John Williams'
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Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 750
FOMC, Producer Price Index, Household Income

September 11, 2015

In a Close Call, FOMC Likely Will Boost Rates,
Irrespective of the Weakening Economy

If Pressures to Delay the Rate Hike Prevail,
Markets Likely Face Troubling Questions
As to What Really Is Frightening the Fed

Virtually Unchanged in July, Real Median Household Income
Remained Below Its Level at the Formal Trough of the Recession

Although Unchanged for the Month, Headline PPI Again Was
Boosted by Absurd "Mixed" Pressures from Falling Oil Prices

PLEASE NOTE: The next regular Commentary, *Tuesday, September 15th, will cover August Industrial Production and Nominal Retail Sales. A* Commentary *on Wednesday, September 16th, will cover the August Consumer Price Index (CPI) and broad income measures out of the* 2014 Poverty Report. *A* Commentary *on Thursday, September 17th, will cover August Housing Starts and the announcement of the preliminary estimate of the 2015 payroll benchmark revision. That afternoon, the FOMC will announce any changes in policy at its September meeting.*

Best wishes to all! — John Williams

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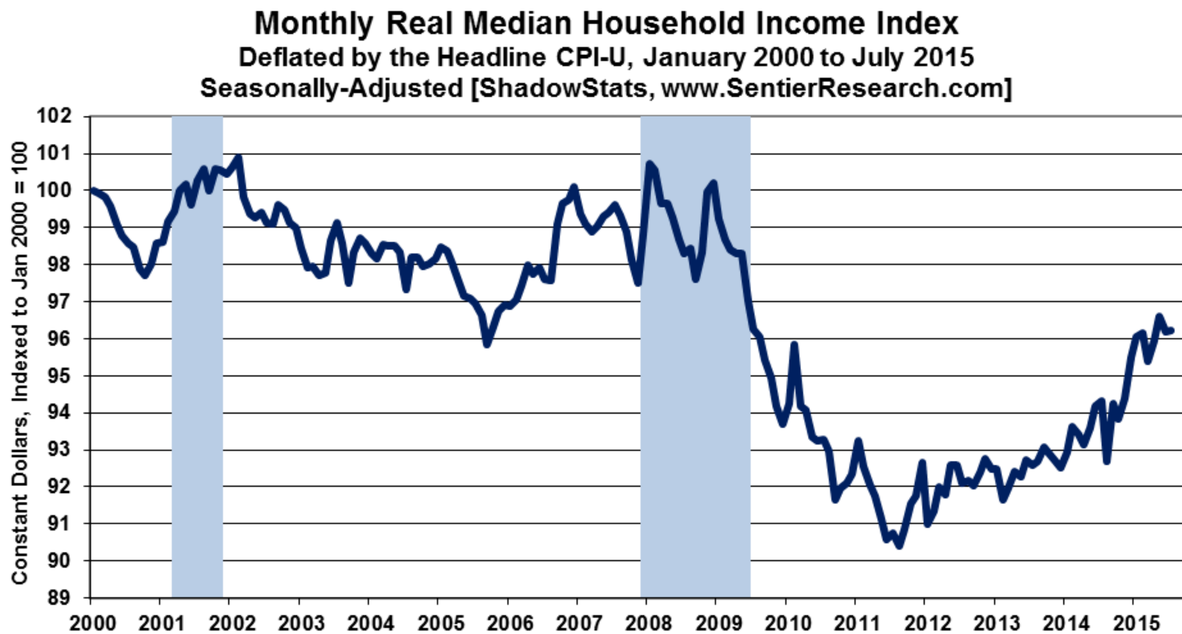
OPENING COMMENTS AND EXECUTIVE SUMMARY

Raising Rates or Not Raising Rates, the Fed Faces and Appears to Fear Unstable Circumstances. The Fed likely will raise rates at the FOMC meeting that ends on Thursday, September 17th, yet there still is too much waffling among those who should know the pending outcome. Purportedly solid indications surfaced a month or two ago that a decision had been made to raise rates at the September meeting, but intervening economic and financial-market developments, along with comments of discouragement out of the IMF and World Bank, have increased market expectations that the Fed will hold off on any rate action until at least its December meeting.

