

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

**COMMENTARY NUMBER 704**  
**February Industrial Production, Producer Price Index**  
**March 16, 2015**

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**Rapidly Rising Risk of First-Quarter GDP Contraction**  
**Industrial Production Revised Sharply Lower;**  
**On Track for First Quarterly Contraction Since 2009 Trough of Economic Collapse**  
**Manufacturing and Motor Vehicle Production Fell for Third Straight Month**  
**February Production Activity Fell by 0.6% (-0.6%) Ex-Utilities,**  
**Headline 0.1% Monthly Gain Was Due Solely to Weather-Distorted Utility Surge**  
**Nonsense of the Redefined PPI: Rising Oil Prices Both Boost and Reduce**  
**Headline Inflation, and So Do Falling Oil Prices**

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*PLEASE NOTE: The next regular Commentary, scheduled for tomorrow, Tuesday, March 17th, will cover February housing starts.*

*Best wishes to all — John Williams*

**OPENING COMMENTS AND EXECUTIVE SUMMARY**

**Outlook for First-Quarter GDP Growth Dimmed Anew.** In conjunction with pending hits from a widening trade deficit and a likely quarterly contraction in real retail sales (see [Commentary No. 703](#)), today's downturn in early first-quarter industrial production detail significantly increased the chances for

initial reporting of a real first-quarter 2015 GDP contraction. Aside from providing a picture of declining production activity, today's manufacturing detail was suggestive of an inventory pullback, which would provide a direct hit to the "advance" GDP estimate on April 29th. This area will be discussed more extensively in tomorrow's *Commentary No. 705*, which also will cover the latest housing starts detail.

***Today's Missive (March 16th).*** The balance of today's *Commentary* concentrates on the specifics of the February 2015 industrial production and PPI. The *Week Ahead* section previews the reporting of tomorrow's February housing starts.

**Industrial Production—February 2015—Heavy Revisions Showed Quarterly Industrial Production in Contraction.** Along with an extraordinarily-weak February showing, a downside revision to the initial headline January 2015 growth rate by 0.5% (-0.5%), from a 0.2% gain to a contraction of 0.3% (-0.3%), changed the outlook for first-quarter industrial production from expansion to contraction and may well have doomed first-quarter 2015 GDP to an outright quarterly decline. Where GDP last contracted in the year-ago first-quarter 2014, quarterly industrial production has not contracted since second-quarter 2009, the formal trough of the recent economic collapse.

Annual growth slowed as well, dropping to 3.5% in February 2015 from a revised 4.4% (previously 4.8%) in January. Annualized quarterly production growth for fourth-quarter 2014 revised to 4.4%, while first-quarter 2015 production (including just January and February) was on track for an annualized quarterly contraction of 0.2% (-0.2%) [down at an annualized pace of 1.5% (-1.5%) net of utility distortions]. As of initial January 2015 reporting, first-quarter 2015 had been on track for a 1.4% annualized quarterly expansion.

The headline 0.1% gain [decline of 0.4% (-0.4%) net of prior-period revisions] in monthly February production entirely was due to unseasonably-cold weather spiking utility usage by 7.3%. Net of the utility spike, headline production fell by 0.6% (-0.6%) for the month, with total manufacturing production and motor vehicle production both falling for the third straight month, and with mining (oil and gas production) falling sharply for the second month. Even so, the headline 0.1% February gain came in below market expectations of a 0.3% headline gain [Bloomberg], which did not anticipate the accompanying downside revisions.

***Industrial Production—Headline Detail.*** Headline monthly production rose by 0.07% in February 2015, following a revised decline of 0.32% (-0.32%) in January, and a revised decline of 0.23% (-0.23%) in December. Net of prior-period revisions, monthly February 2015 production fell by 0.36% (-0.36%).

By major industry group, the headline February 2015 monthly gain of 0.1% [January 2015 contraction of 0.3% (-0.3%)] in aggregate production was composed of a February decline of 0.2% (-0.2%) [January decline of 0.3% (-0.3%)] in manufacturing; a February decline of 2.5% (-2.5%) [January contraction of 1.3% (-1.3)] in mining (oil production); and a February surge of 7.3% [January gain of 1.0%] in utilities.

Year-to-year growth in February 2015 production was 3.47%, versus a revised annual gain of 4.36% in January 2015, and a revised annual gain of 4.44% in December 2014.

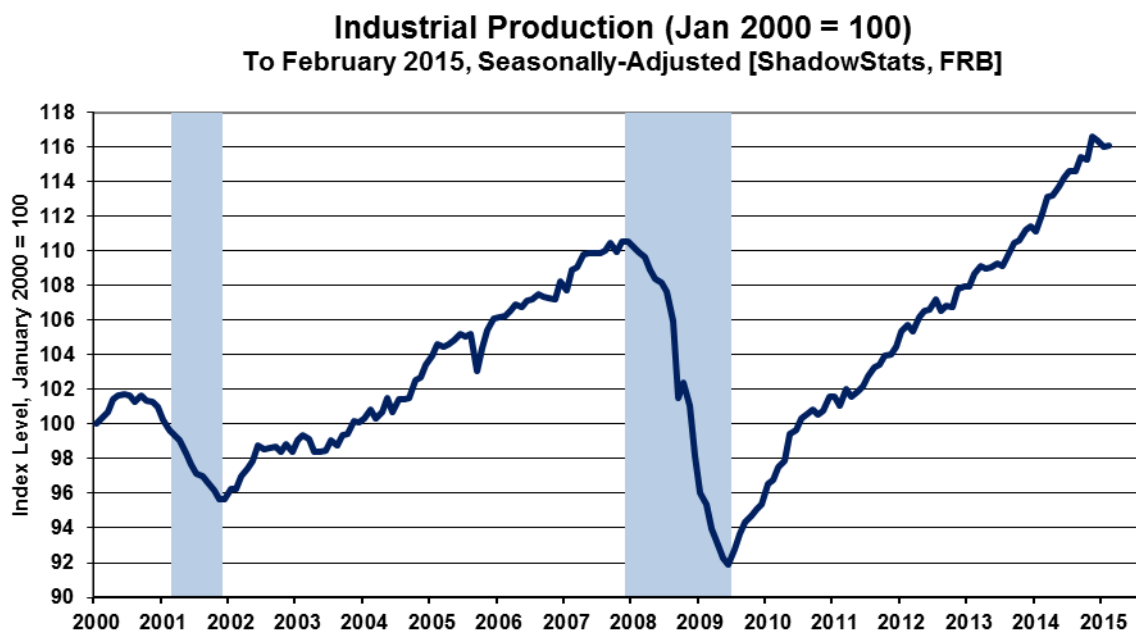
***The Fish Are Beginning to Smell—Massive Benchmark Revisions Should Show Much-Weaker Production and GDP, Unless Delayed.*** Language changes in today's industrial production press release

