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

COMMENTARY NUMBER 567
Hyperinflation Update, Durable Goods, Trade Deficit

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Hyperinflation in 2014

Trade Data Should Have Negligible Impact on Initial Third-Quarter GDP Estimate and on Expectations for Same

Durable Goods Orders Remained Stagnant (Ex-Commercial Aircraft), Consistent with Renewed Economic Downturn

BLS Will Count Furloughed Government Employees as Unemployed in Household Survey, but as Employed in Payroll Survey

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PLEASE NOTE: The next regular Commentary *is scheduled for Monday, October 28th, covering September industrial production; followed by Commentaries on October 29th covering retail sales and the PPI; and on October 30th, covering the CPI, real retail sales and earnings.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

The U.S. Economy Continues to Weaken. The broad outlooks on the U.S. economy, the U.S. dollar and gold, inflation and hyperinflation, and systemic stability have not changed. The economy never recovered from its 2008 collapse and is turning down anew. The U.S. dollar (all references here are to the U.S. dollar unless otherwise specified) likely faces a massive sell-off in the global currency markets in the near future, which will usher in the initial phase of a domestic hyperinflation, accompanied by an offsetting rally in the price of gold. Physical gold and silver remain the primary hedges for those looking to preserve the purchasing power of their dollars and dollar-denominated paper assets and wealth. Systemic stability has not been in place since before the 2008 financial panic. The financial system remains unstable and subject to renewed panic and turmoil.

The *Summary Hyperinflation Outlook* largely has been re-written and is found in the *Hyperinflation Watch* section. Plans for publishing the fully updated hyperinflation report, *Hyperinflation 2014—The End Game*, also are discussed there.

Latest Economic Data and Handling of Furloughed Government Workers. The just-published trade and durable goods orders data held few surprises. Orders continued to stagnate, while the monthly trade data were little changed from the prior month, in line with expectations.

Yes, You Can Be Unemployed and Employed at the Same Time! ShadowStats has indicated that the October shutdown of the federal government likely would spike the October unemployment rate and shrink nonfarm payrolls (see *Commentary No. 564* and *Commentary No. 566*). The reopened Bureau of Labor Statistics (BLS) now is offering some guidance as to how the once-furloughed federal employees will be handled in the labor statistics.

The furloughed workers, who were out of work for the full reference week ended October 12th, should be counted as unemployed, on temporary lay-off, as part of the household survey. That should add about 0.3-percentage point to whatever the headline (U.3) October unemployment rate would have been otherwise.

Anyone who was employed at any time during the payroll period that included October 12th is counted as employed in the payroll survey. Some two-week payrolls and certainly monthly payrolls would cover some of the furloughed employees. Separately, though, since the government (after the fact) determined that the furloughed employees would be paid, the BLS has decided to include the furloughed among the employed.

None of this applies to government contract workers, or to those who lost their jobs as a secondary effect, such as private restaurant employees at a National Park. Accordingly, the payroll impact is not as clear-cut as the household survey. Nonetheless, with the BLS trend model geared to generate only a 67,000 jobs gain in October—exclusive of any government shutdown considerations—the headline jobs number still has a solid chance of reflecting a net monthly jobs loss. If there is a headline contraction, the popular media likely still will blame the furloughs, irrespective of what has been happening in a rapidly-slowing real-world economy.

New Orders for Durable Goods (September 2013). Dominated once again by surging non-defense aircraft orders, the 3.66% headline gain in September new orders for durable goods was not meaningful, well within the normal range of monthly reporting. Net of the volatility in airplane orders, new orders for durable goods have been stagnant month-to-month, for the last four months. As a result, the ongoing long-term patterns of stagnation remain in place, despite any short-term blips. The growth patterns in this series remain of a nature that usually precedes or coincides with a recession or deepening business downturn.

Official, Nominal September 2013 Reporting. The seasonally-adjusted nominal (not-adjusted-for-inflation) level of September 2013 new orders for durable goods rose by 3.66% in September, following a revised 0.24% gain in August, and an unrevised monthly decline of 8.07% in July. Before prior-period revisions, September new orders rose by 3.78%.

