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

COMMENTARY NUMBER 634
May Retail Sales, Monetary Conditions

June 12, 2014

May Retail Sales Likely Were Flat After Inflation Adjustment

Fed Currently Monetizing 69% of Net Treasury Issuance of Publicly Held Debt

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PLEASE NOTE: The next regular Commentary *is scheduled for Monday, June 16th, covering the May producer price index and industrial production, followed by a* Commentary *June 17th, covering the May CPI, real retail sales and earnings and housing starts.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Second-Quarter GDP Contraction Remains in Play. Despite what in aggregate was a relatively strong headline nominal retail sales report for May, inflation-adjusted real retail sales remain likely to be flat-to-minus for the second-quarter, following the first-quarter contraction. The various GDP components continue to suggest strongly a second consecutive quarterly contraction for the GDP, as of second-quarter 2014 reporting on July 30th.

Today's (June 12th) brief missive concentrates on the May retail sales release in the *Opening Comments* and *Reporting Detail* sections, and updates monetary conditions in the *Hyperinflation Watch* section. A broad review of major May economic reporting will follow in *Commentary No. 636*, scheduled for next Tuesday (June 17th), along with a summary case for the unfolding second-quarter GDP contraction.

Retail Sales—May 2014—Likely Flat, After Inflation Adjustment. The headline 0.34% gain in May 2014 retail sales was not statistically significant and likely did not exceed the headline CPI-U inflation rate for the month by much, it at all. That means headline real (inflation-adjusted) retail sales in May likely were flat. The estimate of real, or inflation-adjusted, retail sales will be published on June 17th and reviewed in the *Commentary* of that date (see *Week Ahead* section).

Beyond the headline number, though, the combination of an upside revision to April reporting, along with the May gain, brought the aggregate retail-sales reporting into general alignment with market expectations for May. Net of prior-period revisions, May headline growth would have been 0.71%. Subject to inflation reporting, second-quarter real retail sales would appear to be on track for minimal growth, following a first-quarter contraction. Nonetheless, underlying consumer fundamentals, apparent seasonal distortions in the latest reporting and a developing uptrend in consumer inflation, all still favor a flat-to-minus second-quarter for real retail sales activity.

Indeed, the usual seasonal factor distortions appeared to be at play in the May data, where the headline numbers reflected concurrent seasonal adjustments. Given Census Bureau reporting practices, those numbers were not comparable with earlier reporting. Accordingly, current headline data can reflect growth shifts from earlier periods, without the detail being made available to the public.

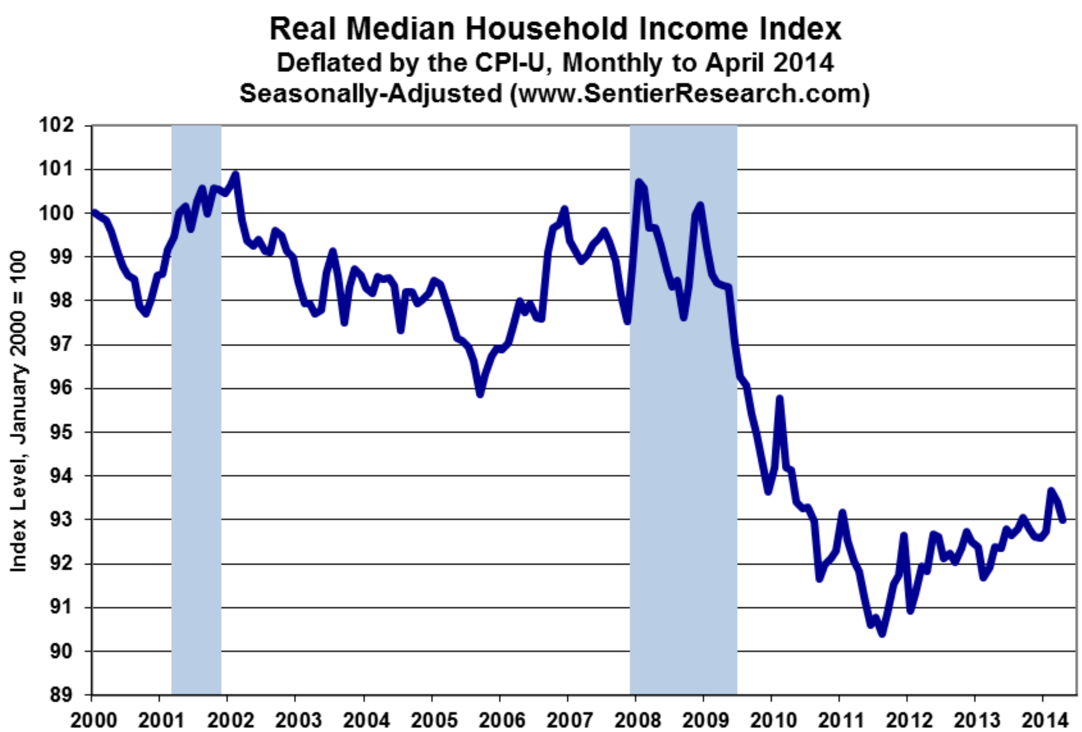
***Reporting Instabilities and Distortions*.** The year-ago numbers for April and May 2014 were revised lower, along with the publication of the May 2014 data, as were all other historical numbers, but only the new details for April and May 2013 were published. These revisions of one year ago do not reflect any changes to actual retail sales activity, only the continuing unstable monthly revisions in the concurrent-seasonal-adjustment process.

