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

COMMENTARY NUMBER 758
September Retail Sales, Producer Price Index

October 14, 2015

Stagnant Nominal Retail Sales
Reflected Ongoing Constraints on Consumer Liquidity

Market Sentiment Increasingly Shifts
Towards Renewed U.S. Economic Contraction

PPI Plunge of 0.54% (-0.54%) Was Muted by
Nonsensical Inflation Pressures from Falling Gasoline and Oil Prices

---

PLEASE NOTE: The next regular Commentary*, scheduled for tomorrow, Thursday, October 15th, will cover the September Consumer Price Index (and Real Retail Sales and Earnings), with a subsequent* Commentary *on Friday, October 16th, covering September Industrial Production.*

Best wishes to all! — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Expectations Continue to Shift Towards Recession. Other than for likely, minimally-negative headline CPI-U inflation for September, which would tend to boost relative "real" inflation-adjusted growth for series such as retail sales and weekly earnings, the news on the economy should become increasingly negative in the near term. September retail sales showed somewhat greater weakness than had been anticipated, following on top of worse-than-expected August trade and September employment data. Upcoming industrial production and housing starts reporting (see *Week Ahead*) should continue to pummel the consensus outlook. In combination with deterioration in the recent headline data, reporting of the next week should accelerate meaningfully the shift in market expectations towards a broadly deteriorating domestic economy, and a weakening outlook for headline third-quarter GDP growth.

Noted in prior *Commentary No. 757*, coincident with the housing starts release on October 20th, in *Commentary No. 761* of that date, ShadowStats will update its broad economic outlook and provide an estimate of initial headline GDP-growth reporting for third-quarter 2015, to be reported by the Bureau of Economic Analysis (BEA) on October 29th. The general outlook has not changed and is not likely to change in the near-term. Moving from protracted low-level stagnation—not a robust economic recovery—broad U.S. economic activity has entered a period of renewed downturn, one that eventually should gain recognition as a "new" recession, timed from a likely formal onset of December 2014.

Today's *Commentary* (October 14th). The balance of these *Opening Comments* provides summary coverage of September nominal Retail Sales and the Producer Price Index (PPI), along with an updated review of Consumer Conditions. The *Hyperinflation Outlook Summary* has not been changed. The *Week Ahead* has updated previews for the September CPI inflation measure and related inflation-adjusted Retail Sales and Earnings series, Friday's Industrial Production and next Tuesday's Housing Starts.

Nominal Retail Sales—September 2015—Sales Stagnation. In the context of a downside revision to prior reporting for August, the headline nominal gain of 0.10% in September 2015 retail sales was somewhat weaker than expected by the markets. Without the prior-period revisions, headline September sales would have been down by 0.01% (-0.01%) for the month. As the headline detail now stands, the September headline monthly gain of 0.10% followed a revised headline 0.03% gain [previously up by 0.19%] in August. Current nominal, monthly activity in retail sales has not been statistically significant and reasonably can be described as "stagnant."

The headline 0.10% gain in September sales was before adjustment for tomorrow's September CPI-U inflation, which likely will be minimally on the downside, providing a small, relative boost to the inflation-adjusted, real retail sales for the month.

Nonetheless, annual real growth in the series should continue generating a solid signal for a formal, new recession. Adjusting for realistic inflation (see *Commentary No. 752* and *No. 742 Special Commentary: A World Increasingly Out of Balance*), real retail sales and the broad economy never truly recovered from the economic collapse into 2008 and 2009. Discussed fully in the ensuing *Consumer Conditions ...* section, the primary problems constraining current retail sales activity remain the intense, structural-liquidity woes besetting the consumer.

***Nominal (Not-Adjusted-for-Inflation) Retail Sales—September 2015*.** In the context of a downside revision to August and an upside revision to July retail sales activity, September 2015 sales rose by a statistically-insignificant, seasonally-adjusted gain of 0.10%. Net of prior-period revisions, nominal

September retail sales declined by 0.01% (-0.01%) month-to-month. Such followed a statistically-insignificant, revised monthly change of 0.03%in August, and a revised monthly gain of 0.76% in July.

