John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 608
February Retail Sales

March 13, 2014

February Retail Sales Rose by 0.27%,
But that Was After a 0.41% Downward Revision to January's Sales

Sales Are on Track for Annualized 2.5% First-Quarter Contraction,
Before Inflation Adjustment

Shifting Seasonal Factors Appear to Be Boosting Headline Retail Growth

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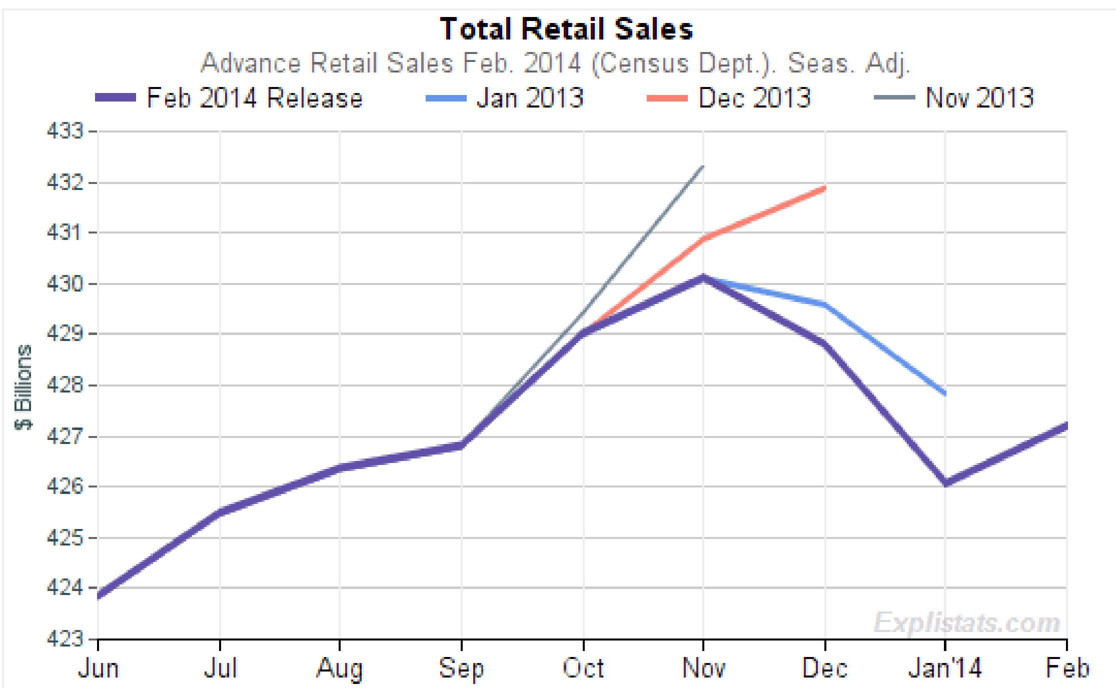
PLEASE NOTE: The next regular Commentary *is scheduled for Monday, March 17th, covering the February PPI and industrial production, followed on the 18th by the February CPI and related real retail sales and earnings, plus February housing starts. Publication of the expanded* Special Commentary *on 2013 U.S. GAAP accounting and the* Second Installment *on the hyperinflation report should be published about mid-week, next week. Specific timing will be posted in the schedule box on the home page of www.ShadowStats.com.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

The Numbers Continue to Suggest a Decline in First-Quarter GDP. Today's (March 13th) reporting of nominal retail sales—before any consideration for the effects of inflation—showed continued sharp deterioration in broad consumer economic activity. The latest numbers suggested increasing odds of a first-quarter GDP contraction. Today's relatively brief *Commentary* concentrates on the retail sales reporting and a minimally-revised outlook on consumer liquidity. The pending March 18th *Commentary No. 610*, covering the February CPI and housing starts will provide a general review of the latest economic reporting. That will be followed by *Hyperinflation 2014—Renewed Economic Tumble*, which will provide an extensive review of economic activity to date, along with what likely will unfold in the months and year ahead.