Discussed frequently here, actual U.S. economic activity has not recovered from its collapse into 2009; it is not recovering, and it is not about to recover. Despite all the gimmicked and upside-biased GDP reporting, underlying economic reality is weak enough to have begun to surface in recent, downside headline reporting (see *Commentary No. 747*).

Among other factors hurting economic activity, U.S. consumers remain constrained by currently intractable liquidity woes, which prevent sustainable real or inflation-adjusted growth in personal consumption and residential investment, areas that account for more than 70% of broad, domestic economic activity. Updating consumer liquidity conditions discussed in *Commentary No. 748*, Sentier Research (www.SentierResearch.com) just posted its estimate of real monthly median household income for July 2015, virtually unchanged versus June 2015 and still below where it was at the time of the June 2009 headline trough of the formal 2007 recession, as shown in the following graph. Details will be discussed further in *Commentary No. 752* of July 16th, along with the headline annual income numbers from the 2014 *Poverty Report* (see *Week Ahead*).



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To the extent the Fed needs any political cover, going forward, to defend its not raising interest rates, or to justify its launching a new round of quantitative easing, ongoing stagnation and deterioration in domestic business conditions will continue to provide such cover for the foreseeable future. The Fed's quantitative easing always was about supporting the banking system, not the economy, and therein lies the quandary for the Fed on its pending interest rate decision. While the stock market has been conditioned like Pavlov's dogs to salivate with the ringing of a bell—in this case the tolling of weak economic statistics—any inability of the Fed to act at this time, after all the hype, likely will raise issues in the market as to what really has the Fed so scared about systemic-stability.

While my expectation is that the FOMC will move to raise rates, such remains a close call; there is an increasingly good chance they will not. Some expect that a rate hike will hit stocks hard and damage financial-system prospects going forward, that may or may not be, but much of that anticipation already should have been discounted in the equity and currency markets.

If, however, the Fed does not move, such will not be due to economic weakness. It will be because the Fed still deems the post-2008 financial system to be too fragile and vulnerable, unstable. Given a day or two following the FOMC meeting, conceivably, market reaction could be even more-violently negative than anticipated with a rate hike, if the central bank does not act. That area will be discussed further as circumstances unfold.

Today's *Commentary* (September 11th). The balance of these *Opening Comments* provides a summary of today's reporting on the August Producer Price Index (PPI), with more-complete coverage found in the *Reporting Detail*.

The *Hyperinflation Watch* includes an updated *Hyperinflation Outlook Summary*.

The *Week Ahead* reviews the outlook for the August CPI, Industrial Production, Retail Sales and Housing Starts, along with annual releases on income measures from the *2014 Poverty Report* and the initial estimate of the 2015 benchmark revision to Payroll Employment.

Producer Price Index (PPI)—August 2015—"Unchanged" Headline Inflation Again Was Boosted by Nonsensical Mixed Pressures from Falling Energy Prices. The headline "unchanged" August PPI Final Demand inflation reflected a gain of 0.36% in Final Demand Services inflation, offset fully by a decline of 0.63% (-0.63%) in monthly Final Demand Goods inflation. A drop in energy prices dominated the decline in goods inflation, while surging "inflation" in the trade sector dominated services inflation. As often has been the case, though, falling energy prices also had the effect of boosting some "margins" (not prices), used in calculating the trade-services inflation.

Separate reporting issues of note included an upside revision of 0.2% to headline monthly April 2015 PPI inflation, which now is down by 0.1% (-0.1%), having previously contracted by 0.3% (-0.3%) in initial reporting. Also, in the never-headlined numbers on construction spending, inflation declined month-to-month for the first time in three years.

From a practical standpoint, the aggregate Final Demand Producer Price Index has minimal relationship to real-world activity. Beyond issues of substitution and hedonic-quality-adjustment methodologies (see *Public Commentary on Inflation Measurement*), problems in the goods area have been and remain unstable seasonal factors (particularly as applied to energy), versus shifting market activity. In the services sector—the dominant component of the index, by weighting—inflation, again, is defined in terms of profit margins, not prices, where those margins often move initially in the opposite direction of related prices, such as "inflationary" rising margins created by falling oil and gasoline prices.

August 2015 Headline PPI Detail. The seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for August 2015 was unchanged at 0.00%, versus an unrevised gain of 0.18% in July.

