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

COMMENTARY NUMBER 542
June Retail Sales

July 15, 2013

June Retail Sales Gain Reflected Little More Than Rising Inflation

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PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Tuesday, July 16th, covering June CPI, related inflation-adjusted series and industrial production. That will be followed by a* Commentary *on July 17th covering June housing starts.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Problems with Phony Inflation Numbers. The usual mid-month releases of major economic series for June 2013 have been spread out over a number of days—instead of the usual one- or two-day concentration—with a resulting spate of brief *Commentaries* on individual major series. The PPI was published on July 12th, retail sales was today (July 15th), CPI and industrial production will be tomorrow, July 16th, and housing starts will be July 17th. Accordingly, the July 17th (Wednesday) *Commentary* will include the summary of major June economic releases to that point, along with an updated summary of the *Hyperinflation Outlook*. The July 16th CPI report will include the regular reporting of the inflation-adjusted series, such as real retail sales and average weekly earnings.

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Along those lines, the headline monthly gain of 0.4% (0.37% at the second decimal point) in June retail sales, which was not adjusted for inflation, likely did not exceed the pending headline June CPI-U inflation rate estimate by much, if at all.

Netting out the impact of price changes from retail sales (and other nominal numbers) allows those assessing the data, in theory, to estimate the portion of sales-change due to changes in economic activity, versus the portion of sales-change due to changes in prices. That once was a meaningful and useful exercise for both retailers and economists.

Discussed in the *Public Comment on Inflation*, however, methodological changes in recent decades have changed the significance of such an inflation-adjusted analysis. The introduction of "hedonic quality adjustments" to prices now reflects nebulous price-impact assessments of quality changes that cannot be measured directly and that generally are not recognized by consumers of the affected products. Although the gerrymandered pricing has been applied to items ranging from clothing, textbooks and cell phones to washing machines and automobiles, the process has not been applied consistently or uniformly, and it usually is implemented only when the effect will be to reduce reported inflation.

As a result, while nominal retail sales reporting reflects something akin to actual dollar sales, the CPI inflation that is backed out the series, for inflation-adjusted analysis, usually is well shy of the actual price-increase impact on the sales numbers. The effect is that the highly-questionable and nebulous quality changes simply are being counted as imaginary economic growth, instead of price increases, while, at the same time, consumers are puzzling over why they cannot keep up with the "low" rate of official inflation. These issues will be discussed further, and the effects on reported economic activity will be displayed, in the "corrected" real retail sales graph of the July 16th *Commentary*.

June 2013 Retail Sales. Impaired by the continuing structural income and credit constraints on the U.S. consumer (see *Commentary No. 541*), June 2013 retail sales showed a statistically-insignificant, monthly gain of 0.37%. Not only was the headline gain largely, if not fully, accounted for by headline June consumer inflation (as discussed above), it came in well below market expectations. The June increase followed a revised, statistically-insignificant month-to-month gain of 0.54% (previously 0.55%) in May.

Year-to-year, June 2013 retail sales rose by a statistically-significant 5.72%, versus a revised 4.42% (previously 4.31%) in May. Prior-period revisions one year ago reflected little more than the unstable monthly revisions in concurrent-seasonal-adjustment process, where revised numbers are shown only selectively. The pattern of growth here remains distorted by the Census Bureau knowingly publishing inconsistent data.

Adjusted for inflation, the June 2013 year-to-year change in retail sales likely will remain in a range that would signal pending recession, in normal economic times. This pattern effectively indicates an intensifying downturn in the current circumstance.

[For further detail on June Retail Sales, see the* Reporting Detail *section.]

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HYPERINFLATION WATCH

Hyperinflation Outlook—Unchanged Summary. *[This summary will be revised in the pending Housing Starts* Commentary *of July 17th. Otherwise, this summary has not been revised since* Commentary No. 536 *of June 26th]*. The comments here are intended as background material for new subscribers and for those looking for a brief summary of the broad outlook of the economic, systemic and inflation crises that face the United States in the year or so ahead.

