John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 581
November Retail Sales, Budget Agreement, Fed Policy

December 12, 2013

No Effort to Address Long-Range Solvency Issues of the United States in Budget-Deficit Agreement

Consumers Remain Strapped by Structural Liquidity Issues Despite Gain in November Retail Sales

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PLEASE NOTE: The next regular Commentary *is scheduled for Monday, December 16th, covering November industrial production and the PPI; followed by* Commentaries *on December 17th, covering the CPI, real retail sales and earnings; on December 18th, covering September, October and November housing starts; and on December 20th covering the second revision and third estimate of third-quarter GDP, plus November existing home sales.*

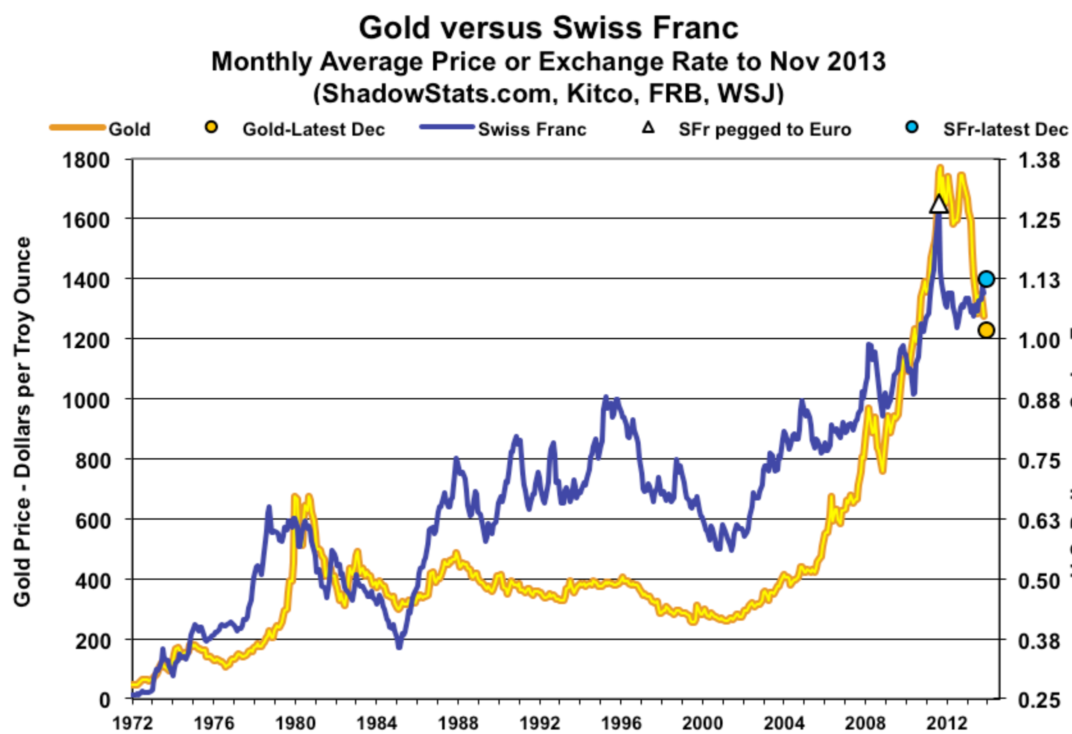
Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

A Budget Deal of No Substance; Meaningful Fed Tapering Not Likely. On December 10th, federal-budget negotiators announced a two-year deal, which did absolutely nothing in terms of addressing the longer-range solvency issues of the United States. This attempt to push off the deficit-crisis negotiations until well after the 2014 midterm election should not sit well with either the global financial markets, or with the increasingly politicized and arm-twisted credit-rating agencies. In response, the U.S. dollar has weakened somewhat. See *Commentary No. 577* for related details. This circumstance will be updated as necessary.

Separately, market expectations are being built-up, once again, for the Federal Reserve's Federal Open Market Committee (FOMC) to announce some "tapering" or pullback on quantitative easing QE3 on Wednesday, December 18th, following its upcoming meeting. With a new Fed Chairman coming into power, there always is the possibility of a gesture being made to the Fed's critics, but no serious tapering is likely. Instead, continuing systemic stress (see *Commentary No. 580*) suggests increased, not reduced accommodation to the banking system. Separately, deepening economic troubles—irrespective of some false-positive indications in series such as unemployment and retail sales—promise significant political cover for any actions the Fed wants to take (see *Commentary No. 575*).