The broad impact of seasonal adjustments on headline PPI reporting largely was neutral in August, with unadjusted monthly August inflation also unchanged at 0.00%. On a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year PPI Final Demand inflation dropped by 0.81% (-0.81%) in August 2015, the same annual decline as the 0.81% (-0.81%) in July 2015.

For the three major subcategories of August 2015 Final Demand PPI, headline monthly Goods inflation fell by 0.63% (-0.63%), Services inflation rose by 0.36%, and Construction inflation declined for the month by 0.09% (-0.09%).

Final Demand Goods (Weighted at 34.67%). Running somewhat in parallel with the old Finished Goods PPI series, headline month-to-month Final Demand Goods inflation dropped by 0.63% (-0.63%) in August 2015, versus a decline of 0.09% (-0.09%) in July. There was neutral impact on the aggregate headline August reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, August Final Demand Goods inflation also fell by 0.63% (-0.63%) for the month.

Unadjusted, year-to-year goods inflation was down by 4.09% (-4.09%) in August 2015, versus an annual contraction of 3.73% (-3.73%) in July 2015.

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

- "Foods" inflation rose month-to-month by 0.34% in August 2015, having declined in July by 0.08% (-0.08%), with August's headline gain boosted partly by seasonal adjustments. Unadjusted, August foods inflation rose by 0.25% in the month. Unadjusted and year-to-year, August 2015 foods inflation contracted by 2.20% (-2.20%), versus a decline of 2.85% (-2.85%) in July 2015.
- "Energy" inflation fell by 3.25% (-3.25%) in August 2015, following a headline decline of 0.57% (-0.57%) in July, with the August decline minimally intensified by seasonal adjustments. Unadjusted, monthly August energy inflation fell by 3.18% (-3.18%). Unadjusted and year-to-year, the annual contraction in energy prices widened to 19.63% (-19.63%) in August 2015, versus an annual decline of 17.63% (-17.63%) in July 2015.
- "Less foods and energy" ("Core" goods) inflation fell month-to-month by 0.18% (-0.18%) in August 2015, versus an unchanged reading of 0.00% in July. Seasonal adjustments were positive for monthly core inflation, with an unadjusted decline of 0.27% (-0.27%) in August. Unadjusted and year-to-year, August 2015 core inflation rose by 0.37%, versus an annual gain of 0.55% in July 2015.

Final Demand Services (Weighted at 63.31% of the Aggregate). Headline monthly Final Demand Services inflation rose by 0.36% in August 2015, the same monthly increase as seen in July. The overall seasonal-adjustment impact on headline August services inflation was neutral, with an unadjusted monthly August gain also of 0.36%. Year-to-year, unadjusted August 2015 services inflation was 1.00%, versus an annual gain of 0.64% in July 2015.

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

- "Services less trade, transportation and warehousing" inflation, or the "Other" category, showed monthly inflation of 0.18% in August 2015, versus a gain of 0.37% in July. Seasonal-adjustment impact on the adjusted August detail was negative, where the unadjusted monthly change was a gain of 0.28%. Unadjusted and year-to-year, August 2015 "other" services inflation was 1.20%, versus an annual increase of 1.30% in July 2015.
- "Transportation and warehousing" inflation fell month-to-month by 0.69% (-0.69%) in August 2015, having increased by 0.17% in July. Seasonal adjustments had minimally negative impact on the headline August number, where the unadjusted monthly August reading showed a decline of 0.60% (-0.60%). Unadjusted and year-to-year, August 2015 transportation inflation fell by 3.02% (-3.02%), versus an annual contraction of by 2.18% (-2.18%) in July 2015.
- "Trade" inflation rose by 0.90% month-to-month in August 2015, following a monthly gain of 0.36% in July. Seasonal adjustments had a minimally negative impact here, where the unadjusted monthly inflation rose by 0.99% in August. Unadjusted and year-to-year, August 2015 trade inflation rose by 1.63%, having increased by 0.09% in July 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 declined by 0.09% (-0.09%) in August 2015, having jumped by 0.53% in July 2015. Such was the first month-to-month decline in the series since September 2012. The impact of seasonal factors on the August reading was neutral. On an unadjusted basis, month-to-month August 2015 construction inflation also declined by 0.09%. Further, on an unadjusted basis, year-to-year construction inflation eased to 1.80% in August 2015, versus an annual increase of 1.99% in July 2015.