Year-to-Year Annual Change. Year-to-year nominal retail sales in September 2015 increased by a statistically-significant 2.36%, versus a downwardly revised 2.04% annual gain in August 2015, and an upwardly revised annual gain of 2.65% in July 2015.

Annualized Quarterly Changes. The pace of annualized nominal retail sales decline in first-quarter 2015 remained at 4.04% (-4.04%), the worst quarter-to-quarter showing since the economic collapse, with annualized second-quarter 2015 retail sales unrevised at 6.81%. Based on the initial full reporting for third-quarter 2015, annualized nominal third-quarter growth was 4.80%.

Net of inflation, the real retail sales change in first-quarter 2015 remained at an annualized quarterly contraction of 1.02% (-1.02%). The quarterly change in second-quarter real retail sales is an unrevised gain of 3.72%. Third-quarter detail will be assessed in the tomorrow's CPI-U *Commentary*, but it should be solidly in positive territory.

Real (Inflation-Adjusted) Retail Sales—September 2015. The nominal gain of 0.10% in September 2015 retail sales was before accounting for inflation. The change in real retail sales for September will be published along with the headline estimate of consumer inflation for September 2015 in tomorrow's *Commentary No. 759*. Barring an upside surprise to what likely will be a headline monthly contraction in the September CPI-U, the headline monthly change in real September retail sales likely will be somewhat stronger than the headline nominal gain of 0.10% (see *Week Ahead* section). Real annual growth, however, should continue to signal imminent recession.

Consumer Conditions Support Neither Economic Recovery Nor Expansion. 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 (see *Commentary No. 755* for a discussion on the broad economy).

Updating *Commentary No. 752* of September 16th, and as otherwise discussed regularly in these *Commentaries*, structural liquidity woes continue to constrain domestic economic activity, severely, as they have since before the Panic of 2008. Never recovering in the post-Panic era, limited growth in household income and credit, and a faltering consumer outlook, have eviscerated and continue to impair domestic business activity, which feeds off the financial health and liquidity of consumers.

Without meaningful 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 a sustainable economic expansion. 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.

Household Income Measures Signal Increasing Economic Difficulties. The Census Bureau recently updated key annual measures of household income for 2014, as graphed here and discussed in greater detail in *Commentary No. 752* (some material from *No. 752* is repeated in this section). Unexpected weakness in some of the headline annual data, though partially masked by changes in survey questions, signaled increasing liquidity difficulties for U.S. households.

Shown first, though, in *Graph 1*, is monthly real median household income detail through August 2015, as reported by www.SentierResearch.com. This measure of real monthly median household income generally can be considered as a monthly version of the annual detail shown in *Graph 2*, but the monthly specifics are generated from separate surveying and questioning by Census, discussed later. Real median monthly household income jumped in August 2015, largely due to the impact of declining gasoline prices on the headline CPI-U, where the up-trending income measure had held even in July, having turned lower in June.

The income series has been in low-level stagnation, with the 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 had reversed in recent months, although it has returned in August and likely in September.

