

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

COMMENTARY NUMBER 688
CPI, PPI, Industrial Production, Real Retail Sales and Earnings, Swiss Franc
January 16, 2015

**Major Crack in U.S. Dollar Facade, as
Swiss Franc Breaks Free and Gold Rallies**

**Headline December Real Retail Sales Fell by 0.6%;
Annual Growth at Traditional Recession Level**

**Unchanged before Inflation, Real Average Monthly Earnings Rose 0.5%
Entirely Due to Decline in Headline CPI-W Inflation**

December Year-to-Year Inflation: 0.8% (CPI-U), 0.3% (CPI-W), 8.4% (ShadowStats)

Decline in PPI Inflation Muted by Offsetting Pressures from Oil-Price Plunge

December Industrial Production Notched Lower

PLEASE NOTE: The next Regular Commentary is scheduled for Wednesday, January 21st, covering December 2014 housing starts. Publication of the Special Commentary will follow soon (see subscriber e-mail of January 15th).

Best Wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

The Swiss Franc Resumes Its Status as the World's Safe-Haven Currency. The façade of a stable and ever-strengthening U.S. dollar just developed a large, structural crack, with the Swiss National Bank (SNB) removing a significant market distortion that it had put in place back on September 6, 2011. Then, the SNB capped (effectively pegged) its Swiss franc relative to the euro, ostensibly in an effort to restrict the franc's increasing strength against the euro. The issue went well beyond the Swiss franc-euro relationship; it also tied specifically to the nature of the Swiss franc as a safe-haven, flight-to-safety currency, in a world still trying to live with unresolved issues from the Panic of 2008. Most of those issues still exist.

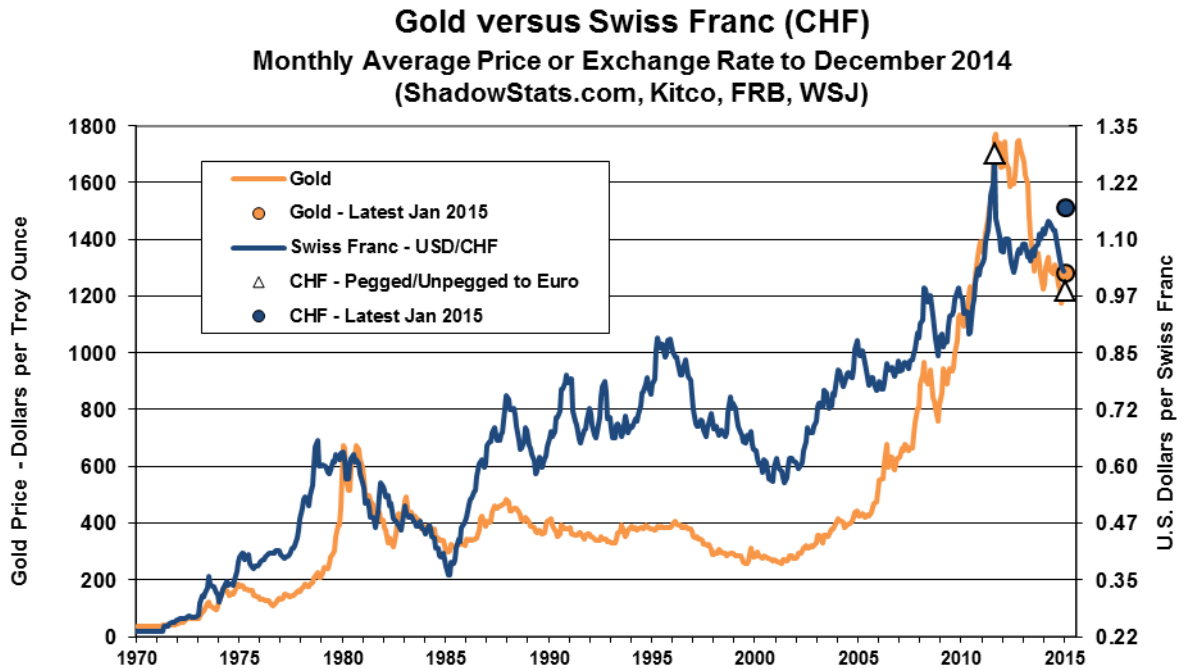
The Swiss action in 2011 was taken in the heat of the dollar-selling dollar panic of August and September of that year, following Standard and Poor's downgrade of the sovereign-solvency rating of the United States. Beyond coincident euro issues, the major problem at the time for the global markets was the accelerating pace of flight from the U.S. dollar into safe havens such as the Swiss franc and gold.

Generally, central-bank intervention in the currency markets does not work against basic, opposing market forces, unless the intervention is accompanied by significant changes to a currency's underlying fundamentals, changes designed to supplant the perceived need for intervention. Underlying fundamentals did not change here. As a result, the SNB intervention not only was extremely expensive, but also it likely began to create systemic imbalances or instabilities.

Expressing some concern for a weakening euro pulling the Swiss franc down in value versus the U.S. dollar (an effect desired in 2011), the Swiss Bank ended its euro cap yesterday, January 15th. In the immediate trading frenzy that followed, the Swiss franc soared almost 40%, briefly hitting its 2011 historic high value against the U.S. dollar, before settling down. As of late this afternoon (Friday, January 16th), the Swiss franc stood almost 19% higher in value against the U.S. dollar than it had before the SNB announced its action.

In the graph that follows, the late-Friday value of Swiss franc is represented by the blue dot on the right-hand side of chart. Directly below that is a white triangle that shows the Swiss franc's value just before the announcement of the policy change. Irrespective of where near-term markets settle, the Swiss franc is back as a safe-haven instrument.

Indeed, even with negative interest rates, the Swiss franc again should be strong on a relative basis, versus other currencies, as the primary safe-haven currency. Gold already has reflected something of a sympathetic move. These developments do not bode well for what recently and increasingly had been touted as the ultimate global safe-haven currency: the U.S. dollar. More will follow in the *Special Commentary*.



Today's Missive (January 16th). Today's *Commentary* concentrates on the detail from the December 2014 reporting of the CPI, PPI, industrial production and real retail sales and earnings. The *Week Ahead* section highlights the December housing starts report of January 21st.

Given new material in the pending year-end *Special Commentary*, today's missive excludes any general review of economic activity, as well as the *Hyperinflation Summary* usually found in the *Hyperinflation Watch* section. The latest *Hyperinflation Summary* is found in [Commentary No. 684](#); it will be updated post-*Special Commentary*. The *Hyperinflation Watch*, however, does include the gold graphs that regularly accompany the *CPI Commentaries* (one of those graphs is preceding), updated through today's market activity.

Consumer Price Index—December 2014—Tumbling Oil and Gasoline Prices Should Bottom Out in the Next Couple of Months. Discussed regularly here, selling pressure on oil has continued—largely unabated since June 2014—tied to what still appears to be U.S.-orchestrated efforts to intensify financial stress on Russia. The circumstance is tied closely to the recent ongoing strength in the U.S. dollar, which also should prove to be a transitory phenomenon. Separately, oil prices appear to have reached levels that are below what would be expected with an economic balance in the oil industry. Accordingly, dollar-denominated prices likely are near bottom and will tend to stabilize at levels much higher than they are now, particularly when the weakening dollar kicks in (see discussions in the pending *Special Report*).

Temporarily-depressed headline-inflation rates help to boost, temporarily, the reporting of real, or inflation-adjusted, series. Where inflation growth gets subtracted from the nominal, or not-inflation adjusted series, the effect of negative inflation is to add to or increase the pace of real growth.

Nonetheless, the economy slowed at a fast enough pace so that December real retail sales, which dropped by a nominal 0.94% (-0.94%) month-to-month, still contracted by 0.57% (-0.57%) for the month, after absorbing the headline monthly inflation decline of 0.37% (-0.37%) in the CPI-U.

In contrast, what had been "unchanged" month-to-month nominal average weekly earnings in December 2014, ended up showing a headline real gain of 0.51% for the month, due entirely to the headline monthly contraction of 0.51% (-0.51%) in the CPI-W. More heavily dependent upon gasoline prices than the CPI-U, the CPI-W is more vulnerable to changes in gasoline prices.

Although the pace of annual inflation also has slowed with decline in monthly oil prices, year-to-year inflation is not quite as soft as indicated by headline reporting, when considered in the context of traditional CPI reporting and common experience. Further discussion in this area is found in the *Reporting Detail* section.

Headline Inflation Reporting CPI-U. The headline, seasonally-adjusted CPI-U for December 2014 declined month-to-month by 0.37% (-0.37%), versus a headline monthly contraction in November of 0.26% (-0.26%). On a not-seasonally-adjusted basis, the December CPI-U fell by 0.57% (-0.57%) month-to-month, following an unadjusted 0.54% (-0.54%) contraction in November.

Quarter-to-Quarter CPI-U. Seasonally adjusted, annualized quarter-to-quarter CPI-U inflation contracted a pace of 1.20% (-1.20%) in fourth-quarter 2014, versus positive inflation of 1.10% in the third-quarter, 3.03% in the second-quarter and 1.91% in the first-quarter.

Annual Average CPI-U. Annual average CPI-U inflation was 1.62% in 2014, versus 1.46% in 2013.

Year-to-Year CPI-U. Not seasonally adjusted, December 2014 year-to-year inflation for the CPI-U was a headline gain of 0.76%, versus 1.32% in November 2014, and versus 1.50% in December 2013.

Year-to-year, CPI-U inflation would increase or decrease in next month's January 2015 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.14% monthly inflation gain currently reported for January 2014 (pending a February 20th benchmark revision). The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2015, the difference in January's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the December 2014 annual inflation rate of 0.76%.

Core CPI-U. Seasonally-adjusted "Core" CPI-U inflation (net of food and energy) was "unchanged" in December 2014, with an increase of 0.00% [down by 0.20% (-0.20%) unadjusted] for the month, versus a 0.07% adjusted monthly gain in November [down by 0.07% (-0.07%) unadjusted].

Core inflation showed unadjusted year-to-year inflation of 1.61% in December 2014, versus 1.70% in November 2014, and against 1.72% in December 2013. Annual average core inflation was 1.75% in 2014, versus 1.76% in 2013. Seasonally adjusted, annualized quarter-to-quarter Core CPI-U inflation increased by 1.41% in fourth-quarter 2014, 1.30% in the third-quarter, 2.54% in the second-quarter and 1.61% in the first-quarter.

CPI-W. The December 2014 seasonally-adjusted, headline CPI-W, which is a narrower series and has greater weighting for gasoline than does the CPI-U, fell by 0.51% (-0.51%) in December, following a contraction of 0.41% (-0.41%) in November. On a not-seasonally-adjusted basis, the December CPI-U fell by 0.71% (-0.71%) month-to-month, following an unadjusted decline of 0.72% (-0.72%) in November.

Quarter-to-Quarter CPI-W. Seasonally adjusted, annualized quarter-to-quarter CPI-W inflation contracted by 2.16% (-2.16%) in fourth-quarter 2014, after gaining 1.00% in the third-quarter, 3.07% in the second-quarter and 1.79% in the first-quarter.

Annual Average CPI-W. Annual average CPI-W inflation was 1.50 % in 2014, versus 1.37% in 2013.

Year-to-Year CPI-W. Unadjusted, December 2014 year-to-year CPI-W inflation was 0.32%, versus 1.06% in November 2014, and 1.45% in December 2013.

Chained-CPI-U. Initial reporting of unadjusted year-to-year inflation for the December 2014 C-CPI-U was 0.28%, versus 1.02% in November. Year-to-year inflation as of December 2013 was 1.35%. Although not formally published by the BLS due to surveying and revision issues, implied annual average inflation here was 1.43% in 2014, versus 1.24% in 2013.

ShadowStats Alternate Consumer Inflation Measures. The ShadowStats-Alternate Consumer Inflation Measure (1990-Base)—year-to-year annual inflation was roughly 4.3% in December 2014, versus 4.9% in November 2014. Annual average inflation in the 1990-based measure was 5.2% in 2014, versus 4.9% in 2013.

The December 2014 ShadowStats-Alternate Consumer Inflation Measure (1980-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was at about 8.4% year-to-year, versus 9.0% in November. Annual average inflation was 9.3% in 2014, versus 9.1% in 2013.

Real Retail Sales—December 2014—Headline Monthly Contraction of 0.6%, Annual Growth Again at Recession Level. In nominal terms, before adjustment for inflation, headline monthly retail sales declined by a statistically-significant, seasonally-adjusted 0.94% (-0.94%) in December 2014, having increased by 0.41% (previously up by 0.72%) in November, as discussed in [Commentary No. 687](#).