- "Construction for private capital investment" inflation in August 2015 declined month-to-month by 0.18% (-0.18%), following a headline gain of 0.71% in July. As usual, seasonal adjustments also had neutral impact here, where the unadjusted monthly inflation decline was 0.18% (-0.18%) in August. Unadjusted and year-to-year, August 2015 private construction inflation was 1.81%, versus 2.08% in July 2015.

- "Construction for government" inflation declined month-to-month by 0.09% (-0.09%) in August 2015, following a 0.44% monthly increase in July. Seasonal adjustments also had neutral impact here, where unadjusted monthly August inflation also saw a contraction of 0.09% (-0.09%). Unadjusted and year-to-year, August 2015 government construction inflation was 1.89%, versus 2.07% in July 2015.

[The Reporting Detail section includes expanded detail on the August PPI reporting.]

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HYPERINFLATION WATCH

HYPERINFLATION OUTLOOK SUMMARY

Broad Outlook Generally Is Unchanged: Economy Remains in Downturn; Dollar Faces Massive Decline with Ongoing Implications for Hyperinflation. The *Hyperinflation Outlook* has been updated, but the major points are not altered fundamentally from the prior incarnation of the *Summary Outloo*k, found in *Commentary No. 735*.

Background Documents to this Summary. Underlying this *Summary* are *No. 742 Special Commentary: A World Increasingly Out of Balance* of August 10th, and *No. 692 Special Commentary: 2015 - A World Out of Balance* of February 2, 2015, which 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 two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts. In terms of underlying economic reality, one other reference is the *Public Commentary on Inflation Measurement*. The regular *Commentaries* also update elements of the general outlook, as circumstances develop.

Primary Summary. The U.S. economy remains in ongoing downturn, while the U.S. dollar still faces a massive decline. Those factors, in confluence with extreme domestic fiscal imbalances, have implications for a meaningful upturn in domestic inflation evolving into a great hyperinflationary crisis.

Signs of systemic instability continue to mount, as the Fed faces the question of raising interest rates in the week ahead (see the *Opening Comments*). The Fed's protracted unwillingness and/or inability to act decisively on increasing interest rates has been symptomatic of a financial system in serious distress. Continued inaction or waffling by the Fed is likely to trigger a shift in focus and concerns, of both the domestic and global financial markets, into the area of systemic instabilities, prospective or otherwise, that are so troubling to the U.S. central bank.

Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by eventual, unfettered monetization of the national debt and obligations, leading to a hyperinflation. As first estimated by ShadowStats in 2004, such hyperinflation appeared likely by 2020. That time horizon for the hyperinflation forecast was moved to 2014, because of the 2008 Panic, the near-collapse of the financial system, and official (U.S. government and Federal Reserve)

responses to same. That hyperinflation forecast remains in place, but it has been adjusted to 2015 or 2016, as discussed in *No. 742* and *No. 692*.

The basic 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 *2014 Hyperinflation Report—The End Game Begins—First Installment Revised*.

Dollar Circumstance. Discussed in the background documents, 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 over-estimated by global markets looking to support the dollar.

The still 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 briefly backed off its highs, with some related upside pressure having been seen on oil prices. Pressures reversed recently, spiking the U.S. dollar—also hitting oil prices anew—with false domestic economic strength being touted by Wall Street, and with some in the Fed indicating that interest rates would be raised in September, irrespective of negative indications on the economy. Coincident, with these events, not-so-covert central-bank actions appear to have driven the price of gold lower, also in the context of mounting global financial-market instabilities.

The U.S. economy remains in contraction (see *Commentary No. 747*), with a variety of key indicators, such as industrial production, real retail sales and revenues of the S&P 500 companies showing recession. Although formal recognition could take months, consensus recognition of a "new" recession should gain relatively rapidly, in tandem with a variety of monthly, quarterly and annual data reflecting the downturn in business activity. When formal recognition comes, timing of the onset of the "new" recession likely will be December 2014.

As market expectations move towards an imminent, new recession, such should reduce not only expectations for a significant tightening in Fed policy—if the Fed has not tightened already—but also renew 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, also would 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 unwind what has 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. Further, oil prices should spike anew, along with a sharp reversal in the dollar's strength.