The reporting of monthly surges and contractions in commercial aircraft orders is seen in an irregularly repeating the process throughout the year. These extremely volatile orders, which usually dominate the aggregate durable goods growth numbers, are booked well into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

Commercial aircraft orders jumped by 57.48% in September, following a revised 5.41% gain in August, and a revised 58.94% plunge in July. Net of prior-period revisions, September commercial aircraft orders rose by 68.06%. Net of these orders, aggregate new orders rose by 0.64% in September, fell by a revised 0.03% in August, and fell by an unrevised 1.57% in July.

What those numbers show is no growth—stagnation—in new orders for durable goods in the last four months, net of commercial aircraft order activity and before any consideration for the effects of inflation.

Aircraft order volatility also has impacted year-to-year change in seasonally-adjusted, total new orders. In September 2013 they were up by 7.44% (up 6.64% ex-commercial aircraft), up by a revised 13.81% (up 8.42% ex-commercial aircraft) in August, and down by a revised 1.14% (up by a revised 3.90% ex-commercial aircraft) in July.

Also affected by aircraft-order activity, seasonally-adjusted new orders for nondefense capital goods in September rose by 6.88% (down by 2.67% ex-commercial aircraft), versus a revised 0.61% decline (down by 1.67% ex-commercial aircraft) in August. All of the preceding is before adjustment for inflation.

Inflation-Adjusted and Smoothed, September 2013. Due to the recent government shutdown, the reporting of the September 2013 producer price index (PPI) and the corresponding finished-goods, capital-equipment deflator, have been delayed until October 29th. Accordingly, the regular analysis and the related graphics published here on real durable goods orders have been delayed and will accompany the ShadowStats analysis of PPI detail.

U.S. Trade Deficit (August 2013). The shutdown of the U.S. government likely exacerbated the recent problems with trade-flow paperwork. As discussed previously, computer-system problems, at one of the world's largest handlers of cargo containers, triggered major delays in the flow of goods and related paperwork through the Port of New York and New Jersey. This second- and third-quarter paperwork problem had to be exacerbated recently by the effects of the federal government shutdown in October. Accordingly, unusual reporting activity may have been involved the latest trade data, and may be seen again in the next several months.

In a month where trade activity was virtually unchanged, the numbers were near consensus. Where the latest inflation-adjusted detail suggested a small narrowing of the third-quarter trade deficit (a neutral or small-positive contribution to third-quarter 2013 GDP growth), the July trade report should not have any meaningful impact on existing market expectations for GDP.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. In nominal terms, the seasonally-adjusted monthly trade deficit in goods and services for August 2013, on a balance-of-payments basis, changed minimally, widening to $38.8 billion from a revised $38.6 (previously $39.1) billion in July. The monthly trade data reflected virtually unchanged levels of seasonally-adjusted exports and imports. A small decline in seasonally-adjusted oil-related imports was dominated by reduced imports in physical volume in the context of rising oil prices.

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil-price swings and other inflation (2009 chain-weighted dollars, used for GDP deflation), the August 2013 merchandise trade deficit (no services) held at $47.3 billion, versus a revised $47.3 (previously $47.7) billion in July, and was down from $50.2 billion deficit in August 2012.

As the inflation-adjusted numbers currently stand, the annualized, real merchandise trade deficit for full reporting of second-quarter 2013 was $571.8 billion, versus an annualized $567.6 billion for the first two months of third-quarter 2013 (July and August). This is the final trade report before the initial estimate of third-quarter GDP is published November 7th. It suggests a neutral-to-small-positive contribution to third-quarter GDP growth, with no impact likely in terms of current market expectations.

[For further detail on September new orders for durable goods and the August trade deficit, see the* Reporting Detail *section.]

