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

COMMENTARY NUMBER 696
January Retail Sales, Slowing Economy

February 12, 2015

January Retail-Sales Plunge Is on Track for a First-Quarter Contraction, Both Before and After Inflation Adjustment

The Better-Quality Headline Data are Showing a Marked Downturn in Broad Economic Activity

Gasoline and Oil Prices Appear to Be Bottoming

PLEASE NOTE: The next regular Commentary *is scheduled for Wednesday, February 18th, covering January industrial production, housing starts and the producer price index (PPI).*

Best Wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Headline Economic Activity Appears to Be Turning Down, Once Again. The evolving outlook for near-term economic activity is not a happy one. It remains consistent with the likely conditions for the year ahead, as outlined in *No. 692 Special Commentary: 2015 - A World Out of Balance*.

Aside from the highly gimmicked and questionable releases of the January 2015 payroll employment numbers, and the accompanying benchmark revision (see *Commentary No. 694* and *Commentary No. 695*), and recent nonsense reporting on the GDP (see *Commentary No. 691* and *No. 692 Special*), current reporting of fundamental, underlying economic activity has been consistent with an intensifying, renewed economic downturn. That pattern of a deteriorating contraction increasingly should become the common experience, in the next several months.

GDP and employment detail eventually will catch up with underlying reality, as the financial markets and serious economic analysts pick up on the failing business fundamentals in key series. These series drive not only the headline GDP reporting, but also affect employment and unemployment assumptions. Contrary to current market hype, broad economic growth is not at a ten-year high, and there was no basis for the introduction of a pattern of rapidly-accelerating, payroll-employment growth, in a benchmark revision that should have aggregated to nil.

Consider the reporting of December new orders for durable goods (*Commentary No. 690*), where fourth-quarter 2014 orders contracted versus the third-quarter, anyway you look at them. Those numbers are signaling a downturn in industrial production, a result that has a strong chance of surfacing in next week's January production reporting.

January 2015 retail sales activity, covered in today's *Commentary*, is suggestive of a contraction in first-quarter 2015 consumer activity. Similar signals should begin to surface in other series. That trend will become increasingly evident as oil and gasoline prices bottom out (the bottom likely was in January), with a general move to higher inflation in the months ahead.

The trade deficit is in renewed deterioration (*Commentary No. 693*), which is a direct subtraction from aggregate broad U.S. economic activity. Also, the various indicators of construction and residential sales activity continue to show flat-to-minus monthly changes, with broad construction continuing in stagnation at a low level of activity (see *Commentaries No. 689*, *No. 690* and *No. 693*).

As the process advances towards broad-market recognition of renewed contraction in the U.S. economy, risks will mount for a shock number, some surprise downside-economic statistic, with the potential for being particularly disruptive to the financial markets and to confidence in the U.S. dollar

Today's Missive (February 12th). The balance of this *Commentary* concentrates on detail from today's reporting of nominal retail sales for January 2015.

No. 692 Special Commentary: 2015 - A World Out of Balance updated the *Hyperinflation 2014* reports and the broad economic outlook. There is no *Hyperinflation Watch* section today, but one will follow soon with an updated *Hyperinflation Summary Outlook* based on *No. 692*. In the interim, anyone looking for such a *Summary* is referred to the *Opening Comments* of *No. 692*, or to *Commentary No. 684*, for the prior version.

The *Week Ahead* section previews next Wednesday's reporting of headline January industrial production, housing starts and the producer price index.

Retail Sales—January 2015—Sales Plunge Sets Stage for First-Quarter Downturn. On top of the weakest holiday-shopping season for retailers since the economic collapse in 2008, the weaker-than-expected 0.8% (-0.8%) plunge in January sales was a further indication of intensifying liquidity stresses for the consumer, and of a broad economy that remains in deep trouble, not in the expanding rebound as touted by some in the financial media. [Bloomberg showed a consensus expectation for a headline decline of 0.5% (-0.5%), coming into this morning's retail-sales reporting.]

The aggregate downturn in the January retail trade was dominated by declining automobile and gasoline-station sales, with generally negative-to-weak sales activity across a variety of retail outlets, and strong sales at food services and drinking places.

Structural Liquidity Issues Constrain Consumer Economic Activity. The underlying problem with the economy remains intense, structural-liquidity woes besetting the consumer. That circumstance, during the last seven-plus years of economic collapse and stagnation, has continued to prevent a normal recovery in broad U.S. business activity, as discussed and detailed in *No. 692 Special Commentary: 2015 - A World Out of Balance*.