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A crash back to recognition of more-realistic domestic-economic circumstances looms, possibly in the weeks and certainly in the months ahead. It should be accompanied by a crash in the U.S. dollar versus major currencies, such as the Swiss franc, Canadian dollar and Australian dollar (currencies with some perceived ties to gold); 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 risk for fueling further heavy selling of the dollar. Once in heavy downturn, the dollar's gains since June 2014 should reverse fully, pushing the exchange-rate value of the dollar to new historic lows. Again, the nascent currency crisis also has meaningful potential to resurrect elements of the Panic of 2008.

Unexpected economic weakness intensifies 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. The Fed's games now are on the brink of being played out or collapsing.

Indeed, the Fed still likely will move to normalize interest rates (see today's *Opening Comments* as well as those in *Commentary No. 726*), if it can 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*). Actions by the FOMC on September 17th will be telling. The Panic of 2008 never was resolved, and the Fed increasingly has found 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. Again, despite loud promises of higher rates next week, banking-system issues (not the economy) may keep the pending interest rate hike in a continual state of suspension.

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 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 in the near future, 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 banking system and to the increasingly unstable equity markets.

While higher domestic interest rates would tend to act as a dollar prop, a hike in rates also could crash the stock market, as some on Wall Street fear, triggering a round of other systemic problems. Again, there is no happy way out of this for the Fed.

The 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 likely will become dominated by deteriorating 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 and contracting production, 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. 748*). Sharply-negative economic reporting shocks, versus softening consensus forecasts, still remain a heavily-favored, proximal trigger for intensifying 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 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, with total net obligations of the U.S. government pushing $100 trillion, including the net present value of unfunded liabilities. Still, many in Washington look to continue increasing spending and to take on new, unfunded liabilities. 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 2014 monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury, but more of that lies ahead. If the Fed does not move soon to boost interest rates, it may be trapped in a renewed expansion of 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 the intensifying 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

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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. 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 intensifying, 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 global financial instabilities and a quick, significant reversal in the dollar's strength should intensify the "dump-the-dollar" rhetoric rapidly. Consider that China has been selling some of its U.S. Treasury debt holdings to raise cash in for its near-term financial needs. Again, much of the rest of the world also has been backing away from holding U.S. treasury securities.

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, still 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. See Chapter 10, *2014 Hyperinflation Report—Great Economic Tumble* for detailed discussion on approaches to handing the hyperinflation crisis and *No. 742*, for other factors afoot in the current environment.

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REPORTING DETAIL

PRODUCER PRICE INDEX—PPI (August 2015)

Unchanged August PPI Again Was Boosted by Nonsensical Mixed Pressures from Falling Energy Prices. The headline "unchanged" August PPI Final Demand inflation reflected a gain of 0.36% in Final Demand Services inflation, offset fully by a decline of 0.63% (-0.63%) in monthly Final Demand Goods inflation. A drop in energy prices dominated the decline in goods inflation, while surging "inflation" in the trade sector dominated services inflation. As often has been the case, the falling energy prices also had the effect of boosting some "margins" (not prices), used in calculating the trade-services inflation.

Separate reporting issues of note included an upside revision of 0.2% to the headline April 2015 PPI inflation, which now is down by 0.1% (-0.1%), having previously contracted by 0.3% (-0.3%) in initial reporting. Also, in the never-headlined numbers on construction spending, inflation declined month-to-month for the first time in three years.

From a practical standpoint, the aggregate Final Demand Producer Price Index has minimal relationship to real-world activity. Beyond issues of substitution and hedonic-quality-adjustment methodologies (see *Public Commentary on Inflation Measurement*), problems in the goods area have been and remain unstable seasonal factors (particularly as applied to energy), versus shifting market activity. In the services sector—the dominant component of the index, by weighting—inflation, again, is defined in terms of profit margins, not prices, where those margins often move initially in the opposite direction of related prices, such as "inflationary" rising margins created by falling oil and gasoline prices.

Inflation that Is More Theoretical than Real World? *[This background text is as published previously.]* 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 circumstance of "increased" margins—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 declining 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

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(just six years of post-2008-panic data) to establish any meaningful relationship to general inflation or other economic or financial series.