Background Material. *No. 527: Special Commentary* (May 2013) supplemented *No. 485: Special Commentary* (November 2012), reviewing shifting market sentiment on a variety of issues affecting the U.S. dollar and prices of precious metals. *No. 485*, in turn, updated *Hyperinflation 2012* (January 2012)—the base document for the hyperinflation story—and the broad outlook for the economy and inflation, as well as for systemic-stability and the U.S. dollar. Of some use, here, also is the *Public Comment on Inflation*.

These are the primary articles outlining current conditions and the background to the hyperinflation forecast, and they are suggested reading for subscribers who have not seen them and/or for those who otherwise are trying to understand the basics of the hyperinflation outlook. The fundamentals have not changed in recent years, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, the next, fully-updated hyperinflation report is planned for the near future.

Beginning to Approach the End Game. Nothing is normal: not the economy, not the financial system, not the financial markets and not the political system. The financial system still remains in the throes and aftershocks of the 2008 panic and near-systemic collapse, and from the ongoing responses to same by the Federal Reserve and federal government. Further panic is possible and hyperinflation remains inevitable.

Typical of an approaching, major turning point in the domestic- and global-market perceptions, bouts of extreme volatility and instability have been seen with increasing frequency in the financial markets, including equities, currencies and the monetary precious metals (gold and silver). Consensus market expectations on the economy and Federal Reserve policy also have been in increasing flux. The FOMC and Federal Reserve Chairman Ben Bernanke have put forth a plan for reducing and eventually ending quantitative easing in the form of QE3. The tapering or cessation of QE3 is contingent upon the U.S. economy performing in line with overly-optimistic economic projections provided by the Fed. Initially, market reaction pummeled stocks, bonds and gold.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment should shift quickly towards no imminent end to QE3, and then to expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and, eventually, they will have to recognize same. Business activity remains in continued and deepening

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trouble, and the Federal Reserve—despite currency-market platitudes to the contrary—is locked into quantitative easing by persistent problems now well beyond its control. Specifically, banking-system solvency and liquidity remain the primary concerns for the Fed, driving the quantitative easing. Economic issues are secondary concerns for the Fed; they are used as political cover for QE3. That cover will continue for as long as the Fed needs it.

At the same time, rapidly deteriorating expectations for domestic political stability reflect widening government scandals, in addition to the dominant global-financial-market concern of there being no viable prospect of those controlling the U.S. government addressing the long-range sovereign-solvency issues of the United States government. All these factors, in combination, show the end game to be nearing.

The most visible and vulnerable financial element to suffer early in this crisis likely will be the U.S. dollar in the currency markets (all dollar references here are to the U.S. dollar, unless otherwise stated). Heavy dollar selling should evolve into massive dumping of the dollar and dollar-denominated paper assets. Dollar-based commodity prices, such as oil, should soar, accelerating the pace of domestic inflation. In turn, that circumstance likely will trigger some removal of the U.S. dollar from its present global-reserve-currency status, which would further exacerbate the currency and inflation problems tied to the dollar.

This still-forming great financial tempest has cleared the horizon; its impact on the United States and those living in a dollar-based world will dominate and overtake the continuing economic and systemic-solvency crises of the last eight years. The issues that never were resolved in the 2008 panic and its aftermath are about to be exacerbated. Based on the precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises. Attempts to save the system all have inflationary implications. A domestic hyperinflationary environment should evolve from something akin to these crises before the end of next year (2014). The shifting underlying fundamentals are discussed in *No. 527: Special Commentary*; some of potential breaking crises will be expanded upon in the next revision to the hyperinflation report.

Still Living with the 2008 Crisis. 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 (see new detail in *Commentary No. 530*). The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series (see *No. 527: Special Commentary*, *Commentary No. 528* and *Public Comment on Inflation*). Nonetheless, given the nature of official reporting, 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 turmoil. 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 ongoing panicked actions by the Federal Reserve, where it still proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise.

