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

COMMENTARY NUMBER 734
Nominal June Retail Sales, Financial Turmoil and Gold

July 14, 2015

June Retail Sales Generated an Intensifying Recession Signal

In the Context of Downside Revisions to April and May Retail Sales Activity, the "Unexpected" June Contraction of 0.3% (-0.3%) Should Rattle Expectations

Rising Inflation Means an Even Greater Decline in Real June Retail Sales

Mounting Global Financial and Economic Instabilities Suggest a Good Time to Batten Down the Hatches

June M3 Annual Growth Still at 5.2% versus 5.0% in May

PLEASE NOTE: Tomorrow's regular Commentary *for July 15th will cover June Industrial Production and the Producer Price Index (PPI), with a further missive on the 17th, covering June Housing Starts and the Consumer Price Index (CPI).*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

U.S. Economic Concerns Begin to Mix with Other Global Instabilities. The crises involving the solvency of Greece and the stock-market crash in China likely are far from over, but global circumstances are about to be complicated by a renewed and increasing awareness that all is not right with the U.S.

economy. At risk are shocks to the system that could trigger broad, massive selling of the U.S. dollar against other currencies.

Still encompassing the largest economic and financial system on Earth, the United States does not have quite the ability that it once had to bailout the rest of the world. Domestic circumstances never recovered from the Panic of 2008, when the U.S. federal government and the Federal Reserve did everything in their power to forestall an imminent financial-system collapse. Actions simply were taken at any cost to prevent the collapse. Little was done to address the underlying issues that had led the system to the brink. No obvious consideration was given to what might be required in order to return the domestic-financial system to normal, healthy and sustainable functioning, following the panic (see *No. 692 Special Commentary: 2015 - A World Out of Balance*).

As result, the U.S. economy never really recovered; the U.S. still faces long-range sovereign-solvency issues; and domestic banking-system stability remains shaky, at best. Recognizing such, but still in a quasi-panic-recovery stage, the Fed continues to use the weak domestic economy as political cover for maintaining its quantitative easing. The quantitative easing was designed as a prop for the banking system, not as a stimulus for the economy.

Market hype and hopes of the last year, however, have been built around a purported acceleration in the U.S. economic recovery. Such helped to boost the U.S. dollar's exchange rate value and the levels of the domestic equity markets, yet, as discussed frequently in these *Commentaries*, the real-world economic activity never recovered (see *Commentary No. 731*). Further, underlying economic reality has weakened enough at present that even the heavily upside biased, headline economic-reporting system has started to show a renewed downturn.

Retail Sales Take an "Unexpected" Hit. Today's (July 14th) headline reporting of unexpectedly-weak June 2015 retail sales should be part of the process in shifting broad market expectations on the economy back towards reality. Production and housing-starts reporting later this week should accelerate that process. The broad outlook for U.S. economic reporting and upcoming GDP detail will be reviewed in the July 17th *Commentary No. 736.*

Gold Remains the Primary Hedge. Despite mounting global instabilities, gold prices remain depressed. Whether hit by selling to meet the liquidity needs of those in heavily stressed stock markets, or pummeled by central banks trying to discourage investment in gold by those who are not overly impressed by the recent behavior of those same central banks, physical gold and silver remain the best hedges against the financial instabilities ahead.

As the global financial system has become increasingly unstable, significant further negative shocks and surprises remain likely, particularly from the U.S. economy, along with related negative implications for U.S. fiscal conditions and stresses on its banking system. The financial markets are particularly vulnerable to unhappy surprises out of the United States, which would tend to be negative for the U.S. dollar. It appears increasingly prudent to look to batten down the hatches (see the *Hyperinflation Report* links in the *Hyperinflation Watch* section).

M3 Money Supply Growth Still at 5.2% in June 2015. Following up on the *Monetary Conditions* reporting in prior *Commentary No. 733*, the estimate of year-to-year change for June 2015 money supply

M3 held at 5.2%, in near-final reporting, versus 5.0% in May. Estimates for annual growth in M3, M2 and M1 for June 2015 have been updated on the Alternate Data tab of www.ShadowStats.com.

Today's Missive (July 14th). The balance of today's *Opening Comments* concentrates on the detail from the headline reporting of the June nominal Retail Sales and an update of related consumer liquidity conditions.

Money supply M3 was updated in the opening paragraphs of this section. Otherwise, the *Hyperinflation Watch (Hyperinflation Outlook Summary)* has not been revised from the prior *Commentary*.

The *Week Ahead* section has updated previews for June industrial production and housing starts reporting scheduled for the balance of this week, along with an outlook for the pending CPI and PPI inflation detail.

Nominal Retail Sales—June 2015—Prior-Period Revisions and Seasonal-Adjustment Shenanigans Minimized the "Unexpected" Monthly Sales Decline. In the context of downside revisions to April and May activity, the headline decline of 0.3% (-0.3%) in nominal June retail sales was much worse than it appeared. Net of prior period revisions, where the level of May activity was revised lower—boosting the relative June change—aggregate June sales dropped by 0.7% (-0.7%). Net of games played with the seasonal adjustment factors, which also boosted relative June activity (see *Seasonal-Factor Distortions and Other Reporting Instabilities* in the *Reporting Detail* section), the total headline contraction would have been about 0.9% (-0.9%), and that all was before adjustment for rising inflation.

Where consensus expectations had been for a headline, nominal monthly retail sales gain in the range of 0.2% to 0.3%, the consensus outlook for generally-positive, near-term economic growth has to have been shaken by today's reporting. With likely further, negative reporting shocks in the immediate future (see the *Week Ahead* section), the consensus broad economic outlook should soften quickly and significantly.

With expectations for headline June CPI-U inflation at 0.3%, real or inflation-adjusted retail sales should be weaker than today's headline numbers, with annual real growth still generating a solid signal for a formal, new recession. Adjusting for realistic inflation (as will be detailed in the July 17th CPI *Commentary*), retail sales and the broad economy never actually recovered from the economic collapse into 2008 and 2009.

Discussed in the following *Consumer Liquidity* section, the primary, underlying issue hurting current retail sales activity remains the intense, structural-liquidity woes besetting the consumer. 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 retail sales.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—June 2015. In the context of downside revisions to April and May retail sales activity that narrowed the headline June contraction by 0.4%, and despite the usual seasonal-adjustment aberrations that likely narrowed the headline June sales contraction by a further 0.2%, the net headline June contraction of 0.3% (-0.3%) sharply disappointed consensus expectations for a 0.2% gain [MarketWatch] to 0.3% gain [Bloomberg]. In nominal terms—before adjustment for consumer inflation—June 2015 retail sales showed a statistically-insignificant, seasonally-adjusted decline of 0.27% (-0.27%). Net of prior-period revisions, however, the monthly change in June was a drop of 0.65% (-0.65%).

