

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

COMMENTARY NUMBER 635
May Industrial Production, Producer Price Index (PPI)
June 16, 2014

Drop in Headline PPI Inflation Ran Counter to Underlying Indicators
May Production Jump Reflected Issues with Seasonal Adjustments and
Conflict with Underlying Fundamentals
Outlook for Second-Quarter GDP Contraction Remains in Place

PLEASE NOTE: The next regular Commentary is scheduled for tomorrow, Tuesday, 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

Onset of Renewed Official Recession Remains at Hand. Despite what was a relatively strong headline showing for May industrial production, on top of what likely was a neutral May real retail sales number, net of inflation impact, 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 16th) relatively brief missive concentrates on the reporting of May industrial production and the producer price index (PPI). A broad review of major May economic reporting will follow in tomorrow's *Commentary No. 636*, along with a summary case for the unfolding second-quarter GDP contraction.

Industrial Production—May 2014—Seasonality Issues and Underlying Fundamentals Suggest a Weaker Production Circumstance. May headline reporting of upside revisions to otherwise negative activity in seasonally-adjusted April manufacturing and utilities production (manufacturing moved from a 0.4% to 0.1% contraction, and weather-dominated utilities production moved from a 5.3% to a 4.8% contraction), suggested continued heavy seasonal-factor distortions in Federal Reserve reporting of the production series. Given recent unusual patterns in both economic activity and the weather, there likely have been ongoing seasonal distortions in May reporting built upon the April data. Recently, there simply has been too-little consistent and seasonally-repetitive reporting to generate meaningful seasonal adjustments for the series. Separately, at a fundamental level, recent indications of weakening orders and consumption, and slowing inventory building, are suggestive of weaker, not stronger, production. Some downside revisions to the current production numbers are likely in the months ahead.

