

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

COMMENTARY NUMBER 674
October Industrial Production

November 17, 2014

Unexpected Production Decline Was on Top of Downside Revisions

Annual Growth Dropped to Six-Month Low

Implied Fourth-Quarter Production Pace Slowed Sharply

**Continued Contractions in, and Downside Revisions to, Auto Production
Should Hammer Inventory and Third- and Fourth-Quarter-GDP Estimates**

PLEASE NOTE: The next Commentary is planned for Wednesday, November 19th, covering the October PPI and housing starts, followed by one on Thursday, November 20th, covering the October CPI, related real retail sales and earnings, and existing-home sales.

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Fourth-Quarter Economic Slowdown-Downturn Continued. In line with headline October 2014 retail sales reporting ([Commentary No. 672](#)), October's industrial production detail suggested a significant slowing of broad economic activity in the current quarter. It also indicated downside pressure on the upcoming first-revision to third-quarter GDP growth.

Along with today's (November 17th) headline reporting, the Federal Reserve also published revisions that not only lowered the estimate of September production activity, but also shifted patterns of production growth for the last six months, pushing some activity from August and September back into earlier periods. Disappointing the consensus expectations in the markets, headline monthly October 2014 production activity declined by 0.11%, (-0.11%), following a downwardly revised 0.80% gain in September, which initially had been a gain of 1.01%. The consensus outlook (Bloomberg) had been for a 0.2% headline gain in October, without considering a downside revision to September. Net of prior-period revisions, the headline October 2014 monthly change was a contraction of 0.21% (-0.21%).

Using the headline October number as a surrogate measure for fourth-quarter industrial production activity, annualized quarter-to-quarter growth (same method for growth rate calculation as used with the GDP) slowed sharply to 1.45% in fourth-quarter 2014, down from 3.29% in the third-quarter (GDP at 3.55%), and 5.66% in the second-quarter (GDP at 4.59%). In first-quarter 2014, when the GDP contracted at an annualized pace of 2.11% (-2.11%), annualized industrial production growth was a positive 3.90%. A balancing factor here is inventory change. With auto production still in decline, and in deeper contraction than estimated previously, both pending third-quarter GDP revisions and the initial fourth-quarter GDP growth estimate should be hit negatively by further inventory contractions.

Today's Missive. Today's relatively brief missive concentrates on the October industrial production release (*Opening Comments* and *Reporting Detail*). The *Hyperinflation Summary Outlook* was updated in prior [Commentary No. 673](#) and is repeated here in the *Hyperinflation Watch* section, with no changes other than for minor language adjustments referencing that prior *Commentary*.

With Thursday's *Commentary No. 676*, planned for November 20th, Shadowstats will continue to update broad assessments of market, economic and inflation conditions, as well as potential actions open (or not open) to the federal government and Federal Reserve in terms of addressing the U.S. fiscal and economic crises. *No. 676* will concentrate heavily on current economic activity.

Industrial Production—October 2014—Contracting Automobile Production Not Only Continued, but It Deepened in Revision. Reflecting still-softier automobile sales, and with implications for downside inventory adjustments, auto manufacturing fell by 1.7% (-1.7%) in October and by a revised 1.8% (-1.8%) in September. September auto production previously had been down by 1.1% (-1.1%). The downside revision to September auto production was a major factor in the downside revisions to both the growth rate for September production and for the aggregate manufacturing component. As a result, inventory implications also were negative for both third- and fourth-quarter GDP growth estimates.

Headline Reporting—October 2014. The headline, seasonally-adjusted, October 2014 industrial production level fell by 0.11% (-0.11%) in October, versus a revised 0.80% (previously 1.01%) gain in September. Net of prior-period revisions, the monthly October contraction was 0.21% (-0.21%).

The revised September headline monthly gain was against a revised decline of 0.20% (-0.20%) in August, a revised 0.28% gain in July and a revised 0.35% in June.

By major industry group, the headline October 2014 contraction of 0.1% (-0.1%) [September revised gain of 0.8%] in aggregate production was composed of an October gain of 0.2% [September revised gain of