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. The monthly graphs on consumer and liquidity conditions will be updated along with the detail on real retail sales and new- and existing- home sales scheduled for the *Commentary* (likely *No. 698*) of Thursday, February 26th. The latest graphs otherwise are found in *No. 692*.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—January 2015. Headline, nominal retail sales showed a seasonally-adjusted, statistically-significant monthly decline for a second straight month. January sales tumbled by 0.79% (-0.79%), in the context of minimal revisions to headline activity in November and December. Net of prior-period revisions, the January decline was 0.71% (-0.71%) for the month.

The January 2015 decline followed a revised, statistically-significant, monthly decline of 0.86% (-0.86%) in December, and a revised gain of 0.42% in November.

Year-to-Year Annual Change. Year-to-year sales growth in January 2015 held at a statistically-significant gain of 3.33%, versus a revised annual gain of 3.34% in December 2014, and an unrevised gain of 4.70% in November.

Annualized Quarterly Growth on Track for a First-Quarter Contraction. The pace of annualized, nominal-retail sales change in first-quarter 2015—suggested solely by the level of headline nominal activity in January 2015—was a contraction of 4.81% (-4.81%). Revised fourth-quarter 2014 annual sales, versus the third-quarter, rose at an annualized pace of 1.88%, while third-quarter versus second-quarter growth held at an unrevised 4.27%.

Real (Inflation-Adjusted) Retail Sales—January 2015. The headline 0.79% (-0.79%) contraction in January 2015 retail sales was before accounting for inflation. Real retail sales growth in January will be reviewed along with the headline estimate of consumer inflation for the January 2015 CPI-U, in the *Commentary* (likely *No. 698*) of Thursday, February 26th.

As happened in December 2014, the headline January 2015 CPI-U most likely contracted sharply, month-to-month, due to the continued drop in gasoline prices, with a resulting positive impact likely, in real terms, on top of this morning's headline nominal-retail sales contraction rate. Nonetheless, after adjustment for the negative monthly inflation, headline January real retail sales still should be in contraction, month-to-month. As an aside, the plunge in gasoline prices appears to be in the process of bottoming out.

Retail-Sales Benchmark Revision on April 30th. The Census Bureau has scheduled its annual retail-sales benchmark revision for April 30, 2015. The revisions likely will play catch up on the downside, where consideration of some negative-revision detail was excluded from last year's benchmarking, due to lingering impact from the shutdown of the federal government in October 2013.

[Further background material on January Retail Sales is included the* Reporting Detail*, with various drill-down and graphics options on the headline data available to subscribers at our affiliate:* www.ExpliStats.com*].

REPORTING DETAIL

RETAIL SALES (January 2015)

January Retail-Sales Plunge Sets Stage for First-Quarter Downturn. Following the weakest Holiday Season for the retail sales industry, since the economic collapse in 2008, the weaker-than-expected 0.8% (-0.8%) plunge in January sales was a further indication of intensifying liquidity stresses for the consumer, and of a broad economy that remains in deep trouble, not in the expanding rebound as touted by some in the financial media. [Bloomberg showed a consensus expectation for a headline monthly decline of 0.5% (-0.5%), coming into this morning's retail-sales reporting.]

The aggregate decline in retail activity was dominated by declining automobile and gasoline-station sales, with generally negative-to-weak activity across a variety of retail-store outlets, and strong sales at food services and drinking places.

Structural Liquidity Issues Constrain Consumer Economic Activity. The underlying problem remains intense, structural-liquidity woes besetting the consumer. That circumstance, during the last seven-plus years of economic collapse and stagnation, has continued to prevent a normal recovery in broad U.S. economic activity, as discussed and detailed in *No. 692 Special Commentary: 2015 - A World Out of Balance*.

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. The monthly graphs on consumer and liquidity conditions will be updated along with the detail on real retail sales and new- and existing- home sales scheduled for the *Commentary* (likely *No. 698*) of Thursday, February 26th. The latest graphs otherwise are found in *No. 692*.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—January 2015. In nominal terms—before adjustment for consumer inflation—today's (February 12th) report on January 2015 retail sales—issued by the Census Bureau—showed a statistically-significant, seasonally-adjusted, headline monthly decline, for a second month. January sales tumbled by 0.79% (-0.79%) +/- 0.58% (this and all other confidence intervals are expressed at the 95% level). Such was in the context of minimal revisions to headline activity in November and December. Net of prior-period revisions, the monthly decline in January was 0.71% (-0.71%).

The headline monthly decline in January 2015 followed a revised, statistically-significant, month-to-month decline of 0.86% (-0.86%) +/- 0.35% [previously down by 0.94% (-0.94%)] in December, and followed a revised 0.42% gain [previously up by 0.41%, initially up by 0.72%] in November.