August 2015 Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported this morning, September 11th that the seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for August 2015 was unchanged at 0.00%, versus unrevised gains of 0.18% in July, 0.36% in June, 0.37% in May and an upwardly revised, or less-negative monthly contraction in April of 0.09% (-0.09%) [first reported as down by 0.27% (-0.27%)].

The broad impact of seasonal adjustments on headline PPI reporting largely was neutral in August, with unadjusted monthly August inflation also unchanged at 0.00%. On a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year PPI Final Demand inflation dropped by 0.81% (-0.81%), the same annual change as the unrevised decline of 0.81% (-0.81%) in July 2015, versus unrevised annual contractions of 0.72% (-0.72%) in June 2015, 0.99% (-0.99%) in May 2015, and a revised annual contraction of 1.08% (-1.08%) [previously down by 1.26% (-1.26%)] in April 2015.

For the three major subcategories of August 2015 Final Demand PPI, headline monthly Goods inflation fell by 0.63% (-0.63%), Services inflation rose by 0.36%, and Construction inflation declined for the month by 0.09% (-0.09%).

Final Demand Goods (Weighted at 34.67%). Running somewhat in parallel with the old Finished Goods PPI series, headline month-to-month Final Demand Goods inflation dropped by 0.63% (-0.63%) in August 2015, versus a decline of 0.09% (-0.09%) in July. There was neutral impact on the aggregate headline August reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, August Final Demand Goods inflation also fell by 0.63% (-0.63%) for the month.

Unadjusted, year-to-year goods inflation was down by 4.09% (-4.09%) in August 2015, versus an annual contraction of 3.73% (-3.73%) in July 2015.

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

- "Foods" inflation rose month-to-month by 0.34% in August 2015, having declined in July by 0.08% (-0.08%), with August's headline gain boosted partly by seasonal adjustments. Unadjusted, August foods inflation rose by 0.25% in the month. Unadjusted and year-to-year, August 2015 foods inflation contracted by 2.20% (-2.20%), versus a decline of 2.85% (-2.85%) in July 2015.
- "Energy" inflation fell by 3.25% (-3.25%) in August 2015, following a headline decline of 0.57% (-0.57%) in July, with the August decline minimally intensified by seasonal adjustments. Unadjusted, monthly August energy inflation fell by 3.18% (-3.18%). Unadjusted and year-to-year, the annual contraction in energy prices widened to 19.63% (-19.63%) in August 2015, versus an annual decline of 17.63% (-17.63%) in July 2015.
- "Less foods and energy" ("Core" goods) inflation fell month-to-month by 0.18% (-0.18%) in August 2015, versus an unchanged reading of 0.00% in July. Seasonal adjustments were positive for monthly core inflation, with an unadjusted decline of 0.27% (-0.27%) in August. Unadjusted and year-to-year, August 2015 core inflation rose by 0.37%, versus an annual gain of 0.55% in July 2015.

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Final Demand Services (Weighted at 63.31% of the Aggregate). Headline monthly Final Demand Services inflation rose by 0.36% in August 2015, the same monthly increase as seen in July. The overall seasonal-adjustment impact on headline August services inflation was neutral, with an unadjusted monthly August gain also of 0.36%.

Year-to-year, unadjusted August 2015 services inflation was 1.00%, versus an annual gain of 0.64% in July 2015.

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

- "Services less trade, transportation and warehousing" inflation, or the "Other" category, showed monthly inflation of 0.18% in August 2015, versus a gain of 0.37% in July. Seasonal-adjustment impact on the adjusted August detail was negative, where the unadjusted monthly change was a gain of 0.28%. Unadjusted and year-to-year, August 2015 "other" services inflation was 1.20%, versus an annual increase of 1.30% in July 2015.
- "Transportation and warehousing" inflation fell month-to-month by 0.69% (-0.69%) in August 2015, having increased by 0.17% in July. Seasonal adjustments had minimally negative impact on the headline August number, where the unadjusted monthly August reading showed a decline of 0.60% (-0.60%). Unadjusted and year-to-year, August 2015 transportation inflation fell by 3.02% (-3.02%), versus an annual contraction of by 2.18% (-2.18%) in July 2015.
- "Trade" inflation rose by 0.90% month-to-month in August 2015, following a monthly gain of 0.36% in July. Seasonal adjustments had a minimally negative impact here, where the unadjusted monthly inflation rose by 0.99% in August. Unadjusted and year-to-year, August 2015 trade inflation rose by 1.63%, having increased by 0.09% in July 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 declined by 0.09% (-0.09%) in August 2015, having jumped by 0.53% in July 2015. Such was the first month-to-month decline in the series since September 2012. The impact of seasonal factors on the August reading was neutral. On an unadjusted basis, month-to-month August 2015 construction inflation also declined by 0.09%.