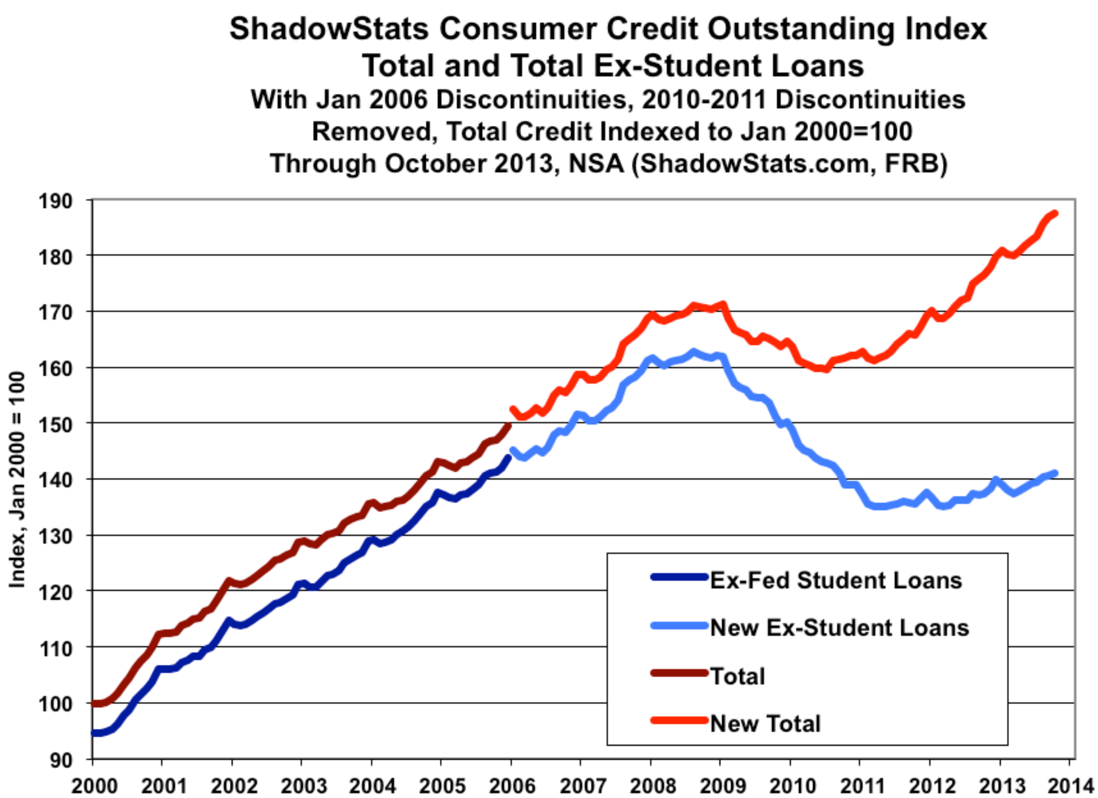
Although the U.S. dollar remains artificially strong, and the gold price artificially weak, the dollar has begun to show some renewed weakness in the current environment, as reflected in the accompanying graph, where the referenced "latest December" Swiss franc and gold numbers are market prices from roughly mid-day New York time, December 12th.



A Most Difficult Time Ahead: *Hyperinflation 2014—The End Game*. The fully-updated version of *Hyperinflation 2012* will be released in several installments, with the first segment targeted for release in the week between Christmas and New Year's Day, a period otherwise lacking scheduled economic releases. Multiple segments are being used in order to keep the production process for this large document manageable and, hopefully, to make the report an easier read.

The first segment will include the broad outlook and rationale behind the forecasts of a hyperinflationary great depression to be unfolding in 2014, including a review of major inflation-versus-deflation arguments and summaries of the subsequent two installments. Those segments will cover historical inflation and economic activity, related historical financial crises, the fiscal condition of the United States, Federal Reserve policies and options, and ways of hedging and/or mitigating the looming crises. Again, the broad outlook remains intact as described in the *Hyperinflation Watch* section.

Separately, the brief *Summary Hyperinflation Outlook*, included in the *Hyperinflation Watch*, has been updated in today's *Commentary* to cover budget-deficit developments and Fed-tapering speculations.