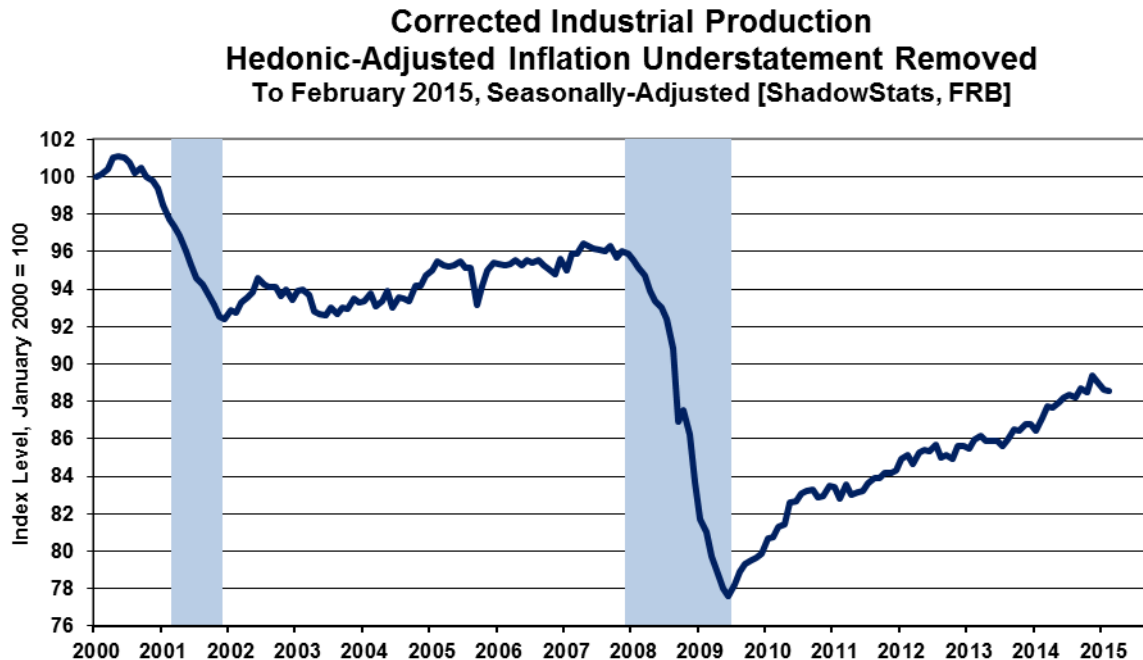
may have hinted at a delay in the pending massive benchmark revisions to industrial production. If a delay ends up pushing the production revisions until after the GDP benchmark revisions of July 30th, the overall revision process for major U.S. economic data will begin to smell about as sweet as rotting fish carcasses (see *Reporting Detail* for further comments).

***Production Graphs—Corrected and Otherwise.*** The *Reporting Detail* section includes the regular graphs of the industrial production level and year-to-year change through February. 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 following 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 shows some growth in the period subsequent to 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. 700](#)). 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 into year-end 2014 reporting and now revised topping-out or pullback in early-2015. Again, the series remains well shy of a formal recovery.

**Producer Price Index (PPI)—February 2015—Rising Oil Prices Helped to Drive PPI Down by 0.5% (-0.5%) for the Month, Down by 0.6% (-0.6%) Year-to-Year.** From a practical standpoint, the aggregate Final Demand Producer Price Index has little relationship to real world activity. The problem is that the services sector, which is the dominant component of the index, reflects profit margins, not prices.

Despite rising oil prices, February headline PPI inflation fell. First, rising oil prices were turned negative by seasonal adjustments in the goods sector. Second, rising oil prices narrowed margins in the services sector, with rising oil costs moving faster than price hikes to the next level of distribution or sales. Narrower margins are deflationary on the services side, even though the nature of the narrowing is suggestive of higher prices ahead. Construction inflation rose for the month. The *Reporting Detail* section contains more-extended commentary on the oil-price conundrum.

**February 2015 Headline PPI Detail.** The seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for February 2015 declined by 0.45% (-0.45%), versus an unrevised headline inflation decline in January 2015 of 0.81% (-0.81%).

The impact of seasonal adjustments on the headline monthly February aggregate PPI change was negative, with the unadjusted month-to-month February number contracting by 0.27% (-0.27%), versus a drop of 0.72% (-0.72%) in January. Also on a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year headline PPI inflation dropped by 0.64% (-0.64%) in February 2015, following an unchanged reading of 0.00% in January 2015.