Such followed a statistically-significant, downwardly revised monthly gain of 1.03% in May, and downwardly revised activity in April of "unchanged" (up by 0.03%).

Year-to-Year Annual Change. Year-to-year nominal retail sales in June 2015 increased by a marginally-insignificant 1.53%, versus a downwardly revised gain of 2.26% in May 2015, and a downwardly revised 1.31% gain in April 2015.

***Annualized Nominal Second-Quarter Gain, First-Quarter Contraction*.** The pace of annualized nominal retail sales change in first-quarter 2015 was an unrevised contraction of 4.04% (-4.04%), the worst quarterly showing since the economic collapse.

The nominal annualized quarterly growth for second-quarter 2015 retail sales was a positive 6.04% in initial reporting. That would have been 6.95%, based solely on April and initial May reporting; and 2.30%, based solely on the initial reporting for April.

Net of inflation, the real retail sales change in first-quarter 2015 was an unrevised quarterly contraction of 1.02% (-1.02%). Detail on the quarterly change in second-quarter real retail sales will follow in the July 17th CPI-U *Commentary*, but it should be solidly in positive territory.

Real (Inflation-Adjusted) Retail Sales—June 2015. The nominal decline of 0.27% in June 2015 retail sales was before accounting for inflation. The change in real retail sales for June will be published along with the headline estimate of consumer inflation for June 2015, to be covered in *Commentary No. 736* of Friday, July 17th. Consensus expectations [MarketWatch and Bloomberg] are for a 0.3% gain in the headline June CPI-U, and those expectations are reasonable.

A consensus inflation reading would widen today's headline nominal contraction from 0.3% (-0.3%), to a drop of about 0.6% (-0.6%), enough effectively to offset the revised headline real monthly gain of 0.58% gain now in place for May 2015, with the June 2015 real level of activity likely below that of March 2015. Annual real growth in June 2015 retail sales will continue generating a strong, historical-warning signal of imminent recession. Where annual real growth below the 2.0% traditionally signals an imminent recession, real annual growth in June 2015 retail sales likely was around 1.3% to 1.4%.

Consumer Liquidity Woes Continue to Thwart Sustainable Consumption Growth. Updating *Commentary No. 729* of June 18th, and as otherwise discussed regularly in these *Commentaries* (see detail in *No. 692 Special Commentary: 2015 - A World Out of Balance*), structural liquidity woes have constrained domestic economic activity, severely, since before the Panic of 2008. Never recovering in the post-Panic era, limited income, credit and a faltering consumer outlook have eviscerated business activity that feeds off the financial health and liquidity of consumers.

Without real (inflation-adjusted) growth in household income and without the ability or willingness to take on meaningful new debt, the consumer simply has not had the wherewithal to fuel sustainable economic growth. Impaired consumer liquidity and its direct restraints on consumption have been responsible for much of the economic turmoil of the last eight-plus years, driving the housing-market collapse and ongoing stagnation in consumer-related real estate and construction activity, as well as constraining real retail sales activity and the related, personal-consumption-expenditures category of the GDP. Together, those sectors account for more than 70% of total U.S. GDP activity.

Recently-released readings on May median real monthly household income and May nominal consumer credit outstanding are updated here. Also shown are the full-June readings on monthly consumer confidence and sentiment, along with the previously-published plot of real first-quarter household-sector credit-market debt outstanding.

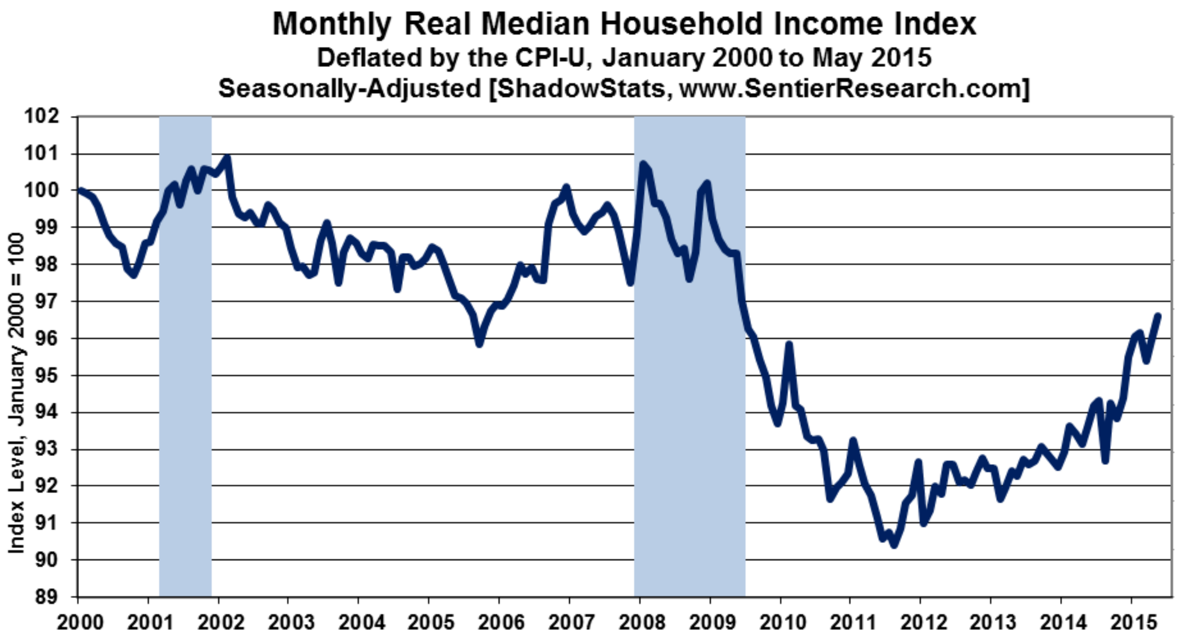
Underlying economic fundamentals simply have not supported, and do not support a turnaround in broad economic activity. There has been no economic recovery, and there remains no chance of meaningful, broad economic growth, without a fundamental upturn in consumer- and banking-liquidity conditions.