Consumer Credit Woes Continue. Consumer liquidity conditions remain seriously constrained, as discussed in *Commentaries* No. 580 and No. 575. Those *Commentaries* included recent updates to real (inflation-adjusted) median household income and consumer confidence measures. The following graph shows consumer credit outstanding, updated for October 2013, where practically all the post-2008-Panic growth in consumer credit has been in federally-backed student loans, instead of in consumer bank lending that would tend to fuel consumption of washing machines, etc.

Without growth in real income; without the ability or the will to expand debt meaningfully; and without the confidence to take on new debt, where possible; the consumer has not been able to support the purported, full-fledged economic recovery indicated in the GDP. Further, there is no recovery pending in the immediate future, particularly for the consumer-dominated retail sales and housing markets.

Retail Sales—November 2013. Despite the continuing severe liquidity constraints on the consumer, headline November retail sales jumped by 0.68% for the month, due largely to seasonal-factor distortions. The November gain was in the context of a 0.20% upside revision in headline October growth to 0.61%. Although the reported monthly increase in November was statistically significant, and somewhat above market expectations, the reporting of the latest data was unstable and inconsistent versus most prior reporting. Particularly in the months of November and December, which dominate the year, slight variations in seasonal factors can make a meaningful difference in the headline reporting.

Where concurrent seasonal adjustments are recalculated every month, but not reported on a consistent, historical basis, the retail sales reporting suffers the same inconsistency issues that are seen with other economic series, such as payroll employment, the unemployment rate, and durable goods orders. The highly variable and unstable seasonal factors here have continued to cloud relative activity in the September 2013-to-November 2013, and in the October 2012-to-November 2012 periods, five months that are published on a non-comparable basis with all other historical monthly numbers. Although the published historical numbers were consistent at the time of the May 31st benchmark revision, seven intervening rounds of post-revision, concurrent-seasonal adjustments now have thrown all the historical data into disorder. The resulting inconsistencies allow for unreported shifts in the historical data that most likely are distorting the estimates of the current headline numbers, even though the November 2013 retail sales gain was technically significant.

Underlying Fundamentals Remain Negative. The new data did not alter the basic outlook or the traditional recession signals that have been in place. As has been the circumstance during the five-plus years of economic collapse, activity in consumer buying of goods and services has been constrained by the intense, structural-liquidity woes besetting the consumer, as discussed in the prior section. Again, 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 the GDP. In like manner, the consumer has lacked the ability to fuel the purported post-June 2009 recovery in economic activity reflected in the GDP measure.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—November 2013. Not adjusted for consumer inflation, headline November 2013 retail sales indicated a statistically-significant, seasonally-adjusted monthly increase of 0.7% (0.68% at the second decimal point). The November increase followed a revised, statistically-significant month-to-month gain of 0.61% (previously 0.41%) in October.

Year-to-year, November 2013 retail sales rose by a statistically-significant 4.69%, versus a revised 4.12% annual gain in October. Prior-period revisions, one year ago, reflected little more than the unstable monthly revisions in the concurrent-seasonal-adjustment process, where revised estimates are reported and 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.

Real (inflation-adjusted) retail sales for November will be reported along with the headline estimate of consumer inflation in November, in the December 17th *Commentary No. 583*, following the release of the CPI-U inflation data. Per the discussion in the *Week Ahead* section, the headline November CPI-U likely will be unchanged or slightly negative.

[For further detail on November retail sales, see the* Reporting Detail *Section.]

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HYPERINFLATION WATCH

Summary Hyperinflation Outlook—Updated. The *Summary Hyperinflation Outlook* includes updated commentary on budget-deficit and quantitative-easing issues, where the new or altered comments are underlined. Otherwise, the *Summary* is as it was last updated in *Commentary No. 567*. Detail on the pending publication of *Hyperinflation 2014—The End Game*, which will be a fully-updated and expanded version of *Hyperinflation 2012,* is discussed in the *Opening Comments*.

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.

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 $16.1 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. Indeed, for fiscal 2013, the GAAP-based annual deficit likely remained well in excess of $6 trillion, with gross federal debt (adjusted for year-end debt-ceiling accounting gimmicks) was about $17.1 trillion and total federal obligations in excess of $90 trillion. Details and discussion can be found in *No. 500: Special Commentary* and *Commentary No. 577*.

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 was demonstrated in the October 2013 crisis negotiations (and in negotiations of recent years) surrounding the debt ceiling, and as openly confirmed in the two-year "budget deal" announced on December 10, 2013, there will be no action taken in the foreseeable future to address the long-term solvency issues facing the United States. There simply is no controlling, political will in Washington to do so.