In terms of the three major subcategories for February 2015 Final Demand PPI, headline monthly Final Demand Goods inflation contracted by 0.37% (-0.37%), Final Demand Services inflation declined by 0.45% (-0.45%), and Final Demand Construction inflation rose by 0.09%.

*Final Demand Goods (Weighted at 34.69%).* Running somewhat in parallel with the old Finished Goods PPI series, headline monthly Final Demand Goods inflation fell by 0.37% (-0.37%) in February 2015, versus a month-to-month decline of 2.15% (-2.15%) in January. There was an aggregate negative impact on the headline February 2015 reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, February final demand goods inflation contracted by 0.18% (-0.18%) for the month. Unadjusted, year-to-year goods inflation was down by 4.23% (-4.23%) in February 2015, versus an annual decline of 3.71% (-3.71%) in January 2015.

Headline seasonally-adjusted monthly changes by major components of February 2015 Final Demand Goods:

- "Foods" inflation dropped by 1.57% (-1.57%) in February 2015, versus a January decline of 1.06% (-1.06%), with February's headline monthly inflation contraction made minimally less negative by seasonal adjustments. Unadjusted, February food inflation fell by 1.58% (-1.58%) for the month. Unadjusted and year-to-year, February 2015 foods inflation gained 0.42%, versus an annual gain of 2.47% in January 2015.
- "Energy" inflation was unchanged at 0.00% month-to-month in February 2015, having collapsed by 10.30% (-10.30%) for the month in January, with the February neutral reading hammered to that level by negative seasonal adjustments. Unadjusted, February energy inflation rose by 1.04% month-to-month. Unadjusted and year-to-year, February 2015 energy inflation slumped by 22.37% (-22.37%), versus an annual decline of 22.24% (-22.24%) in January 2015.
- "Less foods and energy," or "core" goods inflation fell by 0.09% (-0.09%) in February 2015, versus a monthly drop of 0.18% (-0.18%) in January. Seasonal adjustments were a positive for monthly core inflation, with an unadjusted February monthly decline of 0.18% (-0.18%). Unadjusted and year-to-year, February 2015 core inflation rose by 0.37%, versus an annual gain of 0.64% in January 2015.

*Final Demand Services (Weighted at 63.29% of the Aggregate).* Headline monthly Final Demand Services inflation fell by 0.45% (-0.45%) in February 2015, versus a monthly decline of 0.18% (-0.18%) in January. The overall impact on the February month-to-month services inflation reading from underlying seasonal-factor adjustments was negative, with an unadjusted contraction of 0.27% (-0.27%) in the current month. Year-to-year unadjusted services inflation was 1.20% in February 2015, versus 2.04% in January 2015.

The headline monthly changes by major component for February 2015 Final Demand Services inflation:

- "Services less trade, transportation and warehousing" inflation rose by 0.28% in February 2015, having dropped by 0.37% (-0.37%) in January. Seasonal-adjustment impact on the adjusted February detail was negative. The unadjusted monthly gain in February 2015 was 0.37%. Unadjusted and year-to-year, February 2015 "other" services inflation gained 1.03%, versus an annual gain of 0.84% in January 2015.
- "Transportation and warehousing" inflation declined month-to-month by 1.45% (-1.45%) in February 2015, following a monthly decline of 0.76% (-0.76%) in January. Seasonal adjustments had a minimally-positive impact, with an unadjusted monthly contraction of 1.46% (-1.46%) in February. Unadjusted and year-to-year, February 2015 transportation inflation contracted by 0.60% (-0.60%), versus an annual gain of 0.60% in January 2015.
- "Trade" inflation plummeted by 1.51% (-1.51%) month-to-month in February 2015, following a gain of 0.53% in January 2015 (see *Reporting Detail* section for a discussion on the reverse impact of oil price changes on the trade sector). Seasonal adjustments had a negative impact here, where the unadjusted inflation change in February was for a month-to-month decline of 0.89% (-0.89%). Unadjusted and year-to-year, February 2015 trade rose by 2.21%, versus an annual gain of 4.38% in January 2015.

*Final Demand Construction (Weighted at 2.02% 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, and month-to-month construction inflation rose by 0.09% in February, versus a monthly gain of 0.36% in January. The impact of seasonal factors on the February reading was negative. On an unadjusted basis, month-to-month February 2015 construction inflation was up by 0.18%. Also on an unadjusted basis, year-to-year construction inflation was 2.00% in February 2015, versus 1.91% in January 2015.

***[Further background material on February industrial production and the PPI is found in the Reporting Detail section. Various drill-down and graphics options on the headline production numbers are available to subscribers at our affiliate: [www.ExpliStats.com](http://www.ExpliStats.com).]***



## HYPERINFLATION WATCH

### HYPERINFLATION OUTLOOK SUMMARY

**Economic and Inflation Outlooks Unchanged, Continuing to Unfold.** [*Note: The text in this section largely is as published in the prior Commentary*]. Other than for some updated internal links or references, the text here is unchanged from the prior *Commentary*.

[\*No. 692 Special Commentary: 2015 - A World Out of Balance\*](#) of February 2, 2015 updated the *Hyperinflation 2014* reports and the broad economic outlook. Previously, the long-standing hyperinflation and economic outlooks were updated with the publication of [\*2014 Hyperinflation Report—The End Game Begins – First Installment Revised\*](#), on April 2, 2014, and publication of [\*2014 Hyperinflation Report—Great Economic Tumble – Second Installment\*](#), on April 8, 2014. The outlooks also are updated regularly in the weekly *Commentaries*. The *Opening Comments* of [\*No. 692\*](#) should be considered in terms of recent circumstances and near-term, proximal triggers for massive dollar selling. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts.