HYPERINFLATION WATCH

Pending Publication of *Hyperinflation 2014—The End Game*. We receive frequent requests for an updated version of *Hyperinflation 2012*, which was released in January of that year. Publication of a fully-revised version, *Hyperinflation 2014—The End Game*, tentatively is planned by the end of November.

Please consider three factors here. First, the general outlook has not changed meaningfully since the last hyperinflation report. Events have just continued to evolve in a manner consistent with what is being predicted. Second, updates to the outlook and related near-term activity are published regularly in the weekly *Commentaries.* The summary hyperinflation outlook has been partially rewritten and revised below in today's *Commentary*. Third, an update involves massive rewriting, new writing and research, and the publication of updates traditionally have lagged initial, overly-optimistic publication-date estimates. While the writing here actually has been underway for some time, some delay against current timing plans still remains a possibility.

Invitation for Comments, Questions and Discussion. If a subscriber has a specific question or insight, which he or she would like to see addressed in the update, or would like to discuss in person, please contact: johnwilliams@shadowstats.com.

Summary Hyperinflation Outlook—Rewritten/Revised. The *Hyperinflation Outlook* has been partially rewritten and updated from the prior version published in *Commentary No. 564*.

This summary is intended as guidance for both new and existing subscribers, who are looking for a brief version of the broad outlook on the economic, systemic and inflation crises that face the United States in the year or so ahead.

Recommended Background Material. *Commentary No. 559* (September 2013) and *No. 527: Special Commentary* (May 2013) supplemented *No. 485: Special Commentary* (November 2012), which reviewed 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 use here also are *No. 500: Special Commentary* on GAAP-based federal deficit reality and 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 or recent months, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, a fully-updated *Hyperinflation 2014—The End Game* is planned by the end of November, as discussed in the opening section of this *Hyperinflation Watch* section.

Hyperinflation Timing, Set for 2019 Back in 2004, Advanced to 2014 in Aftermath of 2008 Panic. While the U.S. government has lived excessively beyond its means for decades, it was not until the December 2003 (federal government's 2004 fiscal year) enactment of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 that the United States was set solidly on a course for eventual hyperinflation. Back in 2004, ShadowStats began forecasting a hyperinflation by 2019; that forecast was advanced to 2014 as a result of the nature of, and the official handling of the 2008 panic and near-collapse of the domestic financial system. The hyperinflation forecast for 2014 remains in place, with 90% odds estimated in favor of its occurrence.

The initial unfunded liabilities for the Medicare overhaul, alone, added nearly \$8 trillion in net-present-value unfunded liabilities to the fiscal-2004 federal deficit, based on generally accepted accounting principles (GAAP accounting), exceeding the total \$7.4 trillion gross federal debt of the time. When approached by ShadowStats as to how this circumstance likely would lead to an eventual domestic hyperinflation, the response from a member of the Bush Administration was "that is too far into the future to worry about."

That future has come too quickly. Adjusted for one-time events, GAAP-based federal deficits have averaged $5 trillion per year for the last seven years, with government spending and financial commitments exploding out of control. As of fiscal-2012 the GAAP-based annual federal deficit was an uncontainable and uncontrollable $6.6 trillion, with gross federal debt at $16.2 trillion and total federal obligations (net present value) in excess of $85 trillion, more than five-times the level of annual GDP and deteriorating at an annual pace in excess of $6 trillion per year. Details can be found in *No. 500: Special Commentary*.

On a GAAP-basis, the United States faces long-range insolvency. The global financial markets know it, and so do the miscreants currently controlling the U.S. government. Yet, as just demonstrated in the crisis negotiations surrounding the federal-government shutdown and debt ceiling, there is no controlling, political will in Washington to address the long-term solvency issues. The still-festering budget crisis and recent negotiations reflect no more than the formal, continued posturing and political delay of the same issues and crisis that nearly collapsed the U.S. dollar in August and September of 2011, that then were pushed beyond the 2012 election, and then pushed again to the just-postponed negotiations of October 2013.