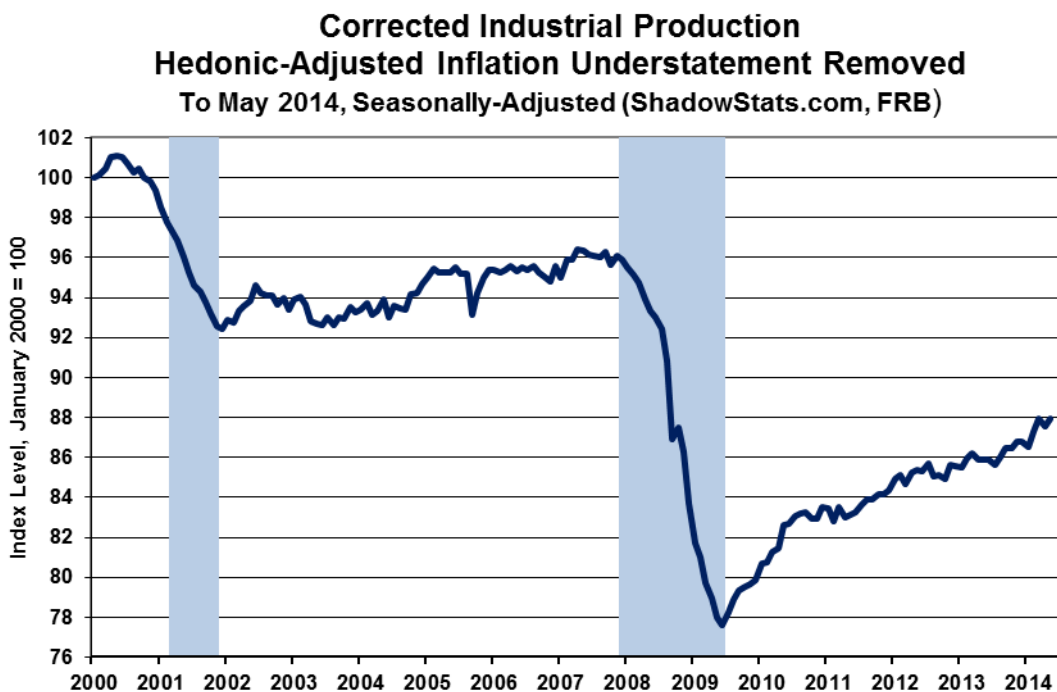
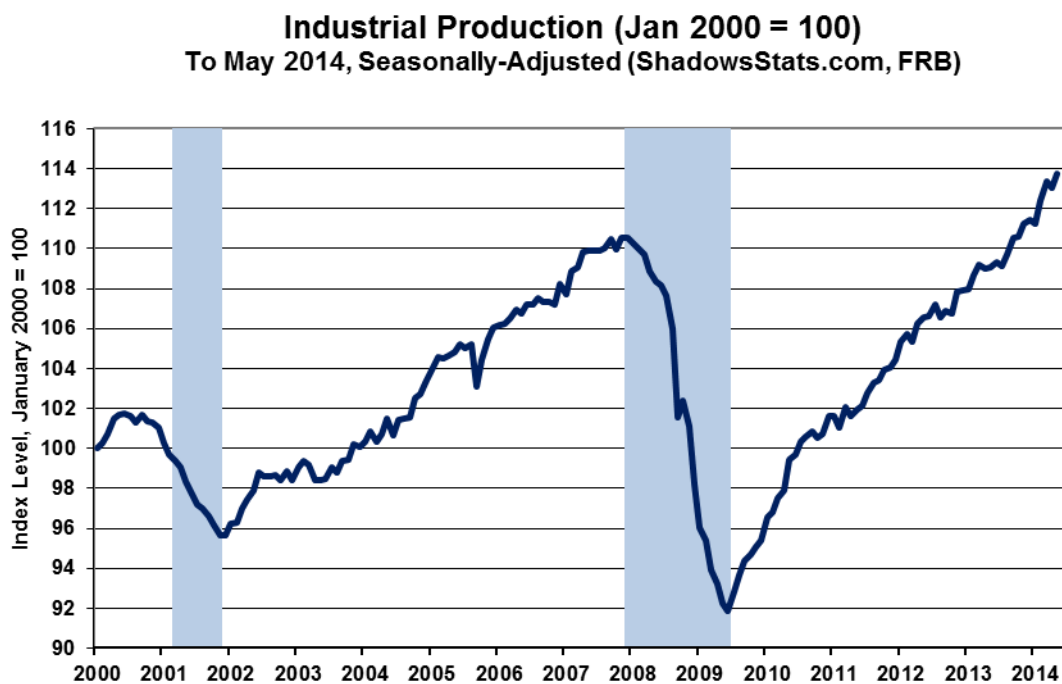
Industrial Production—May 2014 Headline Data. In the context of upwardly revised April activity, and with the March production level unrevised, headline May 2014 industrial production rose by 0.59% for the month, a gain that would have been 0.89% without the prior-period revisions. April production was revised to a 0.26% decline. Year-to-year growth in May increased to 4.27%, from a revised 3.76% in April production.

The headline 0.6% monthly gain in May (0.3% decline in April) production was composed of a 0.6% May gain (0.1% April decline) in manufacturing, a 1.3% May (1.6% April) gain in mining, and a 0.8% May (4.5% April) decline in utilities.

Production Graphs. Two versions of industrial production activity are reflected in the following graphs, the official headline production level, and industrial production as corrected for the understatement of the inflation used in deflating certain components of industrial production. The regular graphs of short- and long-term headline industrial production activity, both in terms of official level and reported year-to-year change, are found in the *Reporting Detail* section. Drill-down and various graphics options for the headline data are available at ShadowStats-affiliate www.ExpliStats.com.

Corrected Industrial Production. Hedonic quality adjustments to inflation understate the inflation used in deflating some components of industrial production. That has the effect of overstating the resulting inflation-adjusted growth in the headline industrial production series (see [Public Comment on Inflation](#) and the discussion in *Chapter 9* of [2014 Hyperinflation Report—Great Economic Tumble](#)).

The two following graphs address that issue. The first reflects official industrial production reporting, indexed to January 2000 = 100, instead of the Fed's formal index that is set at 2007 = 100. The 2000 indexing is used simply so as to provide for some consistency in this series of revamped graphics; it does not affect the appearance of the graph or reported growth rates. The second graph is a version of the first that has been corrected for the understatement of the inflation rate used in deflating the production index, with estimated hedonic-inflation adjustments backed-out of the official industrial-production deflator.