Collapsing Pattern of Retail Sales Intensified, Again. As shown in the accompanying graph (courtesy of ShadowStats-affiliate www.ExpliStats.com), what had appeared once to be an uptrend in nominal retail sales, as of reporting in November 2013, has taken a dramatic downturn in subsequent revisions and current reporting. Although headline February retail sales increased by 0.27% for the month, that was after a 0.41% downside revision to the level of January sales activity (now a 0.64% month-to-month decline), and a further 0.19% downside revision to the level of December activity (now a 0.31% month-to-month decline). The latest December 2013 headline activity now stands 0.72% below its initial reporting. February sales were down by 0.15% versus January, before the prior-period revisions.



With two out of three months of reporting in hand for first-quarter 2014, retail sales are on track to contract at an annualized quarterly pace of 2.5%. March retail sales would have to jump by an improbable 1.7% month-to-month—to a new all-time high—in order for the data to reflect an unchanged first-quarter 2014 versus fourth-quarter 2013.

In real terms, adjusted for inflation, the annual rate of quarterly contraction likely will be close to 3.8%. All this is consistent with an increasingly-likely headline contraction in first-quarter 2014 GDP. This circumstance should gain formal recognition as the onset of a new recession, or a double-dip recession, where the economic downturn that began officially in December 2007, in reality, never ended.

The revisions also reduced the level of year-to-year growth in retail sales, which already was sending out a strong, pending-recession signal. Aside from reducing annual growth, the upside changes to the January and February 2013 estimates of activity suggested that the latest shifts in concurrent seasonal factors were boosting current headline reporting. Indeed, prior-period revisions of one year ago reflected little more than the unstable monthly revisions in the concurrent-seasonal-adjustment process (see *Reporting Detail)*.

The downturn and downside revisions in retail sales reflected some catch-up reporting as well as consumer activity increasingly being constrained by severe, structural liquidity problems. 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, as discussed later in these *Opening Comments.*

Nominal (Not-Adjusted-for-Inflation) Retail Sales—February 2014. Again, in the context of large downside revisions to prior reporting, and not adjusted for consumer inflation, headline February 2014 retail sales came in at a statistically-insignificant, seasonally-adjusted monthly gain of 0.27%, but that was a monthly contraction of 0.15% before prior-period revisions. The February gain followed a revised, statistically-significant, but steeper monthly decline of 0.64% in January; and a revised, deeper monthly decline of 0.31% in December.

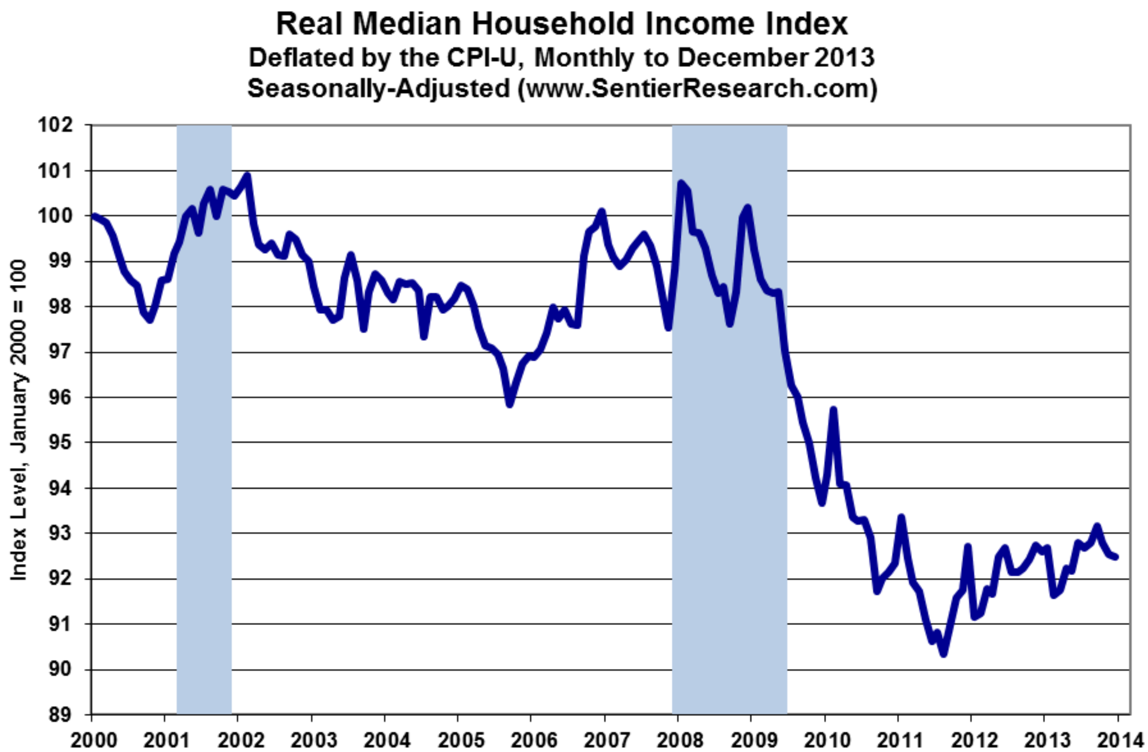
Year-to-year, February 2014 retail sales growth continued to screech towards a halt, up by a statistically-significant 1.48%, versus a revised 1.94% in January, and a revised 3.43% in December. The latest January and February numbers are well below 1.0%, net of inflation.