Official Headline Reporting of Real Retail Sales. Based on a headline decline of 0.37% (-0.37%) in the December 2014 CPI-U, and in the context of a 0.26% (-0.26%) headline November CPI-U decline, seasonally-adjusted real monthly retail sales fell by 0.57% (-0.57%) in December 2014, following a revised 0.67% (previously 0.98%) gain in November.

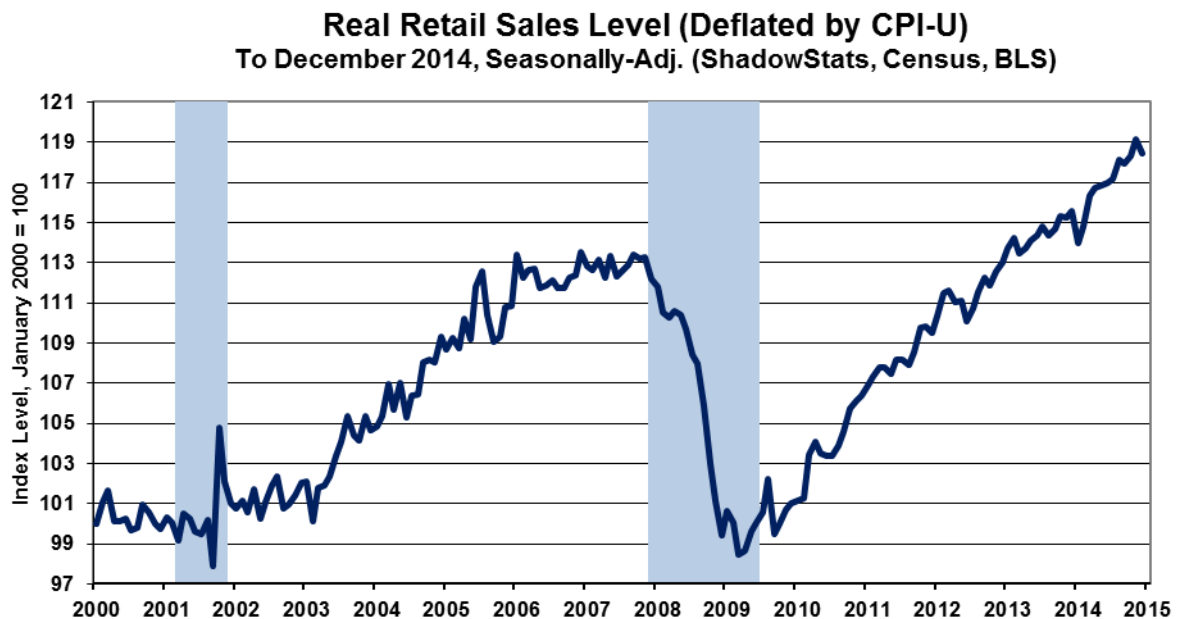
In terms of annualized quarter-to-quarter growth, real retail sales in fourth-quarter 2014 were up by 3.01% versus the third-quarter. In turn, third-quarter annualized growth was up by 3.14%, the second-quarter was up by 6.49%, and the first-quarter contracted at a 1.17% (-1.17%) annualized pace.

Year-to-year change in December 2014 real retail sales slowed to 2.49%, at the upper bounds of traditional recession territory, versus November's downwardly revised real annual gain of 3.37% (previously 3.80%). In normal economic times, annual real growth at or below 2.0% would signal an imminent recession. That signal had been given recently; a signal that still is in play and likely will serve

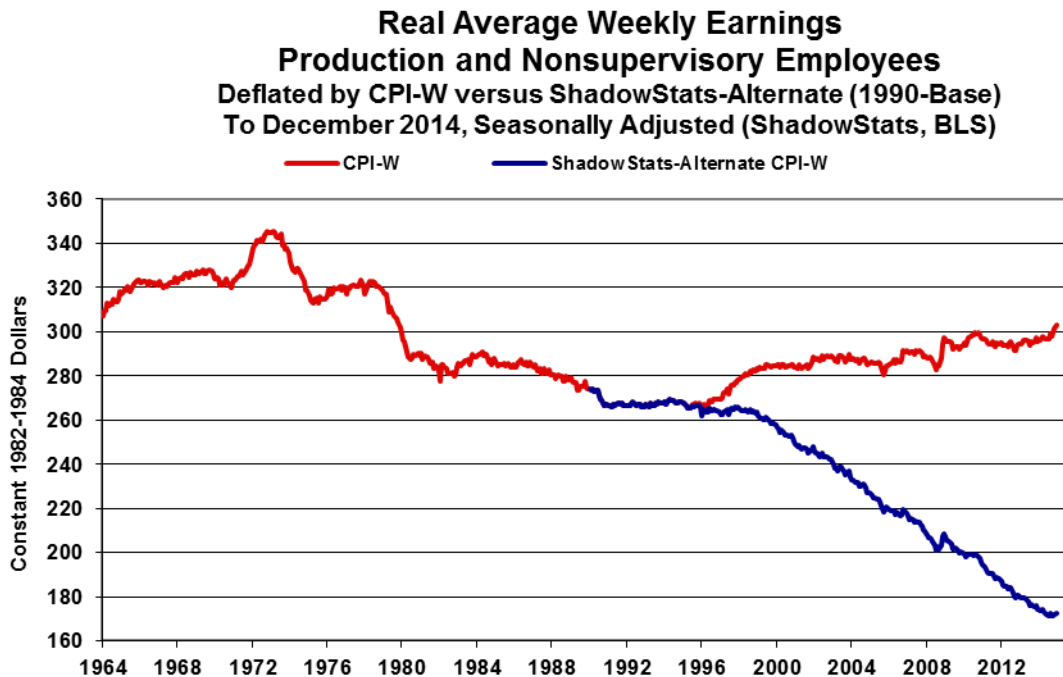
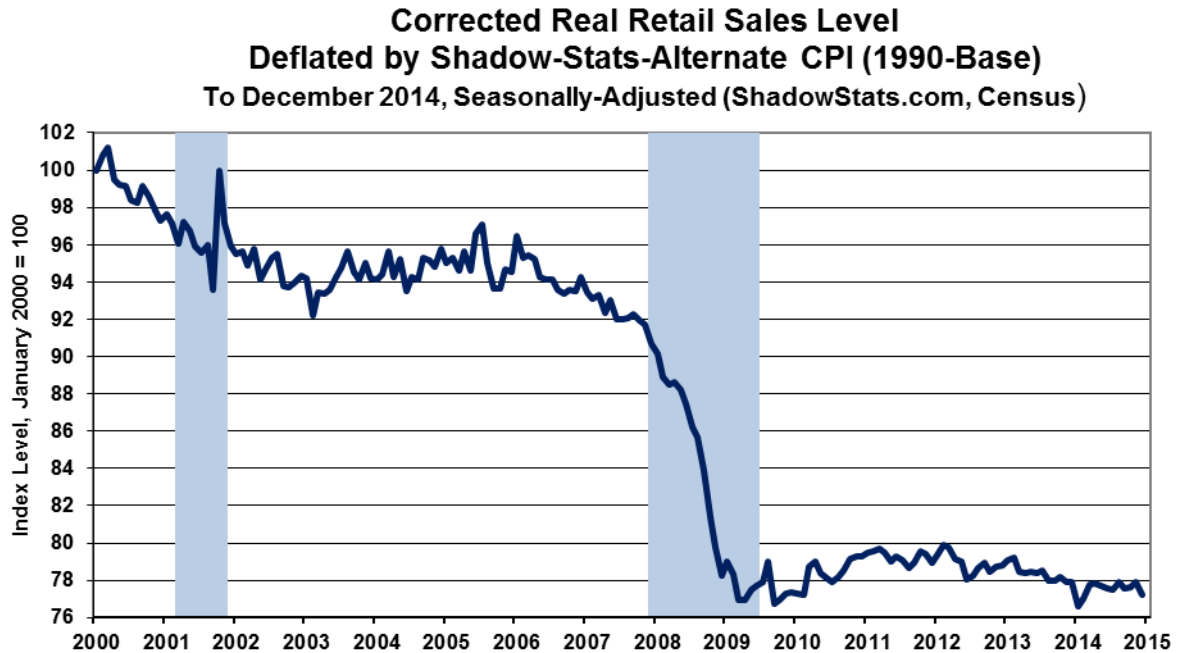
as an indicator of renewed downturn in broad economic activity. Patterns in the level of, and year-to-year growth in, retail sales are plotted in *Reporting Detail* graphs.

Corrected Real Retail Sales—December 2014. The apparent “recovery” in the headline real retail sales generally has continued, although the headline reporting slowed recently, turning down in December 2014. Nonetheless, headline real growth in retail sales continues to be overstated heavily, due to the understatement of the rate of inflation used in deflating the retail sales series. As discussed more fully in *Chapter 9 of [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)*, deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating inflation-adjusted economic growth.

Both graphs following are indexed to January 2000 = 100.0 to maintain consistency in the series of graphs related to corrected inflation-adjustment (including industrial production, new orders for durable goods and GDP). The first graph reflects the official real retail sales series, except that it is indexed, instead of being expressed in dollars. The plotted patterns of activity and rates of growth are exactly same for the official series, whether the series is indexed or expressed in dollars, as can be seen in the comparison with the first plot of real retail sales in the *Reporting Detail* section.



Instead of being deflated by the CPI-U, the “corrected” real retail sales numbers—in the second graph—use the ShadowStats-Alternate Inflation Measure (1990-Base) for deflation. With the higher inflation of the ShadowStats measure, the revamped numbers show a pattern of plunge and stagnation and renewed downturn, consistent with patterns seen in consumer indicators like real median household income, consumer confidence, unemployment and in most housing statistics. A topping out in late-2011 and early-2012 reverted to renewed decline in second-quarter 2012 in this series, which had been bottom-bouncing at a low-level plateau of economic activity since the economic collapse from 2006 into 2009. The renewed contraction has trended into 2014, allowing for the occasional and temporary upside blip.



Real (Inflation-Adjusted) Average Weekly Earnings—December 2014—Flat in Nominal Terms, Real Earnings Rose Due to Negative Inflation. In the production and nonsupervisory employees category—the only series for which there is a meaningful history of average weekly earnings—headline real (inflation-adjusted) earnings, rose by 0.51% in December 2014, reflecting entirely the headline monthly

decline of 0.51% (-0.51%) in December CPI-W inflation. Before inflation adjustment, in nominal terms, headline average weekly earnings were unchanged in December. The December number followed a unrevised headline real gain of 0.60% in November earnings, which reflected a 0.19% gain in nominal earnings and a headline decline of 0.41% (-0.41%) in November CPI-W inflation.

Year-to-year and seasonally-adjusted, December 2014 real average weekly earnings rose by 2.61%, versus an unrevised 1.45% annual gain in November. Both the monthly and annual fluctuations in this series are irregular, but current reporting remains well within the normal bounds of volatility.

In the preceding graph of this series, the earnings as officially deflated by the BLS using the CPI-W are shown with the red-line, and as adjusted for the ShadowStats-Alternate CPI Measure, 1990-Base, with the blue-line. When inflation-depressing methodologies of the 1990s began to kick-in, the artificially-weakened CPI-W (also used in calculating Social Security cost-of-living adjustments) helped to prop up the reported real earnings. Official real earnings today still have not recovered their inflation-adjusted levels of the early-1970s, and, at best, have been flat for the last decade. Deflated by the ShadowStats measure, real earnings have been in fairly-regular decline for the last four decades, which is much closer to common experience than the pattern suggested by the CPI-W. See [Public Commentary on Inflation Measurement](#) for further detail.

Producer Price Index—December 2014—Collapsing Oil Prices Both Subtracted from and Added to December PPI Inflation. December 2014 headline inflation for the Final Demand Producer Price Index (PPI) was an index contraction in of 0.3% (-0.3%), reflecting an oil-price-plunge-driven 1.2% (-1.2%) drop in Final Demand Goods inflation, and largely offsetting oil-price-plunge-driven 0.2% increase in the more-heavily weighted Final Demand Services index.