Recent budget negotiations have reflected 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 now, after further multiple delays, have been pushed until after the 2014 midterm election. Chances that the global financial markets will give the gutless politicians in Washington a pass on this are nil, and renewed selling pressure on the U.S. dollar in the global currency markets has begun to pick up.

The odds of the United States actually not paying its obligations or interest over the long-term are negligible. Instead, typically a country, which issues its debt in the currency it prints, simply prints the cash it needs when it 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 effectively will drop 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 (see *Commentary No. 580*). 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 face incoming Fed Chairman Janet Yellin, along with 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. Even if it were modified minimally in the near-term, in order to placate the Fed's critics, ongoing economic weakness and systemic instabilities favor increased, not reduced, Federal Reserve quantitative easing during the months ahead.

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.

REPORTING DETAIL

RETAIL SALES (November 2013)

Headline November Retail Sales Jumped, Despite Consumer Liquidity Constraints. November 2013 retail sales rose by a statistically-significant 0.68% for the month, in the context of an upside revision in headline October retail sales growth to 0.61% (previously 0.41%). Although the reported monthly gain was statistically significant and somewhat above market expectations, the reporting of the latest data was unstable and inconsistent versus most prior reporting. Particularly in the months of November and December, which dominate the year, slight variations in seasonal factors can make a meaningful difference in the headline data.

Where concurrent seasonal adjustments are recalculated every month, but not reported on a consistent, historical basis, the retail sales reporting suffers the same inconsistency issues that are seen with other economic series, such as payroll employment, the unemployment rate, and durable goods orders. The highly variable and unstable seasonal factors here have continued to cloud relative activity in the September 2013-to-November 2013, and in the October 2012-to-November 2012 periods, five months that are published on a non-comparable basis with all the other historical monthly numbers. Although the published historical numbers were consistent at the time of the May 31st benchmark revision, seven intervening rounds of post-revision, concurrent-seasonal adjustments now have thrown all the historical numbers into disorder. The resulting inconsistencies allow for unreported shifts in the historical data that most likely are distorting the estimates of the current headline numbers, even though the November 2013 retail sales gain was technically significant.

Underlying Fundamentals Remain Negative. The new data did not alter the basic outlook or the traditional recession signals that have been in place. As has been the circumstance during the five-plus years of economic collapse, activity in consumer buying of goods and services has been constrained by the intense, structural-liquidity woes besetting the consumer, as discussed in the *Opening Comments.* 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 reflected in the GDP measure.

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 the Opening Comments *and in* Hyperinflation 2012 *and* Special Commentary (No. 485).

Nominal (Not-Adjusted-for-Inflation) Retail Sales—November 2013. Not adjusted for consumer inflation, today's (December 12th) report on November 2013 retail sales—issued by the Census Bureau—indicated a statistically-significant, seasonally-adjusted monthly increase of 0.7% (0.68% at the second decimal point, a gain of 0.98% before prior-period revisions) +/- 0.58% (all confidence intervals are at the 95% level). The November increase followed a revised, statistically-significant month-to-month gain of 0.61% (previously a gain of 0.41%) +/-0.35% in October.

Year-to-year, November 2013 retail sales rose by a statistically-significant 4.69% (+/- 0.82%), versus a revised 4.12% (previously 3.88%) annual gain in October. Prior-period revisions, one year ago, reflected little more than the unstable monthly revisions in the concurrent-seasonal-adjustment process, where revised estimates are reported and 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. Seasonally-adjusted monthly grocery-store sales fell by 0.30% in November, with gasoline-station sales declining by 1.15% 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:

<u>Version I:</u> November 2013 versus October 2013 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—rose by 1.07%, versus the official gain of 0.68%.

<u>Version II:</u> November 2013 versus October 2013 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—rose by 0.83%, versus the official gain of 0.68%.

Real (Inflation-Adjusted) Retail Sales—November 2013. The headline 0.68% nominal gain in monthly November retail sales was before accounting for inflation. Real retail sales for November (adjusted for inflation), will be reported along with the headline estimate of consumer inflation in November, as measured by the November CPI-U, in the December 17th *Commentary No. 583*, following the release of the inflation data. Per the discussion in the *Week Ahead* section, the headline November CPI-U likely will be unchanged or slightly negative.

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. Data distortions resulting from the October government shutdown temporarily increase the risk for unusual reporting and revisions in most federal-government and related series.

