Further, utility usage bounced back in January by 3.5%, from a revised 4.5% December decline attributed to unseasonable weather. Monthly mining activity fell by 1.0% in January, after being revised to unchanged in December.

Corrected Industrial Production. Hedonic quality adjustments understate the inflation used in calculating components of industrial production, with the effect of overstating the inflation-adjusted growth reported in the headline industrial production series (see *Special Commentary (No. 485)* and *Public Comment on Inflation*). The two graphs following address that issue. The first 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 simply to provide for some consistency in the 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.


Industrial Production
To Jan 2013, Seasonally-Adjusted (ShadowStats.com, FRB)
Index Level, January 2000 = 100
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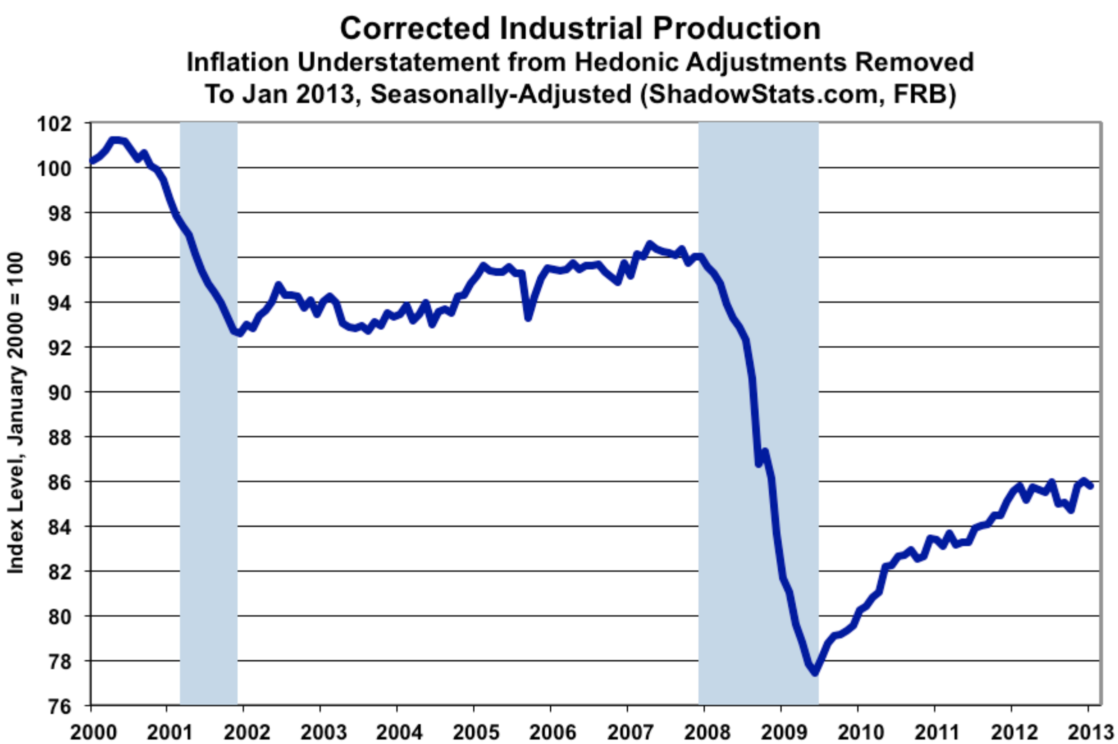
Corrected Industrial Production
Inflation Understatement from Hedonic Adjustments Removed
To Jan 2013, Seasonally-Adjusted (ShadowStats.com, FRB)
Index Level, January 2000 = 100
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The "corrected" graph does show some growth in the period following the official June 2009 near-term trough in production activity. Yet, that upturn has been far shy of the full recovery reported in the GDP. Production levels have not regained pre-recession highs, but, instead, entered a period of protracted low-level stagnation in 2012, with a new quarterly contraction in third-quarter 2012, followed by continuing bottom-bouncing with a downside trend.

***[More-complete detail and further graphs on January industrial production are found in the* Reporting Detail *section.]***

## HYPERINFLATION WATCH

**Hyperinflation Outlook: Summary.** This brief summary of the outlook for current economic activity, systemic solvency and inflation/hyperinflation is unchanged from the previous *Commentary*, intended primarily 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, 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 overlyoptimistic 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.