**Primary Summary.** Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation. The 2008 Panic and near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same, pulled the elements of the eventual hyperinflation crisis at the end of this decade into the current period. The primary and basic summary of the broad outlook and the story of how and why this fiscal, financial and economic crisis has unfolded and developed over the years—particularly in the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked earlier). The following summarizes the underlying current circumstance and recent developments.

Consistent with the above *Special Commentaries*, the unfolding economic circumstance, in confluence with other fundamental issues, should place mounting and massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic. Physical gold and silver, and holding assets outside the U.S. dollar, remain the primary hedges against the pending total loss of U.S. dollar purchasing power, despite sharp and generally ongoing rally in the U.S. dollar's exchange rate since mid-2014 and broadly related selling pressures in the gold and silver markets.

Current relative U.S. economic strength and the relative virtuousness of Fed monetary policy versus major U.S. trading partners are seriously over-estimated (see [\*Commentary No. 703\*](#)). A crash back to recognition of realistic domestic-economic circumstances likely will be accompanied by a crash in the U.S. dollar versus major currencies, such as the Swiss franc, Canadian dollar and Australian dollar; related rallies in precious metals and oil; and related sell-offs in the domestic stock and bond markets. Further, a sharp deterioration in near-term domestic U.S. political stability continues to develop and is of meaningful near-term risk for triggering heavy selling of the dollar.

***Current Economic Issues versus Underlying U.S. Dollar Fundamentals.*** U.S. economic activity is turning down anew, despite overstated growth in recent GDP reporting. GDP and other major economic series face heavy downside-benchmark revisions through the end of July. Weak, underlying economic reality also should become increasingly and painfully obvious to the financial markets in the reporting and revisions of the weeks and months ahead for series such as retail sales, production (see *Opening Comments*), the trade deficit and payroll employment.

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

Unexpected economic weakness intensifies the known stresses on an already-impaired banking system, increasing the perceived need for expanded, not reduced, quantitative easing (see [Commentary No. 703](#)). The highly touted "tapering" by the FOMC ran its course. Future, constructive Fed behavior—purportedly moving towards normal monetary conditions in the currently unfolding, near-perfect economic environment—is pre-conditioned by a continued flow of "happy" economic news. Suggestions that all is right again with world are nonsense. The Panic of 2008 never has been resolved, and the Fed soon will find that it has no easy escape from its quantitative easing (QE3), which continues. Only overt expansion of QE3 ceased; QE4 will become the question.

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

Accordingly, any renewed market speculation as to an added round of Federal Reserve quantitative easing, QE4, could become a major factor behind crashing the dollar and boosting the price of gold. The Fed has strung out its options for propping up the system as much as it could, with continual, negative impact on the U.S. economy. The easings to date, however, appear to have been largely a prop to the increasingly unstable equity markets.

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

Unexpected economic weakness also savages projections of headline, cash-based, federal-budget deficits (particularly the 10-year versions) as well as projected funding needs for the U.S. Treasury. Current fiscal "good news" is from cash-based, not GAAP-based and accounting projections.

All these crises should combine against the U.S. dollar, likely in the very-near future. That said, recent faux market perceptions of domestic economic, financial-system and monetary tranquility have boosted the U.S. dollar's strength significantly in global trading and have contributed to savaging the prices of oil and in weakening the prices of precious metals.



The recent shift in the Swiss franc due to the elimination of the effective pegging of the franc to the euro and, by default to the U.S. dollar, also had had the effect of allowing some upside movement in the dollar prices of gold and silver. Recent intensified weakness in the euro, however, has led to increasingly negative domestic Swiss interest rates and interventions aimed at depressing the franc. Such policies usually prove to be fleeting, due to significant undesired side effects on the domestic economy and in financial-market distortions.

Again, strength in the U.S. dollar should reverse, in the context of underlying reality outlined here and in the sections that follow. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed; it is just a matter of market perceptions shifting anew, against the U.S. currency. That process, again, started with the shift in Swiss National Bank policy. Key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008, is turning down anew and shows no potential for recovery in the near-term.*** The circumstance includes a renewed widening in the trade deficit (see [Commentary No. 702](#)), as well as ongoing severe, structural-liquidity constraints on the consumer, which are preventing a normal economic rebound in the traditional, personal-consumption-driven U.S. economy (see [Commentary No. 703](#)). Sharply-negative economic reporting shocks, versus unrealistically-positive consensus forecasts, remain a heavily-favored, proximal trigger for the pending dollar debacle.
- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of willingness to address long-term U.S. solvency issues, but also the current political impossibility of doing so. The shift in control of Congress does not appear to have altered the systemic unwillingness to address the underlying fundamental issues, specifically to bring the GAAP-based deficit into balance. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version continues to run around \$5 trillion for the annual shortfall, while those in Washington continue to increase spending and to take on new, unfunded liabilities. The history and issues here are explored in the first installment of the *Hyperinflation Report*, as previously linked; the initial fiscal-2014 details were discussed in [Commentary No. 672](#), and the official GAAP-based financial statements for 2014 will be discussed fully, soon (see [Commentary No. 702](#)).
- ***Monetary malfeasance by the Federal Reserve, as seen in central bank efforts to provide liquidity to a troubled banking system, and also to the U.S. Treasury.*** Despite the end of the Federal Reserve's formal asset purchases, the U.S. central bank monetized 78% of the U.S. Treasury's fiscal-2014 cash-based deficit (see [Commentary No. 672](#)). The quantitative easing QE3 asset purchase program effectively monetized 66% of the total net issuance of federal debt to be held by the public during the productive life of the program (beginning with the January 2013 expansion of QE3). The monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury. With highly tenuous liquidity conditions for the banking system and the Treasury, it would not be surprising in this period of increasing instability to see covert Federal Reserve activities masked in the purchases of Treasury debt by nations or other entities financially friendly to or dependent upon the United States. Renewed expansion to quantitative easing remains likely, given ongoing banking-system stresses, vulnerable stock markets and weakening, actual U.S. economic activity. As has been

commonplace, the Fed likely would seek political cover for new or expanded systemic accommodation in any "renewed" economic distress.

- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, usually with a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. The weaker the rating, the weaker tends to be the U.S. dollar. The positive rating for the President is off its historic low, but still at levels that traditionally are traumatic for the dollar. Chances of a meaningful shift towards constructive cooperation between the White House and the new Congress, in addressing fundamental issues appear to be nil. Issues such as non-recovered, faltering economic activity and the consumer liquidity crisis, and addressing the nation's long-range solvency issues still could devolve rapidly into an extreme political crisis.
- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, or sitting in place, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the ongoing situation in Ukraine versus Russia and extremely-volatile circumstances in the Middle East. U.S. response to the Ukrainian situation may be behind part of the recent strength in the U.S. dollar and related weakness in oil prices, with U.S. actions aimed at causing financial distress for Russia. The situation has yet to run its full course, and it has the potential to reverse rapidly.
- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar continue to expand. In particular, anti-dollar rhetoric and actions have been seen with Russia, China, France, India and Iran, along with some regular rumblings in OPEC and elsewhere. Recent dollar strength may have bought some time versus those who have to hold dollars for various reasons. Nonetheless, any short-term instability and a quick reversal in the dollar's strength could intensify the "dump-the-dollar" rhetoric rapidly.

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

Both the renewed dollar weakness and the resulting inflation spike should boost the prices of gold and silver, where physical holding of those key precious metals remains the ultimate hedge against the pending inflation and financial crises. Investors need to preserve the purchasing power and liquidity of their wealth and assets during the hyperinflation crisis ahead. Again, see Chapter 10, [\*2014 Hyperinflation Report—Great Economic Tumble\*](#) for detailed discussion on approaches to handling the hyperinflation crisis.

## REPORTING DETAIL

### INDEX OF INDUSTRIAL PRODUCTION (February 2015)

**Heavy Revisions Showed Quarterly Industrial Production in Contraction.** Along with an extraordinarily-weak February showing, a downside revision of 0.5% (-0.5%) to headline monthly production growth in January 2015, from a 0.2% gain to a contraction of 0.3% (-0.3%), changed the outlook for first-quarter industrial production from expansion to contraction and may well have doomed first-quarter 2015 GDP to an outright quarterly decline. Where the GDP last contracted in the year-ago first-quarter 2014, quarterly industrial production has not contracted since second-quarter 2009, the formal trough of the recent economic collapse.

Annual growth slowed as well, dropping to 3.5% in February 2015 from a revised 4.4% (previously 4.8%) in January. Annualized quarterly production growth for fourth-quarter 2014 revised to 4.4% (previously 4.3%), while first-quarter 2015 (through February) is on track for an annualized quarterly contraction of 0.2% (-0.2%) [down at an annualized 1.5% (-1.5%) net of utility distortions]. As of initial January 2015 reporting, first-quarter 2015 had been on track for a 1.4% annualized quarterly expansion.

The headline 0.1% gain [decline of 0.4% (-0.4%) net of revisions] in monthly February production was due entirely to unseasonably-cold weather spiking utility usage by 7.3%. Net of the utility spike, headline production fell by 0.6% (-0.6%) for the month, with total manufacturing and motor vehicle production both falling for the third straight month, and with mining (oil and gas production) falling sharply for the second month. Even so, the headline 0.1% February gain came in below market expectations of a 0.3% headline gain [Bloomberg], which did not anticipate the accompanying downside revisions.

**Industrial Production—February 2015.** The Federal Reserve Board released its first estimate of seasonally-adjusted, February 2015 industrial production this morning (March 16th). Headline monthly production rose by 0.07% in February, following a revised decline of 0.32% (-0.32%) [previously a 0.15% gain] in January, and a revised decline of 0.23% (-0.23%) [previously down by 0.28% (-0.28%), initially down by 0.11% (-0.11%)] in December. Net of prior-period revisions, February 2015 production contracted month-to-month by 0.36% (-0.36%).

By major industry group, the headline February 2015 monthly gain of 0.1% [January 2015 contraction of 0.3% (-0.3%)] in aggregate production was composed of a February decline of 0.2% (-0.2%) [January decline of 0.3% (-0.3%)] in manufacturing; a February decline of 2.5% (-2.5%) [January contraction of 1.3% (-1.3)] in mining (oil production); and a February surge of 7.3% [January gain of 1.0%] in utilities.

