John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 509
February 2013 Retail Sales

March 13, 2013

Beyond Incorporating Significant Inflation
February Retail Sales Gain Ran Counter to Evidence of Slowing Real Activity

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PLEASE NOTE: The next regular Commentary *is scheduled for Friday, March 15th, covering February industrial production, PPI, CPI and related inflation-adjusted series.*

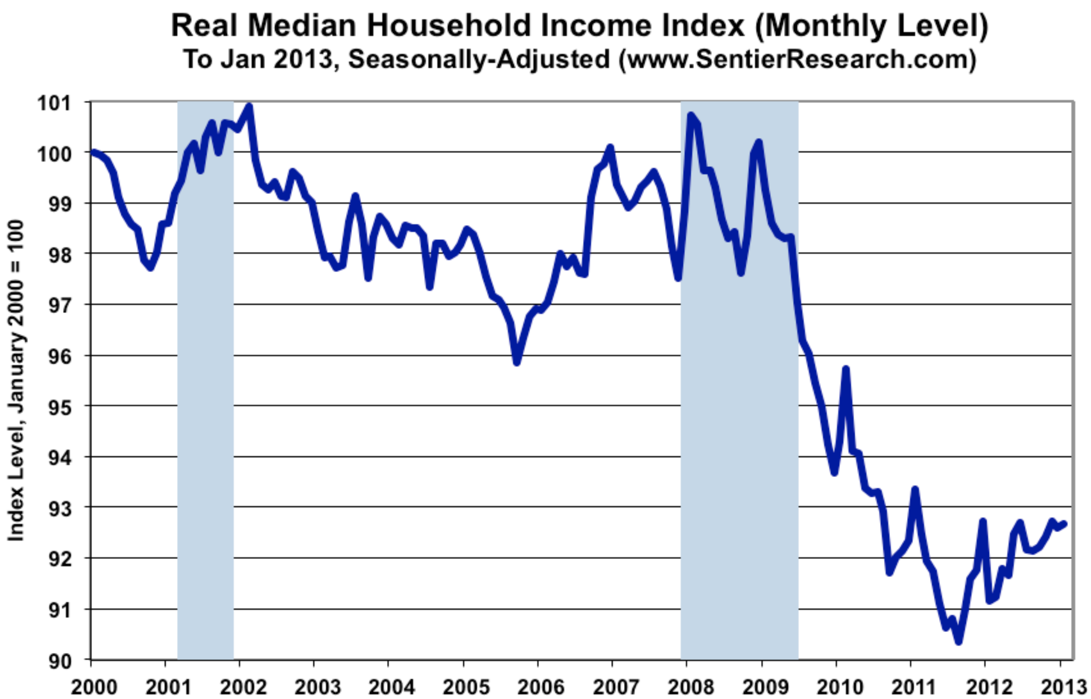
Best wishes to all — John Williams

Opening Comments and Executive Summary. The better part of the headline 1.1% gain in February 2013 retail sales—before accounting for inflation—most likely was inflation. Market expectations for the March 15th release of the headline February CPI-U are running in the 0.5% to 0.6% range (see *Week Ahead* section). Although an upside reporting surprise to inflation expectations is a reasonable bet, chances of the headline CPI-U hitting 1.1% or higher are nil. That means headline real (inflation-adjusted) retail sales should be positive for February, a result that is not credible.