Unlike the Antiquated Production Costs Concept, Rising Margins Can Reflect Falling Costs as Well as Rising Prices. Traditional production costs—effectively Final Demand Goods—fell month-to-month in December by 1.2% (-1.2%), in tandem with a 6.6% (-6.6%) plunge in Final Demand Energy costs. Reflecting the absurdities of the newly redefined aggregate PPI concept, however, the partial offset to the goods deflation from the headline 0.2% increase in Final Demand Services inflation also reflected falling costs tied to collapsing oil prices.

The difference is that the services inflation reflects changes in margin instead of in costs. Discussed in earlier PPI *Commentaries*, margins are not the same thing as the level of prices realized in sales; they are a function of prices received versus cost or prices paid for the product or service. Where rising margins can reflect lower costs-paid-out, as well as higher prices-received, the current stronger margins are due largely to a decline in oil-related prices, at cost, with a corresponding, related cut in prices-received not being passed along either immediately or fully to the next level of consumption.

This nonsense was confirmed in the BLS PPI press release of January 15th: "*Product detail: Leading the December rise in prices for final demand services, margins for fuels and lubricants retailing jumped 24.7 percent.*"

December 2014 Headline PPI Detail. The seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for December 2014 declined by 0.27% (-0.27%), versus a decline of 0.18% (-0.18%) in November.

The impact of seasonal adjustments on the headline monthly December aggregate number was positive, with the unadjusted monthly PPI change in December a contraction of 0.36% (-0.36%), versus a drop of 0.45% (-0.45%) in November. Also on a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year headline PPI inflation eased to 1.10% in December, versus 1.37% in November 2014. Year-to-year inflation was 1.20% in December 2014. On an annual average basis, PPI Final Demand was up by 1.65% in 2014, versus a gain of 1.30% in 2013.

In terms of the three major subcategories for December 2014 Final Demand PPI, headline monthly Final Demand Goods inflation contracted by 1.24% (-1.24%), Final Demand Services inflation rose by 0.18%, and Final Demand Construction inflation was "unchanged."

Final Demand Goods (Weighted at 34.40% of the Aggregate). Running somewhat in parallel with the old Finished Goods PPI series, headline monthly Final Demand Goods inflation in December 2014 was down by 1.24% (-1.24%), following a decline of 0.70% (-0.70%) in November. There was an aggregate neutral impact on the December 2014 reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, headline December final demand goods inflation also contracted by 1.24% (-1.24%) for the month.

Unadjusted, year-to-year goods inflation was down by 0.98% (-0.98%) in December 2014, versus an annual gain of 0.45% in November 2014. December 2013 goods inflation was up by 0.08% year-to-year. On an annual average basis, PPI Final Demand Goods inflation was up 1.33% in 2014, versus 0.81% in 2013.

Headline seasonally-adjusted monthly changes by major components for December 2014 Final Demand Goods:

- "Foods" inflation dropped by 0.41% (-0.41%) in December, versus a decline of 0.16% (-0.16%) in November, with December's headline monthly decline in inflation weakened by seasonal adjustments. Unadjusted, December food inflation fell by 0.25% (-0.25%) for the month.
- "Energy" inflation plunged by 6.64% (-6.64%) in December, having declined by 3.05% (-3.05%) in November, with the December negative reading narrowed by seasonal adjustments. Unadjusted December energy inflation declined by 6.94% (-6.94%) month-to-month.
- "Less foods and energy" ("Core" goods) inflation rose by 0.18% in December 2014, having declined by 0.09% (-0.09%) in November. Seasonal adjustments were a positive for "core" inflation, with an unadjusted December monthly gain of 0.09%.

Final Demand Services (Weighted at 63.52% of the Aggregate). Headline monthly Final Demand Services inflation rose by 0.18% in December 2014, having gained 0.09% in November 2014. The overall impact on the December services inflation reading from underlying seasonal-factor adjustments was positive, with an unadjusted gain of 0.09% in the current month.

Year-to-year unadjusted inflation was 2.23% in December 2014, versus 1.86% in November. Year-to-year inflation as of December 2013 was 1.32%. On an annual average basis, PPI Final Demand Services inflation was up 1.77% in 2014, versus 1.61% in 2013.

The headline monthly changes by major component for December 2014 Final Demand Services inflation:

- "Services less trade, transportation and warehousing" inflation increased by 0.19% in December 2014 versus a 0.09% gain in November. Seasonal-adjustment impact on the December detail was positive. Unadjusted monthly change in December 2014 was a decline of 0.09% (-0.09%).
- "Transportation and warehousing" inflation declined by 0.08% (-0.08%) in December, having plunged by 0.84% (-0.84%) in November. Seasonal adjustments had negative impact, turning the unadjusted December gain of 0.09% into a monthly decline.
- "Trade" inflation rose by 0.63% in December 2014, following a 0.09% monthly gain in November. Seasonal adjustments had a positive impact here, where the unadjusted monthly inflation gain in December was 0.27%.

Final Demand Construction (Weighted at 2.08% of the Aggregate). Although a fully self-contained subsection of the Final Demand PPI, Final Demand Construction inflation receives no formal headline coverage. Nonetheless, headline numbers are published. Headline monthly construction inflation was "unchanged" in December 2014 for the second month. The impact of seasonal factors on the December reading was neutral.

On an unadjusted basis, year-to-year inflation was 2.11% in December 2014, versus 2.20% in November. In December 2013, annual year-to-year inflation here was 3.21%. On an annual average basis, PPI Final Demand Construction was up 2.88% in 2014, versus 1.90% in 2013.

Industrial Production—December 2014—Unseasonably Warm Weather Hit Utility Usage and Industrial Production. Headline December 2014 industrial production fell by 0.1% (-0.1%), which was about as expected, but there also was a small downside revision to November production. Warmer-than-usual weather hit utility usage hard—tied to heating—creating a seasonally-adjusted plunge in utility output. That more than offset gains in manufacturing and mining (oil and gas production). There was little catch-up in this reporting, with the production series looking much as it did last month, in aggregate.

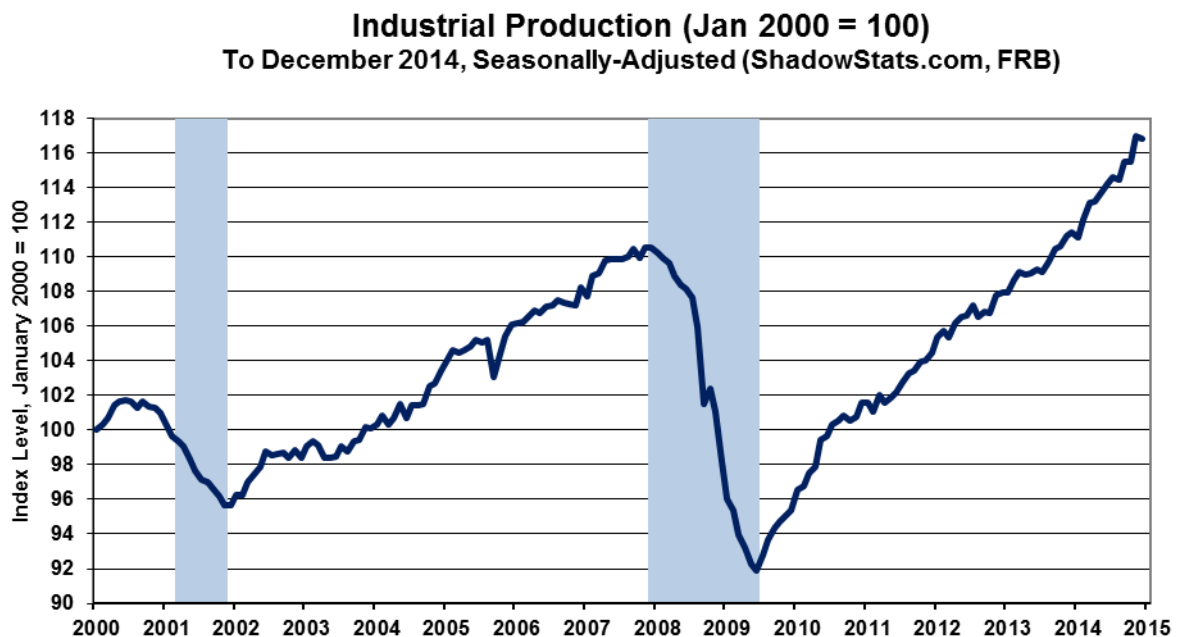
Industrial Production—Headline Detail. Headline industrial production declined by 0.11% (-0.11%) month-to-month in December, following a revised 1.30% gain in November, and a revised decline of 0.02% (-0.02%) in October. Net of prior-period revisions, the monthly contraction in December 2014 production was 0.14% (-0.14%).

By major industry group, the headline December 2014 monthly contraction of 0.1% (-0.1%) [November gain of 1.3%] in aggregate production was composed of a December gain of 0.3% [November gain of 1.3%] in manufacturing; a 2.2% December gain [November contraction of 0.3% (-0.3%)] in mining; and a December decline of 7.3% (-7.3%) [4.2% November gain] in utilities.

Year-to-year growth in December 2014 production was 4.97%, versus a revised 5.18% gain in November, and a revised 4.41% gain in October.

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

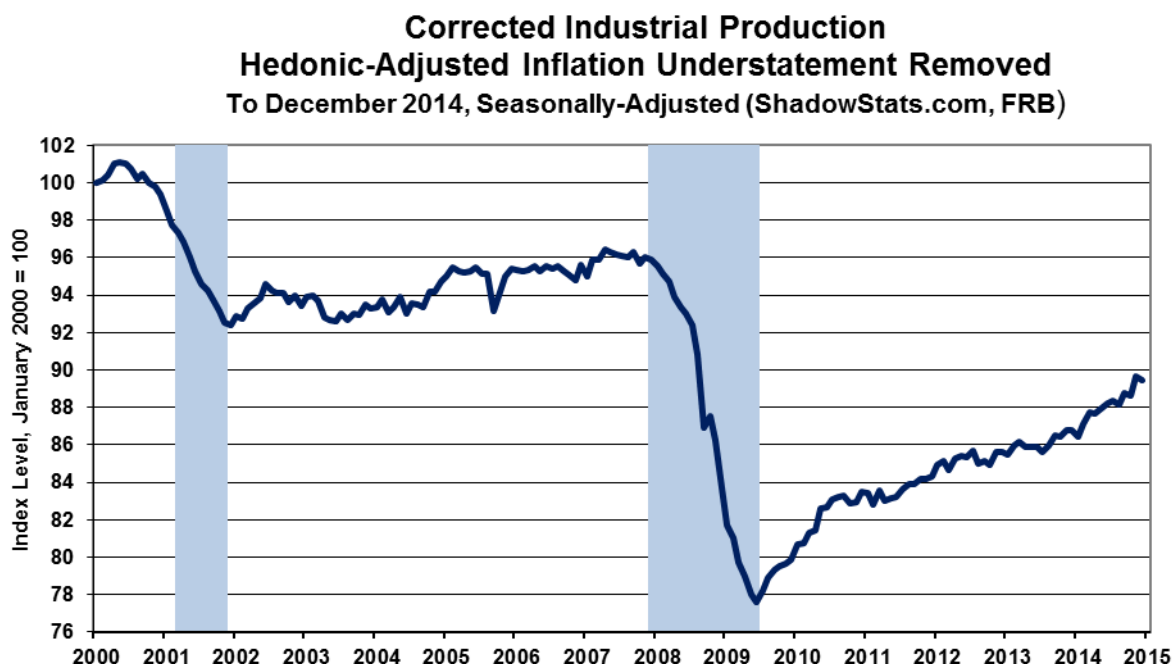
Hedonic quality adjustments to inflation understate the inflation used in deflating some components of the index of industrial production. That has the effect of overstating the resulting inflation-adjusted growth in the headline industrial production series (see [Public Comment on Inflation](#) and the *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. Estimated hedonic-inflation adjustments have been backed-out of the official industrial-production deflators used for headline reporting.

The “corrected” second graph (following) 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. 684](#)). 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 2010, with irregular quarterly contractions seen through 2014, and an irregular uptrend in

the stagnation into 2014, with a jump in headline November 2014 reporting and some pullback in December 2014. Again, the series remains well shy of a formal recovery.



[Further background detail on the CPI, PPI, Industrial Production, Real Retail Sales and Earnings are included the Reporting Detail. Various drill-down and graphics options on the headline CPI and Industrial Production data also are available to subscribers at our affiliate: www.ExpliStats.com].

HYPERINFLATION WATCH

Hyperinflation Outlook Summary. This sub-section will be updated post-Special Commentary. See [Commentary No. 684](#) for the last version of the *Hyperinflation Summary*.