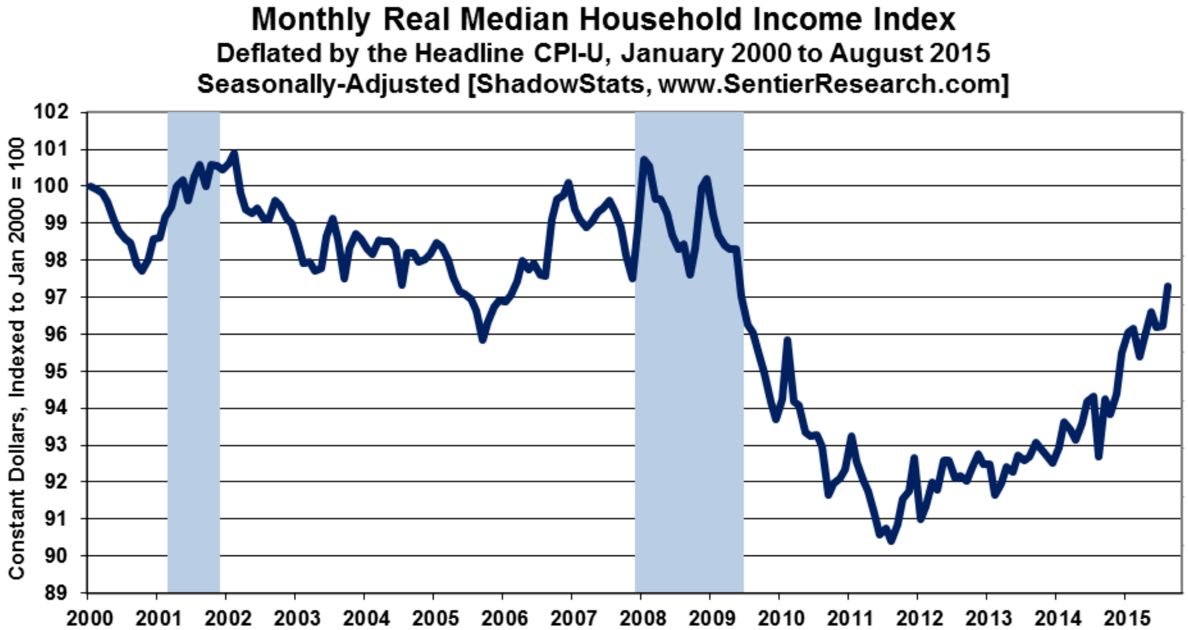
Where lower gasoline prices have provided some minimal liquidity relief to the consumer, indications are that any effective extra cash generally has been used to pay down unsustainable debt, not to fuel new consumption. Despite recent, renewed downside pressure on oil prices, relief from low-priced gasoline should prove increasingly fleeting. As the U.S. dollar resumes its decline, otherwise increasingly-unstable petroleum prices should spike anew.

On a monthly basis, when headline GDP purportedly started its solid economic recovery in mid-2009, the monthly household income number nonetheless plunged to new lows. The August 2015 reading just recovered the lowest level seen during the formal recession, and remains below the pre-recession highs for both the formal 2007 and 2001 recessions. Outside of the post-2007 recession low-level stagnation, 2014 monthly detail remained well below monthly historical activity since first estimation of real month median household income for January 2000.