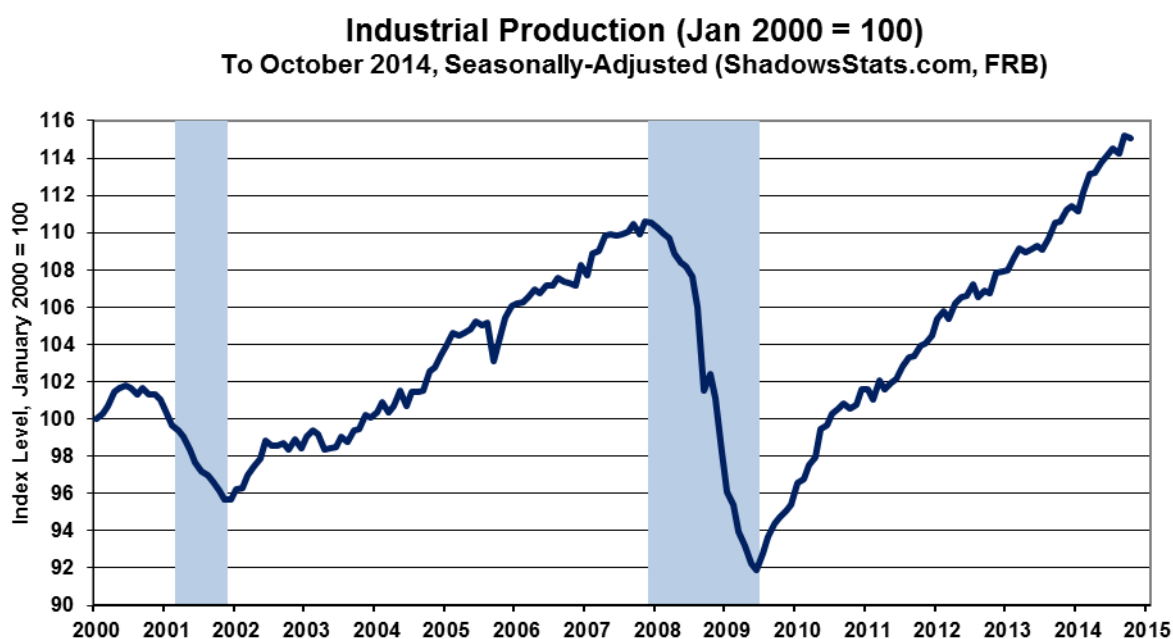
0.2%] in manufacturing; a 0.9% (-0.9%) October contraction [September revised gain of 1.6%] in mining; and a 0.7% (-0.7%) October contraction [September revised gain of 4.2%] in utilities.

In terms of annualized quarterly change, fourth-quarter 2014 growth (based solely on October reporting) slowed to 1.45%, from a 3.29% (previously 3.23%) annualized pace in third-quarter 2014, a pattern more significant in terms of relative shift and leveraged-inventory implications, than in magnitude, for this series that is related to less than 45% of current GDP reporting. Again, implied inventory changes should be negative for both the first revision to third-quarter GDP (November 25th) and for the initial estimate of fourth-quarter GDP (January 30th).

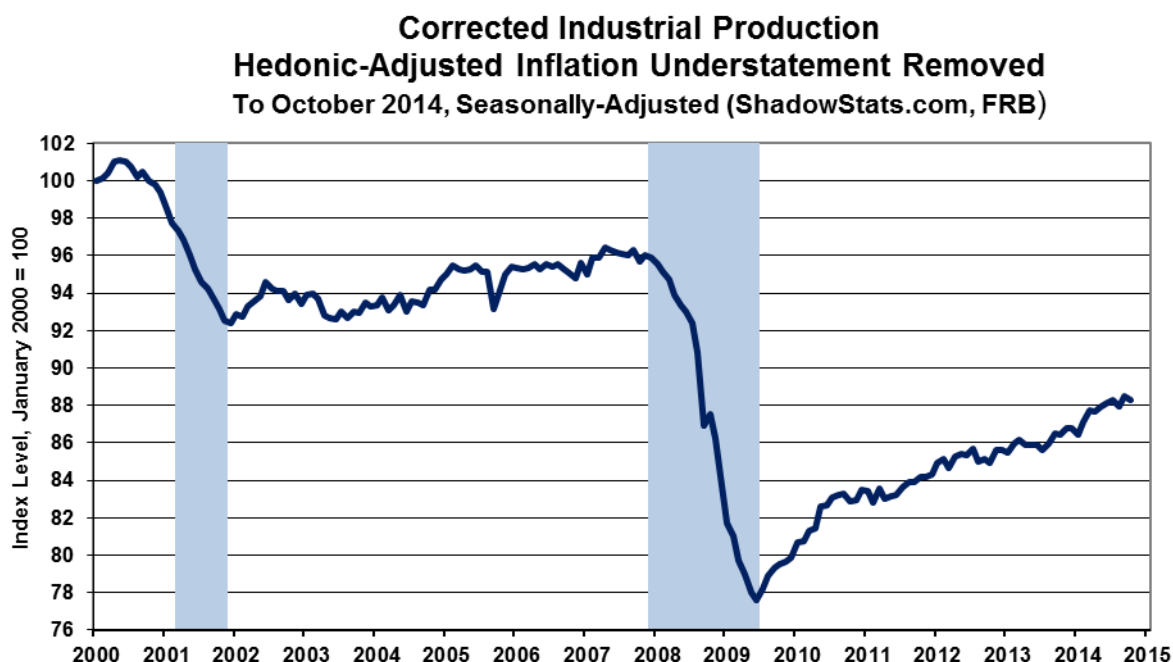
At a six-month low, year-to-year growth in October 2014 production was 4.01%, versus a revised 4.22% in September, a revised 4.14% in August, a revised 4.92% in July and a revised 4.45% in June.

Production Graphs—Corrected and Otherwise. Graphs of the industrial production level and year-to-year change through October are found in the *Reporting Detail* section. The two graphs that follow here address reporting quality issues tied directly to the overstatement of headline growth that results from using too-low an estimate of inflation in deflating an economic series.

Hedonic quality adjustments to inflation understate the inflation used in deflating some components of the index 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 first graph (preceding) shows official, headline industrial production reporting, but indexed to January 2000 = 100, instead of the Fed's formal index that is set at 2007 = 100. The 2000 indexing simply provides 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, corrected for the understatement of the inflation used in deflating the production index, with estimated hedonic-inflation adjustments backed-out of the official industrial-production deflators used for headline reporting.