The “corrected” second graph does show some growth in the period following the official June 2009 near-term trough in production activity. Yet, that upturn has been far shy of the full recovery and the renewed

expansion reported in official GDP estimation. Unlike the headline-production data and the headline GDP, corrected production levels have not recovered pre-recession highs. Instead, corrected production entered a period of protracted low-level stagnation in 2012, with quarterly contractions in third-quarter 2012, second-quarter 2013, with stagnation in third-quarter 2013, and some upturn in the fourth-quarter 2013 and first-quarter 2014, with April and May showing offsetting results that net out to stagnation, so far, in the second-quarter.

Producer Price Index (PPI)—May 2014—Headline Numbers Not Supported by Underlying Real-World Detail. Contrary to some underlying data and common experience, the newly-designed PPI showed headline deflation in May. Despite rising oil and gasoline prices in the real world, and positive seasonal adjustments in the PPI for energy goods, headline wholesale inflation fell in May 2014 in broad final demand, both goods (including energy) and services, with higher inflation in just two major categories. Trade and warehousing had headline monthly inflation of 0.9% and construction prices were up by 0.1%. In the goods sector, “core” inflation (net of food and energy) was unchanged for the month.

May 2014 Headline PPI Detail. The seasonally-adjusted, month-to-month, headline producer price index (PPI) for May 2014 “total final demand” declined by 0.18%, versus a 0.63% gain in April. On a not-seasonally-adjusted basis (all annual growth rates are unadjusted), year-to-year headline PPI inflation was 2.02% in May 2014, versus the 25-month high inflation rate of 2.21% seen in April 2014.

In terms of the three major PPI subcategories for May 2014 “final demand,” headline monthly “final demand goods” was down by 0.17%, “final demand services” was down by 0.18%, and “final demand construction” was up by 0.09%.

Final Demand Goods. Running somewhat in parallel with the old “finished goods” PPI series, headline monthly “final demand goods” in May fell by 0.17%, versus a 0.61% gain in April. Year-to-year inflation was 1.86% in May 2014, versus 2.49% in April. Headline monthly changes by major components for May final demand goods: “foods” was down by 0.24% (plus 2.67% in April), “energy” was down by 0.24% in May (plus 0.08% in April), and “less foods and energy” was down by 0.24% (plus 0.27% in April).

Final Demand Services. Headline monthly “final demand services” inflation fell by 0.18% in May, after gaining 0.65% in April. Year-to-year inflation was 2.16% in May 2014, versus 1.96% in April. The headline monthly changes by major components for May final demand services: “services less trade, transportation and warehousing” was down 0.09% (plus 0.28% in April), “transportation and warehousing” was plus 0.86% (plus 0.78% in April), and “trade” was down by 0.54% (plus 1.38% in April).

Final Demand Construction. Headline monthly “final demand construction” was up by 0.09% In May, versus a gain of 0.36% in April. Year-to-year inflation was 3.18% in May 2014, unchanged from April’s level of annual growth.

[For further details on May industrial production and PPI, see the Reporting Detail section.]

[Various drill-down detail and graphics options for the headline May industrial production and nominal retail sales are available to our readers at ShadowStats-affiliate www.ExpliStats.com.]

HYPERINFLATION WATCH

Hyperinflation Summary Outlook. *[PLEASE NOTE: Other than for the italicized text in the last paragraph—referencing the May production report—the text in this summary is unchanged from the prior Commentary.]* 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 *and production reports*. 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

PRODUCER PRICE INDEX—PPI (May 2014)

Inflation Nonsense. Contrary to underlying data and common experience, the newly-designed PPI showed headline deflation in May. Despite rising energy costs in the real world and positive seasonal adjustments in the PPI for energy goods, headline wholesale inflation fell in May 2014 in broad final demand, both goods (including energy) and services, with higher inflation in just two major categories. Trade and warehousing had headline monthly inflation of 0.9% and construction prices were up 0.1%. In the goods sector, “core” inflation (net of food and energy) was unchanged for the month.

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,” 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 construction.”

In the new structure of the PPI series “final demand services” largely reflects problematic and 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.

May 2014 Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported on June 13th, that the seasonally-adjusted, month-to-month, headline producer price index (PPI) for May 2014 “total final demand” declined by 0.18%, versus a 0.63% gain in April. On a not-seasonally-adjusted basis (all annual growth rates are unadjusted), year-to-year headline PPI inflation was 2.02% in May 2014, versus the 25-month high 2.21% seen in April 2014.