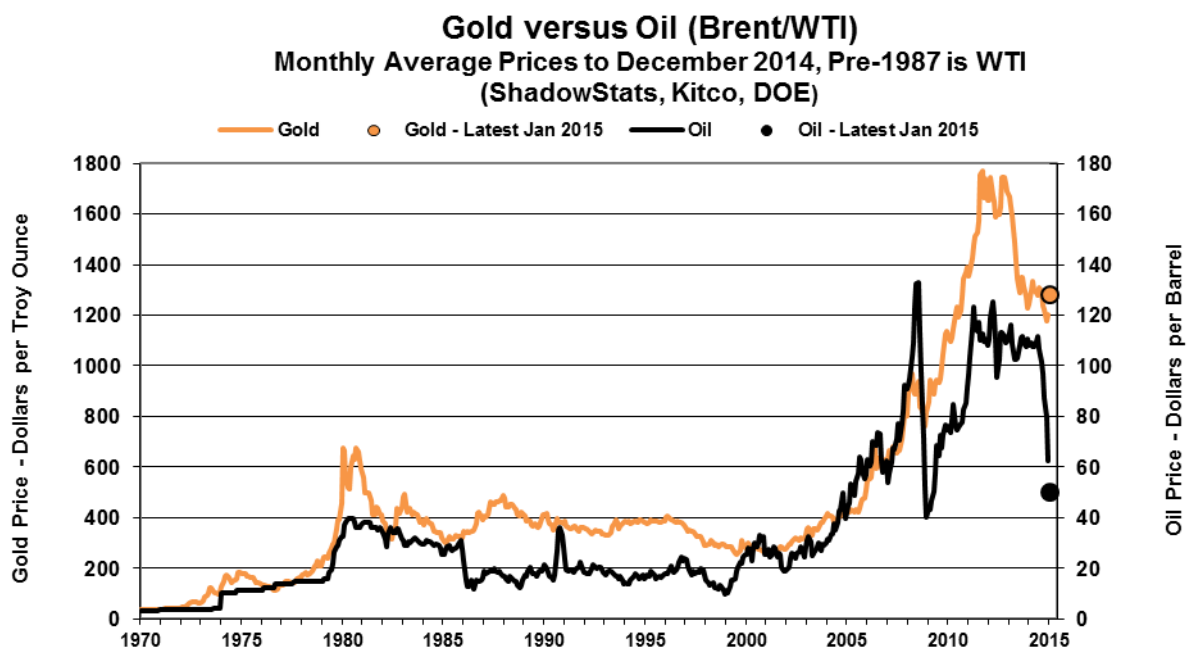
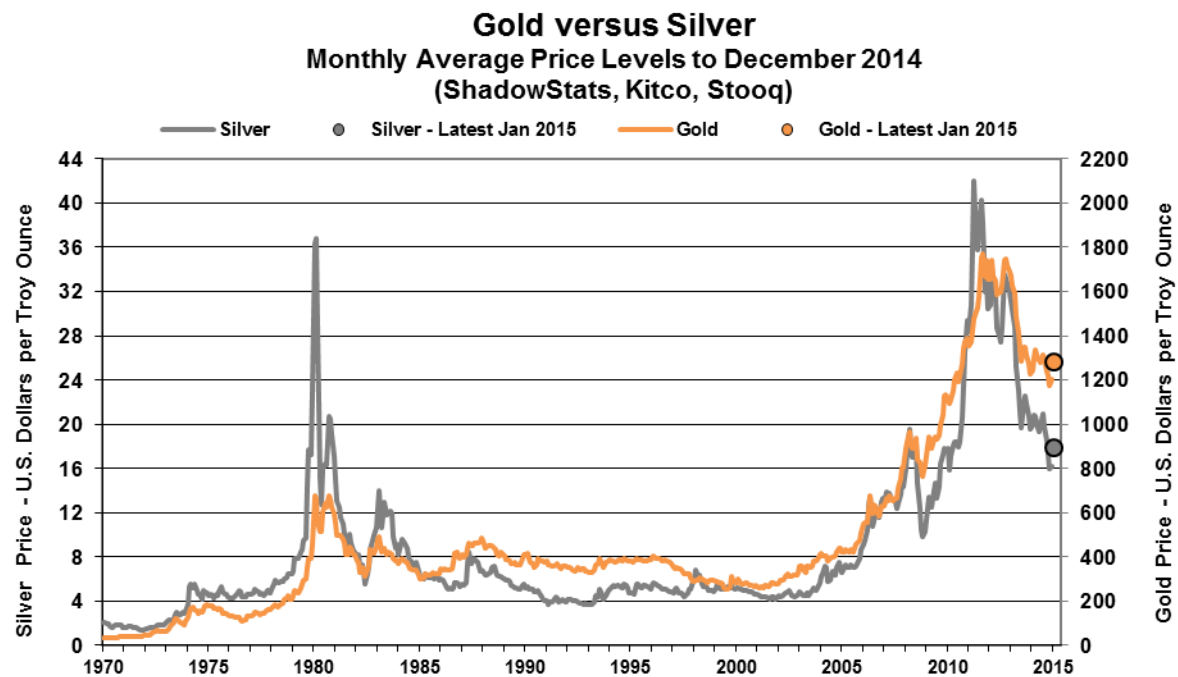
Monthly Gold Graphs. The following two graphs are from the traditional gold graphs that accompany the *CPI Commentaries*. The third of these regular graphs, with the Swiss franc, is included in the *Opening Comments* section. The plots are updated through today, January 16th, reflecting late-afternoon New York prices for the "Latest January" points in the graphs, all in the wake of the Swiss franc removing its pegging versus the euro. A version of these basic graphs also is included in the *Nominal Markets* section of the pending *Special Commentary*. At such time as the U.S. dollar begins a broadly based, massive sell-off, offsetting sharp rallies likely will be seen on coincident basis for gold and silver prices, as well as for oil prices.

Dollar Strength Distorts the Financial Markets. Discussed in [Commentary No. 680](#) and updated extensively in the pending *Special Commentary*, continuing strength in the exchange-rate value of the U.S. dollar against other major Western currencies has been and remains the primary distorting element, at present, in various financial markets. Touched upon in *Opening Comments*, the current Swiss franc developments are the first major crack in the U.S. dollar's façade, since extraordinary measures were put in place to quell the dollar-selling panic, which followed the August 2011 downgrade of the sovereign credit rating of the United States by Standard & Poor's.

The stronger U.S. currency has been a fundamental and primary depressant for oil prices, which have continued to decline. Also at play with falling oil prices are apparent ongoing efforts by the United States in creating financial stress and pressure on Russia. The stronger dollar also has been a primary depressant of, or otherwise has reflected shifts of underlying sentiment for, gold and silver prices, although the precious metals' prices currently are off their near-term bottom levels seen in November 2014, and have rallied some since the non-intervention to depress the Swiss franc.

Otherwise, relative fundamentals supporting the dollar and the current circumstance range from popular market perceptions of a strong U.S. economy and a Federal Reserve in stable control of its system, to improving U.S. fiscal conditions. Unchanged from the discussion in *No. 680*, though, and again as will be explored more deeply in the pending *Special Commentary*, each of those positive perceptions, viewed relative to major U.S. trading partners, is terribly flawed and is not likely to outlive first-quarter 2015. Further systemic shocks and negative surprises lie ahead, as headline underlying U.S. economic reporting turns lower, and any faux "good" behavior by the Fed or federal government evaporates along with the illusion of a relative economic boom.

Other elements ranging from continued efforts by the Federal Reserve to maintain low interest rates and a widening trade deficit, to a nonfunctioning federal government and increasingly dangerous and unstable global political conditions should join in a confluence of negative factors, along with degraded economic and related federal-government and central-bank behavior, to drive the U.S. dollar into oblivion.



REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (December 2014)

Annual CPI-U Inflation Dropped to 0.8% in December, but Tumbling Oil and Gasoline Prices Should Bottom Out in the Next Couple of Months. Discussed regularly here, selling pressure on oil has continued—largely unabated since June 2014—tied to what still appears to be U.S.-orchestrated efforts to intensify financial stress on Russia. The circumstance is tied closely to the recent ongoing strength in the U.S. dollar, which also should prove to be a transitory phenomenon (see discussions in the pending *Special Report*).

Temporarily-depressed headline-inflation rates help to boost, temporarily, the reporting of real, or inflation-adjusted, series. Where inflation growth gets subtracted from the nominal, or not-inflation adjusted series, the effect of negative inflation is to add to or increase the pace of real growth. Nonetheless, the economy slowed at a fast enough pace so that December real retail sales, which dropped by a nominal 0.94% (-0.94%) month-to-month, still contracted by 0.57% (-0.57%) for the month, after absorbing the headline monthly inflation decline of 0.37% (-0.37%) in the CPI-U.

In contrast, what had been "unchanged" month-to-month nominal average weekly earnings in December 2014, ended up showing a headline real gain of 0.51% for the month, due entirely to the headline monthly contraction of 0.51% (-0.51%) in the CPI-W. More heavily dependent upon gasoline prices than the CPI-U, the CPI-W is more vulnerable to changes in gasoline prices.

Although the pace of annual inflation also has slowed with decline in monthly oil prices, year-to-year inflation is not quite as soft as indicated by headline reporting, when considered in the context of traditional CPI reporting and common experience.

Government Inflation Numbers Standardly Are Well Shy of Reality. Inflation as viewed from the standpoint of common experience—generally viewed by the public in terms of personal income or investment use—continues to run well above any of the government's rigged price measures. CPI reporting methodologies in recent decades deliberately were changed so as to understate the government's reporting of consumer inflation, and that inflation-understatement fraud is being expanded. The pace of inflation has been understated, through efforts to adjust for economic substitutions in the CPI surveying (*i.e.*, hamburger being purchased in lieu of more-expensive steak), and by not reflecting actual out-of-pocket costs in its surveying, with generally downside hedonic-quality adjustments made to prices, all as detailed in the [Public Comment on Inflation Measurement](#).

Contrary to its traditional structure, the CPI no longer reflects the cost of living of maintaining a constant standard of living. As a result, those who set or target their income or investment growth to the government's faux headline CPI number simply cannot stay even with inflation, unless they massively exceed their targets.

Longer-Range Inflation Outlook. Going forward, and as discussed generally in [2014 Hyperinflation Report—The End Game Begins](#) – *First Installment Revised* and as will be updated and reviewed in the *Special Commentary*, high risk of a massive flight from the U.S. dollar early in 2015 threatens to generate rapid, upside energy and global-commodity inflation, which would drive headline U.S. consumer inflation much higher. Nascent dollar problems could surface and accelerate at any time, with little warning. Intensifying financial-market turmoil surrounding deteriorating global and domestic political, fiscal and monetary instabilities, and rapidly worsening economic activity, all should pummel the U.S. dollar. Ongoing economic and financial-system-liquidity crises still threaten systemic instabilities that, as with their 2008 Panic precursors, cannot be contained without further, official actions that have serious inflation consequences.

Notes on Different Measures of the Consumer Price Index

The Consumer Price Index (CPI) is the broadest inflation measure published by the U.S. Government, through the Bureau of Labor Statistics (BLS), Department of Labor:

*The **CPI-U (Consumer Price Index for All Urban Consumers)** is the monthly headline inflation number (seasonally adjusted) and is the broadest in its coverage, representing the buying patterns of all urban consumers. Its standard measure is not seasonally-adjusted, and it never is revised on that basis except for outright errors.*

*The **CPI-W (CPI for Urban Wage Earners and Clerical Workers)** covers the more-narrow universe of urban wage earners and clerical workers and is used in determining cost of living adjustments in government programs such as Social Security. Otherwise, its background is the same as the CPI-U.*

*The **C-CPI-U (Chain-Weighted CPI-U)** is an experimental measure, where the weighting of components is fully substitution based. It generally shows lower annual inflation rate than the CPI-U and CPI-W. The latter two measures once had fixed weightings—so as to measure the cost of living of maintaining a constant standard of living—but now are quasi-substitution-based. Since it is fully substitution based, the series tends to reflect lower inflation than the other CPI measures. Accordingly, the C-CPI-U is the "new inflation" measure being proffered by Congress and the White House as a tool for reducing Social Security cost-of-living adjustments by stealth. Moving to accommodate the Congress, the BLS announced pending changes to the C-CPI-U estimation and reporting process on October 22, 2014, which are described in [Commentary No. 668](#).*

*The **ShadowStats Alternative CPI-U Measures** are attempts at adjusting reported CPI-U inflation for the impact of methodological change of recent decades designed to move the concept of the CPI away from being a measure of the cost of living needed to maintain a constant standard of living. There are two measures, where the first is based on reporting methodologies in place as of 1980, and the second is based on reporting methodologies in place as of 1990.*

CPI-U. The Bureau of Labor Statistics (BLS) reported this morning, January 16th, that headline, seasonally-adjusted CPI-U for December 2014 declined month-to-month by 0.4% (-0.4%), down by

0.37% (-0.37%) at the second decimal point, versus a headline monthly contraction in November of 0.3% (-0.3%), down by 0.26% (-0.26%) at the second decimal point. On a not-seasonally-adjusted basis, the December CPI-U fell by 0.57% (-0.57%) month-to-month, following an unadjusted 0.54% (-0.54%) contraction in November.