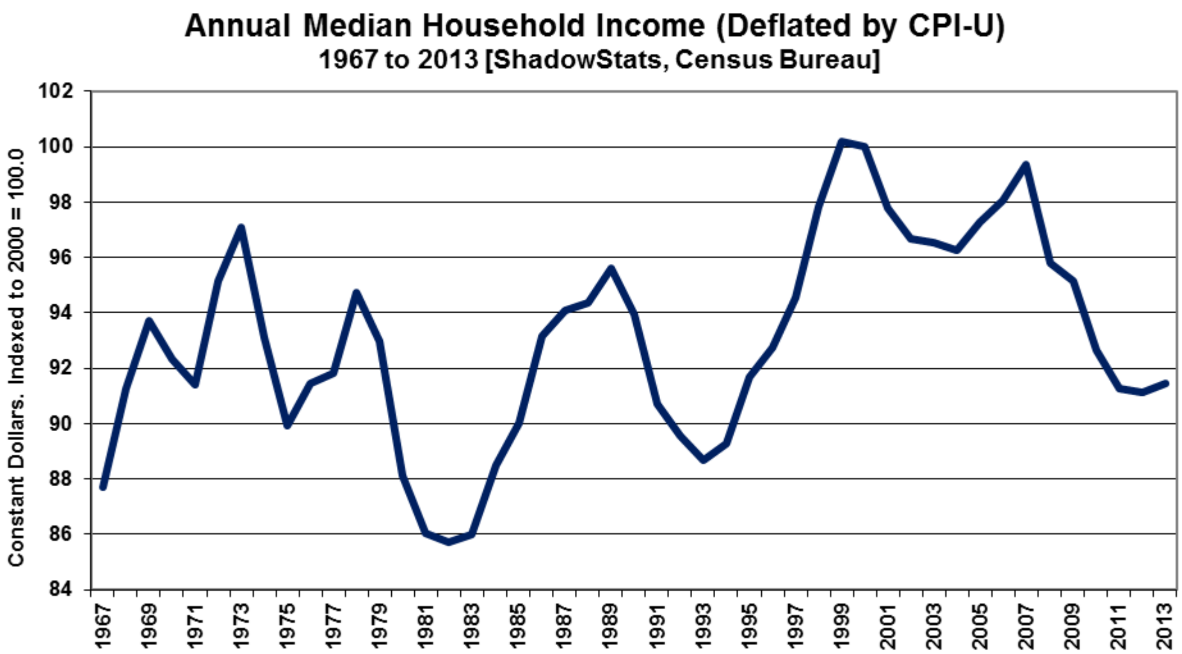
Consider the following graphs. The first graph shows monthly real median household income through May 2015, as reported by www.SentierResearch.com on July 6th. The income series has been in low-level stagnation, with a recent uptrend boosted by dropping gasoline prices. Where negative inflation boosts the level of real growth relative to nominal growth, recent relative "strength" in the series largely reflected temporary, gasoline-price-driven, headline month-to-month contractions in CPI-U reporting, and flat-to-minus annual inflation. That monthly inflation issue was gone with the May reporting, the annual inflation circumstance should disappear along with this week's headline June CPI-U reporting. That said, despite the increase in the May CPI-U, the headline gain in real monthly median household income for May was statistically-significant 0.67%.

Where lower gasoline prices had provided some minimal liquidity relief to the consumer, indications are that any effective extra cash has been used to pay down unsustainable debt, not to fuel new consumption. Relief from low-priced gasoline should prove increasingly fleeting, as the U.S. dollar resumes its decline and petroleum prices continue to spike anew.

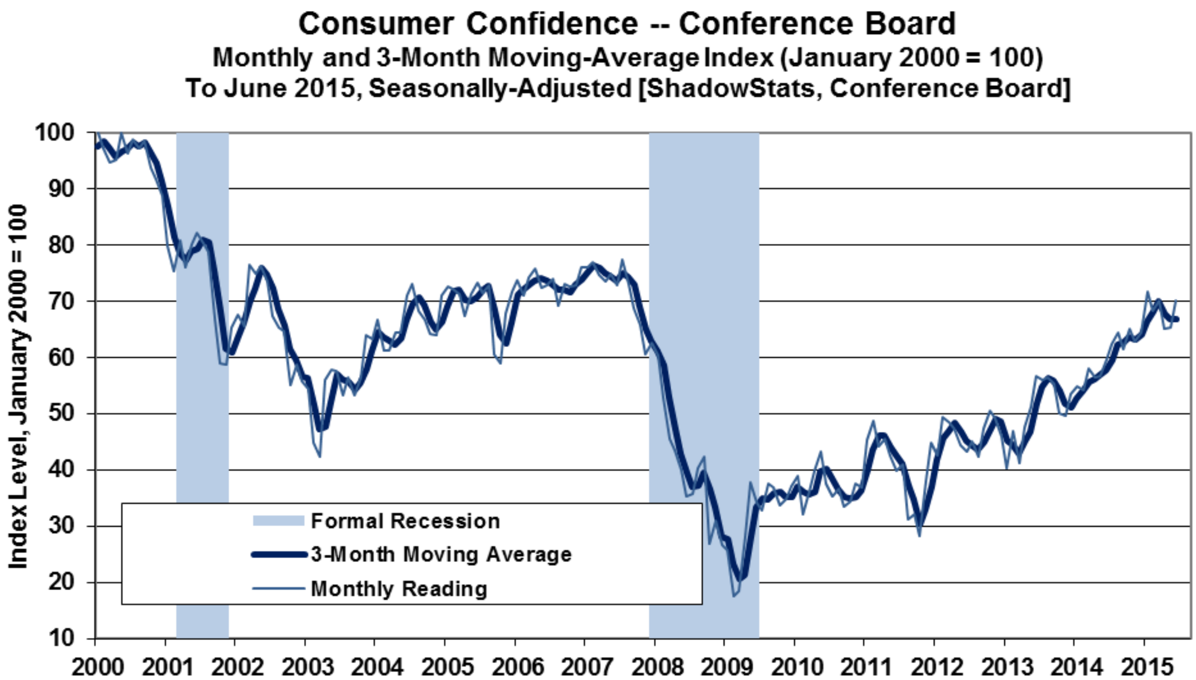
On a monthly basis, when headline GDP purportedly started its solid economic recovery in mid-2009, household income plunged to new lows and has yet to recover its level seen during the formal recession, or the pre-recession highs either for the 2007 recession or the 2001 recession.