Before and since the mid-April rout in gold prices, there had and has been mounting hype about the Fed potentially pulling back on its "easing" and a coincident Wall Street push to talk-down gold prices. As discussed in *No. 527: Special Commentary*, those factors appeared to be little more than platitudes to the Fed's critics and intensified jawboning to support the U.S. dollar and to soften gold, in advance of the still-festering crises in the federal-budget and debt-ceiling negotiations. Despite orchestrated public calls

for "prudence" by the Fed, and Mr. Bernanke's press conference following the June 19th FOMC meeting, the underlying and deteriorating financial-system and economic instabilities have self-trapped the Fed into an expanding-liquidity or easing role that likely will not be escaped until the ultimate demise of the U.S. dollar.

Further complicating the circumstance for the U.S. currency is the increasing tendency of major U.S. trading partners to move away from using the dollar in international trade, such as seen most recently in the developing relationship between France and China (see *No. 527: Special Commentary*).

The Fed's recent and ongoing liquidity actions themselves suggest a signal of deepening problems in the financial system. Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Accordingly, the Fed's continuing easing moves appear to have been primarily an effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury, under the political cover of a "weakening economy." Mounting signs of intensifying domestic banking-system stress are seen in softening annual growth in the broad money supply, despite a soaring pace of annual growth in the monetary base, and in global banking-system stress that followed the crisis in Cyprus and continuing, related aftershocks.

Still Living with the U.S. Government's Fiscal Crisis. Again, as covered in *No. 527: Special Commentary*, the U.S. Treasury is in the process of going through extraordinary accounting gimmicks, at present, in order to avoid exceeding the federal-debt ceiling. Early-September appears to be the deadline for resolving the issues tied to the debt ceiling, including—in theory—significant budget-deficit cuts.

Both Houses of Congress recently put forth outlines of ten-year budget proposals that still are shy on detail. The ten-year plan by the Republican-controlled House proposes to balance the cash-based deficit as well as to address issues related to unfunded liabilities. The plan put forth by the Democrat-controlled Senate does not look to balance the cash-based deficit. Given continued political contentiousness and the use of unrealistically positive economic assumptions to help the budget projections along, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of upcoming negotiations. There still appears to be no chance of a forthcoming, substantive agreement on balancing the federal deficit.

Indeed, 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. Chances also remain nil for the government fully addressing the GAAP-based deficit that hit $6.6 trillion in 2012, let alone balancing the popularly-followed, official cash-based accounting deficit that was $1.1 trillion in 2012 (see *No. 500: Special Commentary*).

Efforts at delaying meaningful fiscal action, including briefly postponing conflict over the Treasury's debt ceiling, bought the politicians in Washington minimal time in the global financial markets, but the time has run out and 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*.

U.S. Dollar Remains Proximal Hyperinflation Trigger. The unfolding fiscal catastrophe, in combination with the Fed's direct monetization of Treasury debt, eventually (more likely sooner rather than later) will

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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 has given way to mounting instabilities, and severe market turmoil likely looms, despite the tactics of delay by the politicians and ongoing obfuscation by the Federal Reserve.

This should become increasingly evident as the disgruntled global markets begin to move sustainably against the U.S. dollar. As discussed earlier, a dollar-selling panic is likely this year—still of reasonably high risk in the next month or so—with its effects and aftershocks setting hyperinflation into action in 2014. Gold remains the primary and long-range hedge against the upcoming debasement of the U.S. dollar, irrespective of any near-term price gyrations in the gold market.

The rise in the price of gold in recent years was fundamental. The intermittent panicked selling of gold has not been. With the underlying fundamentals of ongoing dollar-debasement in place, the upside potential for gold, in dollar terms, is limited only by its inverse relationship to the purchasing power of the U.S. dollar (eventually headed effectively to zero). Again, physical gold—held for the longer term—remains as a store of wealth, the primary hedge against the loss of U.S. dollar purchasing power.

REPORTING DETAIL

RETAIL SALES (June 2013)

Below-Consensus, Headline Retail Sales Gain Reflected Little More Than Higher Prices. The reporting of a statistically-insignificant, monthly 0.37% gain for June 2013 was in nominal terms, before adjustment for the effects of inflation. As covered in the *Week Ahead* section, June 2013 headline consumer inflation should show enough of a month-to-month increase in the CPI-U (due for release tomorrow, July 16th) to offset most, if not all of the headline nominal sales gain.