Monthly Gasoline Prices. The BLS used an 11.1% (-11.1%) headline monthly decline in not-seasonally-adjusted gasoline prices for December 2014, where a 12.2% (-12.2%) decline was indicated by the more-comprehensive, industry-based surveying of the Department of Energy. Generally in line with the prior-year's seasonal-adjustments to gasoline prices, the unadjusted 11.1% (-11.1%) price drop ended up as a seasonally-adjusted monthly decline of 9.4% (-9.4%) in December 2014.

Major CPI Groups. Encompassed by the seasonally-adjusted decline of 0.37% (-0.37%) in December 2014 CPI-U [down by an unadjusted 0.57% (-0.57%)], aggregate December energy inflation was down for the month by an adjusted 4.71% (-4.71%) [down by an unadjusted 5.44% (-5.44%)]. In the other major CPI sectors, adjusted food inflation was up by 0.23% for the month [up by 0.28% unadjusted], while adjusted "core" inflation was "unchanged" with an increase of 0.00% [down by 0.20% (-0.20%) unadjusted] for the month.

Core CPI-U. Separately, Core CPI-U inflation also showed unadjusted year-to-year inflation of 1.61% in December 2014, versus 1.70% in November 2014, and against 1.72% in December 2013. Annual average core inflation was 1.75% in 2014, versus 1.76% in 2013.

Seasonally adjusted, annualized quarter-to-quarter Core CPI-U inflation increased by 1.41% in fourth-quarter 2014, 1.30% in the third-quarter, 2.54% in the second-quarter and 1.61% in the first-quarter.

Quarter-to-Quarter CPI-U. Seasonally adjusted, annualized quarter-to-quarter CPI-U inflation contracted a pace of 1.20% (-1.20%) in fourth-quarter 2014, versus positive inflation of 1.10% in the third-quarter, 3.03% in the second-quarter and 1.91% in the first-quarter.

Annual Average CPI-U. Annual average CPI-U inflation was 1.62% in 2014, versus 1.46% in 2013.

Year-to-Year CPI-U. Not seasonally adjusted, December 2014 year-to-year inflation for the CPI-U was a headline gain of 0.8% (0.76%) at the second decimal point, versus 1.3% (1.32%) in November 2014, versus 1.5% (1.50%) in December 2013.

Year-to-year, CPI-U inflation would increase or decrease in next month's January 2015 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.14% monthly inflation gain reported for January 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2015, the difference in January's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the December 2014 annual inflation rate of 0.76%.

CPI-W. The December 2014 seasonally-adjusted, headline CPI-W, which is a narrower series and has greater weighting for gasoline than does the CPI-U, fell by 0.51% (-0.51%) in December, following a contraction of 0.41% (-0.41%) in November. On a not-seasonally-adjusted basis, the December CPI-U fell by 0.71% (-0.71%) month-to-month, following an unadjusted decline of 0.72% (-0.72%) in November.

Quarter-to-Quarter CPI-W. Seasonally adjusted, annualized quarter-to-quarter CPI-W inflation contracted by 2.16% (-2.16%) in fourth-quarter 2014, after gaining 1.00% in the third-quarter, 3.07% in the second-quarter and 1.79% in the first-quarter.

Annual Average CPI-W. Annual average CPI-W inflation was 1.50 % in 2014, versus 1.37% in 2013.

Year-to-Year CPI-W. Unadjusted, December 2014 year-to-year CPI-W inflation was 0.32%, versus 1.06% in November 2014, and 1.45% in December 2013.

Chained-CPI-U. Initial reporting of unadjusted year-to-year inflation for the December 2014 C-CPI-U was 0.28%, versus 1.02% in November. Year-to-year inflation as of December 2013 was 1.35%. Although not formally published by the BLS due to surveying and revision issues, implied annual average inflation here was 1.43% in 2014, versus 1.24% in 2013.

Pending Revisions and Redefinitions to various CPI Series. In next month's (February 26th) reporting of the January 2015 CPI series, the BLS will redefine the series, along with publishing revised seasonal adjustments to recent history (the historical, unadjusted CPI-U series does not get revised). ShadowStats will preview the revisions and redefinitions in advance of that release.

See the discussion in the *Opening Comments* of [Commentary No. 668](#) on the October 22nd BLS announcement of the forthcoming changes to the calculation of consumer inflation, designed to help set-up the C-CPI-U as a new measure for a reduced-inflation, cost-of-living-adjustment (COLA) for Social Security, etc.

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton methodologies—the ShadowStats-Alternate Consumer Inflation Measure (1990-Base)—year-to-year annual inflation was roughly 4.3% in December 2014, versus 4.9% in November 2014. Annual average inflation in the 1990-based measure was 5.2% in 2014, versus 4.9% in 2013.

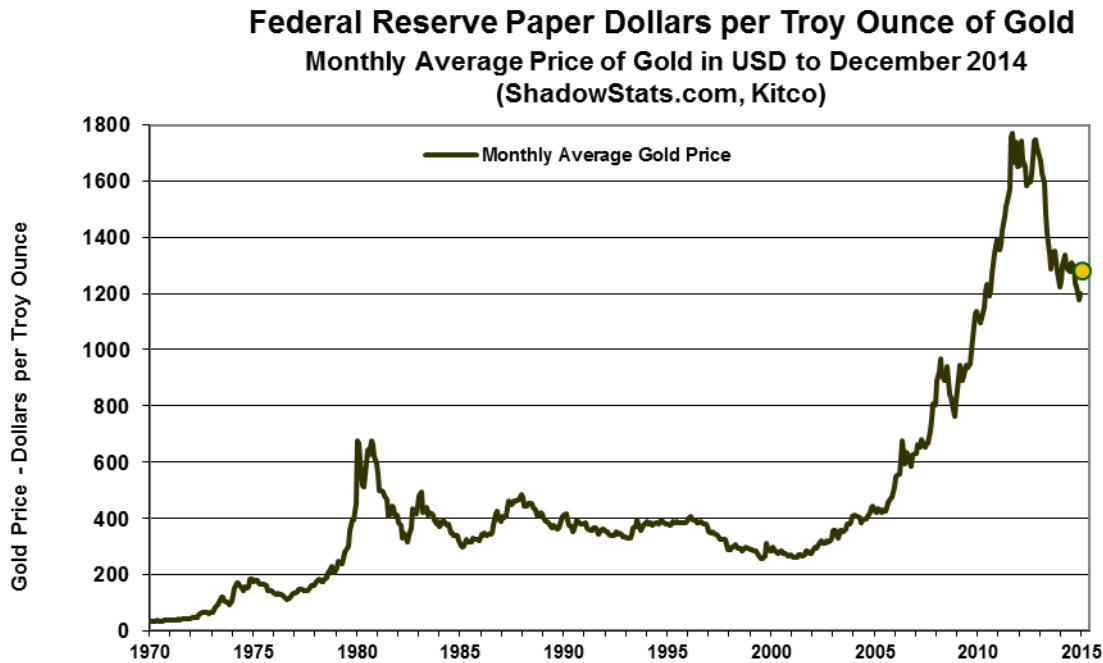
The December 2014 ShadowStats-Alternate Consumer Inflation Measure (1980-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was at about 8.4% (8.41% for those using the second decimal point) year-to-year, versus 9.0% in November. Annual average inflation was 9.3% in 2014, versus 9.1% in 2013.

[The balance of the text in this Alternate Consumer Inflation Measures sub-section is unchanged from the prior CPI Commentary.]

Note: The ShadowStats-Alternate Consumer Inflation Measure largely has been reverse-engineered from the BLS's CPI-U-RS series, which provides an official estimate of historical inflation, assuming that all current methodologies were in place going back in time. The ShadowStats estimates effectively are adjusted on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made by the BLS (the series is not recalculated).

Over the decades, the BLS has altered the meaning of the CPI from being a measure of the cost of living needed to maintain a constant standard of living, to something that neither reflects the constant-standard-of-living concept nor measures adequately what most consumers view as out-of-pocket expenditures. Roughly five percentage points of the additive ShadowStats adjustment reflect the BLS's formal estimate

of the annual impact of methodological changes; roughly two percentage points reflect changes by the BLS, where ShadowStats has estimated the impact not otherwise published by the BLS. (See [Public Commentary on Inflation Measurement and Chained-CPI](#) for further details.)



Gold and Silver Historic High Prices Adjusted for December 2014 CPI-U/ShadowStats Inflation—

CPI-U: GOLD at \$2,565 per Troy Ounce, SILVER at \$149 per Troy Ounce

ShadowStats: GOLD at \$11,359 per Troy Ounce, SILVER at \$661 per Troy Ounce

Despite the September 5, 2011 historic-high gold price of \$1,895.00 per troy ounce (London afternoon fix), and despite the multi-decade-high silver price of \$48.70 per troy ounce (London fix of April 28, 2011), gold and silver prices have yet to re-hit their 1980 historic levels, adjusted for inflation. The earlier all-time high of \$850.00 (London afternoon fix, per Kitco.com) for gold on January 21, 1980 would be \$2,565 per troy ounce, based on December 2014 CPI-U-adjusted dollars, and \$11,359 per troy ounce, based on December 2014 ShadowStats-Alternate-CPI (1980-Base) adjusted dollars (all series not seasonally adjusted).

In like manner, the all-time high nominal price for silver in January 1980 of \$49.45 per troy ounce (London afternoon fix, per silverinstitute.org)—although approached in 2011—still has not been hit since 1980, including in terms of inflation-adjusted dollars. Based on December 2014 CPI-U inflation, the 1980 silver-price peak would be \$149 per troy ounce and would be \$661 per troy ounce in terms of December 2014 ShadowStats-Alternate-CPI (1980-Base) adjusted dollars (again, all series not seasonally adjusted).

As shown in Table 1, on page 31 of [2014 Hyperinflation Report—The End Game Begins – First Installment Revised](#), over the decades, the increases in gold and silver prices have compensated for more

than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation. They also effectively have come close to fully compensating for the loss of purchasing power of the dollar based on the ShadowStats-Alternate Consumer Price Measure (1980-Methodologies Base).

Real (Inflation-Adjusted) Retail Sales—December 2014—Headline Monthly Contraction of 0.6%, Annual Growth Again at Recession Level. In nominal terms, before adjustment for inflation, headline monthly retail sales declined by a statistically-significant, seasonally-adjusted 0.94% (-0.94%) in December 2014, having increased by 0.41% (previously up by 0.72%) in November, as discussed in [Commentary No. 687](#).

Official Headline Reporting of Real Retail Sales. Based on today's (January 16th) reporting of a headline decline of 0.37% (-0.37%) in the December 2014 CPI-U, and in the context of a 0.26% (-0.26%) headline November CPI-U decline, seasonally-adjusted real monthly retail sales fell by 0.57% (-0.57%) in December, following a revised 0.67% (previously 0.98%) gain in November.

In terms of annualized quarter-to-quarter growth, real retail sales in fourth-quarter 2014 were up by 3.01% versus the third-quarter. In turn, third-quarter annualized growth was up 3.14%, the second-quarter was up 6.49%, and the first-quarter contracted at a 1.17% (-1.17%) annualized pace.