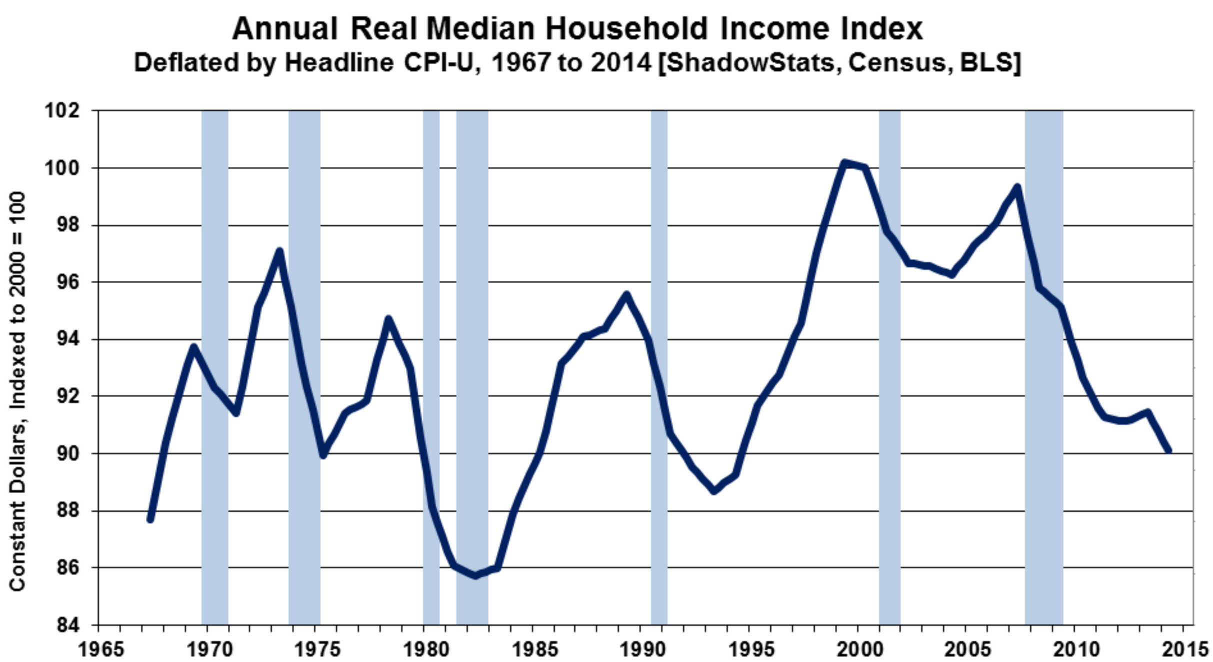
***Differences in the Monthly versus Annual Median Household Income*.** That general pattern of relative historical weakness also has been seen in the headline reporting of the annual Census numbers, shown in *Graph 2*, with the latest 2014 real annual median household income at a ten-year low. The Sentier numbers had suggested a small increase in 2014 versus 2013 levels. Still, the series remain broadly consistent, although based on separate questions within the monthly Consumer Population Series (CPS), as conducted by the Census Bureau. The monthly CPS series also is the source of the Household Survey used by the Bureau of Labor Statistics (BLS) in its unemployment reporting.

Where Sentier uses monthly questions surveying current annual household income, the headline annual Census detail is generated by a once-per-year question in the March CPS survey, as to the prior year's annual household income.

Graph 1: Monthly Real Median Household Income through August 2015



Graph 2: Annual Real Median U.S. Household Income through 2014



Again, discussed in *Commentary No. 752*, the Census Bureau changed its annual income questionnaire for 2014, with the effect of boosting income reported in 2014. The details on changes between 2013 and 2014, however, also were available on a consistent and comparable basis, and the consistent aggregate annual percentage change of median household income in 2014, versus 2013, was applied to the otherwise consistent historical series to generate *Graph 2*.

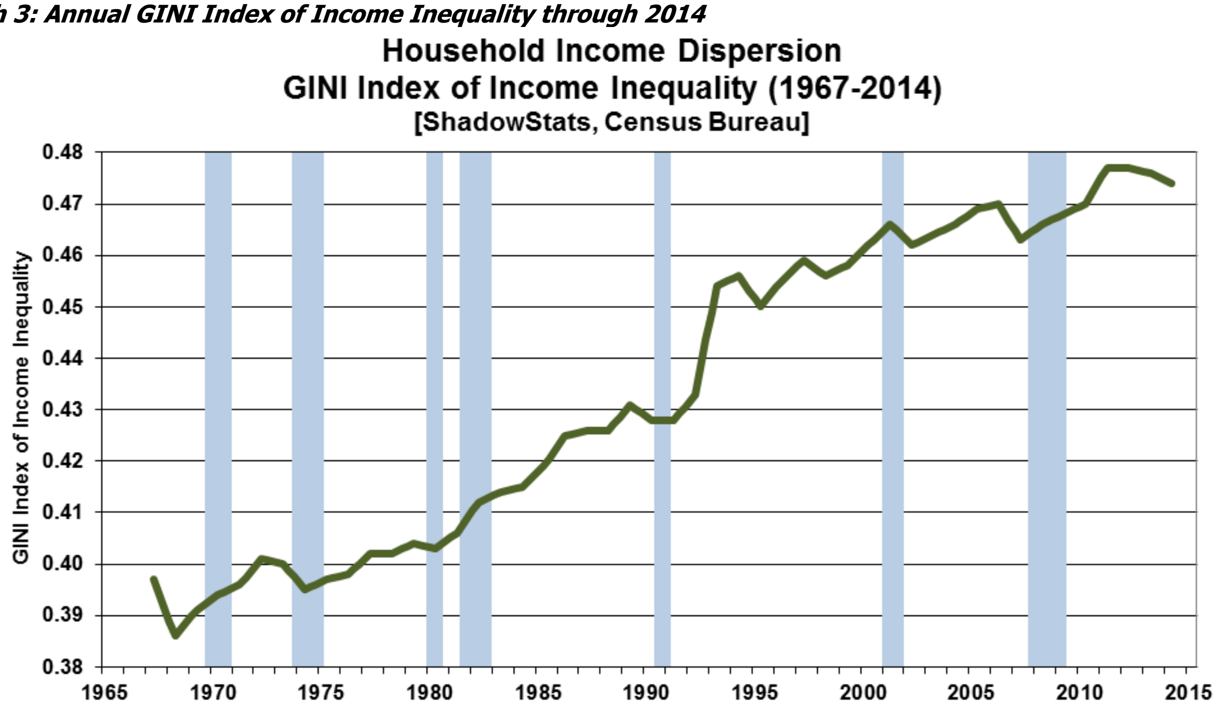
In historical perspective from *Graph 2*, 2011, 2012 and 2013 income levels were below levels seen in the late-1960s and early-1970s, with the 2014 income level below the readings through most of the 1970s, aside from being at a ten-year low. Such indicates the long-term nature of the evolution of the major structural changes squeezing consumer liquidity and impairing the current economy (see related discussions in *2014 Hyperinflation Report—The End Game Begins* and particularly *2014 Hyperinflation Report—Great Economic Tumble*).