Adjusted for inflation, June 2013 year-to-year change in retail sales, also, likely will remain in a range that would signal pending recession, in normal economic times, effectively indicating an intensified downturn in the current circumstance. Further detail, again, will be published along with the availability of the inflation-adjusted series on July 16th.

Actual activity in consumer buying of goods and services remains constrained by the intense, structural-liquidity woes besetting the consumer, as discussed in prior *Commentary No. 541*. 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. In like manner, the consumer has lacked the ability to fuel the purported post-June 2009 recovery in

economic activity. This also will be detailed further, along with the assessment of the June CPI in the July 16th *Commentary.*

Otherwise, highly variable and unstable seasonal factors have just continued to cloud activity in the April 2013-to-June 2013 period, and in May 2012-to-June 2012, five months that are published on a non-comparable basis with all the other historical monthly numbers. Although the historical numbers were consistent at the time of the May 31st benchmark revision, two intervening rounds of of post-revision concurrent-seasonal adjustments have thrown all the historical data into disorder. The resulting inconsistencies allow for unreported shifts in the historical data that most likely distort the reporting of 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. 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, as discussed in Commentary No. 541, Hyperinflation 2012 *and* Special Commentary (No. 485).

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Not adjusted for a likely offsetting increase in headline June consumer inflation, this morning's (July 15th) report on June 2013 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.37% (a gain of 0.39%, before prior-period revisions) +/- 0.6% (all confidence intervals are at the 95% level). The June increase followed a revised, statistically-insignificant May month-to-month gain of 0.54% (previously 0.55% in the benchmark revision) +/- 0.5%.

Year-to-year, June 2013 retail sales rose by a significant 5.72% +/- 0.8%, versus a revised 4.42% (previously 4.31%) in May. Prior-period revisions, one year ago, reflected little more than the unstable monthly revisions in the concurrent-seasonal-adjustment process, where revised estimates are shown only selectively. Indeed, the pattern of growth here remains distorted by the resulting lack of fully-consistent, seasonally-adjusted numbers being published by the Census Bureau.

Core Retail Sales. In June 2013, seasonally-adjusted monthly grocery-store sales declined by 0.20%, while gasoline-station sales rose by 0.70%, despite not-seasonally-adjusted gasoline prices having risen by 0.3% for the month. 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: June 2013 versus May 2013 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—rose by 0.41%, versus the official gain of 0.37%.

Version II: June 2013 versus May 2013 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—increased by 0.32%, versus the official gain of 0.37%.

Real (Inflation-Adjusted) Retail Sales. As discussed in the *Week Ahead* section, headline June 2013 CPI-U inflation likely will come in around "unchanged" for the month. Separately, real year-to-year

change likely should remain in the range of historical growth that traditionally has signaled pending recession. In the current circumstance, that would mean an ongoing signal of pending, intensifying downturn.

The real retail sales detail will be provided in tomorrow's July 16th *Commentary*, which will cover the release of June 2013 CPI-U.

WEEK AHEAD

Weaker Economic and Stronger Inflation Data Are Likely for June and Beyond. *[Except for the underlined text detailing the pending CPI release, the balance of the* Week Ahead *section is unchanged from the prior* Commentary.*]* Despite the stronger than expected headline payroll numbers for June, the balance of upcoming June economic releases, and beyond likely will disappoint a still overly-optimistic consensus view of the broad economy. Separately, with energy-inflation related seasonal-adjustment factors swinging to the plus-side in June, combined with stable oil and higher gasoline prices for the month, higher inflation headline CPI reporting is likely in June, with higher CPI and PPI in the months ahead.

Reflecting the still-likely negative impact on the U.S. dollar in the currency markets from continuing QE3 and the still-festering fiscal crisis/debt-ceiling debacle (see *Hyperinflation Outlook* section), reporting in the ensuing months and year ahead generally should reflect much higher-than-expected inflation (see *No. 527: Special Commentary*).

While expectations for economic data in the months and year ahead should begin to soften, weaker-than-expected economic results still remain likely, given the intensifying structural liquidity constraints on the consumer. Recent downside benchmark revisions to industrial production, new orders for durable goods, retail sales, the trade deficit and construction spending suggest downside revisions to GDP growth of recent years.