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## REPORTING DETAIL

### INDEX OF INDUSTRIAL PRODUCTION (January 2013)

**Ongoing Revision Instabilities Boost Relative Fourth-Quarter 2012 Production.** Along with a 0.10% headline contraction in monthly January 2013 industrial production, related year-to-year growth slowed to 2.10%. That annual reading was the lowest since February 2010, with production turning higher at the time. The last time annual production slowed to 2.10%, though, was in December 2007, which is marked formally as the onset of the unprecedented and ongoing "2007" economic downturn.

Reflecting volatile and unstable revisions, the official, annualized quarter-to-quarter growth for fourth-quarter 2012 revised to 2.6% (previously 1.0%), versus 0.5% (previously 0.4%) in the third-quarter and an unrevised 2.4% in the second-quarter.

The graph of corrected industrial production activity—adjusted for inflation understatement—is displayed in the *Opening Comments and Executive Summary* section. With the latest monthly revisions, the corrected production series gained at a revised 0.8% (previously declined at a 0.8%) annualized quarterly rate) in fourth-quarter 2012, versus a revised contraction of 1.3% (previously 1.4%) in the third-quarter, and an unrevised gain of 0.5% in the second-quarter.

January 2013 Industrial Production. Today's (February 15th) release by the Federal Reserve Board of seasonally-adjusted January 2013 industrial production showed a headline 0.10% monthly contraction (a gain of 0.54% before prior period revisions). The January decline was against a revised 0.38% (previously 0.26%) gain in December 2012, a revised month-to-month gain of 1.43% (previously 1.04%, initially 1.05%) in November, and a shallower month-to-month contraction in October of 0.27% (previously declines of 0.35%, 0.67% and an initial decline of 0.43%).

Limiting the magnitude of the headline decline in January 2013 activity was a 3.5% bounce-back in utility usage, from a revised 4.5% (previously 4.8%) decline in December utility usage attributed to unseasonable weather. Monthly mining activity fell by 1.0% in January, after being revised to unchanged in December, which previously was estimated with a 0.6% monthly gain.

Following a revised 1.1% (previously 0.8%) gain in December 2012, manufacturing fell by 0.4% in the month of January 2013, with consumer goods production down by 0.2%. Suggestive of the continuing liquidation of excessive inventories, January production of automotive products declined by 3.9% for the month.

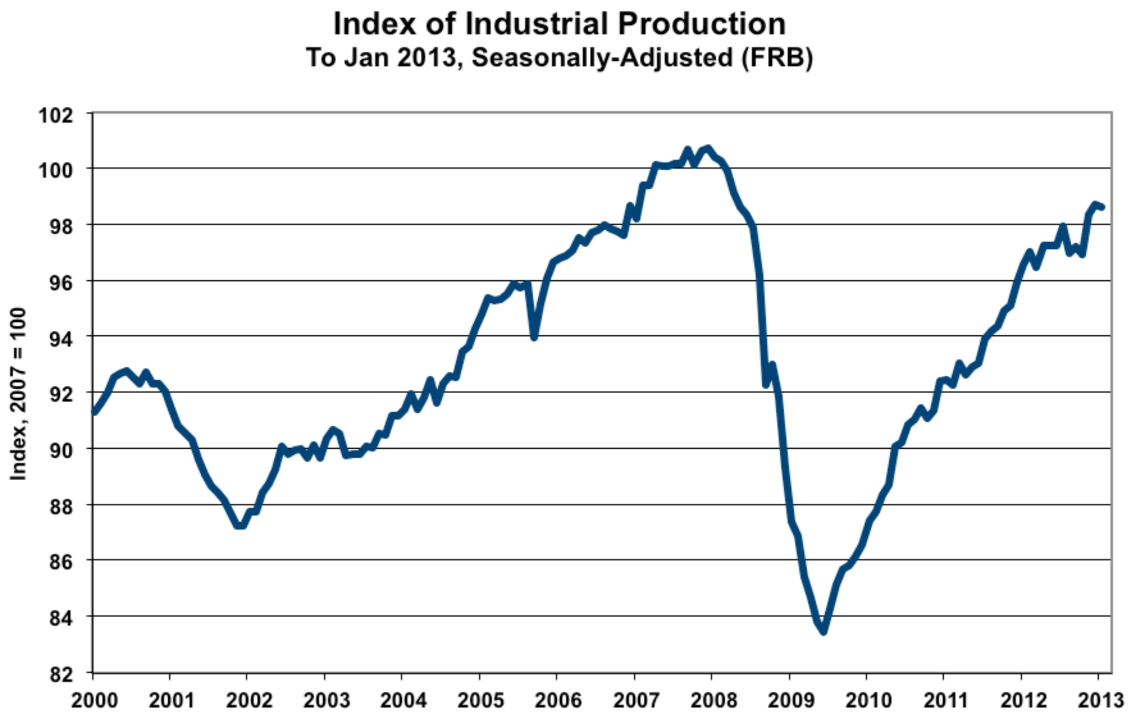
Year-to-year growth for January 2013 production slowed to 2.10%, versus a revised 2.90% (previously 2.25%) in December 2012, down from a revised 3.39% (previously 2.86%, initially 2.51%) in November, and versus a revised 3.13% (previously 2.00%, 1.64% and initially 1.74%) annual rate of growth in October. As discussed in the *Opening Comments*, the last time that year-to-year growth in production slowed to 2.10% was in December 2007, the official onset of the recession.