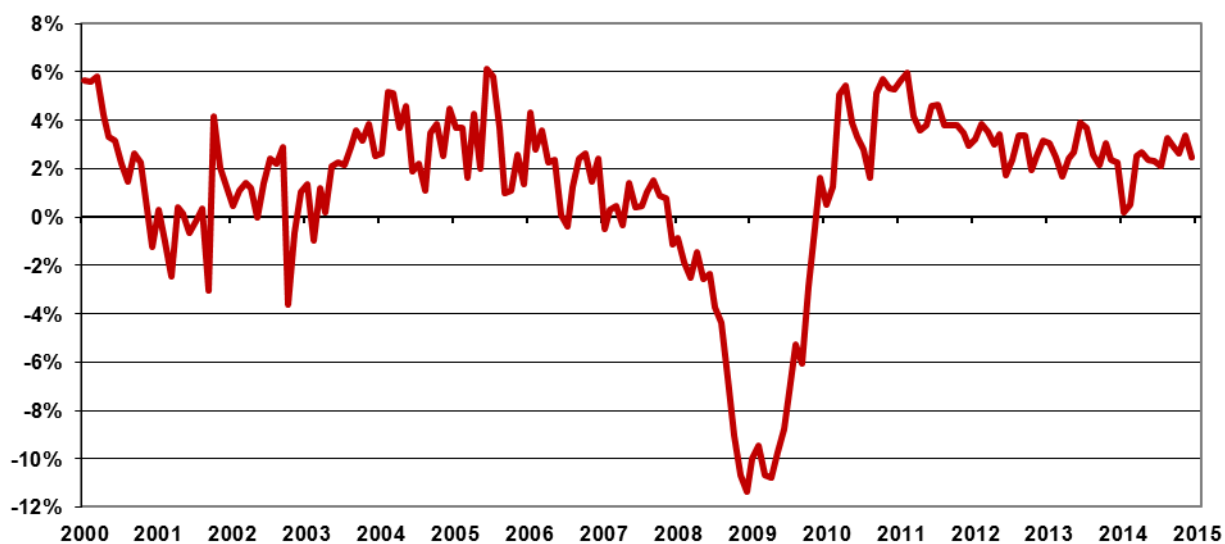
Year-to-year change in December 2014 real retail sales slowed to 2.49%, at the upper bounds of traditional recession territory, versus November's downwardly revised real annual gain of 3.37% (previously 3.80%). In normal economic times, annual real growth at or below 2.0% would signal an imminent recession. That signal had been given recently; a signal that still is in play and likely will serve as an indicator of renewed downturn in broad economic activity. Annual real growth in retail sales is plotted in both the second and fourth graphs following.

Real Retail Sales Graphs. The first of the following four accompanying graphs shows the level of real retail sales activity (deflated by the CPI-U) since 2000; the second graph shows year-to-year percent change for the same period. The level of monthly activity turned lower in the latest headline reporting. Year-to-year activity, which had plunged to a near-standstill in January and February 2014, had bounced back irregularly, hitting its high level for 2014 in November 2014, but it fell back towards two-percent in December. The third and fourth graphs show the level of, and annual growth in, real retail sales (and its predecessor series) in full post-World War II detail.

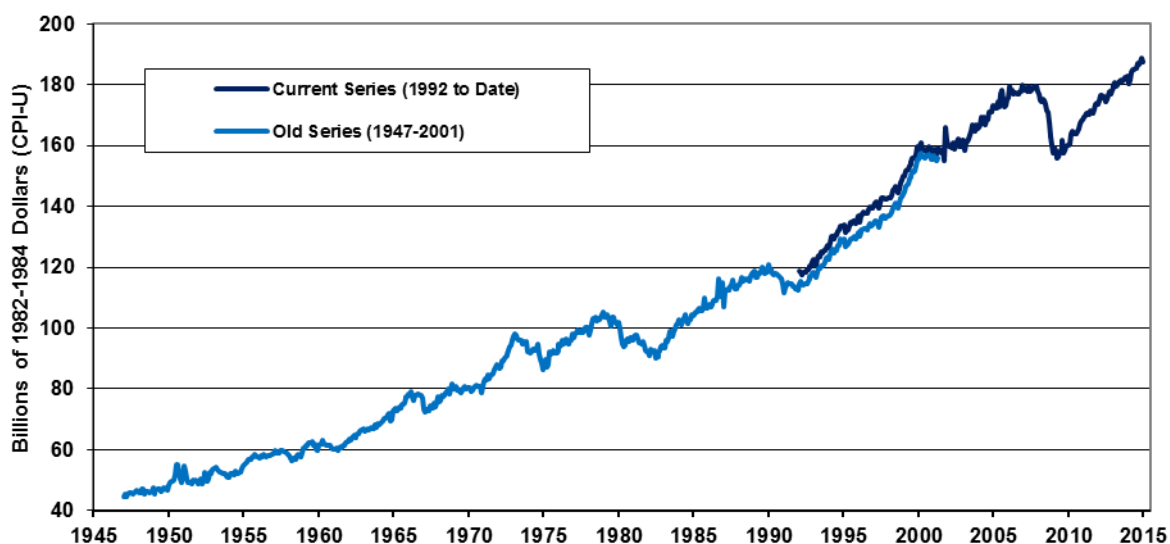
Real Retail Sales (Deflated by CPI-U), Revised
To December 2014, Seasonally-Adj. (ShadowStats, Census, BLS)



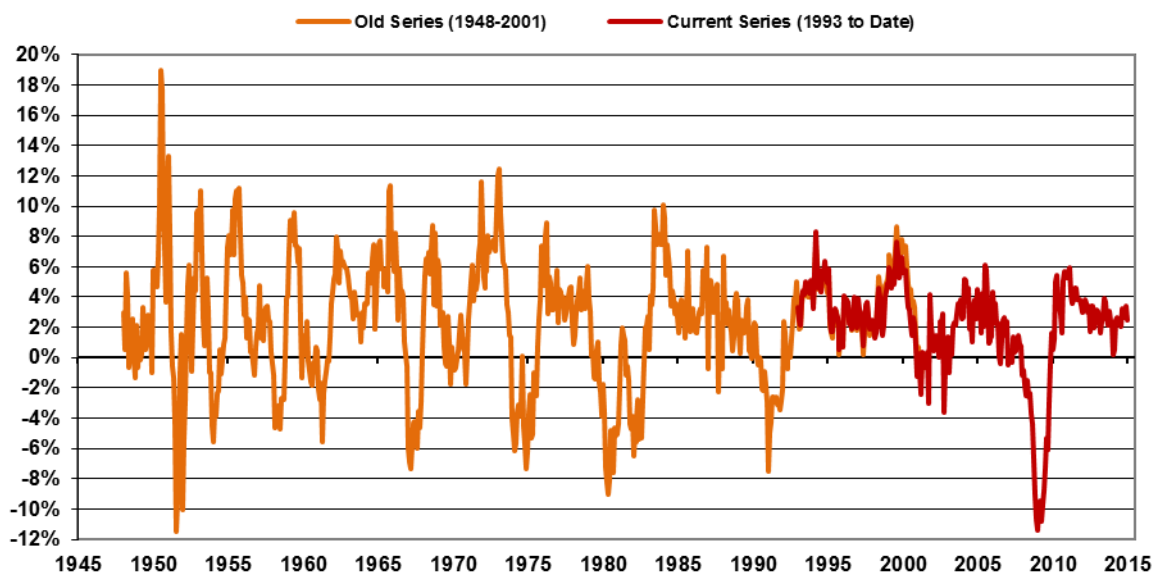
Real Retail Sales Year-to-Year % Change
To December 2014, Seasonally-Adj. (ShadowStats, Census, BLS)



Real Retail Sales (Deflated by CPI-U)
To December 2014, Seasonally-Adj. (ShadowStats, St. Louis Fed)



Real Retail Sales Yr/Yr Percent Change
To December 2014, Seasonally-Adj. (ShadowStats, St. Louis Fed)



The apparent “recovery” in the real retail sales series and (and series such as industrial production and GDP) is due to the understatement of the rate of inflation used in deflating retail sales and other series. As discussed more fully in *Chapter 9* of [2014 Hyperinflation Report—Great Economic Tumble – Second](#)

Installment, deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating inflation-adjusted economic growth.

As shown in the latest “corrected” real retail sales graph, in the *Opening Comments* section, with the deflation rates corrected for understated inflation, the recent pattern of real sales activity has turned increasingly negative. The corrected graph shows that the post-2009 period of protracted stagnation ended, and a period of renewed contraction began in second-quarter 2012. The corrected real retail sales numbers use the ShadowStats-Alternate Inflation Measure (1990-Base) for deflation instead of the CPI-U.

Separately, as discussed in [Commentary No. 684](#) and [Commentary No. 687](#), and as explored further with new detail in the pending *Special Commentary*, during the last six-plus years of economic collapse and stagnation, consumer buying of goods and services has been constrained by the intense, structural-liquidity woes besetting the consumer. Indeed, impaired consumer liquidity remains the primary structural issue preventing meaningful, domestic U.S. economic growth. 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 traditional, consumption-based growth or recovery in U.S. economic activity, including not only retail sales and the still-dominant personal-consumption account of the GDP, but also residential investment and related construction spending. There never was a broad economic recovery, and there is no recovery underway, just general bottom-bouncing that has begun turning down anew.

As official consumer inflation resumes its upturn in the months ahead, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze—reflected partially by the general pattern of real earnings difficulties seen in the next section—these data should continue to trend meaningfully lower, in what should gain recognition as a formal new or double-dip recession.

Real (Inflation-Adjusted) Average Weekly Earnings—December 2014—Flat in Nominal Terms, Real Earnings Rose Due to Negative Inflation. Coincident with today's (January 16th) reporting of December 2014 CPI-W, the BLS published real average weekly earnings for the month of December 2014 (deflated by CPI-W). Again, on a seasonally-adjusted basis, headline monthly CPI-W declined by 0.51% (-0.51%) in December, following a headline decline of 0.41% (-0.41%) in November.

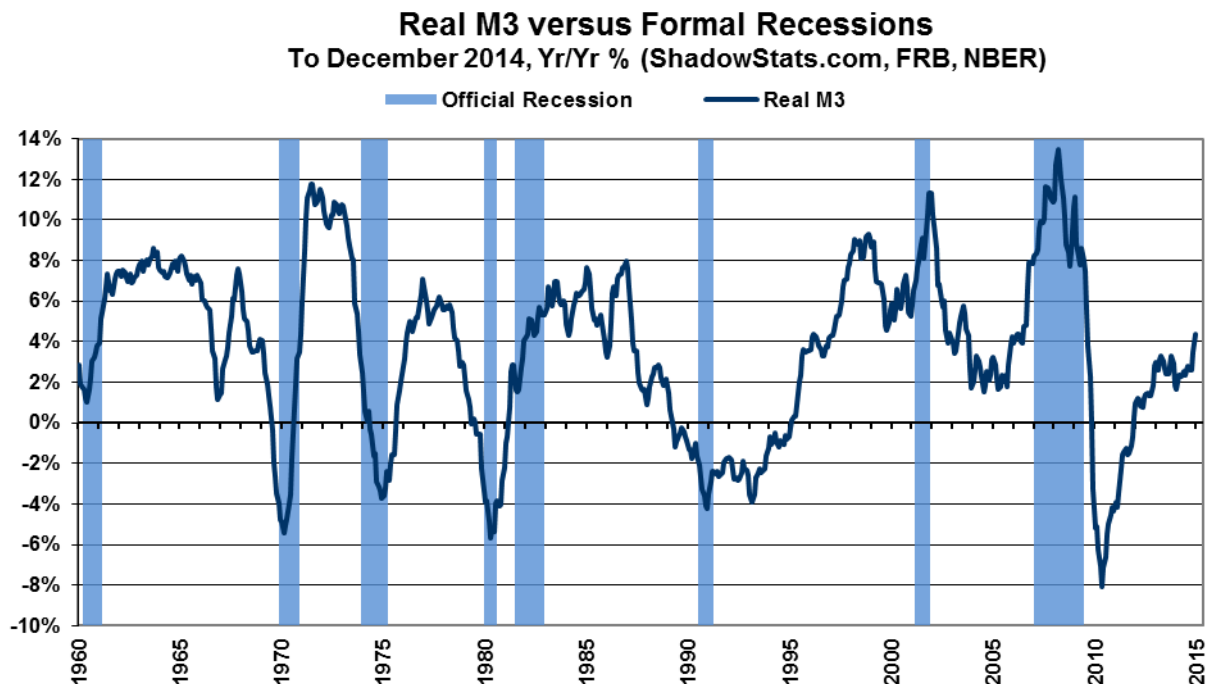
In the production and nonsupervisory employees category—the only series for which there is a meaningful history—headline real average weekly earnings, rose by 0.51% in December 2014, reflecting entirely the headline monthly decline of 0.51% (-0.51%) in CPI-W inflation. Before inflation adjustment, in nominal terms, headline average weekly earnings were unchanged in December. The December number followed a unrevised headline real gain of 0.60% in November, which reflected a 0.19% gain in nominal earnings and a headline decline of 0.41% (-0.41%) in inflation.