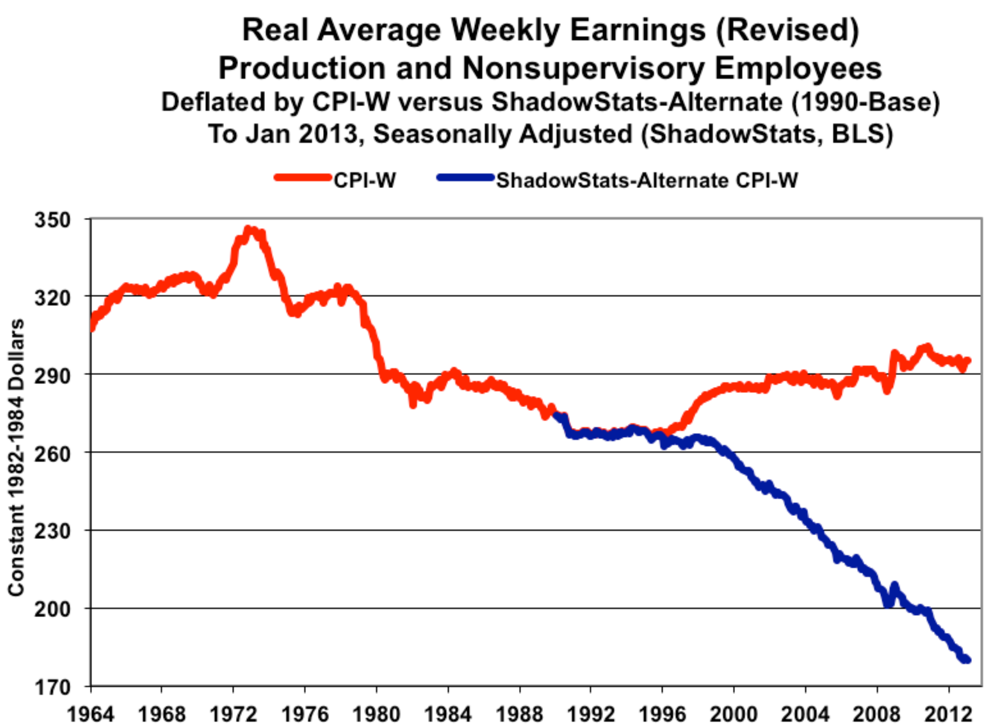
Reporting here of positive real monthly growth runs counter to various indications out of the business sector, including retailers, retail suppliers and those delivering product, and to indications of a build-up in unwanted inventories. It also runs counter to the implications of constraints on consumption from the intense, structural-liquidity woes besetting the consumer. Without real growth in income, and without the ability or willingness to take on meaningful new debt, the consumer cannot sustain real growth in retail sales or in the broader personal-consumption measure of GDP. As usual, monthly reporting also is skewed meaningfully by seasonal-adjustment issues, which are discussed in the *Reporting Detail* section.

Consumer-related graphs that have appeared in recent *Commentaries* are shown here in summary:

