John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 573
October Industrial Production and Money Supply, September Trade Balance

November 15, 2013

Production Activity Suggestive of Pending "New" Recession

Trade Data Should Dampen Growth in Next GDP Revision

October M3 Annual Growth at 4.4%

Reflecting Recent Surge in Treasury Borrowings, Fed Has Monetized 75% of Net Issuance of Publicly-Held Federal Debt, Since January 1st

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PLEASE NOTE: The next regular Commentary *is scheduled for Wednesday, November 20th, covering the October CPI, retail sales (and related constant-dollar series) and existing home sales. A subsequent* Commentary *on November 21st will cover the October PPI.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

The general outlook for business conditions has not changed. The latest trade numbers suggested some downside revision is pending for the headline third-quarter 2013 GDP, while the industrial production numbers remained weak enough to continue signaling a formal, renewed downturn in broad economic activity.

The Fed's QE3 continues, as the U.S. Treasury has resumed increasing its debt (about $400 billion in the last month). Since January 1, 2013, through November 13th, the Federal Reserve has monetized 75% of

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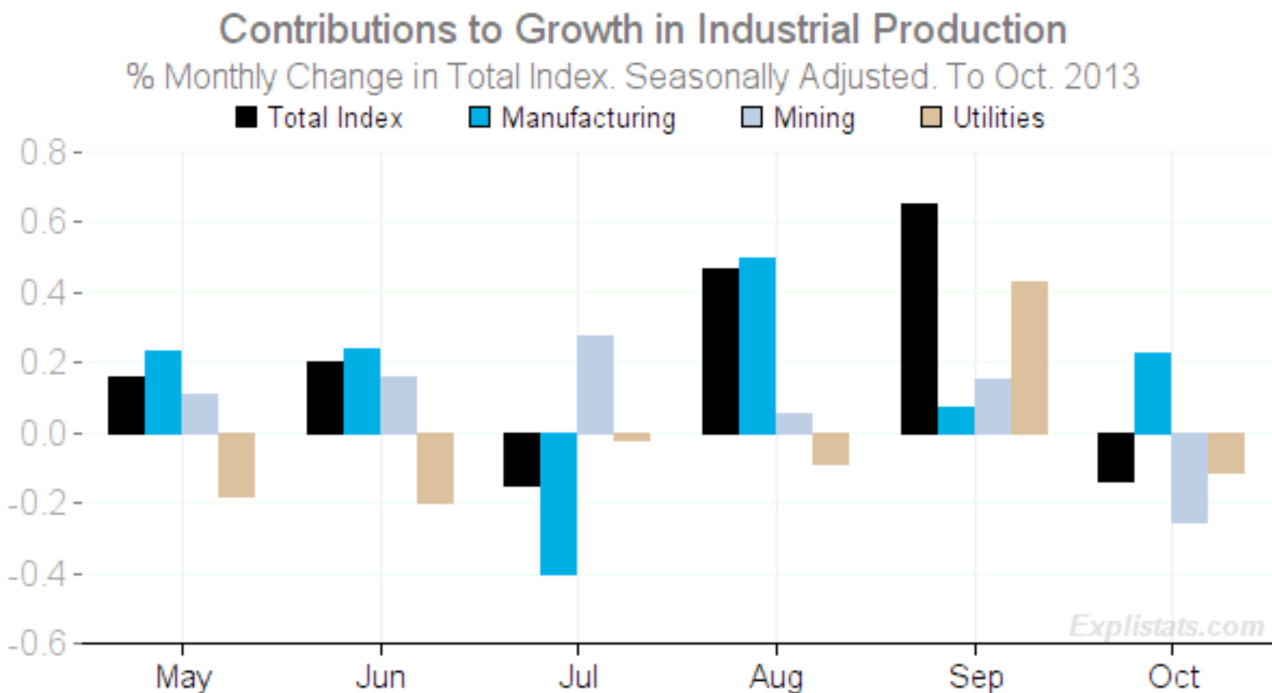
the net issuance of publicly-held Treasury debt, as discussed in the *Hyperinflation Watch*. The latest money supply details also are covered there.

The economic comments today (November 15th) are limited to the industrial production and trade balance releases, as well as to money supply detail. The November 20th *Commentary* will review the released economic data for October 2013 in the context of the broad-economic outlook.

October Industrial Production—Continuing Signals of Renewed Economic Downturn. The production data remained suggestive of a seriously-troubled broad economy, one that is headed into what formally should be recognized as renewed recession. Indeed, the pattern of year-to-year production activity remained "pre-recession," if viewed in the context of normal economic times.

Industrial Production—October 2013. Headline monthly activity in October industrial production contracted by 0.1% (down by a rounded 0.15% at the second decimal point), and it also was down by 0.07% for the month, net of prior-period revisions. September production revised to a gain of 0.65%, August revised to a gain of 0.47%, while July contracted at a revised pace of 0.15% (rounds to 0.2%) for the month.

The headline 0.1% contraction in aggregate October production activity reflected a 0.3% gain in manufacturing, which was against an unrevised 0.1% gain in September. Headline mining activity, including oil and gas activity, fell by 1.6% in the month, following a revised 1.0% (previously 0.2%) gain in September. Ever-unstable utility activity by fell by 1.1% in October, following a revised 4.5% (previously 4.4%) gain in September.