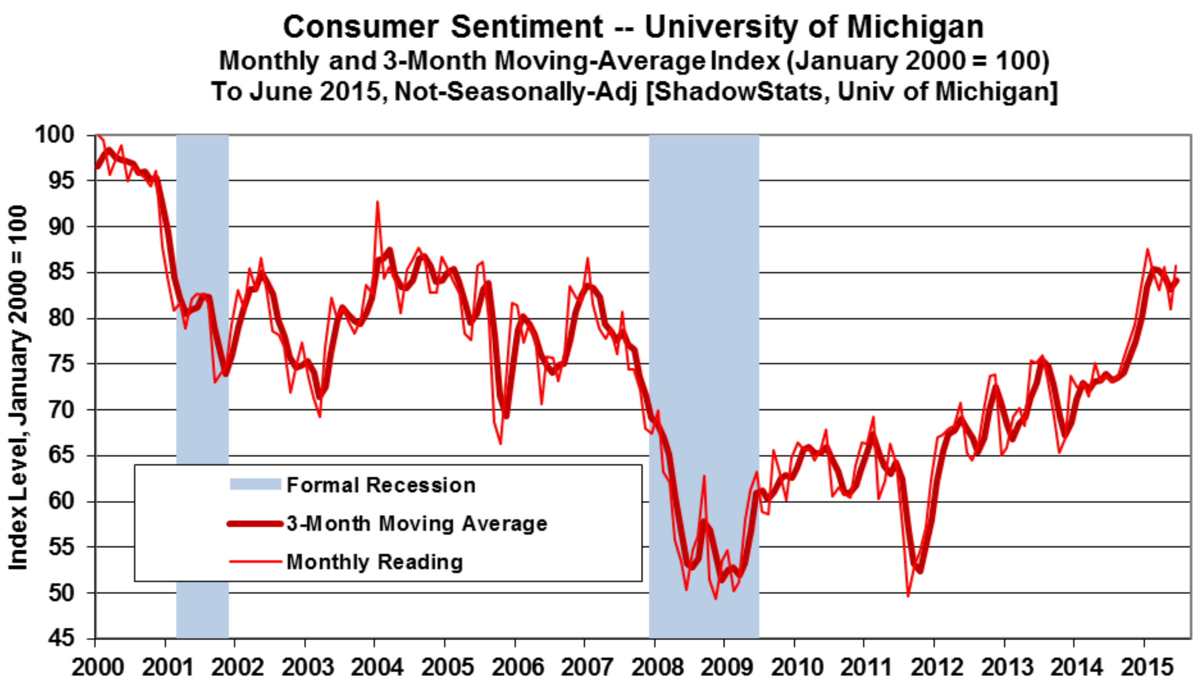
Shown in the second graph, the same series, published by the Census Bureau on an annual basis, deflated by headline CPI-U, confirmed that in 2013—the latest-available annual data—annual real median household income continued to hold at a low level of activity. In historical perspective, 2011, 2012 and 2013 income levels were below levels seen in the late-1960s and early-1970s. Such indicates the long-term nature of the evolution of the major structural changes squeezing consumer liquidity and impairing the current economy. Further discussion of these issues is found in *No. 692 Special Commentary*, *Commentary No. 658*, and in *2014 Hyperinflation Report—The End Game Begins – First Installment Revised* and *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*.



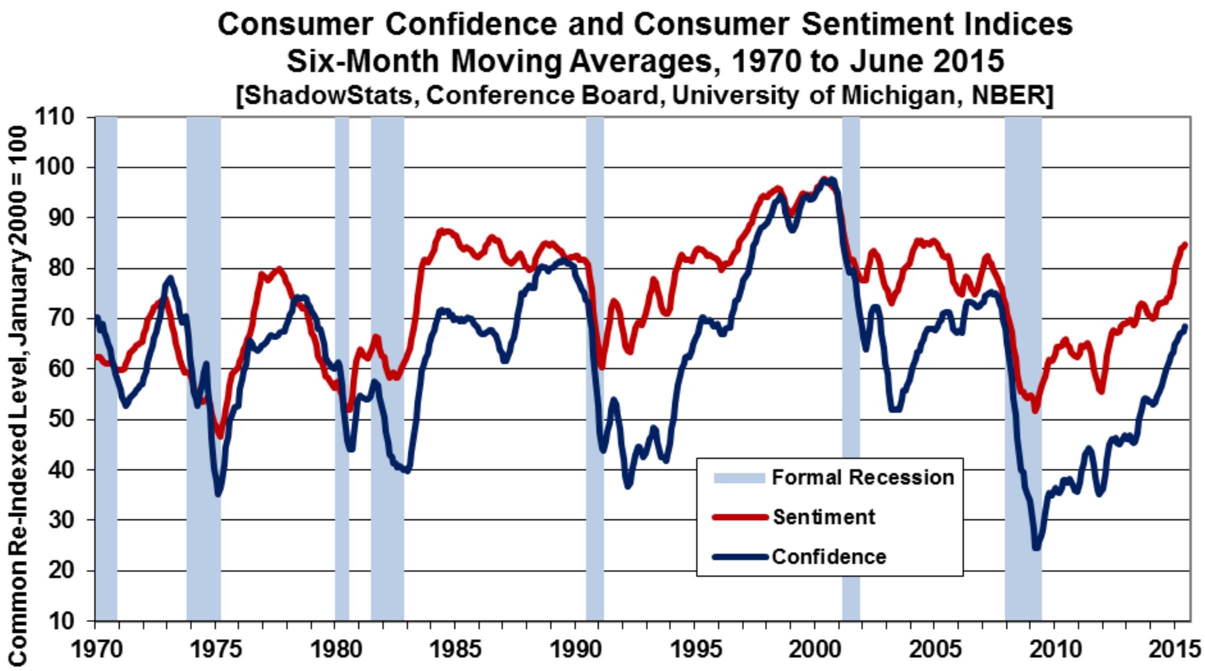


The next three graphs reflect the latest headline activity in consumer confidence and sentiment. The Conference Board's Consumer Confidence Index and the University of Michigan's Consumer Sentiment Index for the full month of June 2015 both notched higher for the month, but they were flat or lower in their three-month moving-average readings. The confidence and sentiment series tend to mimic the tone of headline economic reporting in the press, and often are highly volatile month-to-month, as a result. Despite a short-lived round of economic euphoria in the popular press, an increasingly-negative toll from headline economic reporting should be seen in renewed hits to both the confidence and sentiment readings in the months ahead.





Smoothed for the irregular, short-term volatility, however, the two series remain at levels seen typically in recessions. Suggested in the third graph—plotted for the last 40 years—the latest readings of confidence and sentiment generally have not recovered levels seen preceding most formal recessions of the last four decades. Generally, the consumer measures remain well below, or are inconsistent with, periods of historically-strong economic growth that would rival the recent booming, headline GDP gains briefly seen in mid-2014.