On an unadjusted basis, year-to-year construction inflation eased to 1.80% in August 2015, versus an annual increase of 1.99% in July 2015.

- "Construction for private capital investment" inflation in August 2015 declined month-to-month by 0.18% (-0.18%), following a headline gain of 0.71% in July. As usual, seasonal adjustments also had neutral impact here, where the unadjusted monthly inflation decline was 0.18% (-0.18%) in August. Unadjusted and year-to-year, August 2015 private construction inflation was 1.81%, versus 2.08% in July 2015.

- "Construction for government" inflation declined month-to-month by 0.09% (-0.09%) in August 2015, following a 0.44% monthly increase in July. Seasonal adjustments also had neutral impact here, where unadjusted monthly August inflation saw a contraction of 0.09% (-0.09%). Unadjusted and year-to-year, August 2015 government construction inflation was 1.89%, versus 2.07% in July 2015.

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Discussed in *Commentary No. 748*, ShadowStats uses the Final Demand Construction index for deflating headline activity in the monthly construction-spending series. The October 1st release of August 2015 U.S. Construction Spending detail will be covered in the ShadowStats *Commentary* of October 2nd.

PPI-Inflation Impact on Pending Reporting of Durable Goods. As to the upcoming reporting of August new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods continued in decline for the seventh month, dropping in August 2015 by 0.24% (-0.24%), versus a decline of 0.12% (-0.12%) in July. These numbers are not seasonally adjusted. Annual inflation was down by 0.48% (-0.48%) in August 2015, versus a year-to-year contraction of 0.18% (-0.18%) in July 2015. August 2015 durable goods orders will be reported on September 24th and covered in the ShadowStats *Commentary* of that date.

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WEEK AHEAD

Economic Reporting Generally Should Trend Much Weaker than Expected; Inflation Will Rise Anew, Along with a Renewed Rebound in Oil Prices. Still in a fluctuating trend to the downside, amidst mixed reporting in headline data, market expectations for business activity nonetheless tend to move with the latest economic hype in the popular media. That general effect holds the consensus outlook at overly-optimistic levels, with current expectations still exceeding any potential, underlying economic reality. Again, though, the expectations trend generally has continued to soften.

Headline reporting of the regular monthly economic numbers increasingly should turn lower in the weeks and months ahead, along with an eventual downside revision to the recently, upwardly-revised second-quarter GDP estimate, and along with likely downside or otherwise much weaker-than-expected reporting for at least the next several quarters of GDP (and GDI and GDP) into 2016.

CPI-U consumer inflation—driven lower earlier this year by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low. It turned positive in June 2015, for the first time in six months, notched somewhat higher in July and likely will notch still higher in August, despite a headline monthly decline in gasoline prices.

Upside inflation pressures should continue to build, particularly as oil prices begin to rebound, once again, a process that eventually should accelerate rapidly, along with a pending sharp downturn in the exchange-rate value of the U.S. dollar. These areas, the general economic outlook and longer range reporting trends were reviewed broadly, recently, in *No. 742 Special Commentary: A World Increasingly Out of Balance*, *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. Beyond the pre-announced gimmicked changes to reporting methodologies of the last several decades, which have tended to understate actual inflation and to overstate actual economic activity, ongoing headline reporting issues are tied largely to systemic distortions of monthly seasonal adjustments. Data instabilities—induced partially by the still-evolving economic turmoil of the last eight-to-ten years—have 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, discussed and 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:

Nominal and Real Retail Sales (August 2015). The Census Bureau has scheduled release of August 2015 nominal (not-adjusted-for-inflation) retail sales for Tuesday, September 15th, which will be covered in *Commentary No. 751* of that date. Real (inflation-adjusted) retail sales for August will be published in ShadowStats *Commentary No. 752* of September 16th, in conjunction with the detail on headline CPI-U reporting for August (see below). Wherever likely positive market expectations settler, headline August reporting should be weaker.