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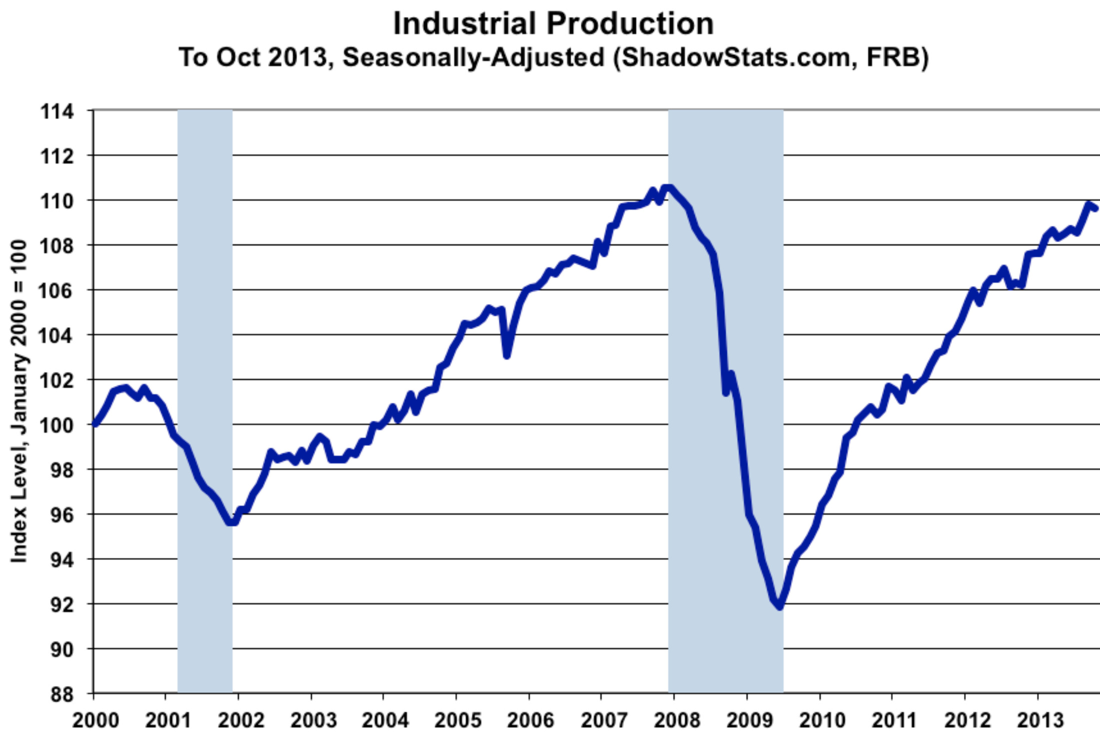
While manufacturing gained 0.3% for October, the production of consumer goods declined by 0.1%, dominated by a drop in automobile production. Offsetting the consumer goods were gains in business and defense manufacturing.

The preceding graph on the relative sector contributions to industrial production is courtesy of our affiliate operation www.ExpliStats.com. Further details on the official production and trade numbers are available on the ExpliStats site (see the discussion in *Commentary No. 566*).

Year-to-year growth in October 2013 production held at 3.24%, versus a revised 3.26% in September, a revised 2.77% in August and a revised 1.49% in July. Allowing for series volatility and special factors tied to year-ago hurricanes and weather-related utility distortions, annual growth has slowed to levels last seen during the mid-2008 economic collapse, and it remains consistent with annual growth patterns usually seen going into recession.

Graphs showing the headline production levels and year-to-year changes in production are found in the *Reporting Detail*. The following graphs also show the official level of production activity (first graph) as well as the official data, net of inflation distortions, as corrected by ShadowStats (second graph).



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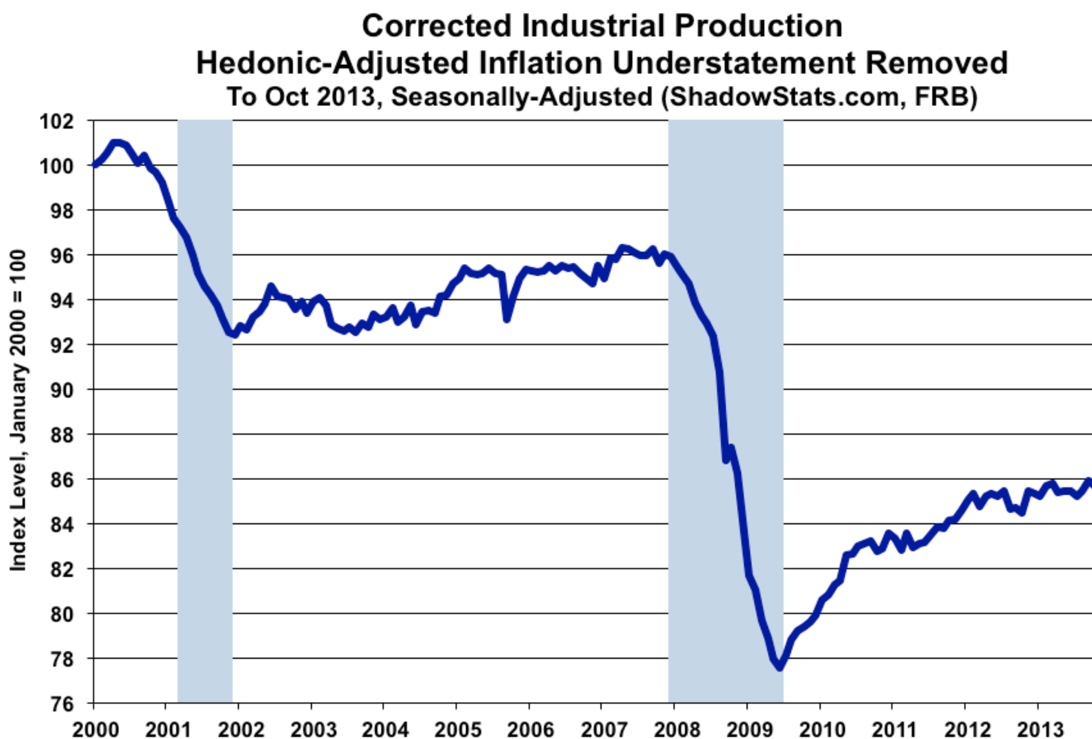

Corrected Industrial Production. Hedonic quality adjustments understate the inflation used in calculating some components of industrial production, with the effect of overstating the inflation-adjusted growth reported in the headline industrial production series (see *Special Commentary (No. 485)* and *Public Comment on Inflation*). The two preceding graphs 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 this series of revamped graphics; it does affect the appearance of the graph. The second graph is a corrected version of the first, with estimated hedonic-inflation adjustments backed-out of the official deflator.