Real (Inflation-Adjusted) Retail Sales—February 2014. The headline 0.27% nominal gain in monthly February retail sales was before accounting for inflation. Real retail sales for February (adjusted for inflation), will be reported along with the headline estimate of consumer inflation, the February CPI-U, in the March 18th *Commentary No. 610*. As discussed in the *Week Ahead* section, February headline inflation should be close to nil, likely on the plus-side, leaving headline February real retail sales at close to their nominal month-to-month gain.

The February detail intensified the basic outlook of renewed downturn and of the traditional recession signals that have been in place. As has been the circumstance during the six-plus years of economic collapse, activity in consumer buying of goods and services has been constrained by the intense, structural-liquidity woes.

Structural Consumer Liquidity Problems Continue to Impair Consumption. Serious, structural liquidity problems continue to constrain consumer activity, meaningfully, as discussed frequently in these *Commentaries* and as indicated in the accompanying graphs. Without real, inflation-adjusted, 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 or in the personal-consumption activity that dominates the headline growth in GDP.

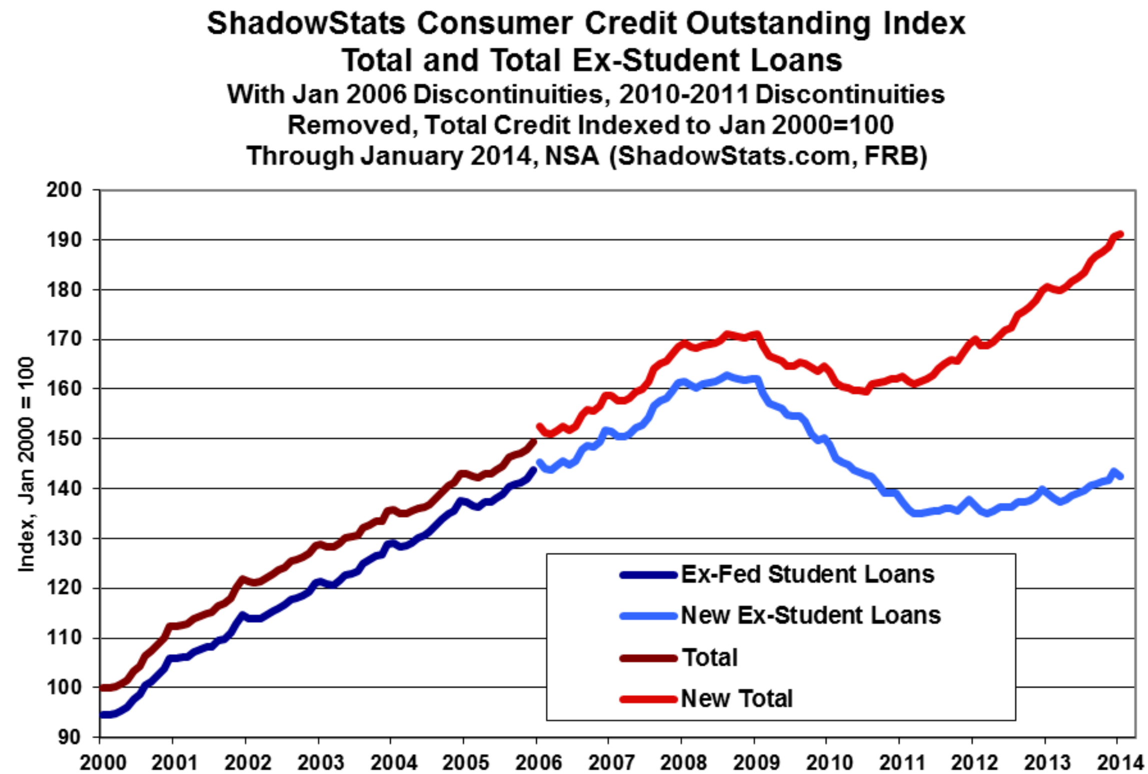
The following graph of real median household income by month, as published by www.SentierResearch.com, showed continued income stagnation in December 2013, near the cycle-low for the series. Updated data await the release of certain numbers that have been delayed by the BLS. We will post an updated graph from Sentier, when the detail is available.