The “corrected” second graph (preceding) shows 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 (see [Commentary No. 670](#)). Unlike the headline industrial production data and the headline GDP numbers, 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/downturn in third-quarter 2013, and some uptrend in fourth-quarter 2013 and into a renewed period of topping-out into a September gain and October pullback in 2014.

[For further details on October Industrial production, see the Reporting Detail section. Also, various drill-down detail and graphics options on the headline reporting are available to ShadowStats subscribers at our affiliate: www.ExpliStats.com/.

HYPERINFLATION WATCH

Hyperinflation Outlook Summary. This *Summary* is unrevised from the just-updated version in prior [Commentary No. 673](#), other than for minor language changes needed to refer back to that *Commentary*.

The long-standing 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. The outlooks also are updated in regular *Commentaries*, such as [Commentary No. 661](#), [Commentary No. 664](#), and [Commentary No. 672](#), and the *Opening Comments* of [Commentary No. 673](#) should be considered in terms of near-term, proximal triggers for massive dollar selling. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts.

Hyperinflation Timing Shifted to 2015. Discussed in the *Opening Comments* of [Commentary No. 673](#), as 2014 draws to a close, the U.S. dollar has strengthened significantly in recent months, instead of being dumped in a panicked sell-off as had been predicted for 2014. Nonetheless, the outlook for the dollar panic remains in place. It could be triggered or otherwise just start, at any time, with little or no warning, and still before year-end.

From a practical standpoint, though, where a dollar-selling panic will be the likely immediate precursor to and trigger of the early stages of a hyperinflation, the outlook for the timing of the hyperinflation as detailed in the *Hyperinflation Reports* has been shifted to 2015, from 2014. I had put 80% odds in favor of the hyperinflation breaking this year, in 2014. Other than for the calendar shift, the general outlook was not changed, with the ultimate currency panic and financial crises still highly likely in the very near-term (80%), virtual certainties (95% in the not-so-distant future, *i.e.*, the year ahead).

Primary Summary. Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation (see [Commentary No. 672](#)). The 2008 Panic and near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same, pulled the elements of the eventual hyperinflation crisis into the 2014-2015 period. The primary and basic summary of the broad outlook and the story of how and why this fiscal, financial and economic crisis has unfolded and developed over the years—particularly in the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked above). The following sections summarize the underlying current circumstance and recent developments.

Consistent with the above *Special Commentaries*, the unfolding economic circumstance, 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. Physical gold and silver, and holding assets outside the U.S. dollar, remain the primary hedges against the pending total loss of U.S. dollar purchasing power, despite sharp recent rallies in the U.S. dollar's exchange rate and related heavy selling in the gold and silver markets.

Current relative U.S. economic strength versus major U.S. trading partners is seriously over-estimated, with a crash back to recognition of realistic domestic-economic circumstances likely to be accompanied by a crash in the U.S. dollar versus major currencies, such as the euro, yen, pound, Swiss franc, Canadian dollar and Australian dollar; related rallies in precious metals and oil; and related sell-offs in the domestic stock and bond markets. Further, a sharp deterioration in near-term domestic U.S. political stability appears to be developing and is of meaningful near-term risk for triggering heavy selling of the dollar.

Current Economic Issues versus Underlying U.S. Dollar Fundamentals. U.S. economic activity is turning down anew, despite gimmicked GDP reporting. The headline contraction in first-quarter 2014 GDP was the reality; the headline second-quarter GDP boom was the aberration. The headline third-quarter growth of 3.5% appears to have been spiked by overly-optimistic trade-deficit and inventory numbers, which already face downside revisions. Such should become increasingly and painfully obvious to the financial markets in the domestic economic reporting and accompanying revisions of the weeks and months ahead, as well as early indications for an outright contraction in fourth-quarter 2014 GDP.

Recent reporting of relatively hard annual numbers from 2013 showed ongoing economic contraction, with no trend towards sustainable economic growth (see [Commentary No. 656](#)). Also, as discussed in [Commentary No. 668](#), real business activity—net of all the happy assumptions and modeling used by the Bureau of Economic Analysis in putting together the overstated third-quarter GDP growth estimate—has been flat-to-minus, with real sales of the S&P 500 showing a decline in third-quarter 2014 activity. Further, Main Street U.S.A. remains the ultimate judge of actual economic activity, and the 2014 election results and related exit polling confirmed no post-Panic economic recovery (see [Commentary No. 672](#)).

Despite short-term pre-election fluff, those basic underlying and increasingly-negative economic conditions should show with mounting frequency in various series, such as the trade deficit, retail sales, industrial production, payroll employment and inventories, providing consensus expectations with downside shocks. In turn, that should shift the popular outlook quite rapidly towards a "new recession," with negative shifts in the economic consensus negatively roiling the extraordinarily unstable financial markets.

As financial-market expectations shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, particularly deteriorating domestic political conditions, should place mounting and massive selling pressures on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic.

Unexpected economic weakness intensifies the known stresses on an already-impaired banking system, hence a perceived need for expanded, not reduced, quantitative easing. The highly touted "tapering" by the FOMC finally has run its course. Future, constructive Federal Reserve behavior—purportedly moving towards normal monetary conditions in the currently unfolding, perfect economic environment—is pre-conditioned by a continued flow of "happy" economic news. Suggestions that all is right again with world are nonsense. The 2008 Panic never has been resolved, and the Fed soon will find that it has no easy escape from its quantitative easing.