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 and the renewed expansion reported in official GDP estimation. Corrected production levels have not regained pre-recession highs (even uncorrected, October 2013 activity still is shy of the pre-recession peak by 0.8%) but, instead, entered a period of protracted low-level stagnation in 2012, with quarterly contractions in third-quarter 2012, second-quarter 2013 and with continued stagnation in third-quarter 2013.

September Trade Numbers Should Trigger Downside Revision to GDP Growth. The widening of the headline September trade deficit to $41.8 billion from a revised $38.7 in August may have reflected some minimal catch-up in recent distortions to trade flows and/or paperwork for same. Nonetheless, the widening of the monthly trade shortfall should be enough to force a significant revision to third-quarter net exports—the trade component of the GDP—and a downside revision to third-quarter GDP.

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As previously discussed, 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. Separately, the government shutdown in October easily could have 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, with continued distortions possible through the next several months of reporting.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The seasonally-adjusted monthly trade deficit in goods and services for September 2013, on a balance-of-payments basis, widened to $41.8 billion from a revised $38.7 billion in August. The monthly trade data deterioration reflected a lower level of exports and a higher level of imports in September than had been seen in August. Higher oil-related imports contributed to the seasonally-adjusted import increase.

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 September 2013 merchandise trade deficit (no services) rose to $50.4 in September, completing the monthly reporting needed to put a hard number to the third-quarter trade balance. The September number deteriorated enough versus earlier reporting in the quarter to turn the net-export account contribution to headline third-quarter GDP growth from positive to negative. As initially guessed at by the BEA (no September detail was available), the net export account contributed 0.31% of the 2.84% headline third-quarter GDP growth (see *Commentary No. 571*). Net of any other revisions, headline third-quarter GDP growth should revise to the downside by at least 0.3-percentage point—due just to the new trade data—in the first-revision, due on December 5th.

In real terms, the August trade deficit revised to $47.4 billion, versus a revised $47.4 billion in July. Beyond monthly comparisons, the $50.4 billion September 2013 deficit also widened against a $48.7 billion trade shortfall in September 2012.

As the inflation-adjusted numbers currently stand, the annualized, real merchandise trade deficit for full reporting of third-quarter 2013 deteriorated to $580.7 billion, versus a revised $572.7 billion in second-quarter 2013. As of the prior August reporting, the annualized deficit of $567.6 billion for the third-quarter (July and August reporting) appeared to have narrowed versus the previous $571.8 billion estimate for the second-quarter.

[For further detail on October production and September trade, see the* Reporting Detail *section.]

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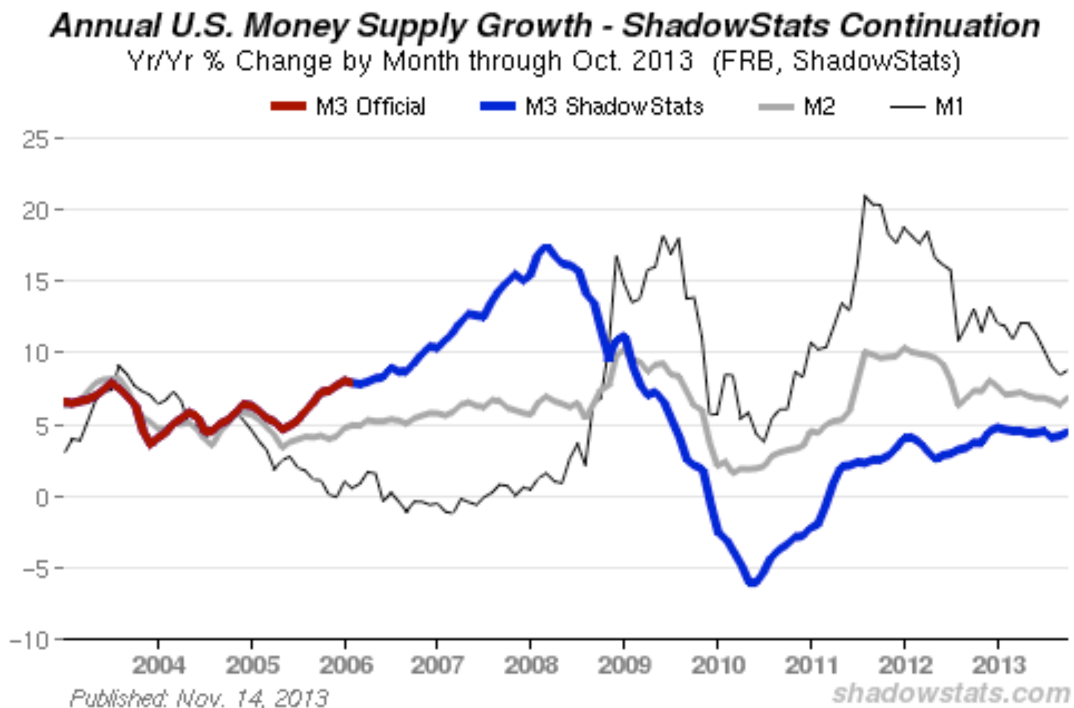
HYPERINFLATION WATCH

October M3 Money Annual Growth Rose to 4.4% from 4.1% in September, With the Monetary Base Still Exploding. The ShadowStats-Ongoing-M3 Estimate for October 2013 annual growth was 4.4%, versus 4.1% in September. Although regaining the annual growth level of June, the October number still showed a pattern of roughly level year-to-year growth as, shown in the accompanying graph, despite the continued explosive growth in the monetary base



Annual M3 growth had weakened in recent months, down from a four-year high annual growth in January 2013 of 4.6%, easing to near-term trough of 4.0% in August 2013. January 2013 was the onset of expanded QE3 easing. The October detail is based on four-plus weeks of data from the Federal Reserve, as published in the Alternate Data tab of www.shadowstats.com.