As the GDP purportedly was starting a solid recovery in mid-2009, household income plunged to new lows. Deflated by headline CPI-U, the annual series published by the Census Bureau showed further that annual real median household income in 2012 was at levels seen in the late-1960s and early-1970s (see *Commentary No. 558*).

The next graph shows consumer credit outstanding (Federal Reserve Board), updated through January 2014. Practically all the post-2008-Panic growth in consumer credit has been in federally-backed student loans, instead of in bank lending to the consumer that would tend to fuel consumption of washing machines, etc., potentially helping to offset lack of income growth.

The last two graphs reflect the ever-volatile consumer confidence (Conference Board) and consumer sentiment (University of Michigan) series for full-February 2014 reporting. Current levels in both series remain deep in traditional recession territory. The pattern here, as with household income, has been one of collapse and stagnation, as opposed to the pattern of economic collapse and recovery indicated in the faulty GDP series.


ShadowStats Consumer Credit Outstanding Index
Total and Total Ex-Student Loans
With Jan 2006 Discontinuities, 2010-2011 Discontinuities
Removed, Total Credit Indexed to Jan 2000=100
Through January 2014, NSA (ShadowStats.com, FRB)
Index, Jan 2000 = 100
200
190
180
170
160
150
140
130
120
110
100
90
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
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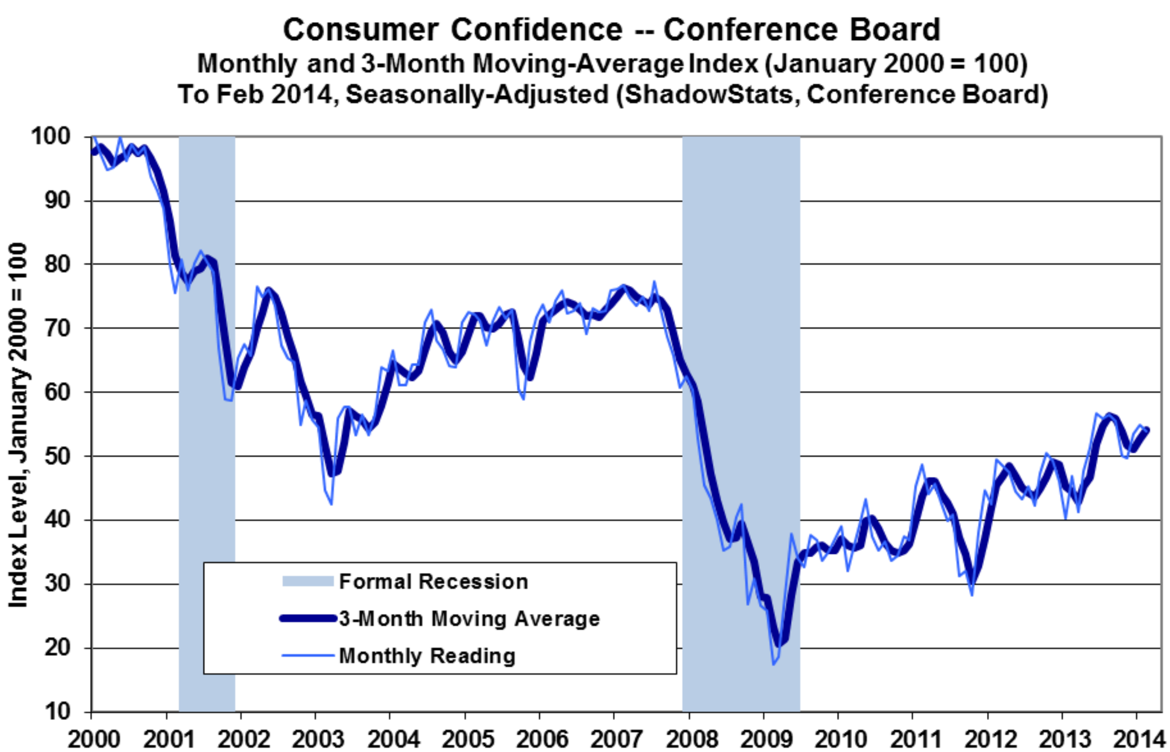
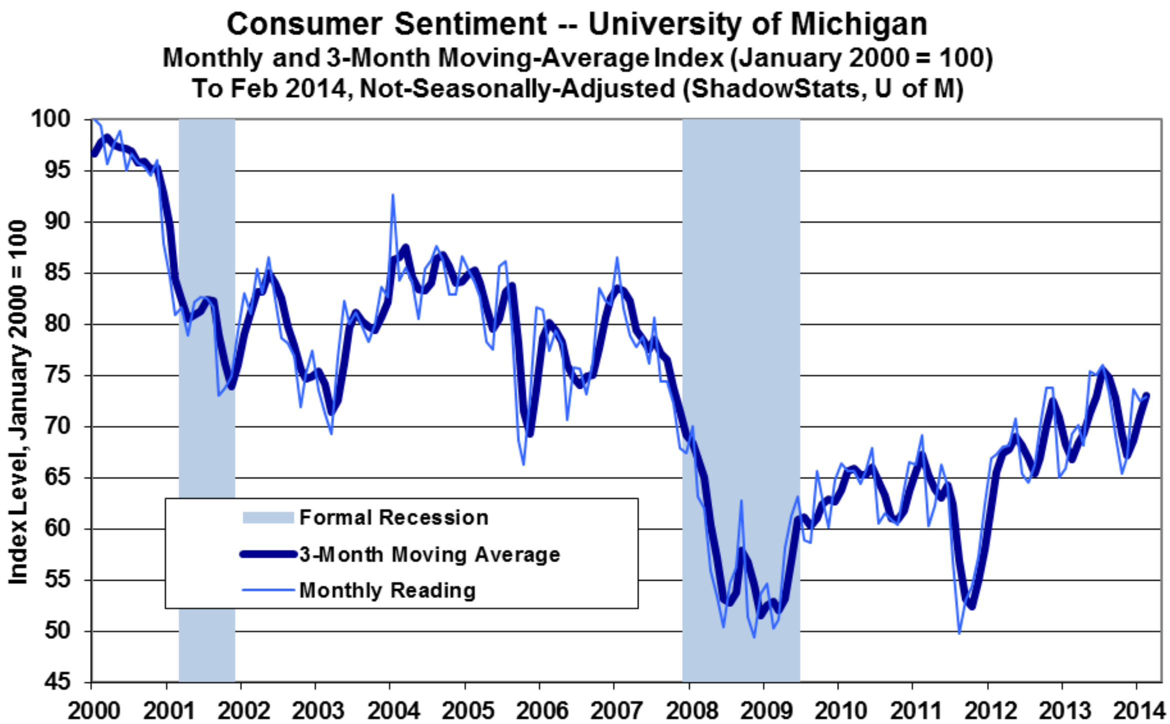
New Ex-Student Loans
Total
New Total


Consumer Confidence -- Conference Board
Monthly and 3-Month Moving-Average Index (January 2000 = 100)
To Feb 2014, Seasonally-Adjusted (ShadowStats, Conference Board)
Index Level, January 2000 = 100
100
90
80
70
60
50
40
30
20
10
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Formal Recession
3-Month Moving Average
Monthly Reading



Again, 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 simply cannot sustain real growth in retail sales, housing or in the dominant personal-consumption measure of the GDP. There is no broad economic recovery that is pending or underway.

[For greater detail on February retail sales, see the **Reporting Detail** *section.]*

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HYPERINFLATION WATCH

Hyperinflation Outlook. With the *First Installment* of *Hyperinflation 2014—The End Game Begins* published, a new *Hyperinflation Summary* for this section will be added in conjunction with the publication of the *Second Installment*, which remains planned for the immediate future. Specific timing will be posted in the schedule box on the home page of www.ShadowStats.com.