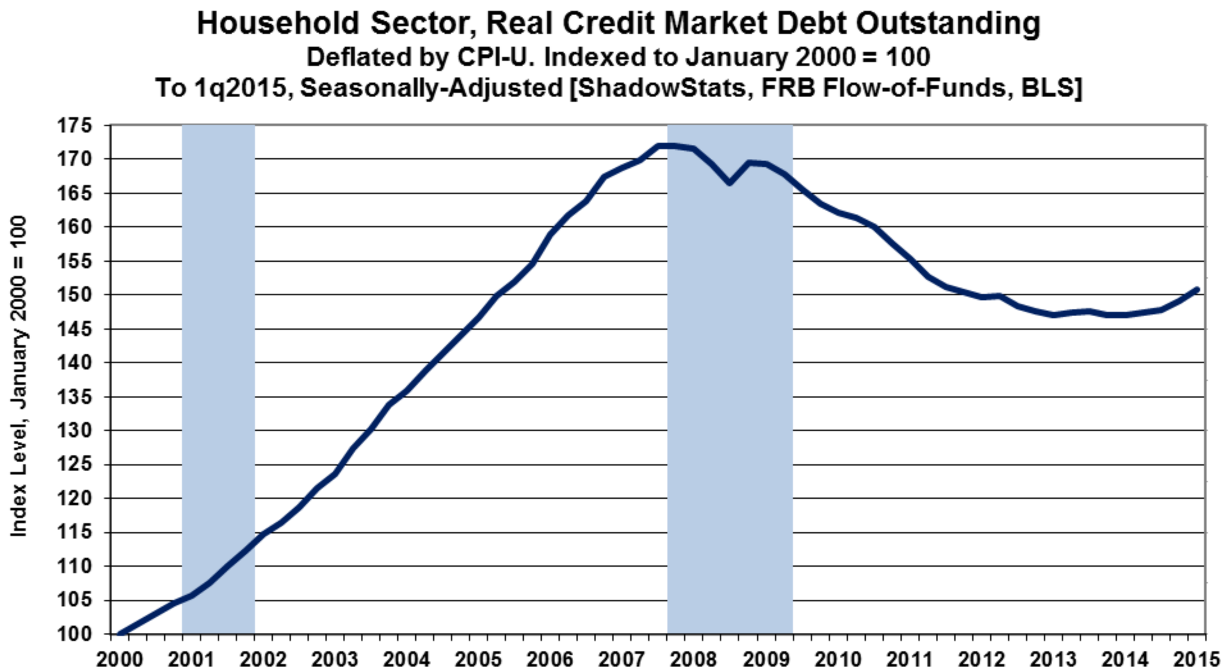


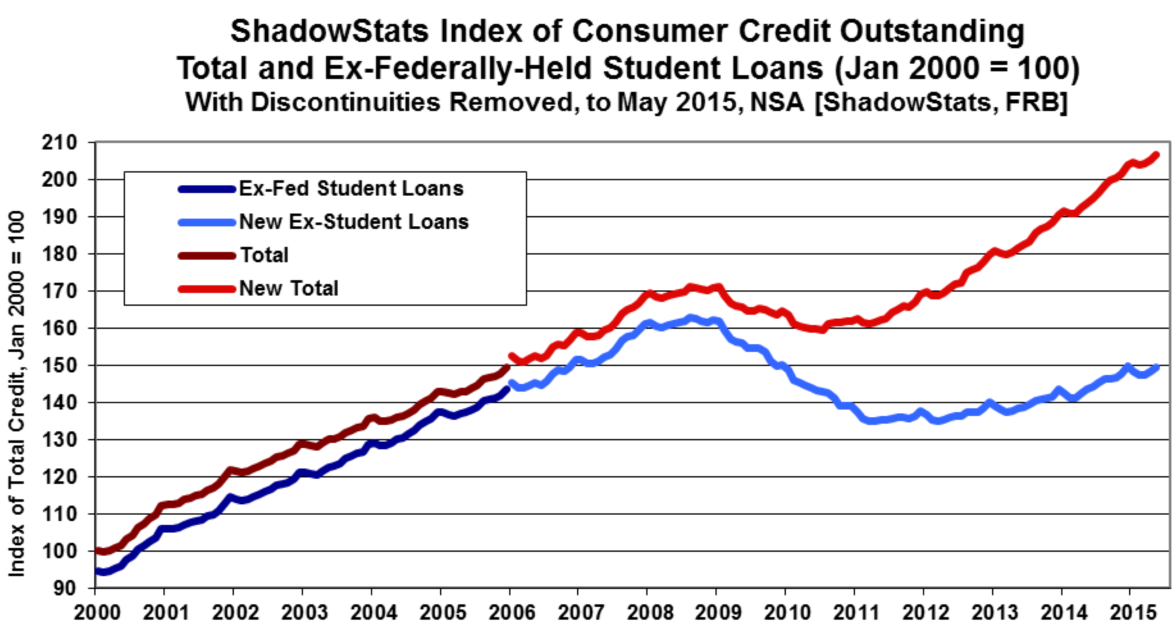
The final two graphs in this section address consumer borrowing. Debt expansion can help to make up for a shortfall in income growth. Shown in the first graph of *Household Sector, Real Credit Market Debt Outstanding*, household debt declined in the period following the Panic of 2008, and it has not recovered. The series includes mortgages, automobile and student loans, credit cards, secured and unsecured loans, etc., all deflated by the headline CPI-U. The level of real debt outstanding has remained stagnant for several years, reflecting, among other issues, lack of normal lending by the banking system into the regular flow of commerce. Updated through first-quarter 2015, the graph reflects the most-recent detail available from the Federal Reserve's flow-of-funds data, published June 11th.

The slight upturn seen in the series in the two most-recent quarters, as with the median household income survey, was due partially to gasoline-price-driven, negative CPI inflation, which has begun to pass out of the system. It also reflected surging student loans, as shown in the next graph.

Updated through May 2015, the graph of monthly Consumer Credit Outstanding is a subcomponent of the prior graph on real household sector debt, but it is not adjusted for inflation. Post-2008 Panic, outstanding consumer credit has continued to be dominated by growth in federally-held student loans, not in bank loans to consumers that otherwise would fuel broad consumption growth. The nominal level of Consumer Credit Outstanding (ex-student loans) has not rebounded or recovered since the onset of the recession. These disaggregated data are available and plotted only on a not-seasonally-adjusted basis.

Again, consumer liquidity woes remain the basic constraint on broad economic activity in the United States, which remains heavily consumer oriented. Without real growth in income and/or debt expansion and willingness to take on new debt, and with consumer confidence and sentiment at levels consistent with a significant portion of consumers under financial stress, there has been no basis for a sustainable economic expansion since the Panic of 2008. There are no prospects for a recovery in the near term.





[The* Reporting Detail *section provides further information on June retail sales.]

HYPERINFLATION WATCH

HYPERINFLATION OUTLOOK SUMMARY

Broad Outlook Is Unchanged: Economy Remains in Downturn; Dollar Faces Massive Decline with Ongoing Implications for a Hyperinflation Crisis. The *Hyperinflation Outlook Summary* has not been revised from its prior publication.

The U.S. economy remains in ongoing downturn, while the U.S. dollar faces a massive decline, with implications for a meaningful upturn in inflation evolving into a great hyperinflationary crisis. Signs of systemic instability are increasing anew.

Background. Underlying this missive, *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 two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts. One other reference should be considered here, in terms of underlying economic reality, and that is the *Public Commentary on Inflation Measurement*.

Primary Summary. Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would have been met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation by 2020, as first estimated by ShadowStats in 2004. That time horizon for the hyperinflation forecast was moved to 2014, as a result of the 2008 Panic, the near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same. That hyperinflation forecast remains in place, adjusted to 2015, as discussed in *No. 692*.

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 the *Hyperinflation Report—First*

Installment Revised (linked earlier). The following summarizes the underlying current circumstance and recent developments.