Where annual growth had been on the upswing into the expanded QE3, the continuing pattern now of stagnant annual growth, in an environment of continued rapid growth in the monetary base, remains a likely sign of mounting banking-system stresses. Any revisions in the following numbers are due to benchmark revisions of underlying data by the Federal Reserve.

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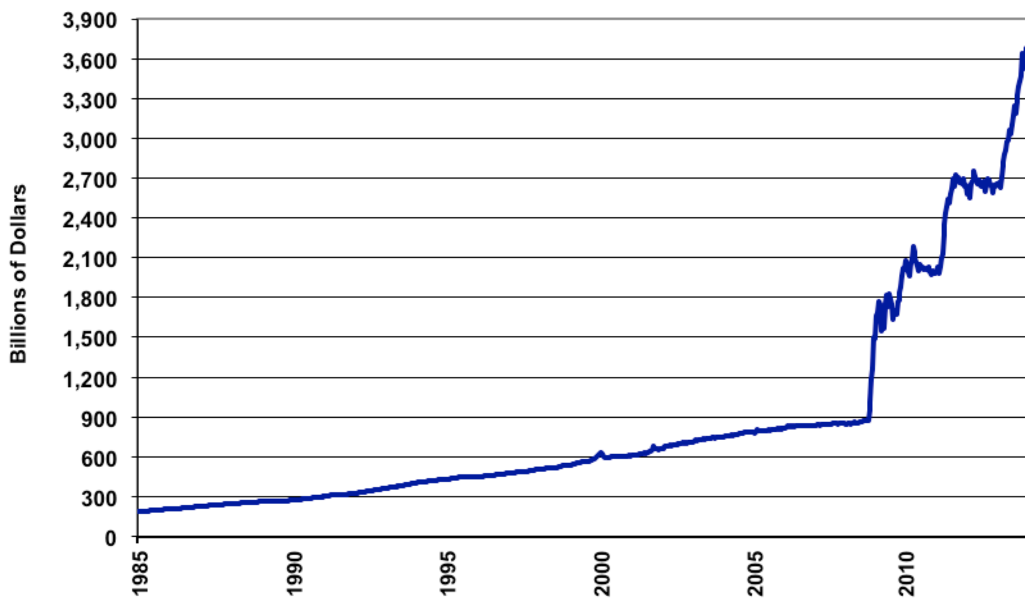
The seasonally-adjusted, preliminary estimate of month-to-month change for October 2013 money supply M3 is for a likely gain of 0.6%, versus a 0.5% (was 0.1%) gain in September. Estimated month-to-month M3 changes, however, remain less reliable than are the estimates of annual growth.

Initial Growth Estimates for September M1 and M2. For October 2013, early estimates of year-to-year and month-to-month changes follow for the narrower M1 and M2 measures (M2 includes M1, M3 includes M2). Full definitions of the measures are found in the *Money Supply Special Report*. M2 for October is estimated to show year-to-year growth of roughly 6.8%, versus a revised 6.4% (previously 6.2%) in September, with month-to-month change estimated at roughly a 1.2% gain in October, versus a revised 0.5% (previously 0.4%) gain in September. The early estimate of M1 for October 2013 is for year-to-year growth of roughly 8.8%, versus a revised 8.4% (previously 7.7%) in September, with a month-to-month October gain of 2.3%, versus a revised September gain of 0.9% (previously 0.4%).

Annual Growth in Monetary Base Rising at Fastest Pace Since Fed First Addressed 2008 Panic. Mirroring the ongoing QE3 activity, the monetary base continues in uncharted territory, both in terms of historical level, and in terms of year-to-year growth for the near-term cycle. As shown in the accompanying graphs, the monetary base (St. Louis Fed) was at a seasonally-adjusted (SA) two-week average level of $3,682.3 billion as of November 13th, a record high. The 38.3% pace of rising year-to-year growth for the November 13th period, also was at a new cycle high, and a level that has not been seen since the Fed first began flooding the system with liquidity, during the 2008 panic. The weekly data are reflected in the first two graphs following.



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Fed Monetization at 75% of Net Issuance of Federal Debt Held by Public. Since the implementation in January 2013 of the Federal Reserve's expanded quantitative easing QE3, the Fed has continued to buy U.S. Treasury securities at a pace suggestive of concerns that the U.S. government otherwise might have some trouble in selling its debt. From the beginning of 2013 through the October government shutdown, the Fed's net purchases of Treasury securities had absorbed in excess of 130.5% of the coincident net issuance of gross federal debt. That circumstance had been exacerbated somewhat, of course, by the level of gross federal debt being contained then at its official debt ceiling. The Fed usually purchases Treasury debt in the opening market (banking system). Where available supply includes all open issues, the central bank purchases will include debt from earlier years, which is how the net monetization could top 100%.

Since the President Obama's waiving of the debt ceiling in October, the Treasury has issued about $0.402 trillion of net, new gross federal debt ($0.717 trillion since January 1st), which totaled $17.149 trillion ($12.206 trillion publicly held, $4.943 trillion held by government such as Social Security) as of November 13th. Based on the latest debt figures and Federal Reserve reporting, since January 1, 2013, the Federal Reserve has monetized $0.471 trillion, the equivalent of 74.9% of the net issuance of publicly-held debt, or 65.7% of the net issuance of gross federal debt.