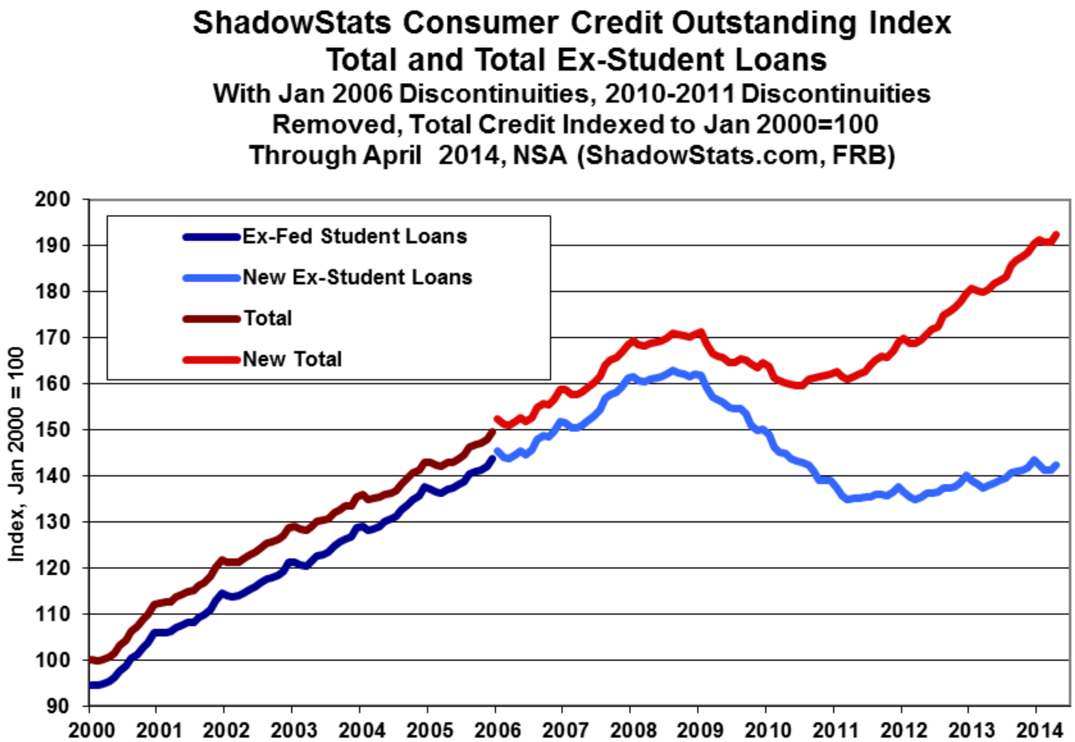
***Underlying Consumer Fundamentals Remain Bleak*.** Outright contraction—as seen in first-quarter real retail sales—and flat-to-minus real retail sales activity that remains likely in the second quarter, have been and would be consistent with the basic outlook of a renewed broad economic downturn, and with 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 fundamentally by the intense, structural-liquidity woes besetting the consumer, as discussed in the next section.