Such also broadly is consistent with real average weekly earnings, as reported by the BLS (see *Commentary No. 752*) and as will be updated through September 2015 in tomorrow's *Commentary*.

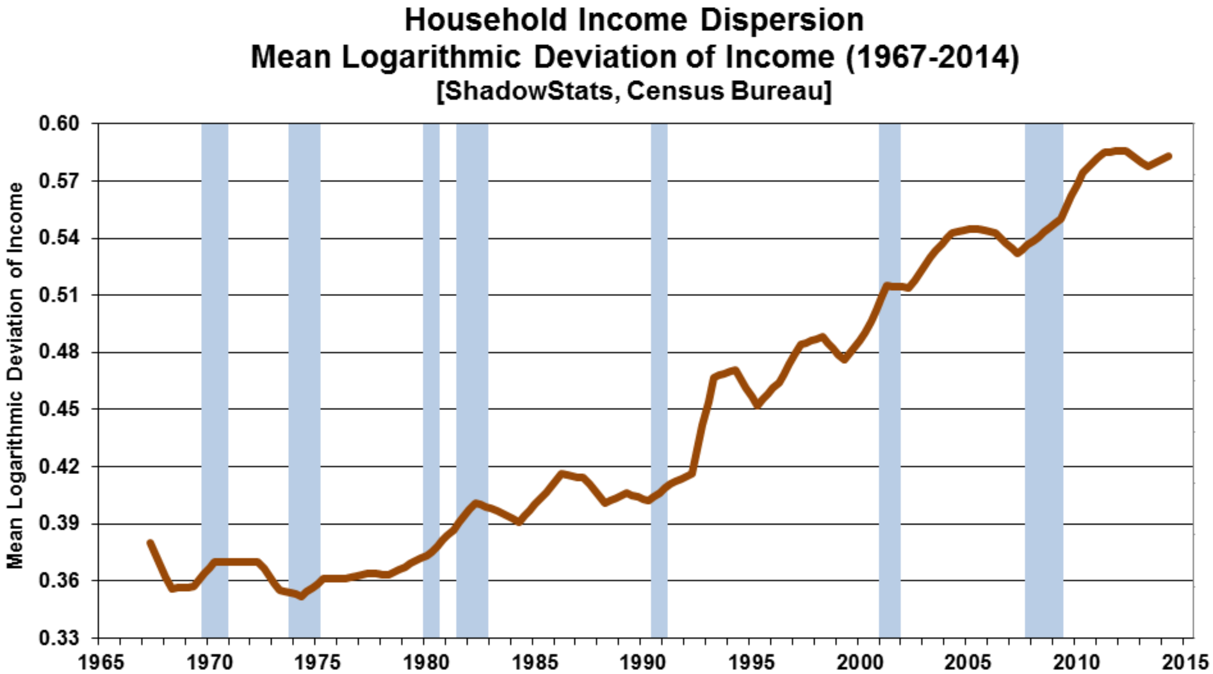
Income Variance. Estimates of income dispersion, or inequality, are shown through 2014 in *Graphs 3* and *4*. Measures of income dispersion, or variance, indicate how income is distributed within a population. A low level of income dispersion indicates that income tends to be concentrated in the middle, while a high level of dispersion indicates heavier income concentrations in the extremes of low and high income, with less in the middle. The higher the variance of income, the greater is the income dispersion. Generally, economies with income concentrated in the middle tend to enjoy the stronger and broader economic growth.