Monetary Base versus M3—"Tapering" in QE3 Remains Unlikely. The monetary base is currency in circulation (part of M1 money supply) plus bank reserves (not part of the money supply) (see a more-complete definition in the *Money Supply Special Report*). Traditionally, the Federal Reserve has used the

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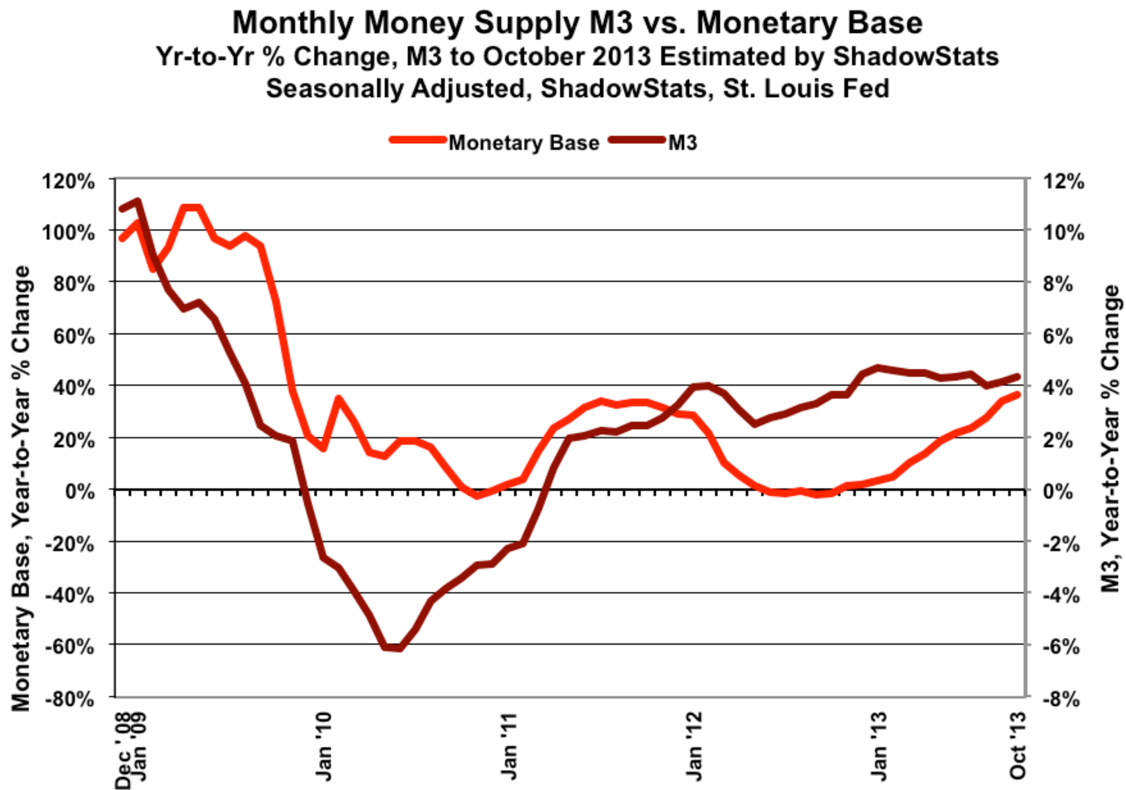
monetary base to increase or decrease growth in the money supply, but that has not had its normal impact in the post-2008 crisis period.

Instead, financially-troubled banks have been holding their excess reserves with the Federal Reserve, not lending the available cash into the normal flow of commerce. When the Fed monetizes U.S. Treasury securities, as it has been doing, that usually adds directly to the broad money supply, and it contributes to selling pressure against the U.S. dollar. Unresponsive year-to-year growth in broad money supply M3, in this circumstance, tends to be an indication of mounting systemic stress in the banking industry.



While there has been no significant flow-through to the broad money supply from the expanded monetary base—a problem directly related to banking-system solvency—there still appears to have been some impact. As shown in the updated graph, there is a correlation between annual growth in the St. Louis Fed's monetary base estimate and annual growth in M3, as measured by the ShadowStats-Ongoing M3 Estimate. The correlations between the growth rates are 58.1% for M3, 39.9% for M2 and 36.7% for M1, all on a coincident basis versus growth in the monetary base.

The divergence between the patterns of annual growth in M3 and the monetary base had continued to increase, although the October detail is suggestive of a convergence. A divergence is suggestive of still-intensifying liquidity stresses in the banking system. Reporting in the next month or two should be telling as to where these numbers are headed, if the money measures indeed are converging.

The Fed's easing activity of recent years has been aimed primarily at supporting banking-system solvency and liquidity, not at propping the economy. When the Fed boosts its easing, but money growth slows or does not respond, there is a suggestion of mounting financial stress within the banking system.

Further, underlying U.S. economic reality is weak enough to challenge domestic banking stress tests. In this environment, the Fed most likely will have to continue to provide banking-system liquidity, while continuing to take political cover for its quantitative easing from the weakening economy (see *No. 527: Special Commentary*). Accordingly, there remains nothing here to suggest an imminent end to QE3.

Summary Hyperinflation Outlook—Unchanged. The *Hyperinflation Outlook* of *Commentary No. 567* is repeated here without change. Detail on the pending publication of *Hyperinflation 2014—The End Game*, which will be a fully-updated version of *Hyperinflation 2012,* also was discussed in *Commentary No. 567*.

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, again, as discussed in *Commentary No. 567*.

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

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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

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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.

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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.

REPORTING DETAIL

INDEX OF INDUSTRIAL PRODUCTION (October 2013)

October Industrial Production—Continuing Signals of Renewed Economic Downturn. The headline monthly contraction of 0.1% in, and related reporting for October 2013 continued to be suggestive of a seriously-troubled broad economy, an economy that remains on the brink of falling to what formally should be recognized as renewed recession. Indeed, the pattern of year-to-year activity remained "pre-recession," if viewed in the context of normal economic times.