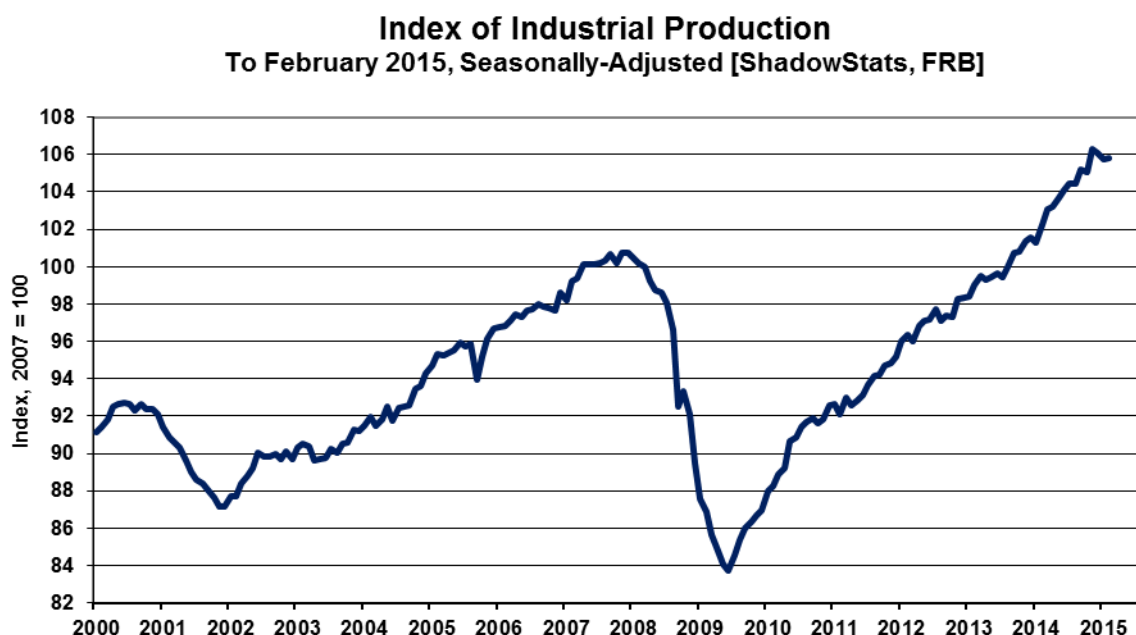
Year-to-year growth in February 2015 production was 3.47%, versus a revised annual gain of 4.36% [previously 4.81%] in January 2015, and a revised annual gain of 4.44% [previously 4.40%, initially 4.97%] in December 2014.

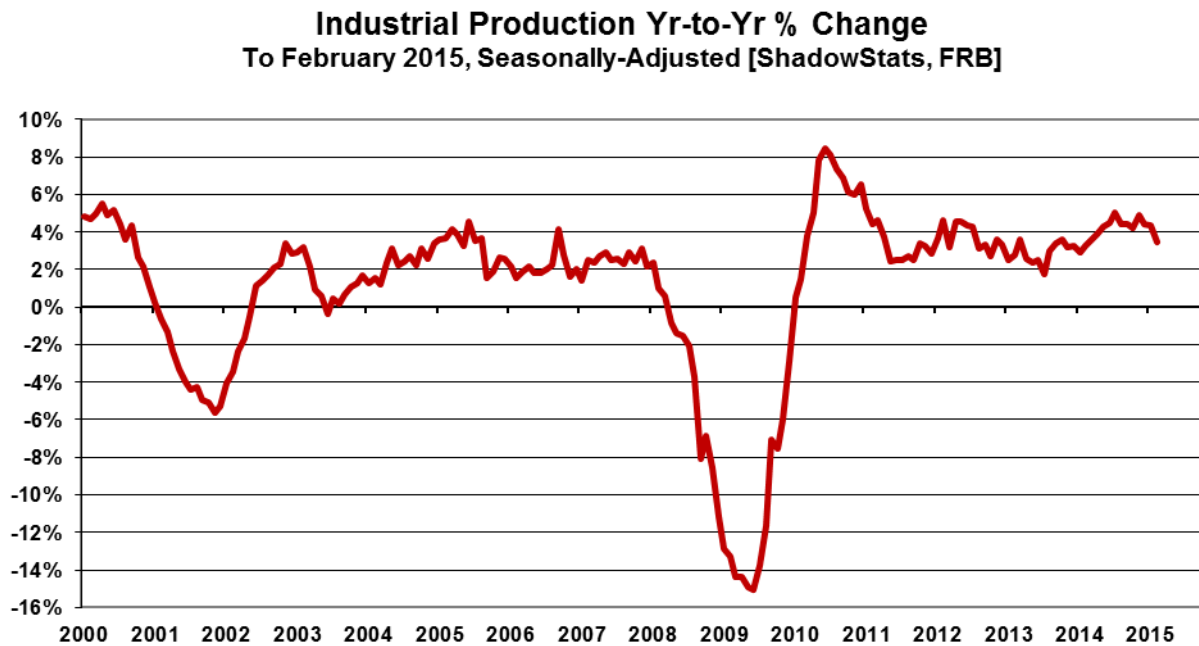
***The Fish Are Beginning to Smell—Massive Benchmark Revisions Should Show Much-Weaker Production and GDP, Unless Delayed.*** Language changes in today's industrial production press release may have hinted at a delay in the pending massive benchmark revisions to industrial production. If a delay ends up pushing the production revisions until after the GDP revisions of July 30th, the overall revision process for major economic data will smell about as sweet as rotting fish carcasses.

Discussed in the last several production *Commentaries*, the Federal Reserve is due to publish a massive annual benchmark revision to the industrial production series, correcting historical detail for more complete information as it has become 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 this year. The Federal Reserve indication now is "mid-2015," instead of its previous "second quarter of 2015," for the revisions. Unusual at this point in time for the Fed, the timing for this year's benchmarking still is not specific. Along with the recent press releases of industrial production (including today's), the Federal Reserve had indicated that 2015 annual benchmarking would include "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 a topping-out process in the last several months of reporting. The second graph shows the year-to-year percentage change in the same series for recent historical detail, beginning January 2000. Annual growth now is slowing sharply. The second set of graphs shows the same data in historical context since World War II.