Rising and near-record income dispersion levels usually foreshadow economic and financial-market turmoil. Despite—or perhaps due to—the ongoing nature of the economic and systemic-solvency crises, and the effects of the 2008 financial panic, income dispersion—the movement of income away from the middle towards both high- and low-level extremes—held near record highs in 2014, instead of moderating, as often seen during periods of financial distress.

Graph 3: Annual GINI Index of Income Inequality through 2014



Graph 4: Annual Mean Logarithmic Deviation of Income through 2014



Conditions surrounding extremes in income variance usually help to fuel financial-market bubbles, which frequently are followed by financial panics and economic depressions. The sequence of those factors tends to redistribute income in a manner that usually lowers income variance, helping economic recovery. Other than for a brief dip following the 1987 stock-market crash, U.S. income variance since 1987 has been higher than has been estimated for the economy going into the 1929 stock-market crash and the Great Depression, and its current reading remains nearly double that of any other "advanced" economy.

Instead of being tempered by the 2008 financial panic and the ongoing economic and systemic-solvency crises, income variance increased to record extremes in the last several years, as shown in *Graphs 3* and *4*, well above levels estimated to have prevailed before the 1929 stock-market crash and the Great Depression. Increasingly difficult times are likely for at least the next several years (see *Commentary No. 658* for a much more extensive discussion of these measures and related economic theory).

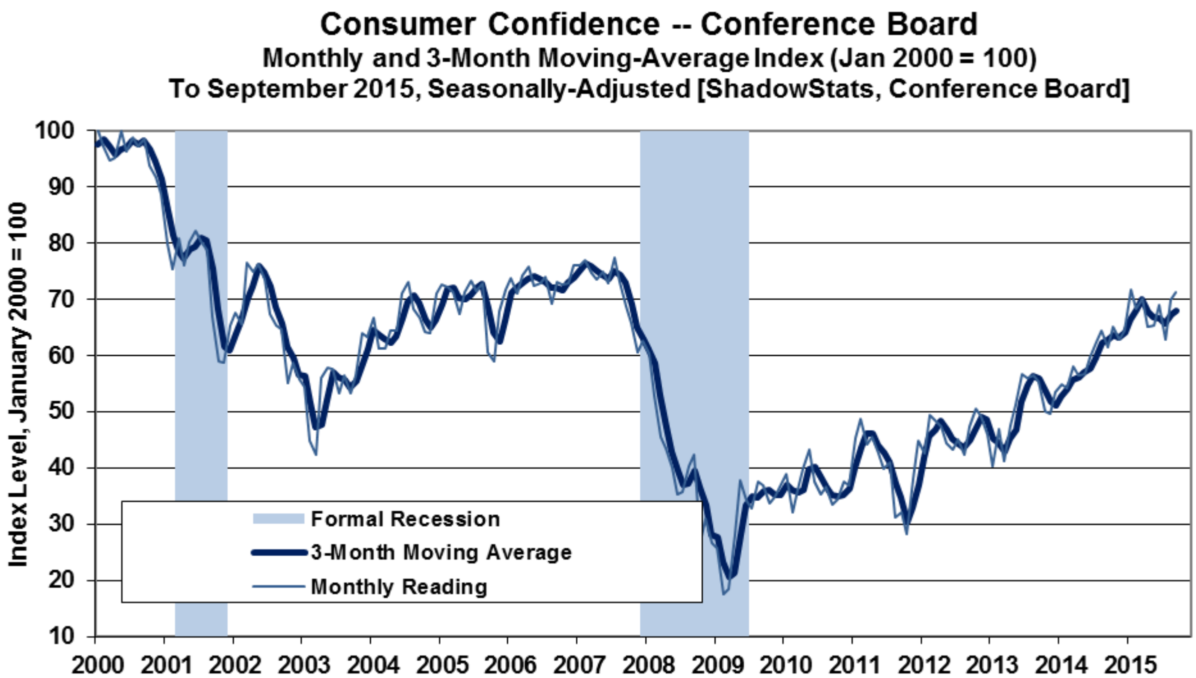
The current income variance patterns also suggest that the greatest negative impact of the systemic turmoil, so far, has been on those in the middle-income area. It also remains suggestive of even greater financial and economic crises still ahead.