The U.S. dollar rallied sharply from mid-2014 into early-2015, initially reflecting likely covert financial sanctions and oil-price manipulations by the United States, aimed at creating financial stresses for Russia, in the context of the Ukraine situation. Relative U.S. economic strength, and the relative virtuousness of Fed monetary policy versus major U.S. trading partners, were heavily picked-up on and heavily over-estimated by the global markets looking to support the dollar. Yet structural faults started to appear in the foundation underpinning U.S. dollar strength (see *Commentary No. 711*).

Consistent with the above referenced *Special Commentaries*, the unfolding, weakening domestic-economic circumstance in 2015, in confluence with other fundamental issues, had begun to raise doubts in the markets as to the sustainability of the purported U.S. economic recovery, and as to the imminence of meaningful monetary tightening by the U.S. Federal Reserve. As a result, the U.S. dollar backed off its recent highs, with some related upside pressure having been seen on oil prices, but those changes have been relatively small, so far.

First-quarter 2015 U.S. GDP contracted by 0.2% (-0.2%) as per its second and "final" revision, other than for benchmark revisions due on July 30th (*Commentary No. 731*). Although early reporting on the second-quarter economy indicated the likelihood of a second, consecutive quarterly GDP downturn, which would constitute a "new" recession, reporting of the last several weeks has been relatively strong, as discussed in the *Opening Comments* of *Commentary No. 726*. Such strong numbers should prove increasingly fleeting in the next four-to-five weeks, with a second-quarter GDP contraction still likely.

Nonetheless, the Fed could raise interest rates at any time, irrespective of economic activity. Where the stock and currency markets pretty much already have anticipated such action in their pricing, the big market moves ahead should come from areas such as downside surprises in U.S. economic reporting, which increasingly will show an ongoing contraction in activity.

Domestic economic data should continue to falter, increasingly moving market expectations towards an imminent new recession, not only further pummeling expectations for a significant tightening in Fed policy, if the Fed has not already tightened, but also renewing expectations for a more-accommodative or newly-accommodative Fed. While such could help to fuel further stock-market mania, any resulting rallies in equity prices likely will be more than offset in real terms, by percentage declines in the exchange-rate value of the U.S. dollar or in the eventual increases in headline consumer inflation.

Faltering expectations on the direction of domestic economic activity, should place mounting and eventually massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the Panic of 2008. Physical gold and silver, and holding assets outside the U.S. dollar, remain the ultimate primary hedges against an eventual total loss of U.S. dollar purchasing power. These circumstances should continue to unwind what had been the sharp and generally ongoing rally in the U.S. dollar's exchange rate since mid-2014, and the broadly-related selling pressures seen in the gold and silver markets.

A crash back to recognition of more-realistic domestic-economic circumstances began, then faltered recently, but should resume shortly, possibly a matter of weeks. It 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;

and related rallies in precious metals and oil. Further, a sharp deterioration in the near-term outlook for domestic and global political stability continues and is of meaningful near-term risk for providing further fuel for heavy selling of the dollar.

Current Economic Issues versus Underlying U.S. Dollar Fundamentals. U.S. economic activity is turning down anew, despite brief fluttering in unstable series. GDP and industrial production face heavy downside-benchmark revisions through the end of July. Other key series all have benchmarked to the downside. Weak, underlying economic reality generally has surfaced in headline reporting. That should become increasingly and painfully obvious to the financial markets in the detail and revisions of the weeks and months ahead, for series such as real retail sales, production, housing and construction, the trade deficit and payroll employment. Again, headline GDP will be in trouble.

As financial-market expectations resume shifting towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, particularly deteriorating domestic political conditions, should intensify mounting and eventually massive selling pressures against the U.S. dollar, more than fully reversing the dollar's gains since June 2014, and pushing the dollar once again to historic lows. Again, the nascent currency crisis also has meaningful potential 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. The highly touted "tapering" by the FOMC ran its course. Future, more-constructive Fed behavior—moving towards normal monetary conditions in what had been an unfolding, purportedly near-perfect economic environment—was pre-conditioned by a continued flow of "happy" economic news. Suggestions that all was right again with world were nonsense. Nonetheless, the Fed still likely would move to normalize interest rates (see *Opening Comments* of *Commentary No. 726*), if it could get away with it. The FOMC meeting of June 17th apparently concluded that the Fed could not get away with it (see *Opening Comments* of *Commentary No. 729*).

The Panic of 2008 never was resolved, and the Fed increasingly is finding that it has no easy escape from its quantitative easing (QE3), which continues. Only overt expansion of QE3 ceased; if the Fed does not act quickly to extricate itself from prior actions, QE4 will become the near-term question.

Unexpected economic weakness—a renewed downturn—also savages prospective federal budget deficit prognostications (particularly the 10-year versions). Such throws off estimates of U.S. Treasury funding needs and estimates as to how long the Treasury effectively can dodge the limits of the recently re-imposed debt ceiling. Current fiscal "good news" remains from cash-based, not GAAP-based and accounting projections and is heavily impacted by changes in business activity.

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 significant, renewed market speculation as to an added round of Federal Reserve quantitative easing, QE4, may 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 thought 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.

Again, 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.

Strength in the U.S. dollar should continue to reverse sharply, 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, increasingly against the U.S. currency. That process may have started with the shift in Swiss National Bank policy early in the year, but it has become dominated by increasingly-negative global perceptions of stability in U.S. economic activity and the ability of the Federal Reserve to control its monetary policy. Key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008, is turning down anew, with no potential for recovery in the near-term.*** The circumstance includes a renewed widening in the trade deficit, 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 details in the *Opening Comments* of *Commentary No. 729*). Sharply-negative economic reporting shocks, versus softening consensus forecasts, still remain a heavily-favored, proximal trigger for the intensifying the unfolding 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 did not alter the systemic unwillingness to address 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 many in Washington look to continue increasing 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*). This circumstance now operates in the context of the formal constraint of a renewed debt ceiling.

- ***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. If the Fed does not move soon to boost interest rates, it may be trapped in a renewed expansion to quantitative easing, 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 any 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 fiscal and economic issues are nil, except possibly for new trade legislation, which would compound domestic economic problems. Issues such as non-recovered, faltering economic activity, the consumer liquidity crisis and the nation's long-range solvency should continue to devolve into extreme political crises.

- ***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 versus Russia and extraordinarily-volatile circumstances in the Middle East. U.S. response to Russian activity in the Ukrainian situation likely was 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. These situations have yet to run their full courses, and they have the potential for rapid and massive negative impact on the financial and currency markets.

- ***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. Temporary, recent dollar strength may have bought some time versus those who have to hold dollars for various reasons. Nonetheless, developing short-term instabilities and a quick, significant reversal in the dollar's strength should 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 handing the hyperinflation crisis and *No. 692 Special Commentary: 2015 - A World Out of Balance*, for other factors afoot in the current environment.