In terms of monthly inflation reporting, energy-inflation-related seasonal-adjustment factors will be turning negative in December and likely were not positive enough in November to offset declines in unadjusted energy prices in the CPI or the PPI. 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 ongoing U.S. fiscal-crisis debacle (see the *Summary 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:

Producer Price Index—PPI (November 2013). The November 2013 PPI is scheduled for release tomorrow, Friday, December 13th, by the Bureau of Labor Statistics (BLS). This lame-duck series faces a complete overhaul and redefinition come the February 2014 release of January 2014 data (see *Commentary No. 575)*. That said, the November PPI energy prices should prove to be a drag, once again. A small monthly decline is likely, with any upside surprises coming from food or "core" inflation. The reporting on the PPI will be covered in *Commentary No. 581* of December 16th.

Depending on the oil contract followed, oil prices, on average, were down by 1.2%-to-6.6% in November, along with a 2.9% contraction in average retail gasoline prices. There will be some offset from positive seasonal adjustments to energy prices.

Index of Industrial Production (November 2013). The November 2013 index of industrial production is scheduled for Monday, December 16th, by the Federal Reserve Board. Strong expectations are a fair bet to be disappointed, as companies increasingly move to reduce excessive inventory levels. There is the potential for unusual reporting volatility and revisions tied to data disruptions resulting from the October shutdown of the federal government.

Consumer Price Index—CPI (November 2013). The release by the Bureau of Labor Statistics (BLS) of the November 2013 CPI is scheduled for Tuesday, December 17th. The headline CPI-U is a fair bet to be flat or in a small contraction for November, down by 0.1% or so.

Average gasoline prices fell month-to-month in November 2013 by 2.9-percentage points, on a not-seasonally-adjusted basis, per the Department of Energy. The BLS seasonal adjustments will give gas prices a boost, but, as with last month, not enough to get them into positive territory. As last revised, an unadjusted 7.7% monthly decline in November 2012 gasoline prices was narrowed to a 6.0% contraction, with upside seasonal adjustments. Similar effects in the November 2013 number would still leave the adjusted number in negative territory, subtracting roughly 0.1-percentage point from the aggregate headline CPI-U number. Again, any upside surprise here would come from food prices or core inflation.

Year-to-year, CPI-U inflation would increase or decrease in November 2013 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.24% decrease in monthly inflation reported for November 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for November 2013, the difference in November's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the October 2013 annual inflation rate of 0.96%. For example, if the headline November 2013 CPI-U declined by 0.1%, the year-to-year inflation would be roughly 1.1%.

Housing Starts (September, October and November 2013). On Wednesday, December 18th, in catch-up reporting, the Census Bureau will publish its estimate on November residential construction, with initial reporting of September, October and November 2013 housing starts, the first estimate of housing-starts activity since before the government shutdown in October.

Any strength in starts likely will be in apartment building, not single-unit construction, as was seen in catch-up reporting in building permits. Further, unusual volatility and instabilities in reporting may be evident, as they were in catch-up reporting of September and October 2013 new home sales. Yet, the broad pattern of plunge and stagnation for housing activity in this economic cycle still should be obvious, as previously discussed (see *Commentaries* No. 576 and No. 578 for related near-term reporting).

Despite near-perpetual market expectations for strengthening activity in housing starts, reported month-to-month change likely will continue to be statistically-insignificant, in September through November, with ongoing stagnation seen in the aggregate series, as well as 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 still does not appear to be in the offing, given consumer-liquidity issues discussed in the *Opening Comments*.

Existing-Home Sales (November 2013). November 2013 existing-home sales are scheduled for release on Thursday, December 19th, by the National Association of Realtors. As is the developing circumstance for this highly volatile and unstable series, 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 will be updated, and as discussed in the previous *Housing Starts* section. New home sales for November are due for release on December 24th, see *Commentaries No. 574* and *No. 578*.

Gross Domestic Product—GDP (Third-Quarter 2013, Third-Estimate, Second Revision). The Bureau of Economic Analysis has scheduled release of the third estimate of third-quarter 2013 GDP for Friday, December 20th. Market expectations appear to be for little more than statistical noise in this second revision, with the headline growth rate holding at 3.6%.

Odds favor a downside revision, though, based on data for trade, inventories and construction spending that were released subsequent to the information incorporated into the second estimate of the GDP. The new data had negative-revision implications for the third estimate, second revision to third-quarter GDP. See *Commentary No. 579* for further detail.