Consumer Confidence, Sentiment and Credit. The full-September measures for the Conference Board's Consumer-Confidence and the University of Michigan's Consumer-Sentiment measures are shown in *Graphs 5* to *7*, along with the latest readings on various consumer credit measures: real second-quarter household-sector credit-market debt outstanding (*Graph 8*) and August consumer credit outstanding (*Graph 9*).

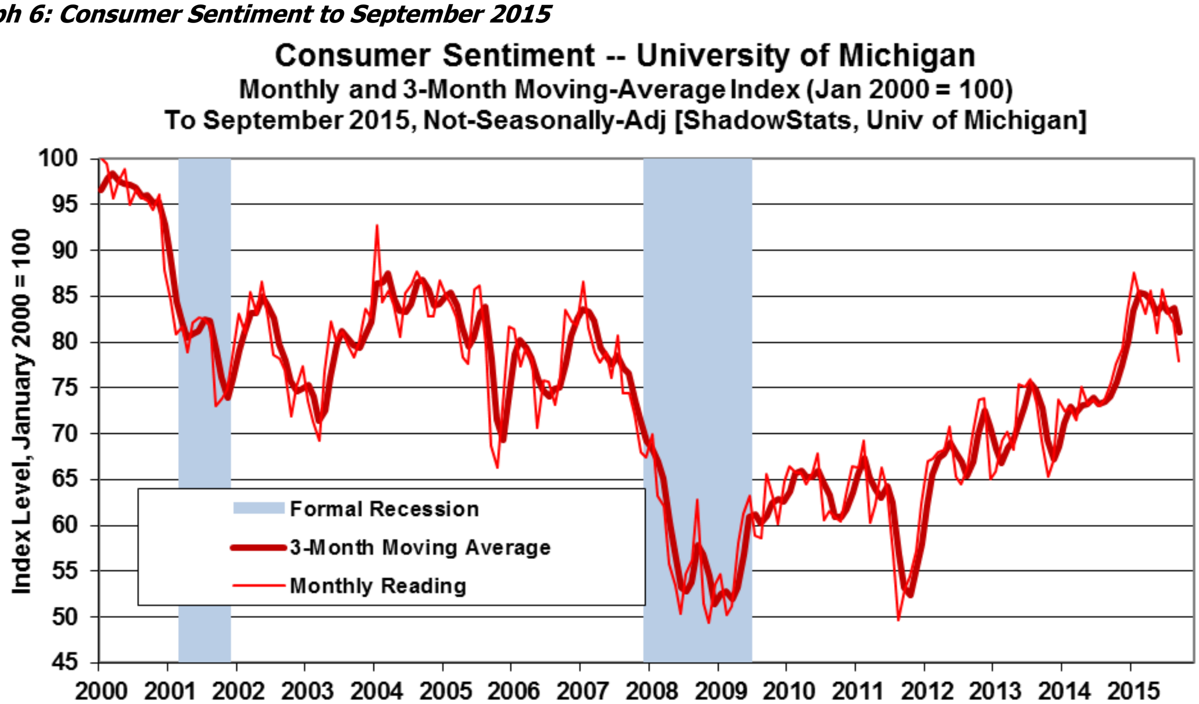
The Conference Board's seasonally-adjusted [unadjusted data are not available] Consumer-Confidence Index (*Graph 5*) and the University of Michigan's not-seasonally-adjusted Consumer-Sentiment Index