Industrial Production—October 2013. The Federal Reserve Board released its estimate of seasonally-adjusted, October 2013 industrial production this morning, November 15th. In the context of minor and mixed revisions to the prior six months of production activity (the period open to revision), headline

monthly October fell by 0.1% (down by a rounded 0.15% at the second decimal point) and was down by 0.07% for the month, net of prior-period revisions. September production revised to a gain of 0.7% (0.65%, previously 0.57%), August revised to a gain of 0.5% (0.47%, previously 0.41%), while July contracted at a revised pace of 0.2% (0.15%, previously 0.07%) for the month.

The headline 0.1% contraction in aggregate October production activity reflected a 0.3% gain in manufacturing, which was against an unrevised 0.1% gain in September. Headline mining activity, including oil and gas activity, fell by 1.6% in the month, following a revised 1.0% (previously 0.2%) gain in September, while ever-unstable utility activity by fell by 1.1% in October, following a revised 4.5% (previously 4.4%) gain in September.

While manufacturing gained 0.3% for October, the production of consumer goods declined by 0.1%, dominated by a drop in automobile production. Offsetting the consumer goods were gains in production of business and defense equipment.

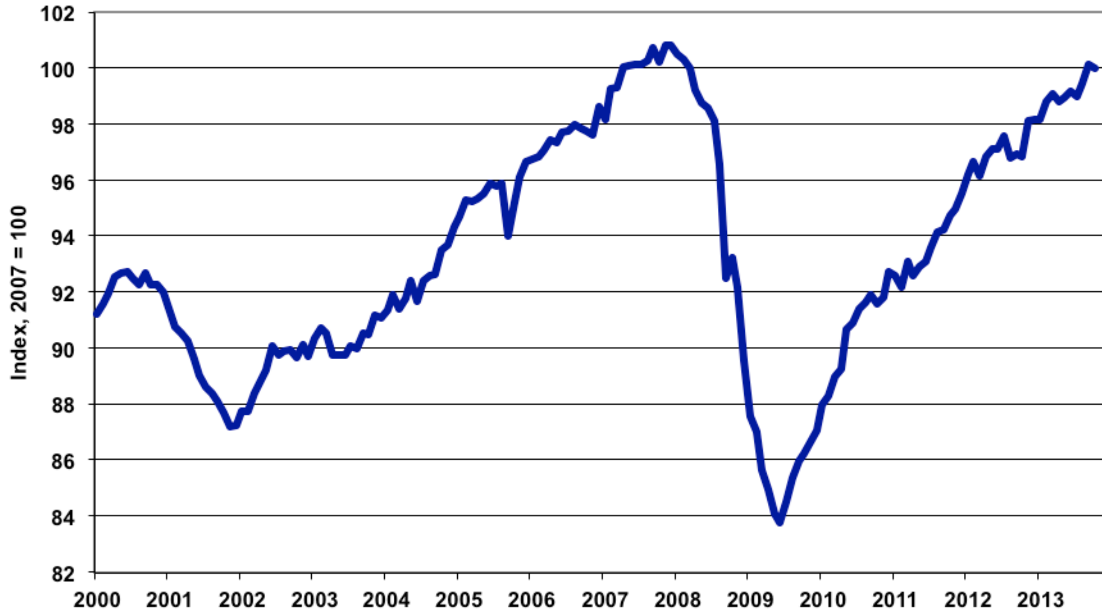
Year-to-year growth in October 2013 held at 3.24%, versus a revised 3.26% (previously 3.19%) in September. August annual growth was a revised 2.77% (previously 2.78%, initially 2.66%), while July growth revised to 1.49% (previously 1.55%, 1.43%, and initially 1.42%). Allowing for the series volatility and special factors tied to year-ago hurricanes and weather-related utility distortions, annual growth has slowed to levels last seen during the mid-2008 economic collapse, and it remains consistent with annual growth patterns usually seen going into recession.

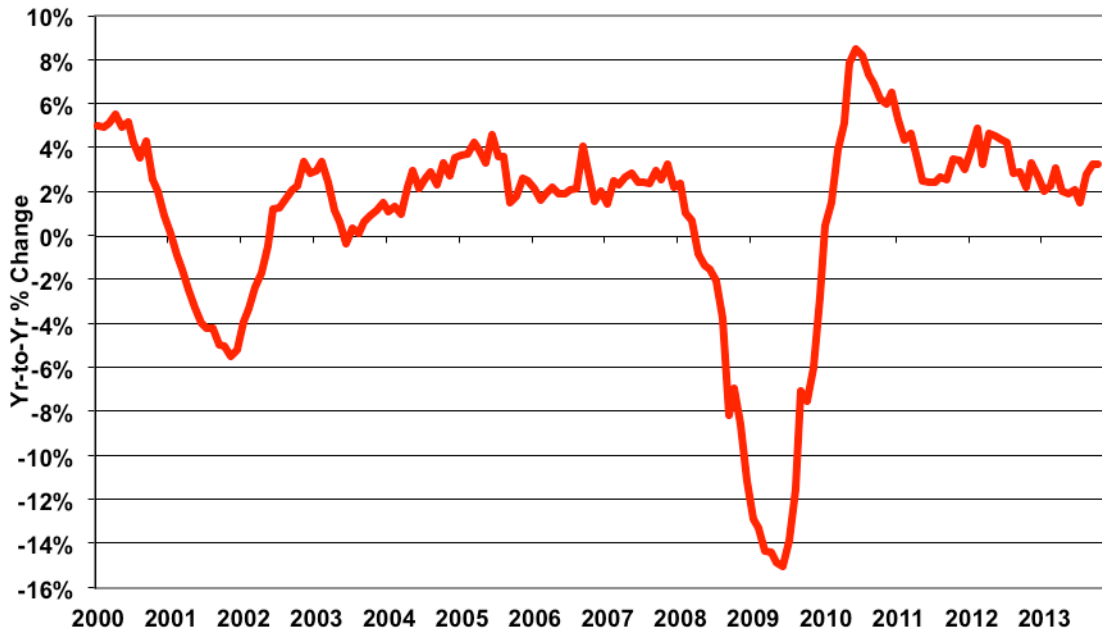
The "recovery" in industrial production is reflected in the following two sets of graphs. The first graph in the first set shows the monthly level of the production index, while the second graph shows the year-to-year or annual percentage change in the same series for recent historical detail, beginning January 2000.