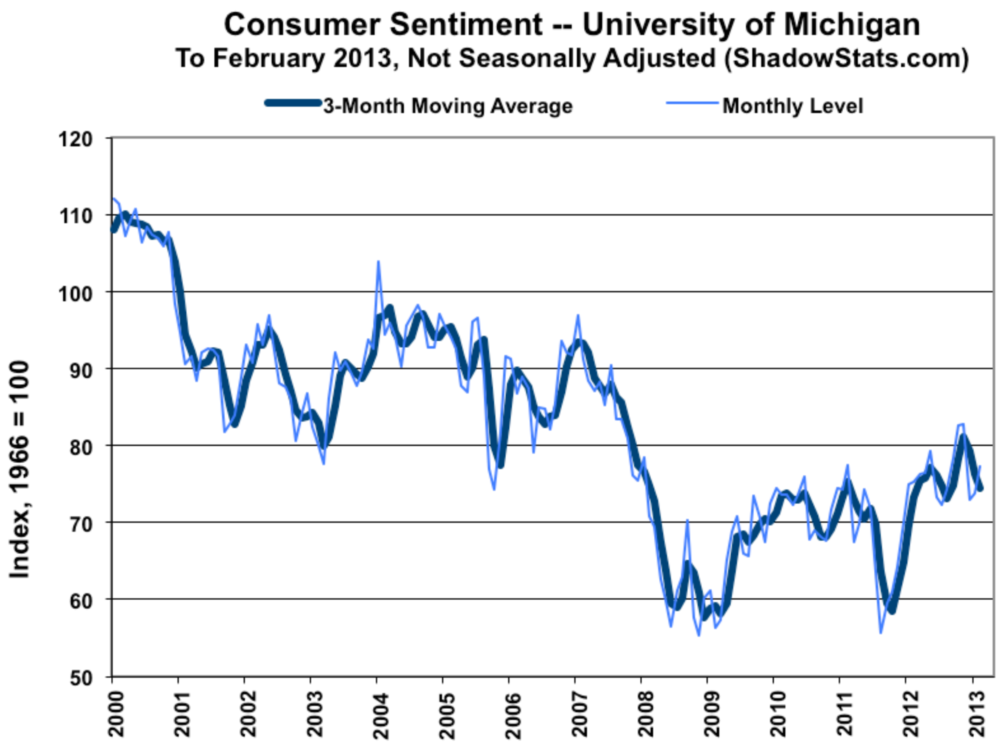
Commentary No. 507

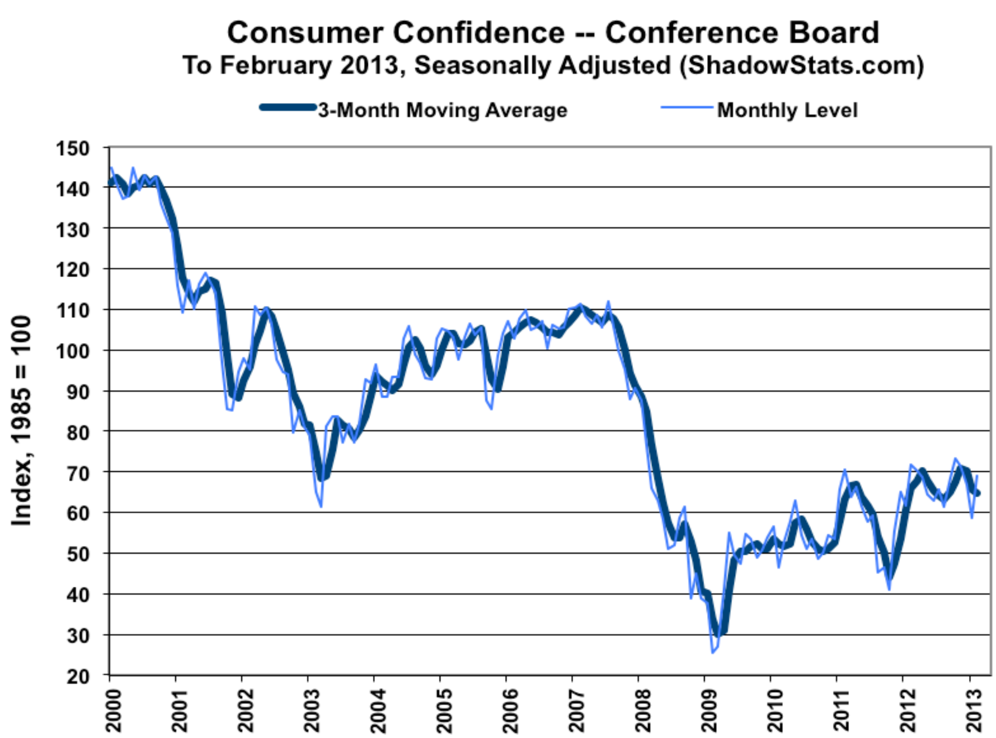


Commentary No. 505

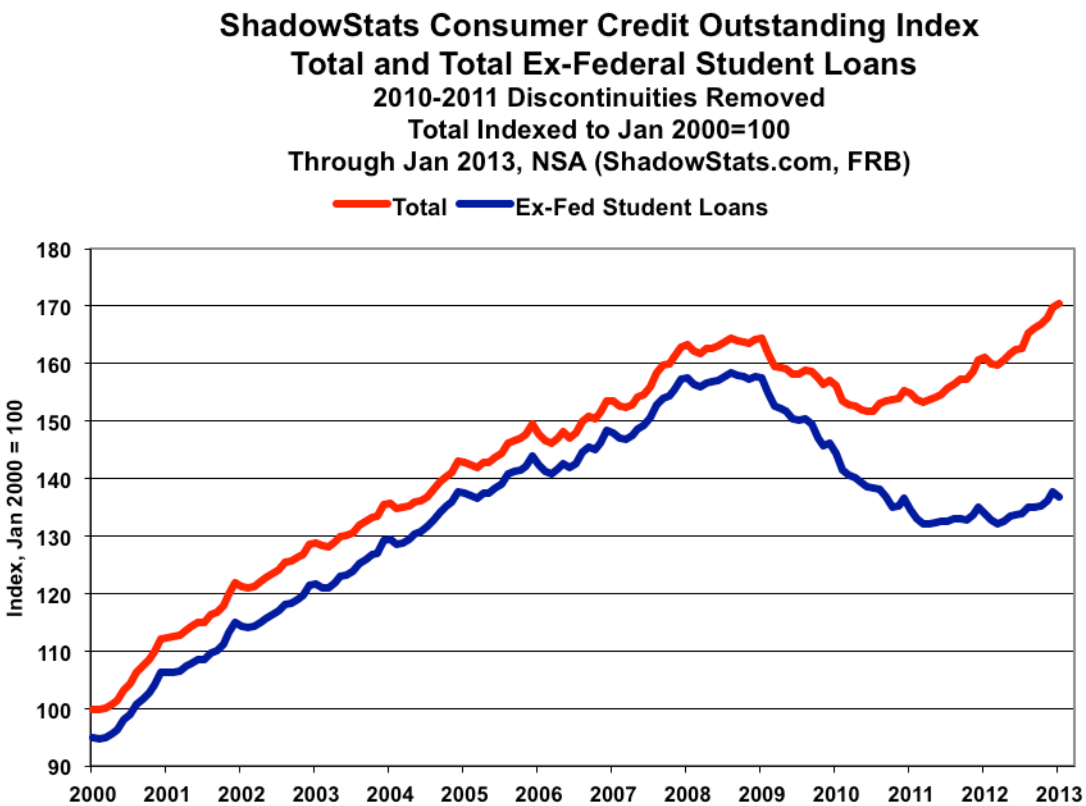


Commentary No. 507





Commentary No. 508



The links provided are to the *Commentaries* with the most-recent usage of the graphs.

Today's (March 13th) *Commentary* is abbreviated. More detail and a broader economic assessment will be presented in the March 15th missive, which will include the specifics of the latest CPI (real retail sales and earnings), PPI and industrial production numbers.

[More-complete details on the February retail sales data are found in the* Reporting Detail *section.]

HYPERINFLATION WATCH

Hyperinflation Outlook: Summary. The next update of this section is planned along with the *Commentary* due for March 15th, which will cover February inflation and industrial production.

This summary is unchanged from *Commentary No. 505*, of February 22nd and is intended for new subscribers and for readers looking for a condensed version of the broad outlook or who otherwise are not familiar with the hyperinflation report or recent special commentaries, 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 outlook 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. Nonetheless, a fully updated hyperinflation report is targeted for publication in the March to April time-frame.

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. As discussed in the *Opening Comments* section [of *Commentary No. 505*], hoopla to the contrary in the popular press, that the Fed might pull-back on its "easing," most likely is designed to help firm-up the U.S. dollar and to soften gold in the immediate period running up to the looming crises in the federal-budget and debt-ceiling negotiations.

The Fed's recent and ongoing 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 the negotiations. Ongoing and deepening 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, eventually will savage the U.S. dollar's exchange rate, boosting oil and gasoline prices, and boosting money supply growth and domestic U.S. inflation. Relative 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 sustainably against the U.S. dollar, despite any near-term gyrations. A dollar-selling panic is likely this year, with its effects and aftershocks setting hyperinflation into action in 2014.

