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

COMMENTARY NUMBER 618
March Producer Price Index

April 11, 2014

March PPI Jumps Unexpectedly in Its Unstable Restructuring

Updated Payroll Employment Trend and Concurrent Seasonal Adjustments

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PLEASE NOTE: The next regular Commentary *is scheduled for Monday, April 14th, covering March retail sales. That will be followed by one on April 15th, covering the CPI and real retail sales and earnings, and one on April 16th, covering housing starts and industrial production, along with a summary of major March 2014 economic reporting.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE COMMENTARY

March Economic Detail Looms in Week Ahead. Where the releases of *2014 Hyperinflation Report—The End Game Begins First Installment Revised* (April 2nd) and *2014 Hyperinflation Report—Great Economic Tumble Second Installment* (April 8th) present a broad picture of likely economic, systemic and financial conditions in the coming year, reporting in the week ahead will do much to set consensus expectations for the "advance" first-quarter 2014 GDP reporting on April 30th. The upcoming March reports (see *Week Ahead* section) generally should continue to disappoint market expectations and to move the consensus outlook increasingly towards a first-quarter 2014 headline GDP contraction.

Accordingly, *Commentary No. 621* (April 16th), covering March 2014 residential construction (housing starts) and industrial production detail, and subsequent to the reporting of March real retail sales, will provide an updated summary of the latest economic detail.

Today's brief *Commentary* covers the March 2014 PPI and delayed detail on the trend and concurrent seasonal factor numbers for the March 2014 nonfarm payrolls.

Patterns Reversed, with Services Boosting the Headline March 2014 PPI Inflation Rate. After three months of higher "final demand goods" inflation being offset by low inflation in "final demand services," the headline March 2014 the aggregate "final demand" PPI reflected a spike from services, with goods inflation otherwise depressed by negative seasonal factor adjustments for energy (an unadjusted March 1.59% gain in energy was turned into an adjusted 1.17% decline). Where the hard numbers here—tied to commodities and production—have some meaning, the soft numbers—tied to services—have minimal, real-world application. The new aggregate series is showing increasingly unstable headline inflation.

In the newly redesigned PPI series "final demand services" largely reflects highly questionable surveying of intermediate or quasi-wholesale profit margins in the services area. To the extent that profit margins shrink in the services sector, one could argue that the resulting lowered estimation of inflation actually is a precursor to higher inflation, as firms move to raise prices in an effort to regain more-normal margins. The recently redesigned PPI series is an interesting concept, but likely is limited as to its aggregate predictive ability versus general consumer inflation. There is not enough history available on the new series (just five years of post-2008-panic data) to establish any meaningful predictive relationship to general inflation, while the goods sector relationship has been established for many years.

March 2014 Headline PPI Detail. The seasonally-adjusted, month-to-month, headline producer price index (PPI) for March 2014 "total final demand" rose by 0.46%, versus a 0.09% monthly decline in February. On a not-seasonally-adjusted basis (all annual growth rates are unadjusted), year-to-year headline PPI inflation was 1.37% in March, versus 0.92% in February. In terms of the three major subcategories for March 2014 "final demand," headline monthly "final demand goods" was unchanged, "final demand services" was up by 0.65%, and "final demand construction" was unchanged.

Final Demand Goods. Running somewhat in parallel with the old "finished goods" PPI series, headline monthly "final demand goods" in March was unchanged, versus a 0.35% monthly gain in February. Year-to-year inflation here was 1.06% in March, versus 0.22% in February.

By major component, the March headline monthly change for "foods" was plus 1.10% (plus 0.59% February), for "energy" was minus 1.17% (plus 0.47% February), and for "less foods and energy" was plus 0.09% (plus 0.18% February). As is usual at this time of year, energy inflation was constrained severely by seasonal adjustments.

Final Demand Services. Headline monthly "final demand services" rose by 0.65% in March, versus a 0.28% monthly contraction in February. Year-to-year inflation here was 1.59% in March, versus 1.03% in February.