The chances of the United States actually not paying its obligations or interest are nil. Instead, typically a country which issues its debt in the currency it prints, simply prints the cash it needs, when it can no longer can raise adequate funds through what usually become confiscatory tax rates, and when it can no longer sucker the financial markets and its trading partners into funding its spending. That results in inflation, eventual full debasement of the currency, otherwise known as hyperinflation. The purchasing power of the current U.S. dollar will drop effectively to zero.

Therein lies the root of a brewing crisis for the U.S. dollar (all "dollar" references here are to the U.S. dollar unless otherwise specified). Global financial markets have wearied in the extreme of the political nonsense going on in Washington. No one really wants to hold dollars to or hold investments in dollar-denominated assets, such as U.S. Treasury securities.

Due to ongoing solvency issues within the U.S. banking system, that Federal Reserve is locked into a liquidity trap of flooding the system with liquidity, with no resulting surge in the money supply. Yet, the Fed's quantitative easings have damaged the dollar, which in turn has triggered sporadic inflation from the related boosting of oil prices. The overhang of dollars in the global markets—outside the formal U.S. money supply estimates—is well in excess of $10 trillion. As those funds are dumped in the global markets, the weakening dollar will trigger dumping of U.S. Treasury securities and general flight from the U.S. currency. As the Fed moves to stabilize the domestic financial system, the early stages of a currency-driven inflation will be overwhelmed by general flight from the dollar, and a resulting surge the domestic money supply. Intensifying the crisis, and likely coincident with heavy flight from the dollar, odds also are high of the loss of the dollar's global-reserve-currency status.

These circumstances can unfold at anytime, with little or no warning. Irrespective of short-lived gyrations, the dollar should face net, heavy selling pressure in the months ahead from a variety of factors, including, but certainly not limited to: (1) a lack of Fed reversal on QE3; (2) a lack of economic recovery and renewed downturn; (3) concerns of increased quantitative easing by the Fed; (4) inability/refusal of those controlling the government to address the long-range sovereign-solvency issues of the United States; (5) declining confidence in, and mounting scandals involving the U.S. government.

It is the global flight from the dollar—which increasingly should become a domestic flight from the dollar—that should set the early stages of the domestic hyperinflation.

Approaching the End Game. As previously summarized, 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, but that appears to have been more of an intellectual exercise aimed at placating Fed critics, than it was an actual intent to "taper" QE3. The tapering or cessation of QE3 was contingent upon the U.S. economy performing in line with deliberately, overly-optimistic economic projections provided by the Fed.

Manipulated market reactions and verbal and physical interventions have been used to prop stocks and the dollar, and to pummel gold.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment even could shift from what now is no imminent end to QE3, to an expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and, increasingly, they are beginning to recognize same. Business activity remains in continued and deepening trouble, and the Federal Reserve 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.

The same systemic problems will face incoming Fed Chairman Janet Yellin. She will face the same quandaries and issues addressed by current Chairman Ben Bernanke. Where she also has been involved actively in formulating current Fed policies, no significant shifts in Fed policy are likely. QE3 should continue for the foreseeable future.

At the same time, deteriorating expectations for domestic political stability reflect government scandals and conflicting policy actions, 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. These factors, in combination, show the end game to be at hand.

This still-forming great financial tempest has cleared the horizon; its early ill winds are being felt with increasing force; and 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 precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises, hoping to push the problems even further into the future. Such attempts to save the system, however, all have exceptional inflationary implications.

The global financial markets appear to have begun to move beyond the forced patience with U.S. policies that had been induced by the financial terror of the 2008 panic. Again, the dollar faces likely extreme and negative turmoil in the months ahead. A domestic hyperinflationary environment should evolve from something akin to these crises before the end of 2014.

Still Living with the 2008 Crisis. Despite the happy news from headline GDP reporting that the recession ended in 2009 and the economy is full recovery, there never has been an actual recovery following the economic crash that began in 2006, and collapsed into 2008 and 2009. No other major economic series has confirmed the pattern of activity now being reported in the GDP. Indeed, 2012 household income data from the Census Bureau showed no recovery whatsoever.