REPORTING DETAIL

RETAIL SALES (February 2013)

Inflation Heavily Spiked February Retail Sales. Most of the headline 1.06% gain in February retail sales was accounted for by inflation, with price-boosted gasoline sales up by 5.04% (despite seasonally-adjusted gasoline prices being up by more than 9%) accounting for 0.51% or about half of the headline gain. Market expectations for headline February CPI-U (March 15th) are running in the 0.5% to 0.6% range (see *Week Ahead*), but even with upside reporting risks versus expectations, chances of headline inflation hitting 1.1% or higher are nil. Hence, headline real (inflation-adjusted) retail sales most likely will be positive for February, a result that is not credible.

As discussed in the *Opening Comments and Executive Summary*, headline positive monthly real growth here runs counter to various indications out of the business sector and counter to constraints on consumption from the intense, structural-liquidity woes besetting the consumer. Without real growth in income, and without the ability or willingness to take on meaningful new debt, the consumer simply cannot sustain real growth in retail sales, let alone in the broader personal consumption measure in GDP.

Otherwise, highly variable and unstable seasonal factors clouded activity in the December 2012-to-February 2013 period, and in January 2012-to-February 2012, five months that are published on a non-comparable basis with all the other historical monthly numbers, due to the use of concurrent seasonal adjustments. These inconsistencies allow for unreported shifts in the historical data that may have the impact of boosting current headline numbers.

Note: The stability of the seasonal-adjustment process (particularly the concurrent seasonal-adjustment process used with retail sales) and of sampling methods has been disrupted severely by the unprecedented depth and length of the current economic downturn in the post-World War II era (the period of modern economic reporting), as well as temporarily from the impact of Hurricane Sandy. Under such circumstances, where the markets effectively are flying blind as to actual economic activity, consideration of broad underlying fundamentals is essential. Consumer income and credit remain structurally impaired, again, as discussed in the Opening Comments *and recently in* Hyperinflation 2012 *and* Special Commentary (No. 485).

Another regular distortion to the retail sales reporting is in sampling assumptions. Like the Bureau of Labor Statistics, with its payroll survey, the Census Bureau assumes that a non-reporting company still is in business and just didn't get around to filing its sales report on a timely basis. So, where businesses are not able to participate in regular surveying, due to economic or disaster impact, the Census Bureau simply estimates what it feels the missing sales reporting should have been, and those numbers are added into the headline reporting.

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Not adjusted for surging monthly inflation, this morning's (March 13th) report on February 2013 retail sales—issued by the Census Bureau—indicated a statistically-significant, seasonally-adjusted monthly increase of 1.06% (a gain of 1.14% before prior-period revisions) +/- 0.6% (all confidence intervals are at the 95% level), versus a revised monthly gain of 0.22% (previously 0.13%) in January.

Year-to-year, February 2013 retail sales rose by 4.62% +/- 0.8%, versus a downwardly revised 4.20% (previously 4.37%) in January. The pattern of growth here remains distorted by a continuing pattern of unstable concurrent seasonal-adjustment factors and the lack of fully-consistent, seasonally-adjusted numbers being published by the Census Bureau.

Core Retail Sales. In February 2013, seasonally-adjusted monthly grocery-store sales rose by 0.69%, while gasoline-station sales increased by 5.04%, reflecting—but not fully—both higher food and gasoline prices. On a seasonally-adjusted basis, gasoline prices were up more than 9%. Under normal conditions, the bulk of non-seasonal variability in food and gasoline sales is in pricing, instead of demand. "Core" retail sales—consistent with the Federal Reserve's preference for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

Version I: February 2013 versus January 2013 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—gained 0.55%, versus the official gain of 1.06%.

Version II: February 2013 versus January 2013 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—gained 0.43%, versus the official gain of 1.06%.