Year-to-Year Annual Change. Year-to-year sales growth in January 2015 held at a statistically-significant gain of 3.33% +/- 1.05%, versus a revised annual gain of 3.34% [previously up by 3.17%)] in December 2014, versus an unrevised annual gain of 4.70% [initially up by 5.13%] in November.

Annualized Quarterly Growth on Track for a First-Quarter Contraction. The pace of annualized nominal retail sales change in first-quarter 2015, based solely on the level of headline nominal activity in January 2015, was a contraction of 4.81% (-4.81%). Revised fourth-quarter 2014 annual sales, versus the third-quarter, rose at an annualized pace of 1.88% (previously up by 1.77%), while third-quarter versus second-quarter growth held at an unrevised 4.27% annualized gain.

January Core Retail Sales—Still-Tumbling Gasoline Prices. In an environment of generally rising food prices, and with a further, unadjusted 16.11% (-16.11%) decline in monthly gasoline prices, seasonally-adjusted monthly grocery-store sales declined by 0.10% (-0.10%) in January 2015, with gasoline-station sales falling by 9.28% (-9.28%) for the month.

Under normal conditions, the bulk of non-seasonal variability in food and gasoline sales is in pricing, instead of demand. "Core" retail sales—consistent with the Federal Reserve's preference for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

<u>Version I:</u> January 2015 versus December 2014 seasonally-adjusted retail sales series—net of total grocery store and gasoline station sales—reflected a monthly gain of 0.04%, versus the official headline decline of 0.79% (-0.79%).

<u>Version II:</u> January 2015 versus December 2014 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—also reflected a monthly gain of 0.04%, versus the official headline decline of 0.79% (-0.79%).

Real (Inflation-Adjusted) Retail Sales—January 2015. The headline 0.79% (-0.79%) contraction in January 2015 retail sales was before accounting for inflation. Real retail sales growth in January will be reviewed along with the headline estimate of consumer inflation for the January 2015 CPI-U, in the *Commentary* (likely *No. 698*) of Thursday, February 26th.

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Retail-Sales Benchmark Revision on April 30th. The Census Bureau has scheduled its annual retail-sales benchmark revision for April 30, 2015. The revisions there likely will play catch up on the downside, where consideration of some negative-revision detail was excluded from last year's benchmarking, due to lingering impact from the shutdown of the federal government in October 2013.

***Reporting Instabilities and Distortions*.** The usual seasonal-factor distortions were at play, again, in January 2015 reporting, where the headline data reflected concurrent seasonal adjustments. Given Census Bureau reporting procedures, the headline detail is not comparable with most earlier reporting. Accordingly, current data can reflect growth shifts from earlier periods, without the specifics being published. The principles and reporting issues with the way the government reports economic series adjusted by concurrent seasonal factors was just explored, in-depth, in *Commentary No. 695*. The issues here are the same as with the employment and unemployment series.

As has been the common pattern, the year-ago numbers for December 2013 and January 2014 were revised, along with the publication of the January 2015 data and revised detail on November and December 2014. The year-ago revisions simply were junk reporting, due solely to shifts in their seasonal adjustments that resulted from the calculation of the unique seasonal factors producing the headline January 2015 detail, not due to the availability of any new historical data back in 2013 or early 2014. Where all other seasonally-adjusted historical numbers also were revised, though, those details were not published. Only the new details for December 2013 and January 2014 were provided for the earlier numbers.

Specifically, a 0.09% (-0.09%) downside revision to December 2013 and a 0.39% upside revision to January 2014 sales indicated meaningful shifts in current headline seasonal-adjustment factors. They likely were enough to mitigate the headline January 2015 contraction by 0.5%, to a reduced headline 0.8% (-0.8%) decline, instead of what otherwise would have been a 1.3% (-1.3%) decline. The same pattern was seen last month with the headline December number, but all this still happens without the specifics as to where headline activity has been shifted month-to-month. Full detail is available internally to the Census Bureau, but the Bureau chooses not publish the detail.

The current reporting process allows for invisible shifts in seasonally-adjusted current activity, which are not consistent with published historical reporting. Further, the stability of the seasonal-adjustment process (particularly the concurrent-seasonal-adjustment process used with retail sales) and sampling methods have been disrupted severely by the unprecedented depth and length of the current economic downturn in the post-World War II era, the period of modern economic reporting.

Again, retail sales reporting suffers the same inconsistency issues seen with other series, such as payroll employment, the unemployment rate, and durable goods orders. The highly variable and unstable seasonal factors here continued to cloud relative activity in the November 2014-to-January 2015, and in the December 2013-to-January 2014 periods, five months that are published on a non-comparable basis with all other historical data.