The economy has not recovered; the banking system is far from stable and solvent; and the Federal Reserve and the federal government still have no way out. Significant banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs will be provided, as needed, by the Fed, under the ongoing political cover of a weakening economy—a renewed, deepening contraction in business activity. The Fed has no choice. Systemic collapse is not an option for the Board of Governors. This circumstance simply does not have a happy solution.

Accordingly, some speculation already has begun to circulate as to an added round of Federal Reserve quantitative easing, QE4. That would be a major factor behind crashing the dollar and boosting the price of gold. The Fed has strung out its options for propping up the system as much as it could, with continual, negative impact on the U.S. economy. The easing to date, however, appears to have been only a prop to the increasingly unstable equity markets (see [Commentary No. 663](#)).

In the event of QE4, any resulting renewed boost to U.S. equities would be a fleeting illusion, at least in terms of real value (purchasing power of the dollar). Such gains would tend to be losses, in real terms, with the stocks valued in terms of Swiss francs, for example, or valued against what would be a rapidly-increasing pace of domestic U.S. inflation.

Unexpected economic weakness also savages projections of headline, cash-based, federal-budget deficits (particularly the 10-year versions) as well as projected funding needs for the U.S. Treasury. Current fiscal "good news" is from cash-based, not GAAP-based and accounting projections, where comparative year-ago, cash numbers recently were distorted against U.S. Treasury and government activity operating *sub rosa*, in order to avoid the limits of a constraining debt ceiling (see [Commentary No. 672](#)).

All these crises should combine against the U.S. dollar, likely in the very-near future. That said, recent faux market perceptions of domestic economic, financial-system and monetary tranquility have boosted the U.S. dollar's strength significantly in global trading and have contributed to savaging the prices of precious metals. Again, such should not prevail in the context of underlying reality. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed. The key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew.*** The circumstance includes a widening trade deficit (an initial improvement reported for the third-quarter 2014 trade balance should prove to be transitory, with a negative first revision already in place), as well as ongoing severe, structural-liquidity constraints on the consumer, which are preventing a normal economic rebound in the traditional, personal-consumption-driven U.S. economy (see *Opening Comments* of [Commentary No. 673](#)). Sharply-negative economic reporting shocks, versus unrealistically-positive consensus forecasts, remain a heavily-favored, proximal trigger for the pending dollar debacle.
- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of will to address long-term U.S. solvency issues, but also the current political impossibility of doing so. The impact of the shift in control of Congress will be assessed in the weeks ahead, but the change does not appear likely to alter the systemic willingness to address the underlying fundamental issues, specifically to bring the GAAP-based deficit into balance. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version continues to run in the \$6-trillion-

plus range for annual shortfall, while those in Washington continue to increase spending and to take on new, unfunded liabilities. The history and issues here are explored in the first installment of the *Hyperinflation Report*, as previously linked; the initial fiscal-2014 details are discussed in [Commentary No. 672](#).

- ***Monetary malfeasance by the Federal Reserve, as seen in central bank efforts to provide liquidity to a troubled banking system, and also to the U.S. Treasury.*** Despite the end of the Federal Reserve's formal asset purchases, the U.S. central bank monetized 78% of the U.S. Treasury's fiscal-2014 cash-based deficit, as discussed in [Commentary No. 672](#). The quantitative easing QE3 asset purchase program effectively monetized 66% of the total net issuance of federal debt to be held by the public during the productive life of the program (beginning with the January 2013 expansion of QE3). The monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury. With highly tenuous liquidity conditions for the banking system and the Treasury, it would not be surprising in this period of increasing instability to see covert Federal Reserve activities masked in the purchases of Treasury debt by nations or other entities financially friendly to or dependent upon the United States.
- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, usually with a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. The weaker the rating, the weaker tends to be the U.S. dollar. The positive rating for the President is at an historic low, post-election. Early post-election activity indicates rapidly disintegrating chances of any shift towards constructive cooperation between the White House and the new Congress in addressing fundamental issues such as non-recovered, faltering economic activity and the consumer liquidity crisis, and addressing the nation's long-range solvency issues, let alone addressing contentious issues such as immigration. Conditions here could devolve rapidly into an extreme political crisis (see *Opening Comments* of [Commentary No. 673](#))
- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the ongoing situation in Ukraine versus Russia and the extremely-volatile circumstances in the Middle East.
- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar continue to expand. In particular, anti-dollar rhetoric and actions have been seen with Russia, China, France and India, along with some rumblings in OPEC and elsewhere.

When the selling pressure breaks massively against the U.S. currency, the renewed and intensifying weakness in the dollar will place upside pressure on oil prices and other commodities, boosting domestic inflation and inflation fears. Domestic willingness to hold U.S. dollars will tend to move in parallel with global willingness, or lack of willingness, to do the same. These circumstances will trigger the early stages of a hyperinflation.

Both the renewed dollar weakness and the resulting inflation spike should boost the prices of gold and silver, where physical holding of those key precious metals remains the ultimate hedge against the pending inflation and financial crises.