What followed the economic crash was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012 (see the corrected GDP graph in the *Opening Comments* section of *Commentary No. 552*). 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* and *Public Comment on Inflation*). Nonetheless, given the nature of official reporting, the renewed downturn still should gain eventual 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. As of the government shutdown, the Fed had monetized in excess of 100% of the net issuance of U.S. Treasury debt, since the beginning of calendar-year 2013.

The Fed's unconscionable market manipulations and games playing in fueling speculation over the future of quantitative easing clearly were used to move the U.S. dollar (the purpose of initial quantitative easing was U.S. dollar debasement). QE3 and continuing efforts at dollar-debasement are not about to go away. 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. The loss of some reserve status for the U.S. dollar is likely, as the crises break, and that would intensify both the dollar-selling and domestic U.S. inflationary pressures.

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 soft annual growth in the broad money supply, despite a soaring pace of annual growth in the monetary base, and in mounting global banking-system stress.

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 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 extreme 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 move sustainably against the U.S. dollar, a movement that may have begun. As discussed earlier, a dollar-selling panic is likely in the next several months, 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.

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REPORTING DETAIL

NEW ORDERS FOR DURABLE GOODS (September 2013)

September 2013 Gain in Durable Goods Orders Was Predominantly in Volatile Commercial Aircraft Sector. Following one month of relative stability, highly-volatile commercial aircraft orders once again dominated reporting of new orders for durable goods, with September orders on the plus-side.

Net of the volatility in airplane orders, new orders for durable goods have been stagnant on a monthly basis for the last four months. Even so, the 3.66% headline September gain was not meaningful, remaining well within the normal volatility of the series. As a result, ongoing long-term patterns of stagnation remain in place, despite any short-term blips. The growth patterns in this series remain of a nature that usually precedes or coincides with a recession or deepening business downturn.

Official, Nominal September 2013 Reporting. The Census Bureau reported today, October 25th, that the regularly-volatile, seasonally-adjusted nominal (not-adjusted-for-inflation) level of September 2013 new orders for durable goods increased by 3.66% in September, following a revised 0.24% (previously 0.12%) gain in August, and an unrevised monthly decline of 8.07% (initially 7.27%) in July. Before prior-period revisions, September new orders rose by 3.78%.

The reporting of surges and contractions in commercial aircraft orders is seen in an irregularly repeating the process throughout the year. These extremely volatile orders, which usually dominate the aggregate durable goods growth numbers, are booked well into the future and are indicative more of longer-term, rather than shorter-term prospects for manufacturing activity.

Nondefense (or commercial) aircraft orders jumped by 57.48% in September, following a revised 5.41% gain (previously a 1.22% contraction) in August, and a revised 58.94% (previously 58.93%, initially 52.33%) plunge in July. Net of prior-period revisions, September commercial aircraft orders rose by 68.06%. Net of these orders, aggregate new orders rose by 0.64% in September, fell by a revised 0.03% (previously rose by 0.20%) in August, and fell by an unrevised 1.57% (initially 1.51%) in July.

What these numbers show is no growth—stagnation—in new orders for durable goods in the last four months, net of commercial aircraft order activity and before any consideration for the effects of inflation.

Aircraft order volatility also has impacted year-to-year change in seasonally-adjusted, total new orders. Total orders in September 2013 were up by 7.44% (up 6.64% ex-commercial aircraft), up by a revised 13.81% (up 8.42% ex-commercial aircraft) in August, and down by a revised 1.14% (up by a revised 3.90% ex-commercial aircraft) in July.

Also affected by aircraft-order activity, seasonally-adjusted new orders for nondefense capital goods in September rose by 6.88% (down by 2.67% ex-commercial aircraft), versus a revised 0.61% decline (down by 1.67% ex-commercial aircraft) in August. All of the preceding is before adjustment for inflation.