The second and final installment will cover historical and prospective economic activity, as well as possible protective and preventative actions and reactions at both a personal and federal level, versus the unfolding circumstance. It also will include analysis of the 2013 GAAP-based financial statements of the United States government (released February 27th) and detail from the Federal Reserve's 2013 annual flow-of-funds analysis (released on March 6th). The new material in the *Second Installment* will supplement and update the basic material already available to ShadowStats readers in Chapters 4, 5 and 9 of *Hyperinflation 2012*.

REPORTING DETAIL

RETAIL SALES (February 2014)

Earlier Retail Sales Activity Revised to the Downside, Again. Although headline February retail sales increased by 0.27% for the month, that was after a 0.41% downside revision to the level of January sales activity, and a further 0.19% downside revision to December activity (see the graph in the *Opening Comments*). The latest December 2013 headline activity now stands 0.72% below its initial reporting. February sales were down by 0.15% versus January, before the prior-period revisions.

With two out of three months of reporting in hand for first-quarter 2014, retail sales are on track to contract at an annualized quarterly pace of 2.5%. March retail sales would have to jump by an improbable 1.7% month-to-month—to a new all-time high—in order for the data to reflect an unchanged first-quarter 2014 versus fourth-quarter 2013.

In real terms, adjusted for inflation, the annual rate of quarterly contraction should be close to 3.8%. All this is consistent with an increasingly-likely headline contraction in first-quarter 2014 GDP. This circumstance probably will gain formal recognition as the onset of a new recession, or a double-dip recession, where the economic downturn that began officially in December 2007, in reality, never ended.

The revisions also reduced the level of year-to-year growth in retail sales, which already was sending out a strong, pending-recession signal. Upside changes to the January and February 2013 estimates of activity suggested that the latest monthly shifts in concurrent-seasonal factors are boosting the current headline reporting.

Reporting Stabilities and Distortions**.** Indeed, the prior-period revisions of one year ago reflected little more than the unstable monthly revisions in the concurrent-seasonal-adjustment process. Concurrent seasonal adjustments are recalculated every month, but not reported on a consistent, historical basis. The stability of the seasonal-adjustment process (particularly the concurrent-seasonal-adjustment process used with retail sales) and 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).

Retail sales reporting suffers the same inconsistency issues that are seen with other major 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 December 2013-to-February 2014, and in the January 2013-to-February 2014 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 31, 2013 benchmark revision (next benchmark revision is set for April 30, 2014), nine 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.

Underlying Fundamentals Remain Negative**.** The February detail intensified the basic outlook of renewed downturn and of the traditional recession signals that have been in place. As has been the circumstance during the six-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, as usual, in the *Opening Comments* section of *Commentaries* that cover the retail sales reporting. Without real, or inflation-adjusted, 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 or in personal-consumption activity that dominates the headline change in GDP.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—February 2014**.** Again, in the context of large downside revisions to prior reporting, and not adjusted for consumer inflation, today's (March 13th) report on February 2014 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.3%. That was an increase of 0.27% at the second decimal point, +/- 0.58% (all confidence intervals are at the 95% level), but a monthly contraction of 0.15% before prior-period revisions. The February gain followed a revised, statistically-significant month-to-month decline of 0.64% (previously a decline of 0.41%) +/-0.35% in January. December's monthly drop deepened to 0.31% in revision (previously a decline of 0.12%, initially a gain of 0.23%).

Year-to-year, February 2014 retail sales growth continued to screech towards a halt, up by a statistically-significant 1.48% +/- 1.05%, versus a revised 1.94% (previously 2.57%) in January, and a revised 3.43%, (previously 3.63%, initially 4.10%) in December. The latest numbers are well below 1.0%, net of inflation.

February Core Retail Sales. Seasonally-adjusted monthly grocery-store sales declined by 0.14% in February, with gasoline-station sales up by 0.08% for the month. Under normal conditions, the bulk of non-seasonal variability in food and gasoline sales is in pricing, instead of demand. "Core" retail sales—consistent with the Federal Reserve's preference for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

Version I: February 2014 versus January 2014 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—rose by 0.35%, versus the official gain of 0.27%.

Version II: February 2014 versus January 2014 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—rose by 0.27%, the same as seen in the aggregate headline number.