REPORTING DETAIL

INDEX OF INDUSTRIAL PRODUCTION (October 2014)

Disappointing the Market's Expectations, Production Growth Slowed Sharply. Discussed in the *Opening Comments*, the Federal Reserve shifted patterns of production growth for the last six months, pushing some activity from August and September back into earlier periods. Disappointing the consensus expectations, headline monthly October 2014 production activity declined by 0.11% (-0.11%), following a downwardly revised 0.80% September gain, which initially had been a gain of 1.01%. The consensus outlook (Bloomberg) had been for a 0.2% headline gain in October, without considering a downside revision to September. Net of prior-period revisions, the headline October 2014 monthly change was a contraction of 0.21% (-0.21%).

Using the headline October number as a surrogate measure for fourth-quarter industrial production activity, annualized quarter-to-quarter growth (as used similarly in GDP calculations) slowed sharply to 1.45% in fourth-quarter 2014, down from 3.29% in the third-quarter (GDP at 3.55%), and 5.66% in the second-quarter (GDP at 4.59%). In first-quarter 2014, when the GDP contracted at a headline pace of 2.11% (-2.11%), annualized industrial production growth was a positive 3.90%. A major balancing factor here is inventory change. With auto production still in decline, and in deeper contraction than estimated previously, both pending third-quarter GDP revisions and the initial fourth-quarter GDP growth estimate should be hit negatively by further inventory reductions.

Industrial Production—October 2014. The Federal Reserve Board released its first estimate of seasonally-adjusted, October 2014 industrial production this morning (November 17th). Headline monthly production fell by 0.11% (-0.11%) in October, versus a revised 0.80% (previously 1.01%) gain in September. Net of prior-period revisions, the monthly October contraction was 0.21% (-0.21%).

The revised September headline gain was against a revised decline of 0.20% (-0.20%), previously down by 0.17% (-0.17%) and initially a drop of 0.10% (-0.10%) in August 2014, versus July. In turn, July was up by a revised 0.28% (previously 0.23%, 0.22% and initially 0.44%), versus June, which was up by a revised 0.35% (previously 0.28%, 0.32%, 0.38% and initially 0.22%), from May.

By major industry group, the headline October 2014 contraction of 0.1% (-0.1%) [September revised gain of 0.8%, previously up by 1.0%] in aggregate production was composed of an October gain of 0.2% [September revised gain of 0.2%, previously up by 0.5%] in manufacturing; a 0.9% (-0.9%) October contraction [September revised gain of 1.6%, previously up by 1.8%] in mining; and a 0.7% (-0.7%) October contraction [September revised gain of 4.2%, previously up by 3.9%] in utilities.

Declining Automobile Production Not Only Continued, but It Deepened in Revision. Reflecting still-soft automobile sales (and downside inventory adjustment), auto manufacturing fell by 1.7% (-1.7%) in October, down by a revised 1.8% (-1.8%) [previously down by 1.1% (-1.1%)] in September, following a revised 5.6% (-5.6%) decline [previously a 5.4% (-5.4%) decline] in August and an unrevised 7.6% gain in July. The more-negative contraction in September auto production was a major factor in the downside revision to the growth rates for September production and the manufacturing component. Inventory implications also were negative for third- and fourth-quarter GDP growth estimates.