Caution: Current durable goods reporting remains subject to many of the same sampling and concurrent-seasonal-adjustment problems that are seen with retail sales, payroll and unemployment reporting. Unusual seasonal-factor volatility raises issues as to the significance of reported seasonally-adjusted monthly changes. While those issues were brought into balance, temporarily, with the recent annual benchmark revision to durable goods orders, subsequent reporting has made all historical reporting prior to May 2013 inconsistent with the current headline numbers.

Inflation-Adjusted and Smoothed, September 2013. Due to the recent government shutdown, the reporting of the September 2013 producer price index (PPI) and the corresponding finished-goods, capital-equipment deflator, have been delayed until October 29th. Accordingly, the regular analysis and the related graphics that are published in the *Opening Comments* section of the new orders for durable goods *Commentaries* have been delayed. They will accompany the ShadowStats analysis of PPI detail.

U.S. TRADE BALANCE (August 2013)

Government Shutdown Likely Exacerbated Trade-Flow Paperwork in Latest Reporting, with Further Effects Likely into October/November Reporting. As discussed in *Commentary No. 548*, computer-system problems, at one of the world's largest handlers of cargo containers, triggered major delays in the flow of goods through the Port of New York and New Jersey. Where the issues started in June and continued into July and beyond, the effects likely have included trade-flow and related paperwork delays tied to the unloading and re-routing of goods, among other issues.

Separately, the government shutdown in October likely exacerbated paperwork flow disruptions tied to the Customs Service, and the shutdown conceivably impacted actual trade flows in October. Accordingly, unusual reporting activity may have been involved the latest trade data, and may be seen again in the next several months.

In an unusual month, where monthly trade activity was virtually unchanged, the numbers were near consensus. Where the latest inflation-adjusted detail suggests a small narrowing of the third-quarter trade deficit (a neutral or small-positive contribution to third-quarter 2013 GDP growth), the July trade report should not have any meaningful impact on existing market expectations for GDP. The first estimate of third-quarter GDP growth is due for release on November 7th, where some slowing in headline, annualized quarterly growth is expected, easing to below 2.0%, versus the last headline growth estimate of 2.5% in the second-quarter.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported October 24th that the nominal, seasonally-adjusted monthly trade deficit in goods and services for August 2013, on a balance-of-payments basis, changed minimally, widening to $38.8 billion from a revised $38.6 (previously $39.1) billion in July. The monthly trade data reflected virtually unchanged levels of seasonally-adjusted exports and imports. A small decline in seasonally-adjusted oil-related imports was dominated by reduced imports in physical volume in the context of rising oil prices.

Energy-Related Petroleum Products. Higher prices and reduced physical imports of oil led to a small drop in the value of imported energy-related petroleum products. For the month of August 2013, the not-seasonally-adjusted average price of imported oil rose to $100.26 per barrel, up from $97.07 in July and up from an average of $94.48 in August 2012. Further, not-seasonally-adjusted, physical oil import volume in August 2013 averaged 7.739 million barrels per day, down from 8.523 million in July, and down from 8.801 million barrels per day in August 2012.

Cautions on Data Quality. As discussed in the opening comments of this section, meaningful distortions in the regular monthly, physical flow-of-trade, and related paperwork, likely are distorting trade data for a third month. Potentially heavy distortions in headline data also continue from 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 (2009 chain-weighted dollars, used for GDP deflation), the August 2013 merchandise trade deficit (no services) held at $47.3 billion, versus a revised $47.3 (previously $47.7) billion in July, and was down from a $50.2 billion deficit in August 2012.

As the inflation-adjusted numbers currently stand, the annualized, real merchandise trade deficit for full reporting of second-quarter 2013 was $571.8 billion, versus an annualized $567.6 billion for the first two months of third-quarter 2013 (July and August). This is the final trade report before the initial estimate of third-quarter GDP on November 7th. It suggests a neutral-to-small-positive contribution to third-quarter GDP growth, with no impact likely in terms of current market expectations.