Current annual growth remains 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 June 2009 trough of the official 2007 recession, unlike the GDP, the official series remains well shy of showing a full recovery.

Corrected for the understatement of inflation used in deflating portions of the industrial production index, the series has shown more of a bottom-bouncing and recent-downturn pattern, since 2009, where it appears to have topped out coming into 2012 and trending lower since second-quarter 2012. The corrected production series, again, is shown in the *Opening Comments* section. Please note also that index base for those graphs, both the corrected graph and the accompanying graph based on official reporting, is January 2000 = 100, instead of the Federal Reserve's official 2007 = 100, used in the graphs here.


Index of Industrial Production
To Jan 2013, Seasonally-Adjusted (FRB)
Index, 2007 = 100
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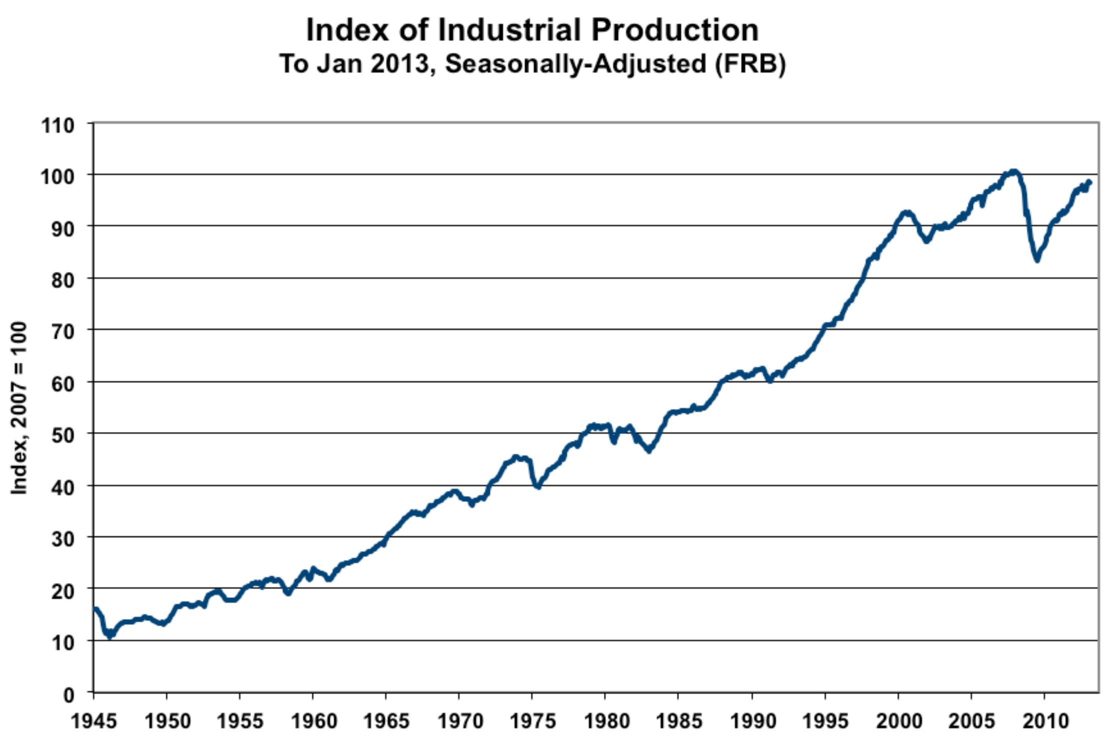
Index of Industrial Production
To Jan 2013, Seasonally-Adjusted (FRB)
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## WEEK AHEAD