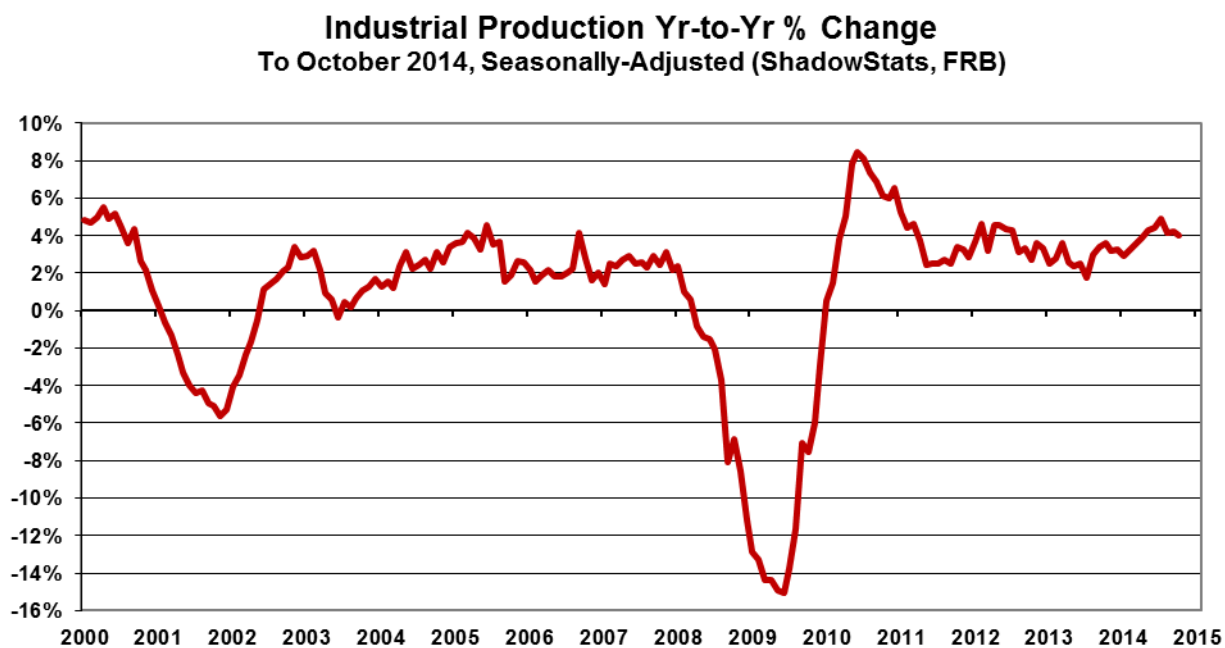
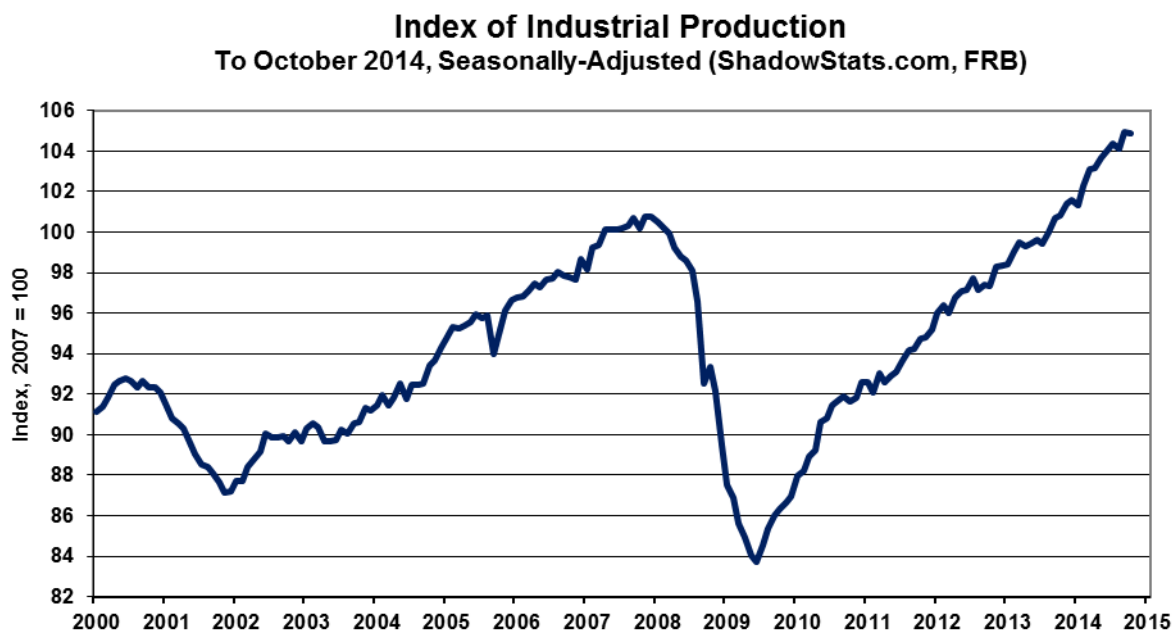
In terms of annualized quarterly production change, fourth-quarter 2014 growth (based solely on October reporting) slowed to 1.45%, from a 3.29% (previously 3.23%) annualized pace in third-quarter 2014, a pattern more significant in terms of relative shift and leveraged-inventory implications, than in magnitude, for this series that is related to less than 45% of current GDP reporting. Again, implied inventory changes should be negative for both the first revision to third-quarter GDP (November 25th) and for the initial estimate of fourth-quarter GDP (January 30th).

At a six-month low, year-to-year growth in October 2014 production was 4.01%, versus a revised 4.22% (previously 4.30%) in September, a revised 4.14% (previously 4.02%, initially 4.12%) in August, a revised 4.92% (previously 4.78%, 4.80%, initially 4.97%) in July and a revised 4.45% (previously 4.36%, 4.40%, 4.34%, and initially 4.32%) in June.

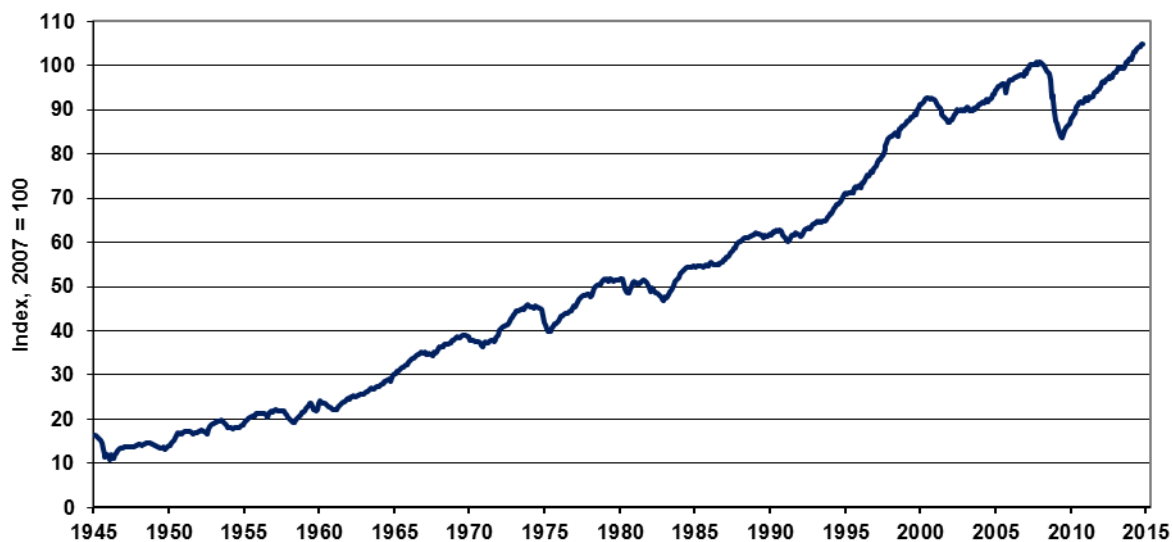
Production Graphs. The following two sets of graphs reflect headline industrial production activity. The first graph in the first set shows the monthly level of the production index, while the second graph shows the year-to-year percentage change in the same series for recent historical detail, beginning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

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 only at the onset of recessions, bounced higher into mid-2014 and headed lower again in the more-recent reporting. 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.