Year-to-year and seasonally-adjusted, December 2014 real average weekly earnings rose by 2.61%, versus an unrevised 1.45% annual gain in November. Both the monthly and annual fluctuations in this series are irregular, but current reporting remains well within the normal bounds of volatility.

The regular graph of this series is found in the *Opening Comments* section. As shown there, the graph plots the earnings as officially deflated by the BLS (red-line), and as adjusted for the ShadowStats-Alternate CPI Measure, 1990-Base (blue-line). When inflation-depressing methodologies of the 1990s began to kick-in, the artificially-weakened CPI-W (also used in calculating Social Security cost-of-living

adjustments) helped to prop up the reported real earnings. Official real earnings today still have not recovered their inflation-adjusted levels of the early-1970s, and, at best, have been flat for the last decade. Deflated by the ShadowStats measure, real earnings have been in fairly-regular decline for the last four decades, which is much closer to common experience than the pattern suggested by the CPI-W. See [Public Commentary on Inflation Measurement](#) for further detail.

Real (Inflation-Adjusted) Money Supply M3—December 2014. The signal for a double-dip or ongoing recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), remains in place and continues, despite real annual M3 growth holding in positive territory. As shown in the accompanying graph—based on December 2014 CPI-U reporting and the latest ShadowStats-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for December 2014 jumped to 4.4% from an unrevised 3.5% in November. The 0.9% increase in December annual growth reflected a 0.3% pick up in the pace of annual headline M3 growth plus a 0.6% drop in the annual inflation rate.



The signal for a downturn or an intensified downturn is generated when annual growth in real M3 first turns negative in a given cycle; the signal is not dependent on the depth of the downturn or its duration. Breaking into positive territory does not generate a meaningful signal one way or the other for the broad economy. The current downturn signal was generated in December 2009, even though there had been no upturn since the economy hit bottom in mid-2009. The broad economy tends to follow in downturn or renewed deterioration roughly six-to-nine months after the signal. Weaknesses in a number of series continued to the present, with significant new softness in recent reporting. Actual post-2009 economic activity has remained relatively low levels of activity—in protracted stagnation.

Despite purported strength in second- and third-quarter 2014 GDP activity, a renewed downturn in official data appears to be underway, and that eventually should lead to official recognition of a “new” or double-dip recession. Reality remains that the economic collapse into 2009 was followed by a plateau of low-level economic activity—no meaningful upturn, no recovery from or end to the official 2007 recession—and the unfolding renewed downturn remains nothing more than a continuation and re-intensification of the downturn that began unofficially in 2006. Further discussion of this issue is found in *Chapter 8* of the [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#).

PRODUCER PRICE INDEX—PPI (December 2014)

Collapsing Oil Prices Both Subtracted from and Added to December PPI Inflation. December 2014 headline inflation for the Final Demand Producer Price Index (PPI) was a month-to-month index contraction of 0.3% (-0.3%), reflecting an oil-price-plunge-driven 1.2% (-1.2%) drop in Final Demand Goods inflation, and largely offsetting oil-price-plunge-driven 0.2% increase in the more-heavily weighted Final Demand Services index.

Unlike the Antiquated Production Costs Concept, Rising Margins Can Reflect Falling Costs as Well as Rising Prices. Traditional production costs—effectively Final Demand Goods—fell month-to-month in December by 1.2% (-1.2%), in tandem with a 6.6% (-6.6%) plunge in Final Demand Energy costs. Reflecting the absurdities of the newly redefined aggregate PPI concept, however, the partial offset to the goods deflation from the headline 0.2% increase in Final Demand Services inflation also reflected falling costs tied to collapsing oil prices.

The difference is that the services inflation reflects changes in margin instead of in costs. Discussed in earlier PPI *Commentaries*, margins are not the same thing as the level of prices realized in sales; they are a function of prices received versus cost or prices paid for the product or service. Where rising margins can reflect lower costs-paid-out, as well as higher prices-received, the current stronger margins are due largely to a decline in oil-related prices, at cost, with a corresponding, related cut in prices-received not being passed along either immediately or fully to the next level of consumption.

This nonsense was confirmed in the BLS PPI press release of January 15th: “*Product detail: Leading the December rise in prices for final demand services, margins for fuels and lubricants retailing jumped 24.7 percent.*”

Inflation that Is More Theoretical than Real World? [The background text here is largely as published in the prior PPI Commentary.] Effective with January 2014 reporting, a new Producer Price Index (PPI) replaced what had been the traditional headline monthly measure of wholesale inflation in Finished Goods (see [Commentary No. 591](#)). In the new headline monthly measure of wholesale Final Demand, Final Demand Goods basically is the old Finished Goods series, albeit expanded.

The new and otherwise dominant Final Demand Services sector 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 subsequently would move to raise prices, in an effort to regain more-normal margins. In like manner, in the recent circumstance of

"increased" margins—most likely due to the lower cost of petroleum-related products not being passed along immediately to customers—competitive pressures to lower margins would tend to be reflected eventually in reduced retail prices (CPI). The oil-price versus margin gimmick works both way. In times of rapidly rising oil prices, it mutes the increase in Final Demand inflation, in times of rapidly decline oil prices, it tends to mute the decline in Final Demand inflation.

The new PPI series remains an interesting concept, but it appears limited as to its aggregate predictive ability versus general consumer inflation. Further, there is not enough history available on the new series (just six years of post-2008-panic data) to establish any meaningful relationship to general inflation or other economic or financial series.

December 2014 Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported, Thursday, January 15th, that the seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for December 2014 declined by 0.27% (-0.27%), versus a decline of 0.18% (-0.18%) in November.

The impact of seasonal adjustments on the headline monthly December aggregate number was positive, with the unadjusted monthly PPI change in December a contraction of 0.36% (-0.36%), versus a drop of 0.45% (-0.45%) in November. Also on a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year headline PPI inflation eased to 1.10% in December, versus 1.37% in November 2014. Year-to-year inflation was 1.20% in December 2014. On an annual average basis, PPI Final Demand was up by 1.65% in 2014, versus a gain of 1.30% in 2013.

In terms of the three major subcategories for December 2014 Final Demand PPI, headline monthly Final Demand Goods inflation contracted by 1.24% (-1.24%), Final Demand Services inflation rose by 0.18%, and Final Demand Construction inflation was "unchanged."

Final Demand Goods (Weighted at 34.40% of the Aggregate). Running somewhat in parallel with the old Finished Goods PPI series, headline monthly Final Demand Goods inflation in December 2014 was down by 1.24% (-1.24%), following a decline of 0.70% (-0.70%) in November. There was an aggregate neutral impact on the December 2014 reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, headline December final demand goods inflation also contracted by 1.24% (-1.24%) for the month.

Unadjusted, year-to-year goods inflation was down by 0.98% (-0.98%) in December 2014, versus an annual gain of 0.45% in November 2014. December 2013 goods inflation was up by 0.08% year-to-year. On an annual average basis, PPI Final Demand Goods inflation was up 1.33% in 2014, versus 0.81% in 2013.

Headline seasonally-adjusted monthly changes by major components for December 2014 Final Demand Goods:

- "Foods" inflation dropped by 0.41% (-0.41%) in December, versus a decline of 0.16% (-0.16%) in November, with December's headline monthly decline in inflation weakened by seasonal adjustments. Unadjusted, December food inflation fell by 0.25% (-0.25%) for the month.

- "Energy" inflation plunged by 6.64% (-6.64%) in December, having declined by 3.05% (-3.05%) in November, with the December negative reading narrowed by seasonal adjustments. Unadjusted December energy inflation declined by 6.94% (-6.94%) month-to-month.
- "Less foods and energy" ("Core" goods) inflation rose by 0.18% in December 2014, having declined by 0.09% (-0.09%) in November. Seasonal adjustments were a positive for "core" inflation, with an unadjusted December monthly gain of 0.09%.

Final Demand Services (Weighted at 63.52% of the Aggregate). Headline monthly Final Demand Services inflation rose by 0.18% in December 2014, having gained 0.09% in November 2014. The overall impact on the December services inflation reading from underlying seasonal-factor adjustments was positive, with an unadjusted gain of 0.09% in the current month.

Year-to-year unadjusted inflation was 2.23% in December 2014, versus 1.86% in November. Year-to-year inflation as of December 2013 was 1.32%. On an annual average basis, PPI Final Demand Services inflation was up 1.77% in 2014, versus 1.61% in 2013.

The headline monthly changes by major component for December 2014 Final Demand Services inflation:

- "Services less trade, transportation and warehousing" inflation increased by 0.19% in December 2014 versus a 0.09% gain in November. Seasonal-adjustment impact on the December detail was positive. Unadjusted monthly change in December 2014 was a decline of 0.09% (-0.09%).
- "Transportation and warehousing" inflation declined by 0.08% (-0.08%) in December, having plunged by 0.84% (-0.84%) in November. Seasonal adjustments had negative impact, turning the unadjusted December gain of 0.09% into a monthly decline.
- "Trade" inflation rose by 0.63% in December 2014, following a 0.09% monthly gain in November. Seasonal adjustments had a positive impact here, where the unadjusted monthly inflation gain in December was 0.27%.

Final Demand Construction (Weighted at 2.08% of the Aggregate). Although a fully self-contained subsection of the Final Demand PPI, Final Demand Construction inflation receives no formal headline coverage. Nonetheless, headline numbers are published. Headline monthly construction inflation was "unchanged" in December 2014 for the second month. The impact of seasonal factors on the December reading was neutral.

On an unadjusted basis, year-to-year inflation was 2.11% in December 2014, versus 2.20% in November. In December 2013, annual year-to-year inflation here was 3.21%. On an annual average basis, PPI Final Demand Construction was up 2.88% in 2014, versus 1.90% in 2013.

Discussed in [Commentary No. 679](#), ShadowStats now uses the "final demand construction" index for deflating headline activity in the monthly construction-spending series.

PPI-Inflation Impact on Pending Reporting of Durable Goods. As to the upcoming reporting December 2014 new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods in December 2014 was "unchanged" versus a negative 0.06% (-0.06%) in November, with annual inflation of 1.09% in December 2014, versus 1.15% in November. December durable goods orders will be published on January 27th and reviewed in the *Commentary* of that date.

INDEX OF INDUSTRIAL PRODUCTION (December 2014)

Unseasonably Warm Weather Hit December Utility Usage and Industrial Production. Headline December 2014 industrial production fell by 0.1% (-0.1%), which was about as expected, but there also was a small downside revision to November production. Warmer-than-usual weather hit utility usage hard—tied to heating—generating a seasonally-adjusted plunge in utility usage. That more than offset gains in manufacturing and mining (oil and gas production). There was little catch-up in this reporting, with the production series looking much as it did last month, in aggregate.

Industrial Production—December 2014. The Federal Reserve Board released its first estimate of seasonally-adjusted, December 2014 industrial production this morning (January 16th). Headline monthly production declined by 0.11% (-0.11%) in December, following a revised 1.30% (previously 1.26%) gain in November, and a revised 0.02% (-0.02%) decline, previously 0.07% gain, initially a contraction of 0.11% (-0.11%) in October. Net of prior-period revisions, December 2014 production contracted month-to-month by 0.14% (-0.14%).

By major industry group, the headline December 2014 monthly contraction of 0.1% (-0.1%) [November gain of 1.3%] in aggregate production was composed of a December gain of 0.3% [November gain of 1.3%] in manufacturing; a 2.2% December gain [November contraction of 0.3% (-0.3%)] in mining; and a December decline of 7.3% (-7.3%) [4.2% November gain] in utilities.