***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.

***Residential Construction (January 2013).*** Detail on January 2013 housing starts is due for release on Wednesday, February 20th, by the Census Bureau. Where there should be some temporary boost in activity from post-Hurricane Sandy reconstruction efforts, the biggest such effects likely still will be seen in later months. Gains seen recently due to the standard inability of the seasonal adjustment process to handle unseasonable weather, however, have a fair shot of not repeating in January on a relative basis. Accordingly, chances remain good that any reported monthly change in January activity will continue to be statistically insignificant.

Continuing in the wake of a 75% collapse in activity from 2006 through 2008, and an ensuing four-year pattern of housing starts stagnation at historically low levels, there remains no chance of a sustainable turnaround in the housing construction market, unless there is a fundamental upturn in consumer and banking liquidity conditions (discussed in the prior *Commentary No. 502*).

***Producer Price Index—PPI (January 2013).*** The January 2013 PPI is scheduled for release on Wednesday, February 20th, by the Bureau of Labor Statistics (BLS). The headline January PPI has a good chance of showing a modest monthly gain, due to rising oil prices.

Depending on the oil contract followed, oil prices, on average, were up month-to-month in January by 3.2-to-7.9 percentage points. Despite negative seasonal adjustments for oil prices in the month, energy costs still should show some gain. Along with higher food prices and relatively strong "core" inflation, the rising energy prices should keep the monthly change in wholesales prices in positive territory.

***Consumer Price Index—CPI (January 2013).*** The release by the Bureau of Labor Statistics (BLS) of the January 2013 CPI numbers is scheduled for Thursday, February 21st. Given the timing of the recent surge in gasoline prices, in combination with regular swings in seasonal factors, the more-significant upturn in consumer inflation should be seen in the reporting of February 2013 data, with the pending January 2013 headline number likely to be minimally-positive to flat.

Also pending are the annual revisions to the seasonally-adjusted monthly headline numbers. Where the unadjusted CPI indices never are revised—barring an outright calculation error—the adjusted headline numbers are revamped once per year. The revisions to adjusted numbers for December 2012 data and before are scheduled for release on Tuesday, February 19th. Detail will be assessed in the scheduled February 20th *Commentary*, in advance of the regular CPI *Commentary* on the 21st.

Seasonally-unadjusted, monthly-average gasoline prices rose by 0.3% in January 2013, per the Department of Energy, but that small monthly gain should be more than offset on the downside by BLS seasonal-adjustment calculations. In January 2012, an unadjusted monthly gain of 3.6% in gasoline prices was reduced to a 0.9% gain by downside seasonal adjustments. With continued upside pressures, however, from both food and core inflation, there is fair chance that the January 2013 headline number will match minimally-positive to unchanged levels that appear to be expected by the markets.

Year-to-year, CPI-U inflation would increase or decrease in January 2013 reporting, dependent on the seasonally-adjusted monthly change, versus a reported 0.21% monthly inflation rate in January 2012. The adjusted change is used 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%. A flat to minimally-positive headline monthly CPI-U inflation could taken January annual inflation into the 1.5% to 1.6% range

***Existing- and New-Home Sales (January 2013).*** January existing-home sales are due for release on Thursday, February 21st, from the National Association of Realtors, while the January new-home sales report from the Census Bureau is not due out until Tuesday, February 26th. Whether existing or new sales, an entrenched pattern of stagnation likely has continued in both series, with the pending reports of monthly change in sales activity not likely to be statistically-significant.

 