Indeed, the pending, big revision event remains the July 31st comprehensive overhaul, benchmark revision and redefinition of the GDP back to 1929. A ShadowStats estimate of the likely net shift in GDP reporting patterns (generally slower growth in recent years) will be published shortly.

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Reporting Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-ongoing economic turmoil of the last six-to-seven years, which has been without precedent in the post-World War II era of modern economic reporting. These impaired reporting methodologies provide particularly unstable headline economic results, where concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data), and they have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

With an increasing trend towards downside surprises in near-term economic reporting, recognition of an intensifying double-dip recession should continue to gain. Nascent concerns of a mounting inflation threat, though muted, increasingly have been rekindled by the Fed's monetary policies. Again, though, significant inflation shocks are looming in response to the fiscal crisis and a likely, severely-negative response in the global currency markets against the U.S. dollar.

The political system and Wall Street would like to see the issues disappear, and the popular media do their best to avoid publicizing unhappy economic news, putting out happy analyses on otherwise negative numbers. Pushing the politicians and media, the financial markets and their related spinmeisters do their best to hype anything that can be given a positive spin, to avoid recognition of serious problems for as long as possible. Those imbedded, structural problems, though, have horrendous implications for the markets and for systemic stability, as discussed in *Hyperinflation 2012*, *No. 485: Special Commentary* and *No. 527: Special Commentary*.

Consumer Price Index—CPI (June 2013). The release by the Bureau of Labor Statistics (BLS) of the June 2013 CPI numbers is scheduled for tomorrow, Tuesday, July 16th. The headline CPI is a fair bet to come in near or above market consensus, which appears to have settled into a range of 0.3% to 0.4%. A consensus result largely would offset the 0.37% monthly gain reported for June 2013 retail sales, leaving retail sales in real terms, net of inflation adjustment, basically unchanged. In like manner, already-negative average weekly earnings in June should take a large hit, net of June inflation.

Average gasoline prices rose month-to-month in June 2013 by 0.4 percentage point, on a not-seasonally-adjusted basis, per the Department of Energy. The BLS seasonal adjustments, however, should boost that monthly gain significantly. As recently revised, an unadjusted monthly 6.1% decline in June 2012 gasoline prices was narrowed to a 0.6% decline by upside seasonal adjustments. Similar effects in the June 2013 number would restore some of the energy-related inflation that was not otherwise counted in the first-half 2013. Given likely upside inflation pressures from food prices and core inflation, a modest headline gain in June 2013 CPI-U is a reasonable expectation. By itself, gasoline inflation should add roughly 0.3 percentage point to the monthly headline June 2013 CPI-U.

Year-to-year, CPI-U inflation would increase or decrease in June 2013 reporting, dependent on the seasonally-adjusted monthly change, versus a reported 0.12% gain in monthly inflation for June 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for June 2013, the difference in June's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted

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directly from the May 2013 annual inflation rate of 1.36%. For example, a headline 0.3% June CPI-U gain would boost the June annual CPI-U inflation to around 1.5% or 1.6%.

Index of Industrial Production (June 2013). The June 2013 index of industrial production also is scheduled for release on Tuesday, July 16th, by the Federal Reserve Board (FRB). With inventories still too high for existing demand, an outright monthly contraction in production is possible. Reporting below developing positive expectations is a fair shot for June, even with some likelihood that unseasonably hot weather will have spiked monthly utility usage to the extent of offsetting some of the weakening production in the manufacturing sector.

Residential Construction (June 2013). On Wednesday, July 17th, the Census Bureau will publish its estimate of June 2013 housing starts activity. Despite developing market expectations for a strong headline gain, reported month-to-month change likely will continue to be statistically-insignificant, with ongoing stagnation in activity, particularly for single-unit housing starts.

In the wake of a 75% collapse in aggregate activity from 2006 through 2008, and an ensuing four-year pattern of housing starts stagnation at historically low levels, little has changed. There remains no chance of a near-term, sustainable turnaround in the housing construction market, unless there is a fundamental upturn in consumer and banking liquidity conditions. That has not happened and does not appear to be in the offing.

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