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WEEK AHEAD

Headline Reporting and Revisions Should Trend Much Weaker versus an Overly-Optimistic Economic Consensus; Inflation Will Rise Anew, Following the Bottoming of Oil-Prices. Shifting some to the downside, again, 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, monthly headline economic reporting should hammer those expectations heavily through mid-year. Recent GDP excesses will not face downside revisions until the July 30, 2015 GDP benchmark revision, other than for the two months of revisions still pending for fourth-quarter 2014 GDP.

Headline consumer inflation—recently driven lower by collapsing prices for gasoline and other oil-price related commodities—likely hit a near-term low in what will be headline January 2015 reporting. Significant upside inflation pressures should resume as oil prices begin to rebound, a process that already appears to be underway, and one that would accelerate rapidly with 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 *No. 692 Special Commentary: 2015 - A World Out of Balance*.

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, see *Commentary No. 695*). Combined with recent allegations 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 (see *Commentary No. 669*).

PENDING RELEASES:

Index of Industrial Production (January 2015). On Wednesday, February 18th, the Federal Reserve Board will release its estimate of the index of industrial production for January 2015. Early market expectations appear to be for a modest (less than 0.5%), headline monthly increase, but risks are high for a downside reporting surprise in headline activity, very possibly a monthly contraction and/or significant downside revisions to prior reporting of recent months.

Whatever the headline results, activity most meaningfully is viewed net of extreme swings in utility usage, resulting from, or reversing, the prior month-to-month effects of "unseasonable weather." For example, the initial headline monthly decline of 0.1% (-0.1%) in December 2014 production was dominated by a weather-driven plunge of 7.3% (-7.3%) in utility-usage. December's weather was "unseasonably warm."

Residential Construction—Housing Starts (January 2015). The Census Bureau will release January 2015 residential construction detail, including housing starts, on Wednesday, February 18th. In line with common reporting experience of recent years, monthly results are likely to be unstable, not statistically meaningful, but generally consistent with down-trending stagnation in the series, particularly when viewed in the context of a six-month moving average of activity. This series also is subject to regular and extremely-large prior-period revisions.

As discussed in *Commentary No. 660* on the August 2014 version of this most-unstable of monthly economic series, the monthly headline reporting detail here simply is worthless, again, best viewed in terms of a six-month moving average. Not only is month-to-month reporting volatility extreme, but also those headline monthly growth rates rarely come close to being statistically-significant. Early-market expectations appear to be for something on the plus-side of flat for the headline January reporting. That still is well shy of what—until recently—would have been expectations of a headline monthly surge. Market expectations increasingly have shifted towards renewed decline in residential construction.

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. Discussed frequently in these *Commentaries*, there remains no chance of a near-term, sustainable turnaround in the housing market, until 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 discussed extensively in *No. 692 Special Commentary: 2015 - A World Out of Balance*.

Producer Price Index—PPI (January 2015). The January 2015 PPI is scheduled for release on Wednesday, February 18th, by the Bureau of Labor Statistics (BLS). Reflecting a continued collapse in oil prices, early market expectations are for continued month-to-month contraction in the January PPI, perhaps a drop of about 0.5% (-0.5%). Such expectations are reasonable, under the circumstances.

Although oil and gasoline prices appear likely to have set a near-term bottom in January 2015, the energy sector, once again, should be the dominant downside component in the headline monthly inflation data. Based on the two most-widely-followed oil contracts, not-seasonally-adjusted, monthly-average oil prices fell by 20.3% (-20.3%) and by 23.4% (-23.4%) in the month of January, along with a 16.1% (-16.1%) plunge in unadjusted monthly-average, retail-gasoline prices (Department of Energy). PPI seasonal adjustments for energy costs in January also should be negative, exaggerating the downside impact of the unadjusted decline in energy prices.

Inflation in food, “core” goods (everything but food and energy), some still-spreading inflationary impact from hard-goods into the soft-services sector, and dropping costs helping to increase services margins, should be mitigating factors, again.

The wildcard in this revamped PPI continues to be in the recently-added services sector, which largely is unpredictable, volatile and of limited meaning, due to its inflation measurements having minimal if any relationship to real-world activity. Nonetheless, the new services sector has a greater weighting in the PPI calculation than does the old goods sector

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. Services "inflation" recently has shown upside movement, due to rising profit margins. Perversely, the rising profit margins and "inflation" are due to energy costs falling faster than any related price decreases are being passed along to the next level of distribution or consumption. Such is disconnected from the goods-related inflation and from common experience. The general approach here to "wholesale" inflation remains of highly-questionable merit.