REPORTING DETAIL

NOMINAL RETAIL SALES (June 2015)

Prior-Period Revisions and Seasonal-Adjustment Shenanigans Minimized the "Unexpected" Decline in June Retail Sales. In the context of downside revisions to April and May activity, the headline decline of 0.3% (-0.3%) in nominal June retail sales was much worse than it appeared. Net of prior period revisions, where the level of May activity was revised lower—boosting the relative June change—aggregate June sales dropped by 0.7% (-0.7%). Net of games played with the seasonal adjustment factors, which also boosted relative June activity (see *Seasonal-Factor Distortions and Other Reporting Instabilities* section), the aggregate headline contraction to nominal retail would have been about 0.9% (-0.9%). That all was before adjustment for rising inflation.

Where consensus expectations had been for a headline, nominal monthly retail sales gain in the range of 0.2% to 0.3%, the consensus outlook for generally-positive, near-term economic growth has to have been shaken by today's reporting. With likely further negative reporting shocks in the immediate future (see the *Week Ahead* section), the consensus broad economic outlook should soften quickly and significantly.

With expectations for headline June CPI-U inflation at 0.3%, real or inflation-adjusted retail sales should be weaker than today's headline numbers, with annual real growth still generating a solid signal for a formal, new recession. Adjusting for realistic inflation (as will be detailed in the July 17th CPI *Commentary*), retail sales and the broad economy never actually recovered from the economic collapse into 2008 and 2009.

***Structural Liquidity Issues Constrain Consumer Economic Activity*.** Discussed, along with updated graphs and details in the *Opening Comments* section, the underlying issue with current retail sales activity remains intense, structural-liquidity woes besetting the consumer. That circumstance—in the last seven-plus years of economic collapse and stagnation—has continued to prevent a normal recovery in broad U.S. economic activity.

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 retail sales and the still-dominant personal-consumption account of the GDP. With a significant portion of consumers under financial stress, there has been no basis for a sustainable economic expansion since the Panic of 2008, and there are no prospects for a recovery in the near future.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—June 2015. In the context of downside revisions to April and May retail sales activity that narrowed the headline June contraction by 0.4%, and despite the usual seasonal-adjustment aberrations that likely narrowed the headline June sales contraction by a further 0.2%, the net headline June contraction of 0.3% (-0.3%) sharply disappointed consensus expectations for a 0.2% gain [MarketWatch] to 0.3% gain [Bloomberg]. In nominal terms—before adjustment for consumer inflation—today's July 14th report on June 2015 retail sales—issued by the Census Bureau—showed a statistically-insignificant, seasonally-adjusted decline of 0.27% (-0.27%) +/- 0.58% (this and all other confidence intervals are expressed at the 95% level). Net of prior-period revisions, however, the monthly change in June was a drop of 0.65% (-0.65%) versus that headline 0.27% (-0.27%).

Such followed a statistically-significant, revised monthly gain of 1.03% +/- 0.24% [previously up by 1.21%] in May, and revised April activity of "unchanged" (up by 0.03%) [previously up by 0.24%, initially unchanged at 0.00%].

Year-to-Year Annual Change. Year-to-year nominal retail sales in June 2015 increased by a marginally-insignificant 1.53% +/- 1.53%, versus a revised gain of 2.26% [previously up by 2.65%] in May 2015, and a revised 1.31% [previously up by 1.51%, initially up by 0.88%] in April 2015.

Annualized Nominal Second-Quarter Gain, First-Quarter Contraction. The pace of annualized nominal retail sales change in first-quarter 2015 was an unrevised contraction of 4.04% (-4.04%), the worst quarterly showing since the economic collapse.

The nominal annualized quarterly growth for second-quarter 2015 retail sales was a positive 6.04% in initial reporting. That would have been 6.95%, based solely on April and initial May reporting; and 2.30%, based solely on the initial reporting for April.

Net of inflation, the real retail sales change in first-quarter 2015 was an unrevised quarterly contraction of 1.02% (-1.02%). Detail on the quarterly change in second-quarter real retail sales will follow in the July 17th CPI-U *Commentary*, but it should be solidly in positive territory.

June Core Retail Sales—Core Sales Growth Weakened Again by Rising Gasoline Prices. Reflecting an environment of generally rising food prices and an unadjusted 2.96% monthly gain in gasoline prices [Department of Energy], seasonally-adjusted monthly grocery-store sales fell by 0.17% (-0.17%) in June 2015, with gasoline-station sales up by 0.81% 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:

Version I: June 2015 versus May 2015 seasonally-adjusted retail sales series—net of total grocery store and gasoline station sales—reflected a monthly decline of 0.40% (-0.40%), versus the official headline aggregate sales loss of 0.27% (-0.27%).

Version II: June 2015 versus May 2015 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—reflected a monthly decline of 0.32% (-0.32%), versus the official headline aggregate sales loss of 0.27% (-0.27%).

Real (Inflation-Adjusted) Retail Sales—June 2015. The nominal decline of 0.27% in June 2015 retail sales was before accounting for inflation. The change in real retail sales for June will be published along with the headline estimate of consumer inflation for June 2015, to be covered in *Commentary No. 736* of Friday, July 17th. Consensus expectations [MarketWatch and Bloomberg] are for a 0.3% gain in the headline June CPI-U, and those expectations are reasonable.

A consensus inflation reading would widen today's headline nominal contraction from 0.3% (-0.3%), to a drop of about 0.6% (-0.6%), enough effectively to offset the revised headline real monthly gain of 0.58% (previously 0.76%) gain now in place for May 2015, with the June 2015 real level of activity below that of March 2015. Annual real growth in June 2015 retail sales will continue generating a strong, historical-warning signal of imminent recession. Where annual real growth below the 2.0% traditionally signals an imminent recession, real annual growth in June 2015 retail sales likely was around 1.3% to 1.4%.

Seasonal-Factor Distortions and Other Reporting Instabilities. The usual seasonal-factor distortions were at play, again, in the June 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 issues with the way the government reports economic series adjusted by concurrent seasonal factors were explored, in-depth, in *Commentary No. 695*.

The adjustment issues here are the same as with the employment and unemployment series. The reporting fraud is not in the use of concurrent seasonal-factor adjustments *per se*, but rather in the Census Bureau's not publishing fully-consistent, historical data each month.

As is the common pattern in all the headline monthly reporting for the retail series, the year-ago numbers of May 2014 and June 2014 were revised, along with the publication of the June 2015 data and revised detail on April 2015 and May 2015. The year-ago revisions simply were junk reporting, due solely to shifts in their seasonal adjustments that resulted from the unique calculations of the seasonal factors that generated today's headline June 2015 detail. The revisions were not due to the availability of any new historical data back in 2014. Only the new details for May and June 2014 and for April and May 2015 were published on a basis consistent with the June 2015 number.