The second set of graphs shows the same data in historical context since World War II.

As shown more clearly in the first set of graphs, current year-to-year activity has dipped lower, with annual growth hitting levels last seen in a slowing-growth pattern in the first two quarters of the formal 2007 recession. Annual growth remains well off the recent relative peak for the series, which was 8.50% in June 2010, going against the official June 2009 trough of the economic collapse. Indeed, as shown in the second set of graphs, the year-to-year contraction of 15.02% in June 2009, at the end of second-quarter 2009, was the steepest annual decline in production since the shutdown of war-time production following World War II.

Although official production levels have moved higher since the June 2009 trough, the headline series, still remains 0.8% shy of a full recovery and appears to be turning down or stalling, anew, allowing for the one-time factors, unlike the dubious data in the GDP, which show full recovery as of second-quarter 2011, with continuous, new expansion ever since.





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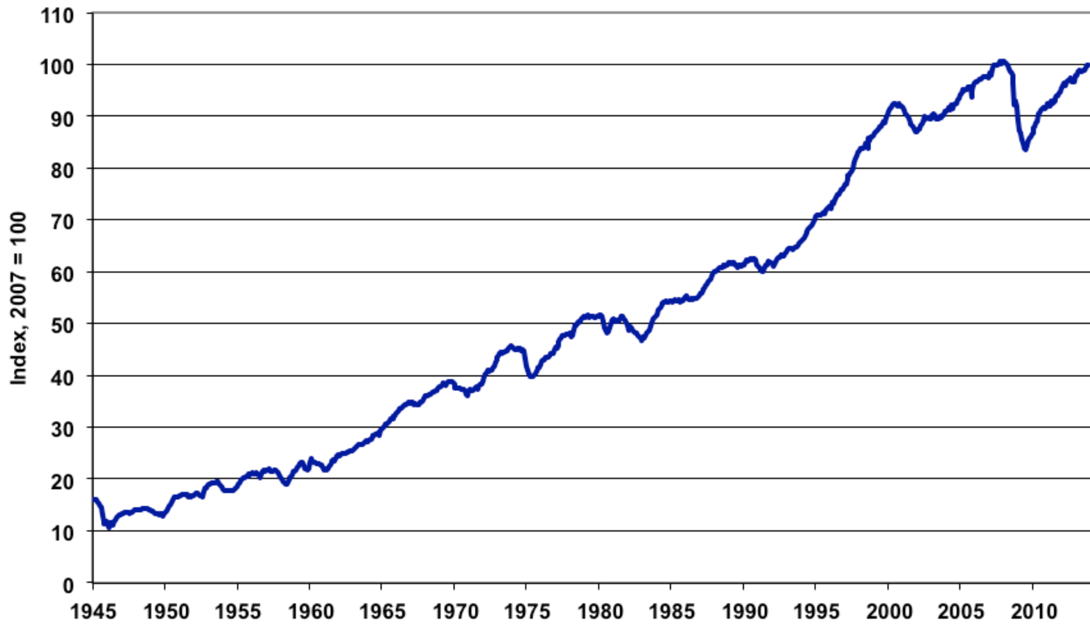

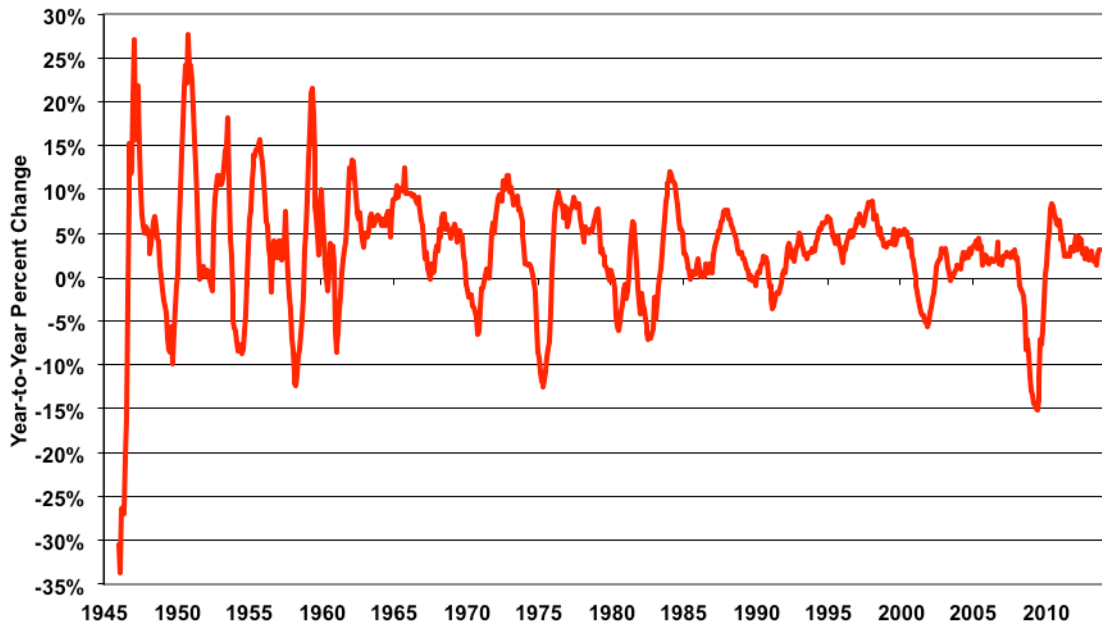

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Corrected for the understatement of inflation used in deflating portions of the industrial production index, the series has shown more of a bottom-bouncing and recent-downturn pattern, since 2009, where it appears to have topped out coming into 2012, with a renewed downturn likely in process. The corrected production series is discussed and graphed in the *Opening Comments*. Please note also that the index base for those graphs showing production levels, 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.