With this series, in the current environment, downside-reporting surprises usually are a good bet, including a weaker-than-expected headline number for August and potential downside revisions to the June and July detail. With an outright contraction in headline nominal retail sales a possibility, real (inflation-adjusted) sales should be even more negative, given a likely minimal monthly increase in the headline August CPI-U. Any unanticipated weakness in the August retail sales detail would be a good bet to dampen excessive growth expectations still surrounding broad economic activity and GDP reporting in the quarters ahead.

Constraining retail sales activity, the consumer remains in an extreme liquidity bind with weakening confidence, detailed most recently in *Commentary No. 748*. Without sustained growth in real income, and without the ability and/or willingness to take on meaningful new debt in order to make up for the income shortfall, the U.S. consumer is unable to sustain positive growth in domestic personal consumption, including retail sales, real or otherwise.

Index of Industrial Production (August 2015). On Tuesday, September 15th, the Federal Reserve Board will release its estimate of the Index of Industrial Production for August 2015, which will be reviewed in *Commentary No. 751* of the same date.

Despite what likely will be positive market expectations, increasingly-negative data should lie ahead. As with the retail sales series, headline August reporting and monthly revisions to earlier months are likely to

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come in well below wherever the consensus settles, dampening overly-positive growth expectations surrounding broad economic activity and GDP reporting in the quarters ahead.

Consumer Price Index—CPI (August 2015). The Bureau of Labor Statistics (BLS) plans to release the August 2015 CPI on Wednesday, September 16th. The headline CPI-U should be close to unchanged, month-to-month, with headline annual inflation turning increasingly positive for the third month.

The average gasoline price moved lower in August 2015, by 5.35% (-5.35) for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). While BLS seasonal adjustments to gasoline prices in August traditionally are sharply on the plus-side, they are enough only to narrow the drop in gasoline prices to about 3.9% (-3.9%) on a seasonally-adjusted basis. That one factor is enough to reduce the headline monthly CPI-U change by 0.17% (-0.17%). Higher food and "core" (net of food and energy) inflation largely should offset the impact of the lower gasoline prices, leaving the headline CPI-U basically flat for the month.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in August 2015 reporting, dependent on the seasonally-adjusted monthly change, versus the adjusted, headline inflation contraction of 0.08% (-0.08%) for August 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for August 2015, the difference in August's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the July 2015 positive annual inflation rate of 0.17%. For example, a seasonally headline monthly "unchanged" in August 2015 CPI-U would push annual August 2015 inflation into a range of 0.2% to 0.3% (0.0% - [-0.08%] +0.17%), depending on rounding.

2015 Poverty Report. The Census Bureau's annual reporting of *Income and Poverty in the United States* for 2014 will be released on Wednesday, September 16th. Where the annual poverty measures virtually are meaningless, some of the broad income measures are of substance. Discussed in *Commentary No. 748*, annual real median household income (deflated by the CPI-U) likely rose in 2014 versus 2013, but not enough to indicate any meaningful liquidity relief for consumers. Income dispersion likely intensified, still signaling a near-term crash/upheaval for the domestic financial markets. Last year's reporting was detailed in *Commentary No. 658*.

Residential Construction—Housing Starts (August 2015). The Census Bureau will release August 2015 residential construction detail on Thursday, September 17th. In line with common-reporting experience of recent years, monthly results are likely to be unstable and not statistically meaningful, holding in general pattern of down-trending stagnation

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.

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As discussed in *Commentary No. 660* on the August 2014 version of this most-unstable of major monthly economic series, the monthly headline reporting detail here simply is worthless. Again, the series best is 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.

Payroll Employment Benchmark Revision—2015 Initial Estimate. The Bureau of Labor Statistics (BLS) will announce its preliminary estimate of the benchmark revision to March 2015 payroll employment (the base for the 2015 revision) on Thursday, September 17th. Discussed in *Commentary No. 749* (see *Birth-Death Model* section), recent, more-frequent quarterly benchmarking already has indicated likely overestimation of payroll growth earlier in 2015, significantly raising the odds of a downside, headline benchmark revision.

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