***Nominal (Not-Adjusted-for-Inflation) Retail Sales—May 2014*.** The latest headline retail sales detail was in the context of an upside revision to April sales. Not adjusted for inflation, headline May 2014 retail sales showed a statistically-insignificant, seasonally-adjusted, headline monthly gain of 0.34%, and what would have been a monthly gain of 0.71%, before prior-period revisions. The May gain followed a revised, statistically-significant month-to-month gain of 0.50% for April 2014. Year-to-year growth in May 2014 retail sales was a statistically-significant 4.26%, versus a revised 4.56% gain in April.

Update to Consumer Liquidity. Ongoing structural and fundamental liquidity problems for the consumer are restraining real, or inflation-adjusted, expansion of retail sales, personal consumption and housing activity, as was last discussed in *Commentary No. 632*. Without real growth in income, and without the ability and/or willingness to offset declining purchasing power with debt expansion, the consumer lacks the ability to fuel a traditional, consumption-based recovery in U.S. economic activity. Despite redefinition of the GDP series in July 2013, personal consumption expenditures still account for 68% of GDP activity.

The two graphs following show first, real median household income through April 2014, based on numbers provided by www.SentierResearch.com and as published previously in *Commentary No. 632*, and second, consumer credit outstanding, as updated by the Federal Reserve for April 2014. Growth in post-2008 Panic consumer credit has continued to be dominated by growth in federally-held student loans, not in bank lending to consumers that otherwise might help to fuel consumption growth.





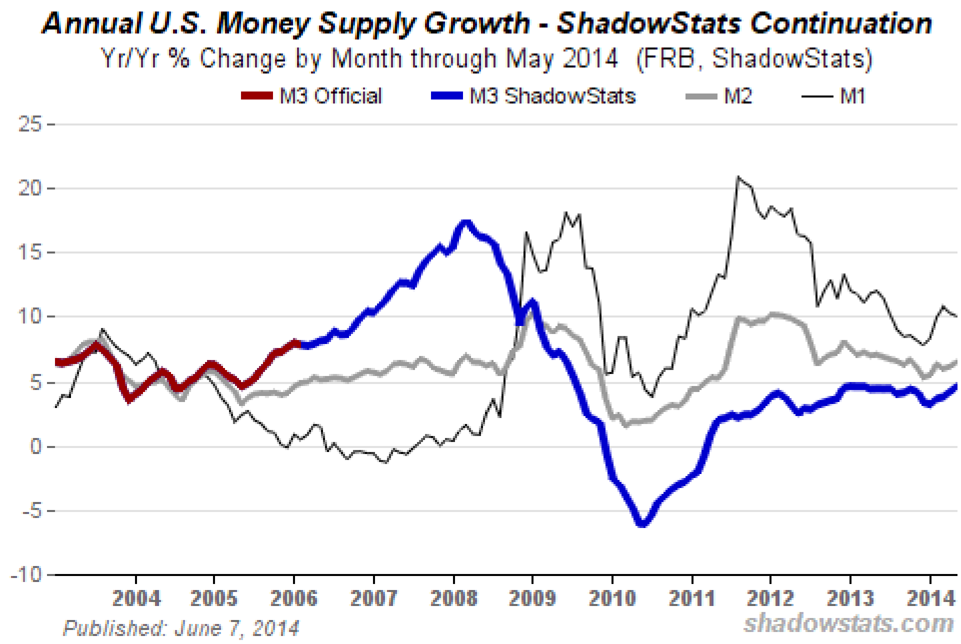
[For further details on May retail sales, see the **Reporting Detail** ***section.]***

HYPERINFLATION WATCH

Monetary Conditions—Fed Continues to Monetize about 70% of Net Treasury Debt Issuance for the Public. Despite the recent "tapering" in the Federal Reserve's quantitative easing program, the Fed's net acquisition of U.S. Treasury securities so far in calendar-year 2014 (through June 5th), versus net debt issuance of the U.S. Treasury for the public in the same period, effectively has reflected monetization of 68.8% of the increase in debt. That is a minimally-reduced portion from the effective monetization of 71.8% of the net issuance of publicly-held debt for the full calendar-year 2013. That is due partially to the slowing of debt issuance by the Treasury.