Real (Inflation-Adjusted) Retail Sales—February 2014. The headline 0.27% nominal gain in the monthly February retail sales was before accounting for inflation. Real retail sales for February (adjusted for inflation), will be reported along with the headline estimate of consumer inflation, the February CPI-U, in the March 18th *Commentary No. 610*. As discussed in the *Week Ahead* section, February headline inflation should be close to nil, likely on the plus-side, leaving headline February real retail sales at close to its nominal month-to-month gain.

WEEK AHEAD

Much Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead. Although shifting to the downside, market expectations generally still appear to be overly optimistic as to the economic outlook. Expectations should continue to be hammered, though, by continuing, downside corrective revisions and continued, disappointing headline economic activity. The initial stages of that process have been seen in the recent headline reporting of most major economic series.

That corrective circumstance and underlying weak economic fundamentals remain highly suggestive of deteriorating business activity. Accordingly, weaker-than-consensus economic reporting should become the general trend until such time as the unfolding "new" recession receives general recognition.

Stronger inflation reporting remains likely. Upside pressure on oil-related prices should reflect intensifying impact from a weakening U.S. dollar in the currency markets, and from ongoing global political instabilities. The dollar faces pummeling from continuing QE3, the ongoing U.S. fiscal-crisis debacle, a weakening U.S. economy and deteriorating U.S. and global political conditions (see *Hyperinflation 2014—The End Game Begins*). Particularly in tandem with a weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected inflation.

A Note on Reporting-Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-evolving economic turmoil of the last eight 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 (February 2014). The February 2014 PPI is scheduled for release, tomorrow, Friday, March 14th, by the Bureau of Labor Statistics (BLS). A small gain is likely

Depending on the oil contract followed, not-seasonally-adjusted monthly-average oil prices, rose by 0.7%-to-6.6% for the month of February, along with a 1.2% increase in average retail gasoline prices. PPI negative seasonal adjustments for energy in February largely should neutralize the higher energy costs. With the new PPI series less dependent on oil prices for the aggregate inflation rate, however, higher food and "core" (ex-food and energy) inflation likely will keep the headline February PPI in positive territory.

Index of Industrial Production (February 2014). The February 2014 index of industrial production is scheduled for release on Monday, March 17th, by the Federal Reserve Board. Net of the irregular volatility in utility output tied to seasonable or unseasonable weather, market expectations for minimal February production growth are a fair bet to be disappointed, as companies increasingly move to reduce excessive inventory levels.

Consumer Price Index—CPI (February 2014). The release by the Bureau of Labor Statistics (BLS) of the February 2014 CPI is scheduled for Tuesday, March 18th. The headline CPI-U is a fair bet to be close to unchanged for the month, perhaps minimally on the plus-side

Average gasoline prices rose month-to-month in February 2014 by 1.2%, on a not-seasonally-adjusted basis, per the Department of Energy, but BLS seasonal adjustments will depress gasoline prices in the headline February CPI. As last revised, an unadjusted 10.1% monthly gain in February 2013 gasoline prices was reduced to a 7.0% monthly gain, with negative seasonal adjustments. Similar effects in the February 2014 number, by themselves, would subtract about 0.1% from the headline CPI-U number. Upside food prices and core inflation, however, should more than offset that decline, slightly, leaving the headline CPI-U on the plus-side of unchanged for the month.

Year-to-year, CPI-U inflation would increase or decrease in February 2014 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.35% increase in the monthly inflation reported for February 2013. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for February 2014, the difference in February's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the January 2014 annual inflation rate of 1.58%. For example, if headline February 2014 CPI-U gained 0.1%, the annual inflation rate likely would be about 1.3% or 1.4%.

Residential Construction—Housing Starts (February 2014). On Tuesday, March 18th, the Census Bureau will publish its estimate of February 2014 housing starts.

This series was distorted heavily to the upside by data-gathering and reporting issues that resulted from the government shutdown in October, and it is still suffering reporting instabilities. Despite near-perpetual market expectations for strengthening activity in housing starts, month-to-month change likely will remain in a pattern of statistical-insignificance, with ongoing stagnation and renewed downturn seen in the aggregate series, as well as particularly in single-unit housing starts.

In the wake of a 75% collapse in aggregate activity from 2006 through 2008, and an ensuing five-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 (see the *Opening Comments* on consumer liquidity).