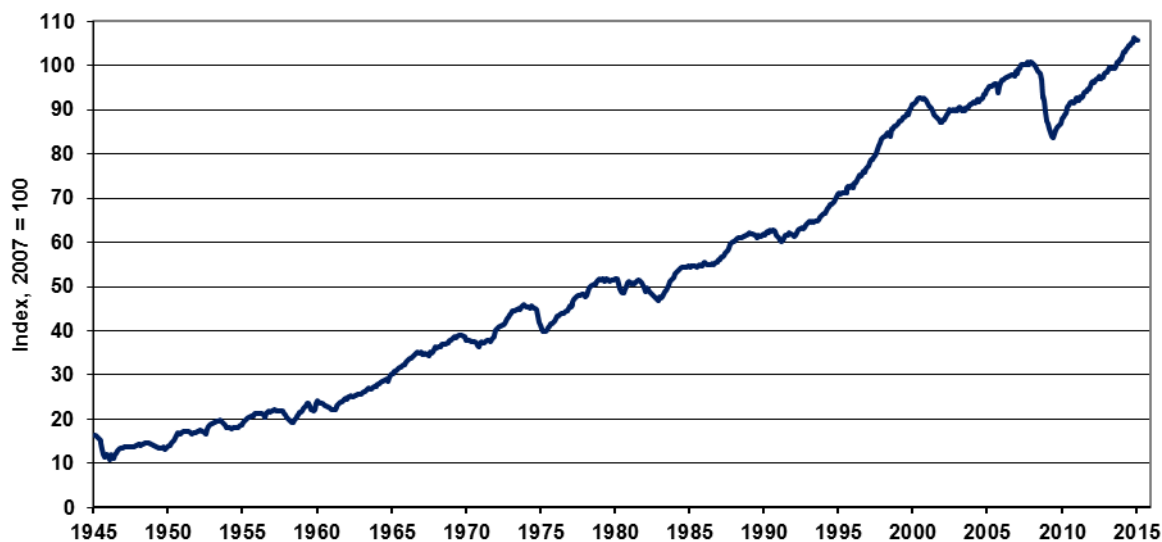




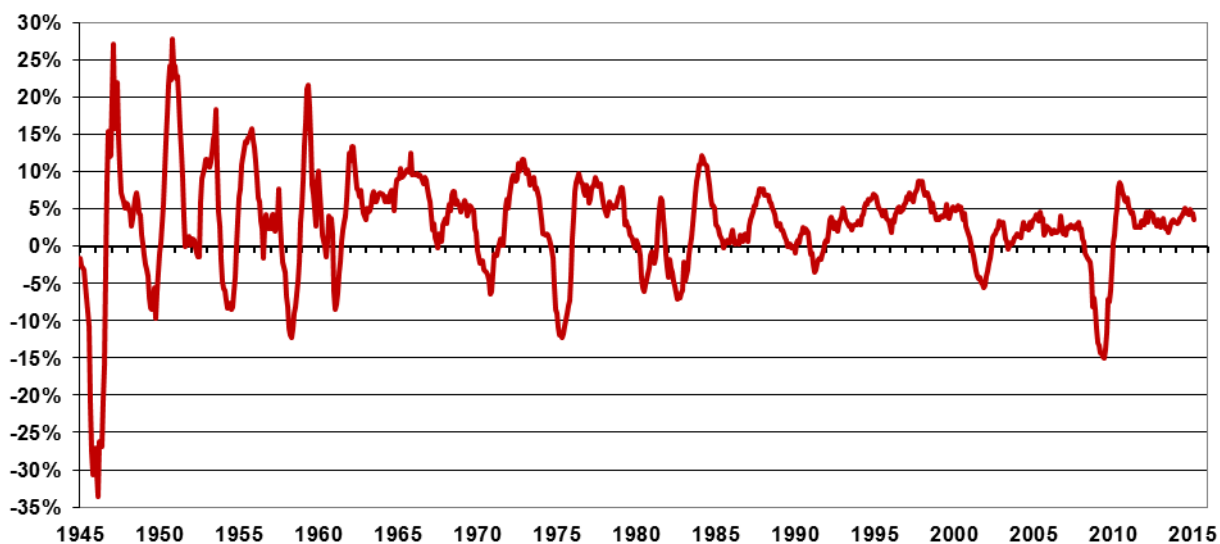
Shown more clearly in the first set of graphs, the pattern of year-to-year activity dipped anew in late-2013 to levels usually seen only at the onset of recessions, bounced higher into mid-2014, fluctuated thereafter and has headed lower again in recent months. Annual growth remains well off the recent 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—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 topping out, renewed downturn in place, coming into 2015. The "corrected" series remains well shy of a formal recovery.

**Index of Industrial Production**  
To February 2015, Seasonally-Adjusted [ShadowStats, FRB]



**Industrial Production Yr-to-Yr % Change**  
To February 2015, Seasonally-Adjusted [ShadowStats, FRB]





## **PRODUCER PRICE INDEX—PPI (February 2015)**

**Perversely, Rising Oil Prices Helped to Drive February 2015 PPI Down by 0.5% (-0.5%) for the Month, and Pushed Year-to-Year Inflation Down by 0.6% (-0.6%).** From a practical standpoint, the aggregate Final Demand Producer Price Index has little relationship to real world activity. The problem is that the services sector, which is the dominant component of the index, reflects profit margins, not prices.

Despite rising oil prices, February headline PPI inflation fell. First, rising oil prices were turned negative by seasonal adjustments in the goods sector. Second, rising oil prices narrowed margins in the services sector, with rising oil costs moving faster than price hikes to the next level of distribution or sales. Narrower margins are deflationary on the services side, even though the nature of the narrowing is suggestive of higher prices ahead. Construction inflation rose for the month.

As in recent months, the inflation gain in Final Demand Services - Trade perversely was tied to falling oil prices. The difference is that the services inflation reflects changes in margin instead of in costs, where costs are the basis for goods inflation. 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, recent stronger margins were 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. That process reversed in February, with higher oil-related prices—and implications for price hikes ahead—narrowing margins.

***Inflation that Is More Theoretical than Real World?*** [The background text here largely is 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.

***February 2015 Headline PPI Detail.*** The Bureau of Labor Statistics (BLS) reported Friday, March 13th, that seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for

February 2015 declined by 0.45% (-0.45%), versus an unrevised headline inflation decline in January 2015 of 0.81% (-0.81%).