The ongoing monetization of the Treasury debt likely is a contributing factor to the minimal pick-up seen in broad money supply (M3) growth to 4.6%, as of May 2014; it also shows that the market in U.S.

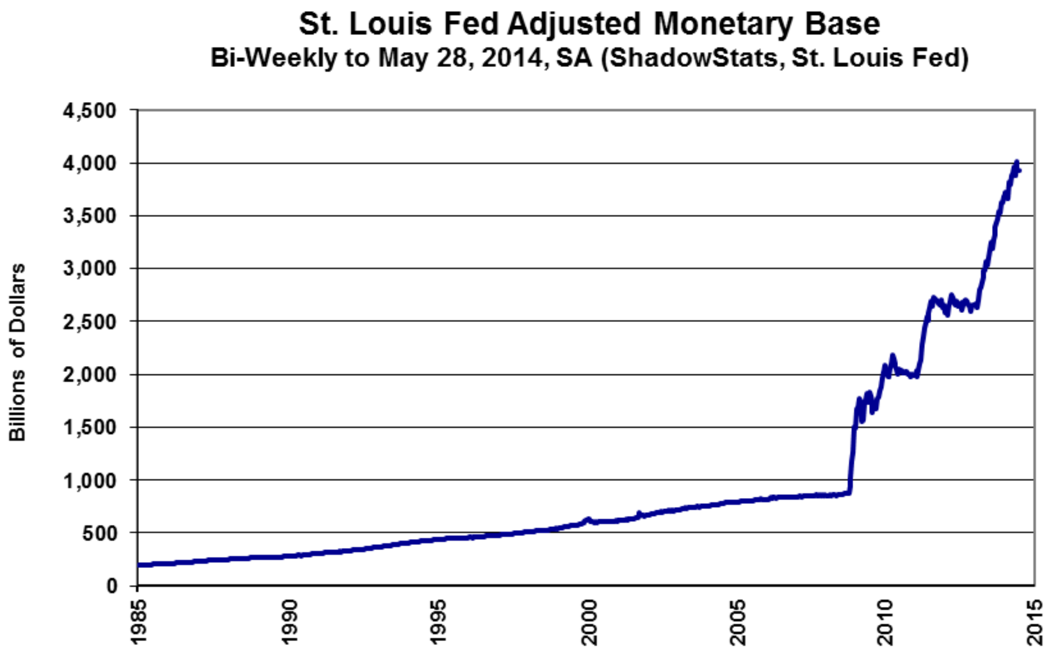
Treasury securities is anything but free and open; and it artificially depresses yields and correspondingly boosts bond prices.