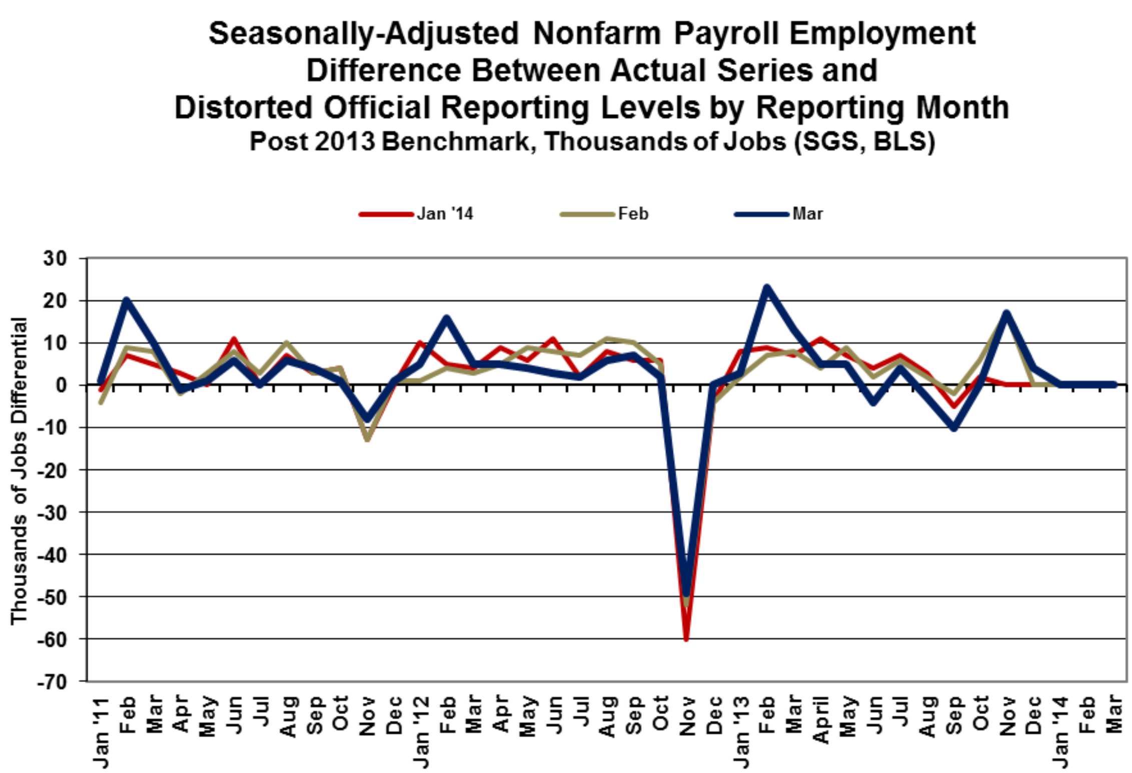
By major component, the March headline monthly change for "services less trade, transportation and warehousing" was plus 0.37% (plus 0.09% February), for "transportation and warehousing" was plus 0.52% (minus 0.17% February), and for "trade" was plus 1.40% (minus 0.09% February).

Final Demand Construction. Headline monthly "final demand construction" was unchanged in March, versus a 0.09% monthly gain in February. Year-to-year inflation was 3.20% in both March and February.

March 2014 Nonfarm Payroll Employment—Trend and Concurrent Seasonal Factors. When the headline employment data for March 2014 were released on April 4th, ShadowStats experienced some data issues with the concurrent seasonal adjustment process and BLS trend-model analysis related to the payroll survey (see *Commentary No. 616*).

"Trend Model" As discussed in *Commentary No. 605*, and as generally described in *Payroll Trends*, the trend indication from the BLS's concurrent-seasonal-adjustment model—prepared by our affiliate www.ExpliStats.com—for March 2014 was for a monthly payroll gain of 178,000, based on the trend structured by BLS modeling of February's reporting. The headline gain for March was 192,000.

Structured based on March 2014 reporting, the trend model for April 2014 suggests a headline monthly aggregate payroll gain of 218,000.



Concurrent Seasonal Factor Distortion. There are serious and deliberate reporting flaws with the government's seasonally-adjusted, monthly reporting of both employment and unemployment. Each month, the BLS uses a concurrent-seasonal-adjustment process to adjust the payroll data for the latest seasonal patterns. As each series is calculated, the adjustment process also revises the history of each series, recalculating prior reporting, for every month, going back five years, on a basis that is consistent with the new seasonal patterns of the headline numbers.

As the headline data are revised each month, the unpublished seasonally-adjusted data revise each month as well, but the published historical data remain set, unrevised. The accompanying graph shows the monthly shifting of differences between the "set" inconsistent history and the unpublished, but consistent and comparable numbers. In March's revisions, seasonal factors shifted so as to boost and bloat January, February and March numbers, which were the latest headline aggregates, but again, offsetting and related downside revisions were excluded from the unaltered published history.

The BLS uses the current monthly estimate but it does not publish the revised history, even though it calculates the consistent new data each month. As a result, headline reporting generally is neither consistent with, nor comparable to earlier reporting, and month-to-month comparisons of these popular numbers usually are of no substance, other than for market hyping or political propaganda.

The BLS explains that it avoids publishing consistent, prior-period revisions so as not to "confuse" its data users. No one seems to mind if the published earlier numbers are wrong, particularly if unstable seasonal-adjustment patterns have shifted prior jobs growth or reduced unemployment into current reporting, without any formal indication of the shift from the previously-published historical data.

[For further detail on the March PPI, see the* Reporting Detail *section.]