The impact of seasonal adjustments on the headline monthly February aggregate PPI change was negative, with the unadjusted month-to-month February number contracting by 0.27% (-0.27%), versus a drop of 0.72% (-0.72%) in January. Also on a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year headline PPI inflation dropped by 0.64% (-0.64%) in February 2015, following an unchanged reading of 0.00% in January 2015.

In terms of the three major subcategories for February 2015 Final Demand PPI, headline monthly Final Demand Goods inflation contracted by 0.37% (-0.37%), Final Demand Services inflation declined by 0.45% (-0.45%), and Final Demand Construction inflation rose by 0.09%.

*Final Demand Goods (Weighted at 34.69%).* Running somewhat in parallel with the old Finished Goods PPI series, headline monthly Final Demand Goods inflation fell by 0.37% (-0.37%) in February 2015, versus a month-to-month decline of 2.15% (-2.15%) in January. There was an aggregate negative impact on the headline February 2015 reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, February final demand goods inflation contracted by 0.18% (-0.18%) for the month.

Unadjusted, year-to-year goods inflation was down by 4.23% (-4.23%) in February 2015, versus an annual decline of 3.71% (-3.71%) in January 2015

Headline seasonally-adjusted monthly changes by major components of February 2015 Final Demand Goods:

- "Foods" inflation dropped by 1.57% (-1.57%) in February 2015, versus a January decline of 1.06% (-1.06%), with February's headline monthly inflation contraction made minimally less negative by seasonal adjustments. Unadjusted, February food inflation fell by 1.58% (-1.58%) for the month. Unadjusted and year-to-year, February 2015 foods inflation gained 0.42%, versus an annual gain of 2.47% in January 2015.
- "Energy" inflation was unchanged at 0.00% month-to-month in February 2015, having collapsed by 10.30% (-10.30%) for the month in January, with the February neutral reading hammered to that level by negative seasonal adjustments. Unadjusted, February energy inflation rose by 1.04% month-to-month. Unadjusted and year-to-year, February 2015 energy inflation slumped by 22.37% (-22.37%), versus an annual decline of 22.24% (-22.24%) in January 2015.
- "Less foods and energy," or "core" goods inflation fell by 0.09% (-0.09%) in February 2015, versus a monthly drop of 0.18% (-0.18%) in January. Seasonal adjustments were a positive for monthly core inflation, with an unadjusted February monthly decline of 0.18% (-0.18%). Unadjusted and year-to-year, February 2015 core inflation rose by 0.37%, versus an annual gain of 0.64% in January 2015.

*Final Demand Services (Weighted at 63.29% of the Aggregate).* Headline monthly Final Demand Services inflation fell by 0.45% (-0.45%) in February 2015, versus a monthly decline of 0.18% (-0.18%) in January. The overall impact on the February month-to-month services inflation reading from underlying seasonal-factor adjustments was negative, with an unadjusted contraction of 0.27% (-0.27%) in the current month.

Year-to-year unadjusted services inflation was 1.20% in February 2015, versus 2.04% in January 2015.

The headline monthly changes by major component for February 2015 Final Demand Services inflation:

- "Services less trade, transportation and warehousing" inflation rose by 0.28% in February 2015, having dropped by 0.37% (-0.37%) in January. Seasonal-adjustment impact on the adjusted February detail was negative. The unadjusted monthly gain in February 2015 was 0.37%. Unadjusted and year-to-year, February 2015 "other" services inflation gained 1.03%, versus an annual gain of 0.84% in January 2015.
- "Transportation and warehousing" inflation declined month-to-month by 1.45% (-1.45%) in February 2015, following a monthly decline of 0.76% (-0.76%) in January. Seasonal adjustments had a minimally-positive impact, with an unadjusted monthly contraction of 1.46% (-1.46%) in February. Unadjusted and year-to-year, February 2015 transportation inflation contracted by 0.60% (-0.60%), versus an annual gain of 0.60% in January 2015.
- "Trade" inflation plummeted by 1.51% (-1.51%) month-to-month in February 2015, following a gain of 0.53% in January 2015 (see opening paragraphs in this PPI section for a discussion on the reverse impact of oil price changes on the trade sector). Seasonal adjustments had a negative impact here, where the unadjusted inflation change in February was for a month-to-month decline of 0.89% (-0.89%). Unadjusted and year-to-year, February 2015 trade rose by 2.21%, versus an annual gain of 4.38% in January 2015.

*Final Demand Construction (Weighted at 2.02% 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, and month-to-month construction inflation rose by 0.09% in February, versus a monthly gain of 0.36% in January. The impact of seasonal factors on the February reading was negative. On an unadjusted basis, month-to-month February 2015 construction inflation was up by 0.18%.

On an unadjusted basis, year-to-year construction inflation was 2.00% in February 2015, versus 1.91% in January 2015.

Discussed in [Commentary No. 702](#), ShadowStats 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 of February 2015 new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods in February 2015 was "unchanged" at 0.00% for the third month, with annual inflation of 0.60% in February 2015, versus 0.72% in January 2015 and 1.09% in December 2014. February 2015 durable goods orders will be released on March 25th and covered in *Commentary* on the same date.

## 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 one monthly revision 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 or was close to a near-term low in January 2015 reporting. Significant upside inflation pressures should resume as oil prices 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 the prior labor data related [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:**

**Residential Construction—Housing Starts (February 2015).** The Census Bureau will release February 2015 residential construction detail, including housing starts, tomorrow, Tuesday, March 17th. 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 a decline in February reporting, probably reflecting weather concerns. Even so, that still is well shy of what—until recently—would have been expectations of a headline monthly gain. Market expectations increasingly are shifting 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 in the *Opening Comments* of prior [Commentary No. 703](#).

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