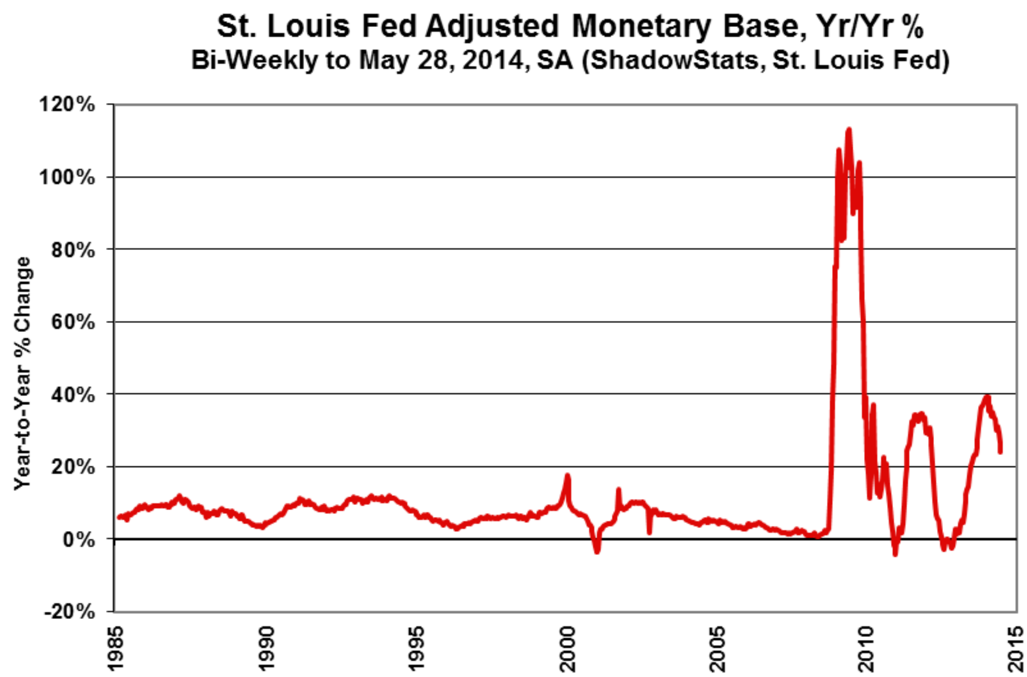


As reflected in the following graphs, despite the "tapering" in debt purchases, the monetary base remains topped-out, temporarily, at $3.933 trillion (May 28th) near its record high level of $4.012 trillion (April 16th). Year-to-year growth, however, has started to slow, as the current flat-to-minus level of activity is measured against a year-ago period of rapid growth.

As the dollar began to push recent lows, policy efforts were undertaken in the euro area, again, to drive funds into the U.S. dollar. Similar activity was seen an effort to counter a nascent U.S. dollar selling panic in August 2011. The underlying fundamentals described in the summary section following could not be worse for the U.S. dollar. A massive dollar sell-off against most other major Western currencies remains likely in the near future.

With the U.S. economy slowing anew, domestic banks will be increasingly troubled and stressed, and more QE will be likely to flow from the Fed. Again, such would be under the political cover of a rapidly slowing U.S. economy.





Hyperinflation Summary Outlook. The hyperinflation and economic outlooks were updated 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. A basic summary of the broad outlook is found in the *Opening Comments* and *Overview and Executive Summary* in the *First Installment Revised*. The broad outlook for a hyperinflationary great depression beginning this year has not changed—only evolved—with various details continuing to fall into place. A formal and more-condensed summary of the extraordinarily-difficult times ahead will take over this section, soon. What follows here is still-evolving detail on the economic disaster, all to be incorporated into that summary.

Economy Turns Down Anew. Consistent with the above *Special Commentaries*, a renewed U.S. business slowdown/downturn was evident in the revised headline contraction of 1.0% in first-quarter 2014 GDP, versus 2.6% growth in fourth-quarter 2013. As the patterns of headline growth in economic reporting continue to slow and to turn down, financial-market expectations increasingly should shift towards renewed or deepening recession. That circumstance, in turn, in confluence with other fundamental issues, should place mounting and massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic.

Intensifying weakness in the U.S. dollar will place upside pressure on oil prices and other commodities, boosting inflation and inflation fears. Both the dollar weakness and resulting higher inflation should boost the prices of gold and silver, where physical holding of those key precious metals remains the primary hedge against the pending inflation and financial crises.

The fundamental issues threatening the dollar, again, include, but are not limited to: the U.S. government not addressing its long-term solvency issues; monetary malfeasance by the Federal Reserve seeking to provide liquidity to a troubled banking system, and to the U.S. Treasury, with a current pace of 69% monetization of effective net issuance of public federal debt; a mounting domestic and global crisis of confidence in a dysfunctional U.S. government; mounting global political pressures contrary to U.S. interests; and a severely damaged U.S. economy, which never recovered post-2008 and is turning down anew (including a sharply widening trade deficit).

GDP Contractions. Generally reflecting weaker data in revisions to underlying data, downside revisions to recent GDP reporting are increasingly likely in the July 30th annual benchmark revisions. Underlying, current economic activity actually is deteriorating and weak enough that the benchmark GDP revision should be accompanied by an initial headline contraction in second-quarter 2014 GDP, on top of a deepening first-quarter 2014 GDP contraction, which faces two further near-term revisions (including the benchmark).