Real (Inflation-Adjusted) Retail Sales. With headline February 2013 CPI inflation likely to be strongly positive, the headline inflation-adjusted, or real, estimate of the January 2013 monthly retail sales change should be less than 0.5%, given the nominal headline estimate of a 1.06% gain. The inflation-adjusted retail sales details will be provided in the March 15th *Commentary*, which will cover the release of February 2013 CPI-U. Real year-to-year change likely will remain in the range of historical growth that traditionally would signal pending recession, during normal economic times.

WEEK AHEAD

Weaker Economic and Stronger Inflation Data Should Surface in the Near-Term. Reflecting structural liquidity constraints on the consumer, and in anticipation of the likely negative impact, of expanded QE3 and the still-ongoing fiscal crisis/debt-ceiling negotiations, on the U.S. dollar in the currency markets, reporting in the months and year ahead generally should reflect higher-than-expected inflation and weaker-than-expected economic results. Increasingly, previous estimates of economic activity should revise lower, particularly in upcoming annual benchmark revisions for industrial production (March 22nd—back to 1972), retail sales (May 31st) and GDP (July 31st—comprehensive overhaul back to 1929).

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.

Producer Price Index—PPI (February 2013) UPDATED. The February 2013 PPI is scheduled for release tomorrow, Thursday, March 14th, by the Bureau of Labor Statistics (BLS). Higher energy prices, combined with rising food and "core" inflation should result in a monthly jump for headline wholesale price inflation, following a 0.1% decline in January's finished goods index. Market consensus seems to be around a headline 0.7%, which is not unreasonable.

Depending on the oil contract followed, oil prices, on average, were up month-to-month in February by 0.7-to-2.7 percentage points, while gasoline prices soared. With seasonal factors for energy and food turning from negative in January to neutral (some positive) in February, a monthly gain in this otherwise volatile series is likely and has a chance of topping market expectations.

Consumer Price Index—CPI (February 2013) UPDATED. The release by the Bureau of Labor Statistics (BLS) of the February 2013 CPI numbers is scheduled for Friday, March 15th. Surging gasoline prices, combined with higher food and core inflation promise a solid uptick in the headline CPI-U, with a fair shot surprising market expectations on the upside.

Seasonally-unadjusted, monthly-average gasoline prices rose by 10.2% in February 2013, per the Department of Energy, but the BLS seasonal adjustments likely will reduce that gain on a seasonally-adjusted basis. Initially, in February 2012, an unadjusted monthly gain of 4.9% in gasoline prices was increased to a 6.0%, by upside seasonal adjustments. Last month, however, the BLS revised its seasonals, and now the unadjusted 4.9% of February 2012 is a 4.0% gain. The difference is that by itself, gasoline inflation would be worth a 0.5% month-to-month increase in the headline CPI, instead of the 0.7% that would have been generated by the earlier seasonals.

With continued upside pressures, however, from both food and "core" inflation, there is good chance that the February 2013 headline CPI-U number will top 0.6%, where the market consensus appears to have settled in the 0.5% to 0.6% range.

Year-to-year, CPI-U inflation would increase or decrease in February 2013 reporting, dependent on the seasonally-adjusted monthly change, versus a reported 0.28% monthly inflation rate in February 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for February 2013, the difference in February's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the January 2013 annual inflation rate of 1.59%. For example, a headline gain in the February 2013 CPI-U of 0.5% would raise the year-to-year inflation rate to roughly 1.8%.

Index of Industrial Production (February 2013) UPDATED. The release of temporary detail on the February 2013 index of industrial production is scheduled for Friday, March 15th, by the Federal Reserve. The headline February production number has a fair shot of outright contraction, following a 0.1% decline in the headline number for January, and odds strongly favor a downside reporting surprise to market expectations that seem to be settling in around 0.5%. Be wary of extremely volatile revisions to month-to-month changes.

The index has tended to overstate recent economic activity, and downside revisions are likely, particularly with the annual benchmark revision due for release on March 22nd, just one week after the monthly headline release. The benchmark revisions here will restate economic history back through 1972.

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