Specifically, the level of May 2014 revised minimally lower by 0.08% (-0.08%), but June 2014 was revised higher by 0.14%, suggestive of an upside, relative shift in the current June 2015 seasonals from where they were implied to be last month and from what they likely would have been in the old fixed-seasonal adjustment system. The effect was to add roughly 0.2-percentage point to the headline monthly change for June, taking the June 2015 monthly change from a contraction of 0.5% (-0.5%) to the headline decline of 0.3% (-0.3%).

Indeed, most commonly, the year-ago number is revised higher each month, with the effect—desired or otherwise—of boosting the seasonal adjustments for the headline month, minimizing the reporting of headline monthly contractions or maximizing the headline gains. All this 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 to publish the detail.

Beyond inconsistencies in the published adjusted historical data, the stability of the seasonal-adjustment process (particularly the concurrent-seasonal-adjustment process) 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 April 2015-to-June 2015, and in the May 2014-to-June 2014 periods, five months that are published on a non-comparable basis with all other historical data.

WEEK AHEAD

Headline Economic Reporting and Revisions Should Trend Much Weaker than Expected; Inflation Will Rise Anew, Along with Rising Oil Prices. In a fluctuating trend to the downside, amidst mixed reporting in headline numbers, market expectations for business activity nonetheless respond primarily to the latest market hype. The general effect tends to hold the market outlook at overly-optimistic levels. Expectations exceed any potential, underlying economic reality.

GDP excesses from 2014 should face downside adjustments in the July 30, 2015 GDP benchmark, and subsequent to the current headline contraction in first-quarter 2015 GDP, expectations for headline growth in second-quarter 2015 should resume shifting to the downside, as headline economic reporting turns lower, particularly in the week ahead.

Headline CPI-U consumer inflation—recently driven lower by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low, having shown monthly declines in annual inflation of less than a full 0.1% (-0.1%) in the three months through March 2015, but dropping by 0.2% (-0.2%) in April 2015. A large jump in gasoline prices for May 2015 and a softening of negative seasonal-adjustments for gasoline promise generated a headline monthly increase in May 2015 CPI-U inflation of 0.4%, with annual inflation effectively pulling even with zero. Year-to-year CPI inflation increasingly will be going against negative year-ago numbers in the months ahead, and should move into relative positive territory with the upcoming headline June 2015 reporting.

Significant upside inflation pressures are building, as oil prices rebound, a process that should accelerate rapidly with the 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* and in the *Hyperinflation Outlook Summary*.

A Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. See *Commentary No. 722* as to recent market and political pressures on the Bureau of Economic Analysis (BEA) relative to GDP reporting. Any meaningful, overt shifts by the BEA in headline GDP reporting methodology, other than those already planned for the July 30, 2015 benchmarking, would be extraordinary in terms of BEA behavior and are not likely. Still, some gimmicked, less-negative summary numbers already have been planned for publication.

Beyond the pre-announced gimmicked changes to reporting methodologies of the last several decades, ongoing headline reporting issues are tied largely to systemic distortions of monthly 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, explored in the labor-numbers 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:

Updated: **Index of Industrial Production (June 2015)*.*** Tomorrow, Wednesday, July 15th, the Federal Reserve Board will release its estimate of the index of industrial production for June 2015. Whatever is reported, however, will be revamped next week, on Tuesday, July 21st, in the context of annual benchmark revisions.

Consensus expectations for headline June 2015 production are minimal, up by 0.1% per MarketWatch, up by 0.2% per Bloomberg, versus a headline monthly decline of 0.2% (-0.2%) in May. Downside-reporting surprises are likely in terms of headline monthly detail and/or prior-period revisions. Such has been the reporting pattern of recent months, and it likely will continue. Ongoing and unexpected weakness in the new production detail remains a good bet. On top of today's weaker-than-consensus June retail sales reporting, a weaker-than-expected production showing should exacerbate the dampening of excessive growth expectations surrounding second-quarter GDP reporting.

Updated: **Producer Price Index—PPI (June 2015).** The Bureau of Labor Statistics (BLS) will release the June 2015 PPI, tomorrow, Wednesday, July 15th. Odds favor a small headline monthly increase in wholesale inflation, although consensus expectations are for a relatively-strong 0.3% headline gain [MarketWatch and Bloomberg], following a headline increase of 0.5% in May.

Unadjusted energy prices were mixed in June. Based on the two most-widely-followed oil contracts, not-seasonally-adjusted, monthly-average oil prices fell by 4.2% (-4.2%) and rose by 0.8% for the month, with an accompanying increase of 3.0% in unadjusted monthly-average retail-gasoline prices (Department of Energy). PPI seasonal adjustments for energy in June generally are negative, although they are minimally positive for gasoline. Given the vagaries of margin shifts in the dominant services sector, along with some likely added monthly inflation from wholesale food and "core" goods (everything but food and energy), again, the headline PPI change could be a small gain or decline, perhaps plus 0.1%.

Updated: **Consumer Price Index—CPI (June 2015).** The Bureau of Labor Statistics (BLS) plans the June 2015 CPI for release on Friday, July 17th. The headline CPI-U should be on the plus-side, month-to-month, for the fourth straight month, with headline annual inflation turning positive for the first time in six months.

The average gasoline price moved higher in June 2015, up by 2.96% for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). BLS seasonal adjustments to gasoline prices in June traditionally turn to the plus-side, pushing the headline, unadjusted gain in gasoline prices enough higher to contribute 0.14% to the headline CPI-U monthly inflation rate. With higher food and "core" (net of food and energy) inflation, a headline gain of 0.3% is likely. Such also is the consensus headline expectation published by both Bloomberg and MarketWatch.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in the June 2015 reporting, dependent on the seasonally-adjusted monthly change, versus the adjusted, headline 0.17% monthly inflation gain for June 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for June 2015, the difference in June's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the May 2015 negative annual year-to-year change of 0.04% (-0.04%). Headline monthly inflation of roughly 0.2% would be needed in order to push the headline annual June CPI-U inflation rate minimally into positive territory, and the headline monthly gain for June is a good bet to exceed that.

Updated: **Residential Construction—Housing Starts (June 2015).** The Census Bureau will release June 2015 residential construction detail, including housing starts, on Friday, July 17th. In line with common-reporting experience of recent years, monthly results are likely to be unstable and not statistically meaningful. Irrespective of the headline detail, the broad pattern should remain generally consistent with the low-level and down-trending stagnation seen currently in the series. Such is particularly evident with the detail 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.

Consensus expectations are for something shy of a headline decline of 10% (-10%) from May's initial headline reporting [both MarketWatch and Bloomberg]. Irrespective of otherwise statistically-meaningless expectations, the broad, general pattern of down-trending stagnation almost certainly continued in headline June 2015 activity.