In terms of the three major subcategories for May 2014 “final demand” PPI, headline monthly “final demand goods” was down by 0.17%, “final demand services” was down by 0.18%, and “final demand construction” was up by 0.09%.

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Descriptive materials on the recently revamped PPI series remain available on the BLS Web site here: [New PPI Series](#), with the latest detail in the May 2014-related [Press Release](#).

INDEX OF INDUSTRIAL PRODUCTION (May 2014)

Seasonal-Factor Instabilities Continue to Distort Production Growth. Upside revisions in May headline reporting to otherwise negative activity in seasonally-adjusted April manufacturing and utilities production (manufacturing moved from a 0.4% to 0.1% contraction, and weather-dominated utilities production moved from a 5.3% to a 4.8% contraction), suggested continued heavy seasonal-factor

distortions in Federal Reserve reporting of the production series. Given recent unusual patterns in both economic activity and the weather, there likely have been ongoing seasonal distortions in May reporting built upon the April data. Recently, there simply has been too-little consistent and seasonally-repetitive reporting to generate meaningful seasonal adjustments for the series. Separately, at a fundamental level, recent indications of weakening orders and consumption, and slowing inventory building, are suggestive of weaker, not stronger, production. Some downside revisions to the current production numbers are likely in the months ahead.

Industrial Production—May 2014. The Federal Reserve Board released its first estimate of seasonally-adjusted, May 2014 industrial production today, June 16th. In the context of upwardly revised April activity, and with the March production level unrevised, headline monthly May production rose by 0.6% (0.59% at the second decimal point); May production would have risen by 0.89% before prior-period revisions. April production was revised to a 0.26% drop, from a headline 0.57% decline, following a revised 0.84% (previously 0.89%) gain in March (the March level was unchanged, but the February level revised higher by a notch).

The headline 0.6% monthly gain in May (0.3% decline in April) production was composed of a 0.6% May gain (0.1% April decline) in manufacturing, a 1.3% May (1.6% April) gain in mining, and a 0.8% May (4.5% April) decline in utilities.

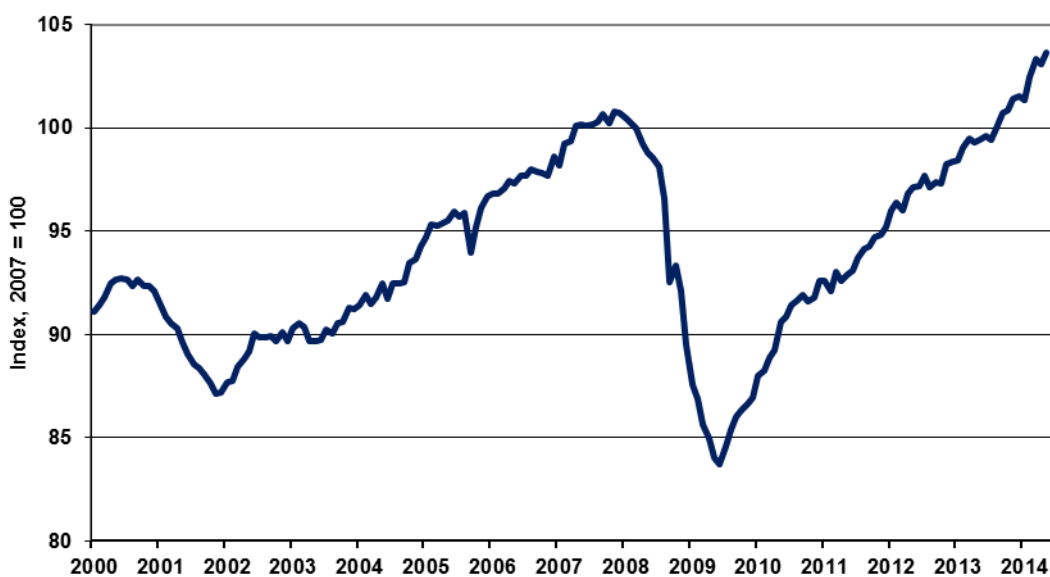
Year-to-year growth in May production increased to 4.27%, from a revised 3.76% (previously 3.46%) in April and versus a revised 3.84% (previously 3.86%, initially 3.77%) gain in March.