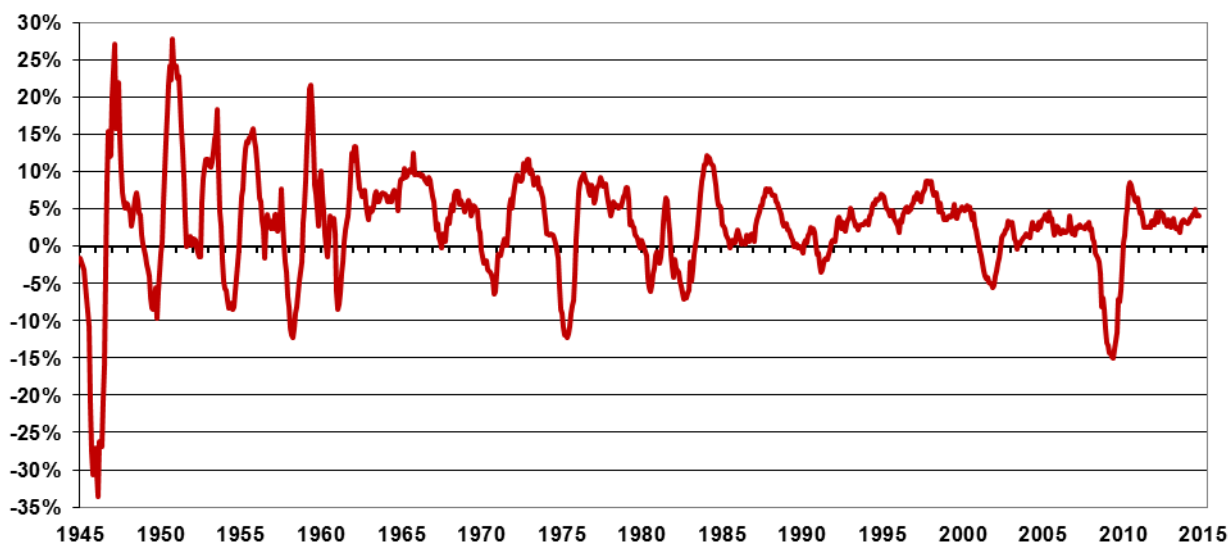
Official production levels have moved higher since the June 2009 trough, setting a new series high with July 2014 reporting, pulling back some in August, surging anew September, and pulling back again October. Corrected for the understatement of inflation used in deflating portions of the industrial production index (see the *Opening Comments* section), however, the series has shown more of a pattern of stagnation with a slow upside trend, since 2009, topping out into 2012, some uptrend in fourth-quarter 2013 and into a renewed period of topping-out and an October pullback in 2014. The series remains well shy of a formal recovery.



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



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



WEEK AHEAD

Against Overly-Optimistic Expectations, Pending Economic Releases and Revisions Should Trend Much Weaker; Inflation Releases Should Be Increasingly Stronger. Shifting some to the downside, again, from the upside, amidst wide fluctuations in the numbers, market expectations for business activity still are overly optimistic in the extreme. They exceed any potential, underlying economic reality. Continuing, downside corrective revisions and an accelerating pace of downturn in broad-based headline economic reporting, increasingly should hammer those expectations.

Longer-Range Reporting Trends. While gradual process of downside shifting in economic-growth expectations has been sporadic, underlying fundamental activity has remained extraordinarily negative. Other than for nonsense-growth in the headline second-quarter GDP (see [Commentary No. 662](#)), and the overstated initial third-quarter GDP growth estimate, renewed weakness has been, and increasingly will be seen in the post-election headline reporting of other major economic series (see [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)). Indeed, weaker-than-consensus economic reporting should become the general trend until the unfolding "new" recession receives broad recognition, which minimally would follow the next reporting of a headline contraction in real GDP growth (very possibly a culmination of pending downside revisions to the headline third-quarter 2014 GDP estimate).

A generally stronger consumer inflation trend remains likely, as seen before August, although headline inflation is muted at present by a temporary decline in oil prices. Beyond the spread of earlier oil-based inflation pressures into the broad economy, upside pressure on oil-related prices should continue and be rekindled from the intensifying impact of global political instabilities and a likely near-term weakening of the U.S. dollar in the currency markets. Such excludes any near-term, covert financial sanctions against Russia that are pushing oil prices lower.

The dollar faces eventual pummeling from the weakening economy, continuing perceptions of needed, ongoing quantitative easing, 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 prospective, significantly-weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected U.S. inflation, across the board.