U.S. TRADE BALANCE (September 2013)

September Trade Data Deteriorated Enough to Weaken GDP Growth. The widening of the headline September trade deficit to $41.8 billion, from a revised $38.7 in August, may have reflected some minimal catch-up in recent distortions to trade flows and/or paperwork for same. That monthly deterioration, though, was enough to generate downside-revision pressures for the third-quarter GDP, due for revision on December 5th.

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. Separately, the government shutdown in October easily could have exacerbated paperwork flow disruptions tied to the Customs Service, and the shutdown conceivably impacted actual trade flows in October. Accordingly, unusual reporting activity still may have been involved the latest trade data, with continued distortions possible through the next several months of reporting.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported November 14th that the nominal, seasonally-adjusted monthly trade deficit in goods and services for September 2013, on a balance-of-payments basis, widened to $41.8 billion from a revised $38.7 (previously $38.8) billion in August. The monthly trade data deterioration reflected a lower level of exports and higher level of imports in September than had been seen in August. Higher oil-related imports contributed to the import increase.

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 on an unadjusted basis, which was reversed by seasonal adjustments. For the month of September 2013, the not-seasonally-adjusted average price of imported oil rose to $102.00 per barrel, up from $100.26 in August and up from an average of $98.90 in September 2012. Further, not-seasonally-adjusted, physical oil import volume in September 2013 averaged 7.661 million barrels per day, down from 7.739 million in August, and down from 8.190 million barrels per day in September 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*

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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 September 2013 merchandise trade deficit (no services) rose to $50.4 billion in September, completing the monthly reporting needed to put a hard number to the third-quarter trade deficit. The September number deteriorated enough versus earlier reporting in the quarter to turn the net-export account contribution to headline third-quarter GDP growth from positive to negative. As initially guessed at by the BEA (no September detail available), the net export account contributed 0.31% of the 2.84% headline third-quarter GDP growth (see *Commentary No. 571*). Net of any other revisions, headline third-quarter GDP growth should revise to the downside by at least 0.3-percentage point—due just to the new trade data—in the first-revision, due on December 5th.

In real terms, the August trade deficit revised to $47.4 (previously $47.3 billion), versus a revised $47.4 (previously $47.3, initially $47.7) billion in July. Beyond monthly comparisons, the $50.4 billion September 2013 deficit also widened against a $48.7 billion trade shortfall in September 2012.

As the inflation-adjusted numbers currently stand, the annualized, real merchandise trade deficit for full reporting of third-quarter 2013 deteriorated to $580.7 billion, versus a revised $572.7 billion in second-quarter 2013. As of the prior August reporting, the annualized deficit of $567.6 billion for the third-quarter (July and August reporting) appeared to have narrowed versus the previous $571.8 billion estimate for the second-quarter.

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Likely in the Months Ahead. The markets generally remain overly optimistic as to the economic outlook, although expectations have softened during the last year. That circumstance, and underlying fundamentals that remain highly 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 will be turning negative by year end, and were not positive enough in October to offset declines in unadjusted energy prices. That said, 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:

Consumer Price Index—CPI (October 2013). The release by the Bureau of Labor Statistics (BLS) of the October 2013 CPI is scheduled for Wednesday, November 20th. The headline CPI is a fair bet to be in contraction for October, down by 0.1% or so.

Average gasoline prices fell month-to-month in October 2013 by 3.4 percentage points, on a not-seasonally-adjusted basis, per the Department of Energy. The BLS seasonal adjustments will give gas prices a boost, but not enough to get them into positive territory. As last revised, an unadjusted 2.1% monthly decline in October 2012 gasoline prices was narrowed to a 0.1% contraction, with upside seasonal adjustments. Similar effects in the October 2013 number would still leave the adjusted number in negative territory, subtracting roughly 0.1 percentage point from the aggregate headline CPI-U number. Any upside surprise here will come from food prices or core inflation.

Year-to-year, CPI-U inflation would increase or decrease with the October 2013 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.17% increase in monthly inflation reported for October 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for October 2013, the difference in October's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the September 2013 annual inflation rate of 1.18%. For example, if the headline October CPI-U inflation fell by 0.1%, annual inflation would slow to approximately 1.0%.

Retail Sales (October 2013). The October 2013 retail sales estimate is scheduled for release on Wednesday, November 20th, by the Census Bureau. With the consumer still in an extreme liquidity bind,

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, before adjustment for consumer inflation, and even after a possible negative headline inflation number for October.

Existing-Home Sales (October 2013). October 2013 existing-home sales are scheduled for release on Wednesday, November 20th, by the National Association of Realtors. As is the usual circumstance for this highly volatile and unstable series, a slight upturn in an entrenched pattern of stagnation likely has continued, with the report of monthly change in existing-home sales activity not likely to be meaningful, in either direction, particularly in the context of the prior-month's revision. This series increasingly should continue to show a relationship with the weakening trend in single-unit housing starts, as last reported and graphed in its most-recent version of August 2013 in *Commentary No. 558*. New home sales for September and October are due for release on December 4th, while housing starts for September and October are due for release on November 26th.

Producer Price Index—PPI (October 2013). The October 2013 PPI is scheduled for on Thursday, November 21st, by the Bureau of Labor Statistics (BLS). For October, PPI energy prices should prove to be a drag. Given still-understated food inflation and ongoing upside "core" inflation, the headline PPI could offer some upside surprise, but most likely it will be in contraction.

Depending on the oil contract followed, oil prices, on average, were down by 2.3% to 5.4%, along with a 5.1% contraction in average retail gasoline prices. Accordingly, without adequate offsetting positive seasonal adjustments to energy prices, a small monthly contraction in PPI is a good bet.

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