With continued deterioration in the trade deficit (see *Commentary No. 632*) and underlying weakness in labor conditions (see *Commentary No. 633)*, broad deterioration remains likely in general economic activity and inflation conditions , despite the relatively positive May retail sales report. As those patterns continue to unfold, market expectations—and related financial-market reactions—should move into the "renewed recession" camp before or coincident with the July 30th annual revisions to GDP.

REPORTING DETAIL

RETAIL SALES (May 2014)

Net of Inflation Effects, Headline May Retail Sales Likely Were Flat. Aside from not being statistically-significant, the 0.34% gain in monthly May 2014 retail sales likely did not exceed the headline CPI-U inflation rate for the month by much, it at all. That means headline real (inflation-adjusted) retail sales likely were flat for the month of May. The estimate of real, or inflation-adjusted, retail sales will be published on June 17th and reviewed in the *Commentary* of that date.

Beyond the headline number, though, the combination of an upside revision to April reporting, along with the May gain, brought the aggregate retail-sales reporting into general alignment with market expectations for May. Net of prior-period revisions, May headline growth would have been 0.71%. Subject to inflation reporting, real retail sales would appear to be on track for minimal growth in the second quarter, following a first-quarter contraction. Nonetheless, underlying consumer fundamentals, apparent seasonal distortions in the latest reporting and a developing uptrend in consumer inflation, all still favor a flat-to-minus second-quarter for real retail sales activity.

Indeed, the usual seasonal factor distortions appeared to be at play in the May data, where the headline numbers reflected concurrent seasonal adjustments. Given Census Bureau reporting procedures, those numbers were not comparable with earlier reporting. Accordingly, current headline data can reflect growth shifts from earlier periods, without the detail being made available to the public.

***Reporting Instabilities and Distortions*.** The year-ago numbers for April and May 2014 were revised lower, along with the publication of the May 2014 data, as were all other historical numbers, but only the new details for April and May 2013 were published. These revisions of one year ago do not reflect changes in actual sales activity, only the continuing unstable monthly revisions in the concurrent-seasonal-adjustment process.

Concurrent seasonal adjustments are recalculated every month, but not reported on a consistent, historical basis. This allows for invisible shifts in seasonally-adjusted current activity that are not consistent with published historical reporting. Further, 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 series, such as payroll employment, the unemployment rate, and durable goods orders. The highly variable and unstable seasonal factors here continued to cloud relative activity in the March 2014-to-May 2014, and in the April 2013-to-May 2013 periods, five months that are published on a non-comparable basis with all the other historical data. Consistent data are calculated and are available within the Census Bureau, but the Bureau chooses not to publish them.

Underlying Consumer Fundamentals Remain Bleak. Outright contraction—as seen in first-quarter real retail sales—and flat-to-minus real retail sales activity that still is likely for the second quarter, have been and would be consistent with the basic outlook of a renewed broad economic downturn, and with 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 in the *Opening Comments* section (see also *Commentary No. 632*). 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—May 2014. The latest headline retail sales detail was in the context of an upside revision to April sales. Not adjusted for consumer inflation, today's (June 12th) report on May 2014 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted, headline monthly gain of 0.3%. That was an increase of 0.34% at the second decimal point, +/- 0.58% (all confidence intervals are at the 95% level), and a monthly gain of 0.71% before prior-period revisions. The May gain followed a revised, statistically-significant month-to-month gain of 0.50% (previously 0.09%) +/- 0.23% for April 2014.

Year-to-year growth in May 2014 retail sales was a statistically-significant 4.26% +/- 0.82%, versus a revised 4.56% (previously 4.05%) gain in April.

May Core Retail Sales—About the Same as the Headline Number. Despite rising food prices, and with an unadjusted 0.4% gain in monthly gasoline prices, seasonally-adjusted monthly grocery-store sales fell by 0.16% in May, with gasoline-station sales rising by 0.36%. 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: May 2014 versus April 2014 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—a gain of 0.40%, versus the official gain of 0.34%.

Version II: May 2014 versus April 2014 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—was a gain of 0.32%, versus the official gain of 0.34%.