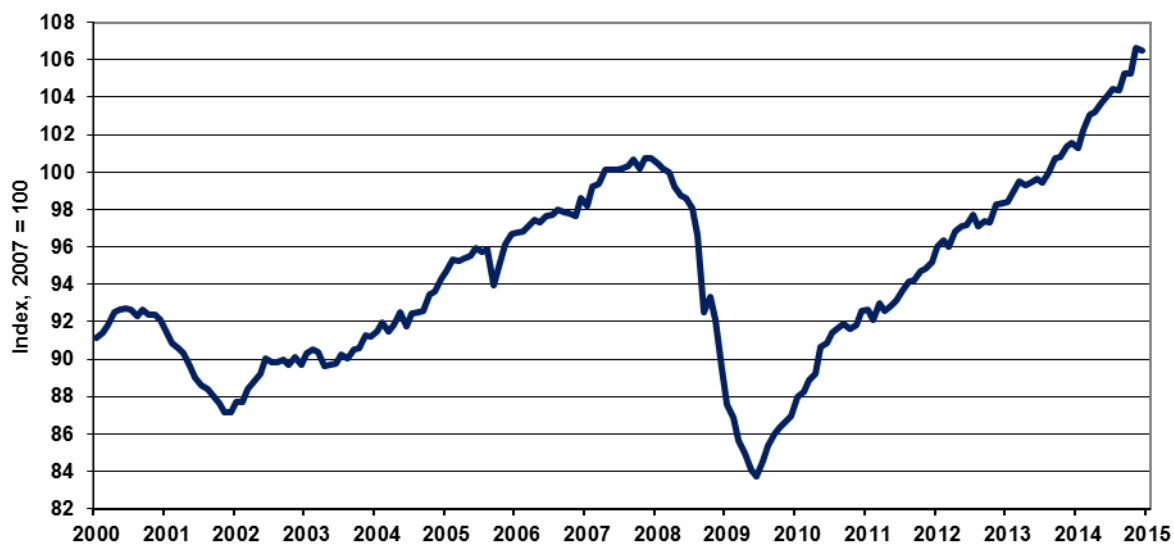
Year-to-year growth in December 2014 production was 4.97%, versus a revised 5.18% (previously 5.22%) gain in November, and a revised 4.41% (previously 4.48%, initially 4.01%) gain in October.

Massive Benchmark Revisions Should Show Much-Weaker Production in Recent Years. Discussed in last month's production *Commentary*, the Federal Reserve publishes an annual benchmark revision to the industrial production series, correcting historical detail for more complete information as it becomes available. The March 2014 benchmark revision, however, largely was incomplete, lacking detail from the regular Census of Manufactures (2012), which apparently had been delayed in its release by the government shutdown of October 2013. As a result, what should have been massive downside revisions to 2012 and 2013 industrial production activity (and broader GDP activity) never took place (see [Commentary No. 613](#)).

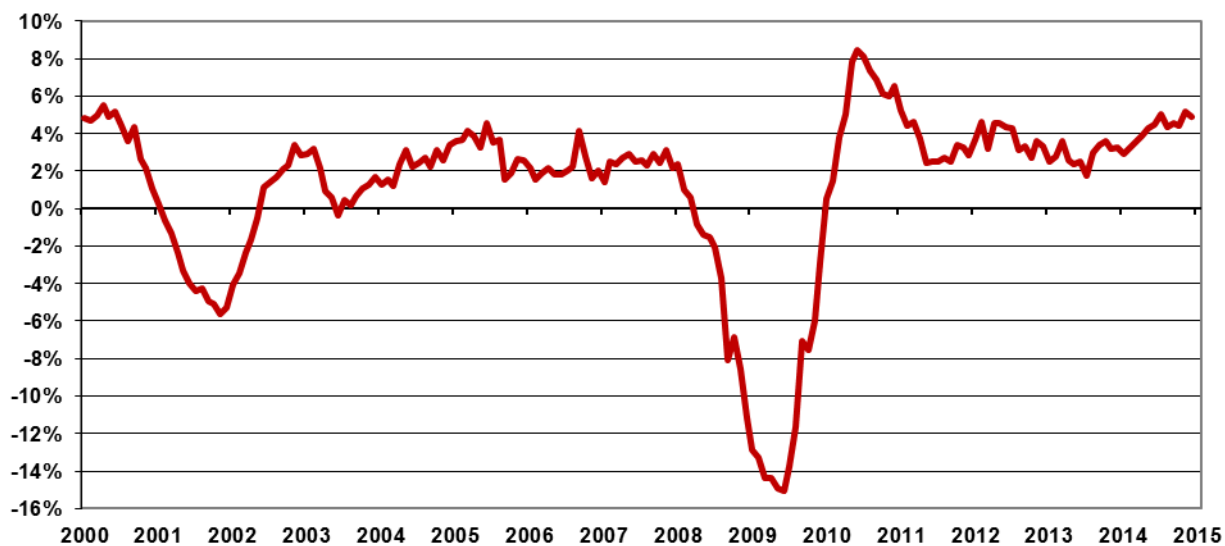
That should be corrected sometime in second-quarter 2015 (the timing still is not specific). Along with press release for November (and again with December) industrial production, the Federal Reserve announced that rough timing for its 2015 annual benchmarking, including "new annual benchmark data for 2012 [previously missing] and 2013 manufacturing ..."

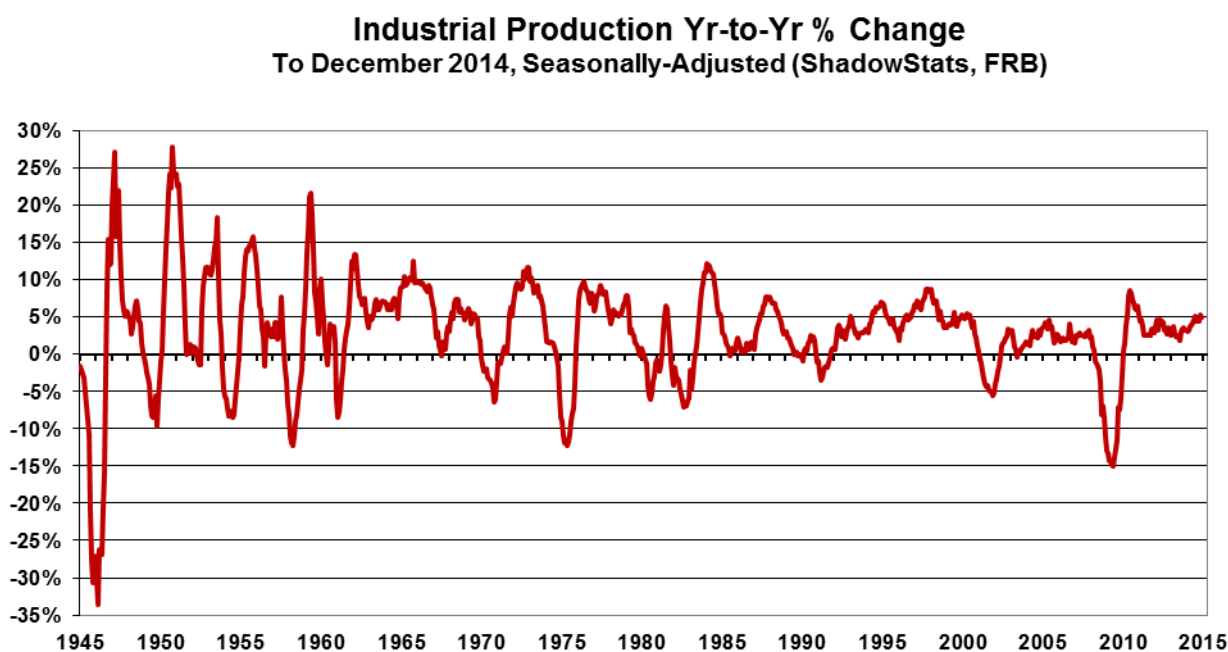
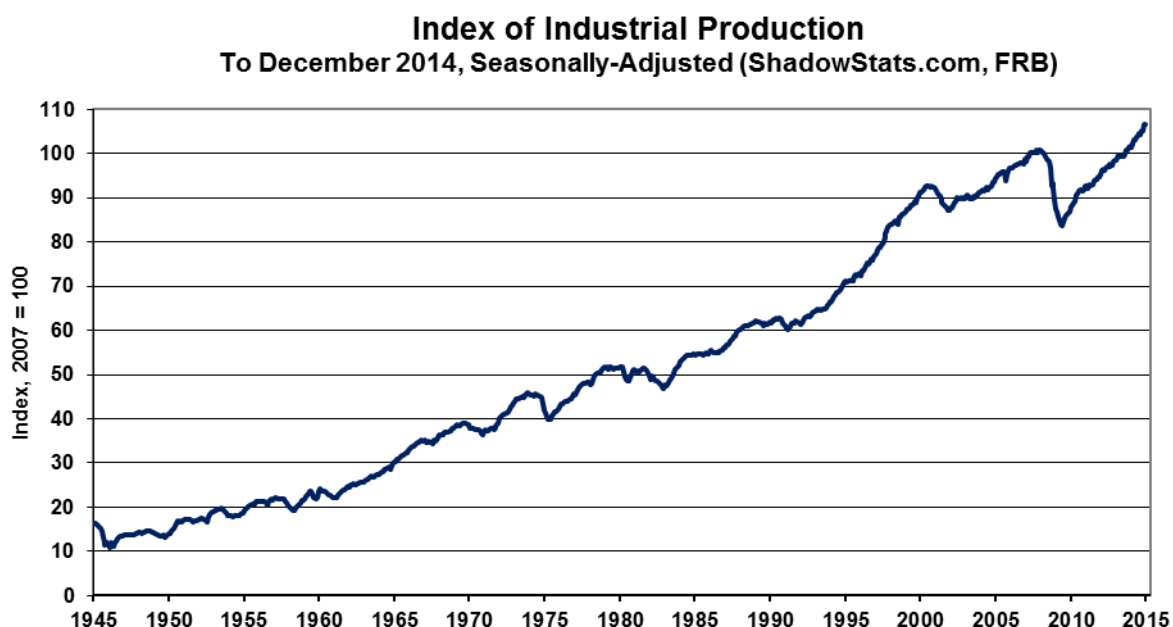
Production Graphs. The following two sets of graphs reflect headline industrial production activity to date. The first graph in the first set shows the monthly level of the production index, with November 2014 having setting an historic high level for the series, before the small decline in December. 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.

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



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





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, headed lower again through October, and moved slightly higher and then lower respectively in November and December 2014 reporting. Even so, 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.

Although official production levels have moved higher since the June 2009 trough, corrected for the understatement of inflation used in deflating portions of the industrial production index (see the *Opening Comments* section) the series has shown more of a pattern of stagnation with a slow upside trend, since 2009, with irregular quarterly contractions since. The slow uptrend continued into 2014, with a boost in November reporting and some pullback in December. The "corrected" series remains well shy of a formal recovery.

WEEK AHEAD

Against Overly-Optimistic Expectations, Economic Releases and Revisions in the Months Ahead Should Trend Much Weaker; Inflation Releases Should Be Increasingly Stronger after the Impact of Temporary Oil-Price Declines. Shifting some to the upside, again, from the downside, amidst wide fluctuations in the numbers, market expectations for business activity remain overly optimistic in the extreme. They exceed any potential, underlying economic reality. Downside corrective revisions and an accelerating pace of downturn in broad-based headline economic reporting should hammer those expectations in the next several months. Recent GDP excesses, however, will not face downside revisions until the July 30, 2015 benchmark revision to that series (see [Commentary No. 684](#)).

Headline consumer inflation—dominated by gasoline and other oil-price related commodities—should hit a near-term bottom in the next two months. Significant upside inflation pressures should resume when oil prices begin their rebound, a process that should be accelerated rapidly by an eventual sharp downturn in the exchange-rate value of the U.S. dollar. These areas, the general economic outlook and longer range reporting trends are reviewed broadly in the pending *Special Commentary*.

A Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. Beyond gimmicked changes to reporting methodologies of the last several decades, ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. Data instabilities were induced partially 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. The severity and ongoing nature of the downturn 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. Again, new issues tied to GDP reporting are discussed in the pending *Special Commentary* and in [Commentary No. 684](#).

PENDING RELEASES:

Residential Construction—Housing Starts (December 2014). The Census Bureau will release December 2014 residential construction detail, including housing starts, on Wednesday, January 21st. Monthly results are likely to be unstable, not statistically meaningful but generally consistent with down-trending stagnation in the series.

As discussed in [Commentary No. 660](#) on the August version of this most-unstable of monthly economic series, the monthly headline reporting detail here simply is worthless. Not only is month-to-month reporting volatility extreme, but also those headline monthly growth rates rarely come close to being statistically-significant. Early-consensus expectations appear to be for something close to an unchanged month-to-month reading for the headline December data. That still is well shy of what until recently, usually would have been expected to be a headline monthly surge. Market expectations increasingly have shifted towards a 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, although, again, with a pattern of no statistical-significance, and 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, discussed in [Commentary No. 687](#) and as will be updated fully in the pending *Special Commentary*.