Production Graphs. Industrial production activity is reflected in the following two sets of graphs. The first graph in the first set shows the monthly level of the production index, while the second graph shows the year-to-year percentage change in the same series for recent historical detail, beginning January 2000. The second set of graphs shows the same data in historical context since World War II.

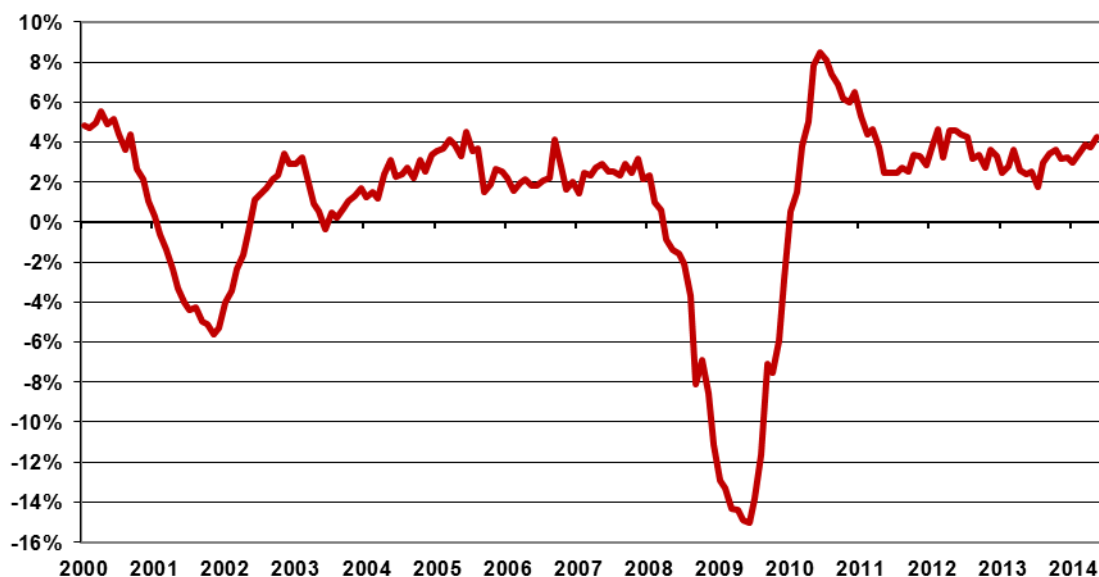
As shown more clearly in the first set of graphs, the pattern of year-to-year activity dipped anew in late-2013 to levels usually seen at the onset of recessions, although more-recent annual growth has firmed slightly. Annual growth remains well off the recent relative peak for the series, which was 8.49% in June 2010, going against the official June 2009 trough of the economic collapse. Indeed, as shown in the second set of graphs, the year-to-year contraction of 15.06% in June 2009, at the end of second-quarter 2009, was the steepest annual decline in production since the shutdown of war-time production following World War II.