Real (Inflation-Adjusted) Retail Sales—May 2014. The headline 0.34% gain in the monthly May retail sales was before accounting for inflation. Real retail sales for May (adjusted for inflation), will be reported along with the headline estimate of consumer inflation, the May CPI-U, in the June 17th *Commentary No. 636*. As discussed in the *Week Ahead* section, May headline inflation should be on the plus-side, with likely headline May real retail sales basically flat month-to-month.

WEEK AHEAD

Much-Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead. Although shifting to the downside, amidst fluctuations, market expectations generally still appear to be overly optimistic as to the economic outlook. Expectations should continue to be hammered, though, by ongoing downside corrective revisions and an accelerating pace of downturn in headline economic activity. The initial stages of that process have been seen in the recent headline reporting of many major economic series (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*), including the second estimate of real first-quarter 2014 GDP, which was the first contemporary reporting of a quarterly contraction since the formal end of the 2007 recession in mid-2009.

Weakening, underlying economic fundamentals indicate still further deterioration in 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 also 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. Food inflation has been picking up as well. The dollar faces pummeling from the weakening economy, continuing QE3, the ongoing U.S. fiscal-crisis debacle, and deteriorating U.S. and global political conditions (see *Hyperinflation 2014—The End Game Begins (Updated) – First Installment*). 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 (May 2014). The May 2014 PPI is scheduled for release tomorrow, Friday, June 13th, by the Bureau of Labor Statistics (BLS). It will be detailed in *Commentary No. 635* of June 16th. A month-to-month increase is likely, reflecting a broad spectrum of goods-related inflation, including energy, food and "core" inflation components (ex-food and energy). Depending on the oil contract followed, not-seasonally-adjusted monthly-average oil prices were up by 0.1% to 1.7% for the month of May, along with a 0.4% unadjusted monthly increase in average retail gasoline prices. PPI seasonal adjustments for energy costs turn slightly to the upside in May.

The wildcard in the PPI remains the new services sector, which largely is unpredictable, volatile and of limited meaning, but also of significant weighting. Although the new series is less dependent on the increasingly "antiquated" concepts of oil, food and "core" (ex-food and energy) inflation, services costs should be seeing continued inflationary pressures—and shrinking profit margins—from rising prices in the "hard" economy. Accordingly, the aggregate headline May PPI inflation most likely will hold in at least in minimally-positive territory.

Index of Industrial Production (May 2014). On Monday, June 16th, the May 2014 index of industrial production will be released by the Federal Reserve Board. Market expectations appear to be for a modest gain, following the 0.6% headline contraction April, but continued weakness and downside surprises to market expectations are likely to continue, as companies continue reducing excessive inventory levels, in line with softening consumption. As usual, this series is subject to large prior-period revisions.

Consumer Price Index—CPI (May 2014). The release by the Bureau of Labor Statistics (BLS) of the May 2014 CPI is scheduled for Tuesday, June 17th. The headline CPI-U is a fair bet to show a small gain for the month, likely to come close to the 0.3% headline growth rate of nominal retail sales in May.

Average gasoline prices rose month-to-month in May 2014 by 0.4%, on a not-seasonally-adjusted basis, per the Department of Energy. BLS seasonal adjustments for gasoline turn slightly positive with the May CPI, providing a net plus, as opposed to a minus, to the aggregate headline inflation number, but it will be shy of contributing 0.1% inflation to the aggregate number, unless it contributes to upside rounding. Higher food and "core" (net of food and energy) inflation will tend to dominate what should be a small headline gain.

Year-to-year, CPI-U inflation would increase or decrease in May 2014 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.18% gain in the monthly inflation reported for May 2013. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for May 2014, the difference in May's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the April 2014 annual inflation rate of 1.95%. For example, a headline 0.2% gain in the May CPI-U would leave year-to-year May 2014 inflation at roughly 2.0%, the same as in April.

Residential Construction—Housing Starts (May 2014). Also on Tuesday, June 17th, the Census Bureau will publish its estimate of May 2014 housing starts. Despite extreme monthly volatility seen regularly in the reporting of this series, and despite near-perpetual wishful upside market expectations for housing starts (although expectations appear to be near flat, at the moment), month-to-month change likely will remain in a pattern of statistical-insignificance, with ongoing stagnation and renewed downturn or downside revisions. 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.