HYPERINFLATION WATCH

Hyperinflation Summary Outlook. The hyperinflation and economic outlook were updated fully in the last week or so, with the publication of *2014 Hyperinflation Report—The End Game Begins First Installment Revised*, on April 2nd, and publication of *2014 Hyperinflation Report—Great Economic Tumble Second Installment*, on April 8th. Consistent with those *Special Commentaries* and any interim economic reporting, a revised summary outlook is planned for this section along with the April 16th *Commentary No. 621*.

REPORTING DETAIL

PRODUCER PRICE INDEX—PPI (March 2014)

Patterns Reversed, with Services Boosting the Headline March 2014 PPI Inflation Rate. As discussed in *Commentary No. 591*, a new producer price index (PPI)—effective with January 2014 reporting—replaced the traditional headline monthly measure of wholesale inflation in "finished goods," with a headline monthly measure of wholesale "total final demand," which is composed of "final demand goods" (basically the old "finished goods" series), "final demand services" which tends to cap the goods inflation when oil prices are an issue, and "final demand constriction."

After three months of higher "final demand goods" inflation being offset by low inflation in "final demand services," the headline March 2014 PPI reflected a spike from services, with goods inflation otherwise depressed by negative seasonal factor adjustments turning higher energy prices into lower energy prices (an unadjusted March 1.59% gain in energy was turned into a 1.17% contraction by seasonal adjustments). Where the hard numbers here—tied to commodities and production—have some meaning, the soft numbers—tied to services—have minimal, real-world application.

In the new structure of the PPI series "final demand services" largely reflects highly questionable surveying of intermediate or quasi-wholesale profit margins in the services area. To the extent that profit margins shrink in the services sector, one could argue that the resulting lowered estimation of inflation actually is a precursor to higher inflation, as firms move to raise prices in an effort to regain more-normal margins. The new PPI series is an interesting concept, but likely limited as to its aggregate predictive ability versus general consumer inflation. There is not enough history available on the new series (just five years of post-2008-panic data) to establish any meaningful predictive relationship to general inflation, while the goods sector relationship has been established for many years.

March 2014 Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported on April 11th, that the seasonally-adjusted, month-to-month, headline producer price index (PPI) for March 2014 "total final demand" rose by 0.46%, versus a 0.09% monthly decline in February. On a not-seasonally-adjusted basis (all annual growth rates are unadjusted), year-to-year headline PPI inflation was 1.37% in March, versus 0.92% in February. In terms of the three major subcategories for March 2014 "final demand," headline monthly "final demand goods" was unchanged, "final demand services" was up by 0.65%, and "final demand construction" was unchanged.

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Descriptive materials on the recently, revamped PPI series remain available on the BLS Web site here: *New PPI Series*, *New PPI Detail*, and today's *Press Release*.

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 (Updated)*). 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:

Retail Sales (March 2014). The Census Bureau's March 2014 retail sales estimate is scheduled for release on Monday, April 14th. With the consumer still in an extreme liquidity bind, odds again favor headline retail sales reporting coming in below-market expectations, which appear to be for a modest headline monthly gain. An outright month-to-month contraction in seasonally-adjusted sales is a fair possibility, with headline March CPI-U likely to provide additional, minimal downside pressure on inflation-adjusted or "real" retail sales.

Consumer Price Index—CPI (March 2014). The release by the Bureau of Labor Statistics (BLS) of the March 2014 CPI is scheduled for Tuesday, April 15th. The headline CPI-U is a fair bet to be close to unchanged for the month, perhaps on the plus-side.

Average gasoline prices rose month-to-month in March 2014 by 5.0%, on a not-seasonally-adjusted basis, per the Department of Energy, but BLS seasonal adjustments will depress gasoline prices in the headline March CPI by enough to knock 0.1% off what otherwise would have been reported. Upside pressure on the CPI likely will come from higher food prices and "core" inflation.

Year-to-year, CPI-U inflation would increase or decrease in March 2014 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.23% decline in the monthly inflation reported for March 2013. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for March 2014, the difference in March's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the February 2014 annual inflation rate of 1.13%. For example, a headline seasonally-adjusted, month-to-month increase of 0.1% in March 2014 would mean that annual inflation for March 2014 would come in at about 1.4% to 1.5%.

Residential Construction—Housing Starts (March 2014). On Wednesday, April 16th, the Census Bureau will publish its estimate of March 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 or downside revisions seen in the aggregate series, as well as particularly in single-unit housing starts. As usual, this series is subject to large prior-period revisions.

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.

Index of Industrial Production (March 2014). Also on Wednesday, April 16th, the March 2014 index of industrial production will be released by the Federal Reserve Board. Net of the ongoing irregular volatility in utility output tied to seasonable or unseasonable weather, market expectations for minimal March production growth are a fair bet to be disappointed on the downside, as consumption slows and companies increasingly move to reduce excessive inventory levels. As usual, this series is subject to large prior-period revisions.