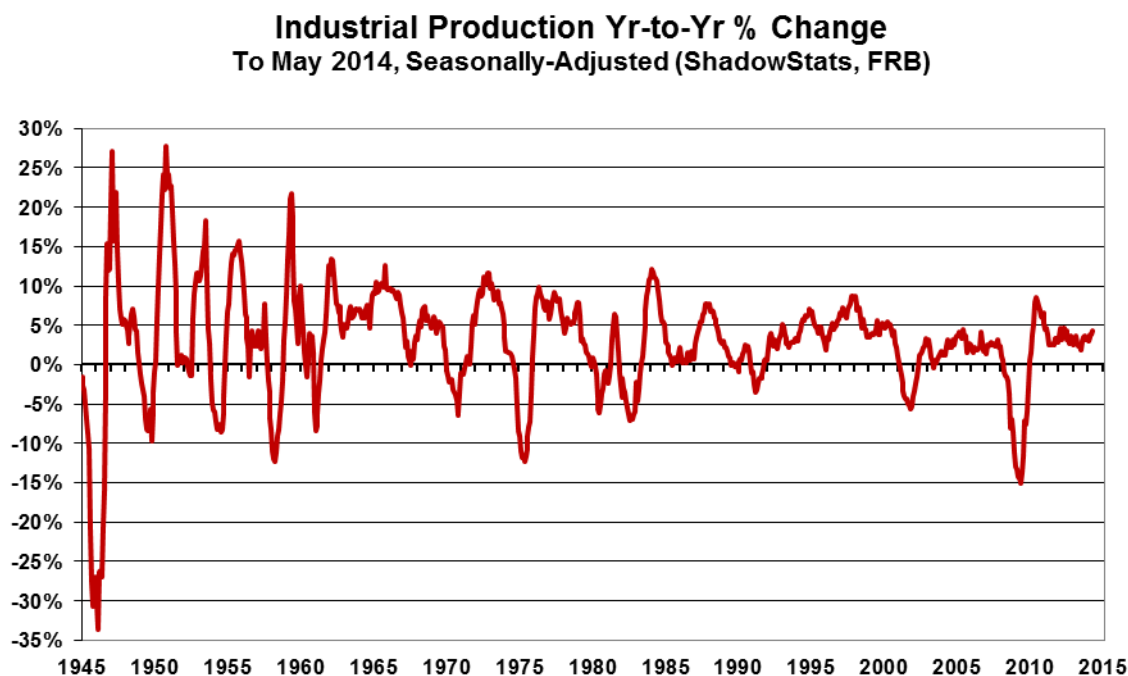
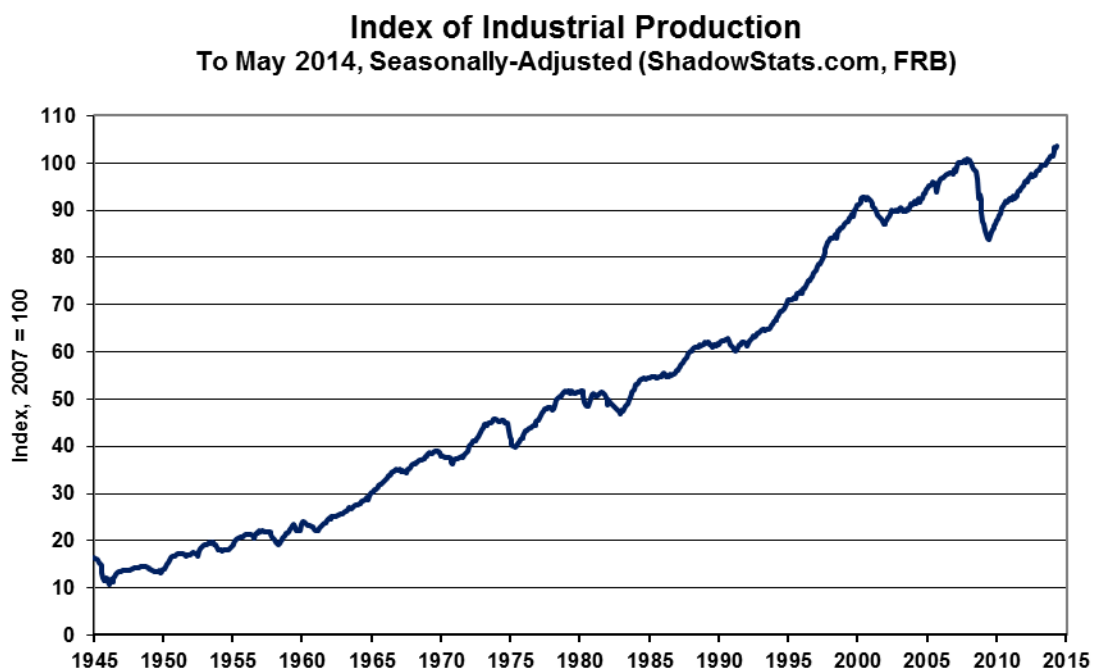
Official production levels have moved higher since the June 2009 trough, and just regained the series high, again, with May's reporting. Corrected for the understatement of inflation used in deflating portions of the industrial production index, however, the series has shown more of a pattern of stagnation with a slow upside trend, since 2009, topping out into 2012, with a renewed upside trend into a recent, protracted period of inventory build-up. The corrected production series is discussed and graphed in the *Opening Comments*.

Index of Industrial Production
To May 2014, Seasonally-Adjusted (ShadowStats.com, FRB)



Industrial Production Yr-to-Yr % Change
To May 2014, Seasonally-Adjusted (ShadowStats, FRB)





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:

Consumer Price Index—CPI (May 2014). The release by the Bureau of Labor Statistics (BLS) of the May 2014 CPI is scheduled for tomorrow, 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 due tomorrow, 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.