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, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment, and unemployment data). Combined with recent allegations (see [Commentary No. 669](#)) of Census Bureau falsification of data in its monthly Current Population Survey (the source for the Bureau of Labor Statistics' Household Survey), these issues 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 (October 2014). The October 2014 PPI is scheduled for release tomorrow, Tuesday, November 18th by the Bureau of Labor Statistics (BLS). Detail, however, will be covered in *Commentary No. 675* of Wednesday, November 19th. Consensus expectations for a minimal decline of 0.1% (-0.1%) (Bloomberg) in October wholesale prices is reasonable.

The energy sector, once again, should be the dominant downside component in the headline monthly data. Inflation in food, “core” goods (everything but food and energy), and some still spreading inflationary impact from hard-goods into the soft-services sector, all are likely to be mitigating factors, again.

Based on the two most widely followed oil contracts, not-seasonally-adjusted, monthly-average oil prices fell by 9.9% (-9.9%), for the month of October, along with a 6.6% (-6.6%) monthly drop in average retail-gasoline prices. PPI seasonal adjustments for energy costs in September should offset the headline unadjusted decline in energy-related prices only partially.

The wildcard in this revamped PPI remains the recently-added services sector, which largely is unpredictable, volatile and of limited meaning due to its inflation measurements having minimal relationship to real-world activity.

The services series, in theory, is much-less dependent on the increasingly “antiquated” concepts of oil, food and “core” (ex-food and energy) inflation of the “hard” production-based economy. Yet, services costs recently had reflected spreading, general inflationary pressures—and shrinking profit margins—from rising prices in that hard economy, although that could will abate some in October, reflecting the lower energy costs. Accordingly, the aggregate headline October PPI inflation most likely will show a minimal headline monthly decline, generally in line with consensus expectations.

Residential Construction—Housing Starts (October 2014). The Census Bureau plans the release of October 2014 residential construction detail, including housing starts, on Wednesday, November 19th.

As discussed in [Commentary No. 660](#) on the August version of this most-unstable of monthly economic series, the headline reporting here simply is worthless. Not only is month-to-month reporting volatility extreme, but also the headline monthly growth rates rarely come close to being statistically significant.

Late-consensus expectations (Bloomberg) have moved to a headline gain of 1.1%, the plus-side of a near-unchanged showing for October, still well shy of the usual expectation of a monthly surge. The broad market outlook appears to be shifting towards a sharp slowing or renewed decline in residential construction activity.

The extreme variability seen regularly in the reporting of month-to-month change in this series likely will continue, though with a pattern of no statistical-significance, with ongoing stagnation and renewed downturn and/or downside revisions seen in the six-month moving-average of the series. This series also is subject to regular and extremely-large prior-period revisions.

In the wake of a 75% collapse in aggregate activity from 2006 through 2008, and of an ensuing five-year pattern of housing starts stagnation at historically low levels, little has changed. As discussed frequently in these *Commentaries*, there remains no chance of a near-term, sustainable turnaround in the housing market, unless there is a fundamental upturn in consumer and banking-liquidity conditions. That has not happened and does not appear to be in the offing, as last updated in the *Opening Comment* section of prior [Commentary No. 673](#).

Consumer Price Index—CPI (October 2014). The October 2014 CPI is scheduled for release on Thursday, November 20th, by the Bureau of Labor Statistics (BLS). The headline CPI-U has a reasonable chance of showing flat-to-minimally-positive inflation, against a late-consensus expectation (Bloomberg) for a headline monthly inflation decline of 0.1% (-0.1%).

Average gasoline prices plunged month-to-month in October 2014 by 6.6% (-6.6%), on a not-seasonally-adjusted basis, per the Department of Energy (DOE). While BLS seasonal adjustments to gasoline prices will be positive in October, they still should leave adjusted monthly gasoline prices down by about 3.3% (-3.3%) or so for the month. By itself, such an adjusted decline in gasoline prices would leave the headline CPI-U down by 0.1% (-0.1%) to 0.2% (-0.2%).

Higher food and “core” (net of food and energy) inflation, however, should more than offset the negative energy number, leading to a minimal headline increase in the CPI.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in October 2014 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted “unchanged” (up by 0.02% at the second decimal point) monthly inflation reported for October 2013. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for October 2014, the difference in October’s headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the September 2014 annual inflation rate of 1.66%. If the headline monthly inflation came in at about 0.1%, the resulting annual inflation pace would be 1.7% or 1.8%, depending on rounding.

Existing- and New-Home Sales (October 2014). October 2014 existing-home sales are due for release on Thursday, November 20th, from the National Association of Realtors, with the October 2014 new-home sales report due from the Census Bureau the next week, on Wednesday, November 26th.

Despite a headline monthly gain in September, recent negative trends in headline monthly reporting likely continued in October existing-home sales, and such would be consistent with market expectations of a 0.4% (-0.4%) decline (Bloomberg). A headline monthly contraction in excess of 0.7% (-0.7%), would generate the twelfth straight month of year-to-year decline, with the trailing twelve-month average sales level down by more than 4.0% (-4.0%) from the year before. Continued faltering activity in both home-sales series remains closely tied to persistent consumer liquidity problems (again, see the *Opening Comment* section of prior [Commentary No. 673](#)).

Smoothed for extreme and nonsensical monthly gyrations, a pattern of stagnation or intensifying downturn also appears to be in play for new-home sales. While monthly changes in activity rarely are statistically-significant here, still-unstable reporting and revisions (both likely to the downside) remain a

fair bet for October new-home sales, with both home-sales series increasingly reflecting downside instabilities in their respective headline activity.