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Likely in the Months Ahead. See the schedule for the latest detail on the rescheduling of the delayed September and October economic reporting in the post-government shutdown period. *[Other than elimination of detail of the just-released data covered elsewhere in this* Commentary*, the* Week Ahead *section is unchanged from* Commentary No. 566 *of October 22nd.]*

Despite continuing downside adjustments to consensus expectations on the domestic economy, the markets still are overly optimistic. That circumstance, and underlying fundamentals that are suggestive of deteriorating business activity, mean that weaker-than-consensus economic reporting should remain the general trend. Inflation likely will be higher than market expectations.

In terms of monthly inflation reporting, energy-inflation-related seasonal-adjustment factors are on the plus-side through the end of the year. That, combined with likely stable or higher oil and gasoline prices, means stronger-than-expected headline CPI and PPI are a good bet for at least the next four months, and beyond. Upside pressure on oil-related prices should reflect intensifying impact from a weakening U.S. dollar in the currency markets, and from ongoing political instabilities in the Middle East. The dollar faces pummeling from continuing QE3, and the soon-to-resurface fiscal-crisis/debt-ceiling debacle (see opening comments and the *Hyperinflation Outlook* section). Particularly in tandem with the likely weakened dollar, inflation reporting in the year ahead generally should reflect much higher-than-expected inflation (see also *No. 527: Special Commentary*).

A Note on 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.

PENDING RELEASES:

Index of Industrial Production (September 2013). The September 2013 index of industrial production was rescheduled for Monday, October 28th, by the Federal Reserve Board. Inventories still are too high for existing demand, and an outright monthly contraction in production remains a fair bet. Minimally, continuing downside surprises to artificially high expectations are likely in September production, as are continuing downside revisions to prior-period reporting. The federal government shutdown should have some negative impact on the production in the month of October, which will be released in November.

Retail Sales (September 2013). The September 2013 retail sales estimate was rescheduled for release on Tuesday, October 29th, by the Census Bureau. With the structural liquidity issues increasingly constraining consumer activity, once again, odds favor the headline retail sales reporting to come in below market expectations. An outright month-to-month sales contraction is a good possibility, even before adjustment for consumer inflation.

Producer Price Index—PPI (September 2013). The September 2013 PPI was rescheduled for release on Tuesday, October 29th, by the Bureau of Labor Statistics (BLS). For September, PPI energy prices face relatively positive seasonal factor biases. Given still-understated food inflation and ongoing upside "core" inflation, the headline PPI should come in on the plus-side.

Depending on the oil contract followed, oil prices, on average, were up or down by 0.3% for the month of September, with average retail gasoline prices down by 1.1% for the second month. Accordingly, with positive seasonal adjustments to energy prices, a small monthly gain in PPI again is a good bet.

Consumer Price Index—CPI (September 2013). The release by the Bureau of Labor Statistics (BLS) of the August 2013 CPI numbers has been rescheduled for Wednesday, October 30th. The headline CPI is a fair bet to come in around the market consensus of about 0.1% to 0.2%.

Average gasoline prices eased month-to-month in September 2013 by 1.1 percentage point, on a not-seasonally-adjusted basis, per the Department of Energy. The BLS seasonal adjustments, however, should offset the nominal monthly decline in gasoline prices. As last revised, an unadjusted monthly 2.2% gain in September 2012 gasoline prices was widened to a 4.1% gain, with upside seasonal adjustments. Similar effects in the September 2013 number would push the unadjusted monthly gasoline price contraction to the plus-side, contributing roughly 0.1 percentage point to the aggregate headline CPI-U number. Given likely upside inflation pressures from food prices and core inflation, a small headline gain in September 2013 CPI-U is a reasonable expectation.

Year-to-year, CPI-U inflation would increase or decrease in September 2013 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.52% increase in monthly inflation reported for September 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2013, the difference in September's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the August 2013 annual inflation rate of 1.52%.

For example, if the headline September CPI-U inflation were 0.1%, annual inflation would slow to approximately 1.1%.