(*Graph 6*) for the full-month of September 2015 moved in opposite directions, with confidence up slightly and sentiment sharply lower for the month. A good case never has been made for seasonally-adjusting confidence.

Graph 5: Consumer Confidence to September 2015

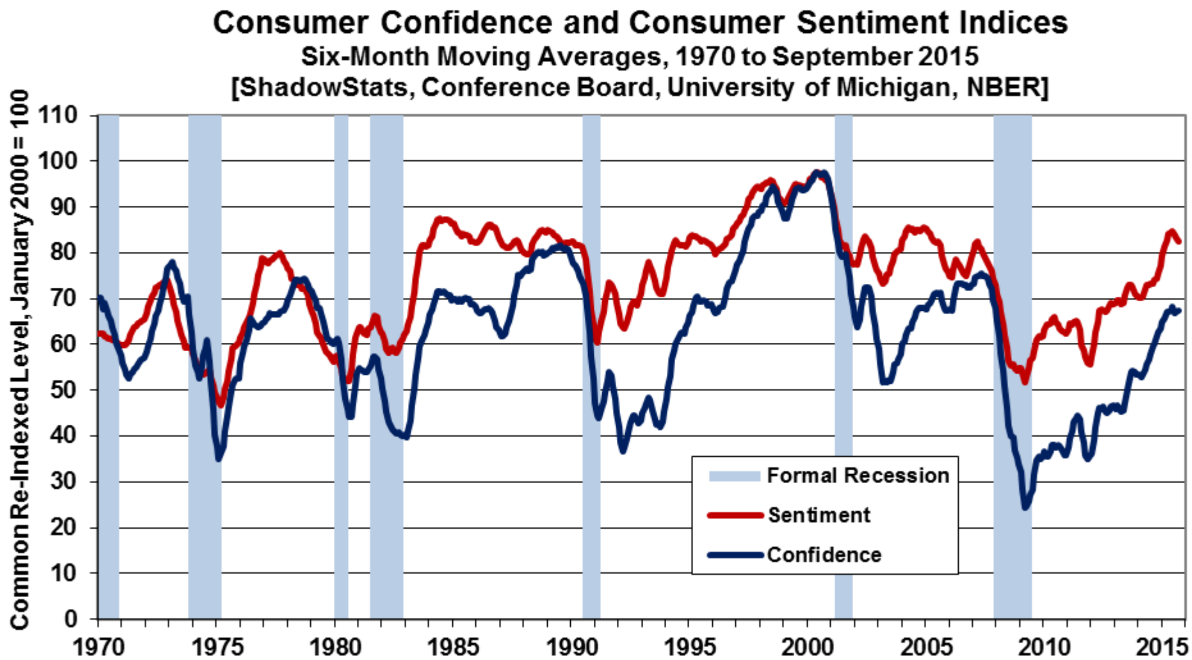


Graph 6: Consumer Sentiment to September 2015



Both series continued to move lower or to hold off near-term peaks, though, smoothed for their three-month and six-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. With increasingly-negative, headline financial and economic reporting and circumstances ahead, successive negative hits to both the confidence and sentiment readings remain highly likely in the months ahead.

Graph 7: Comparative Consumer Confidence and Sentiment (6-Month Moving Averages) since 1970



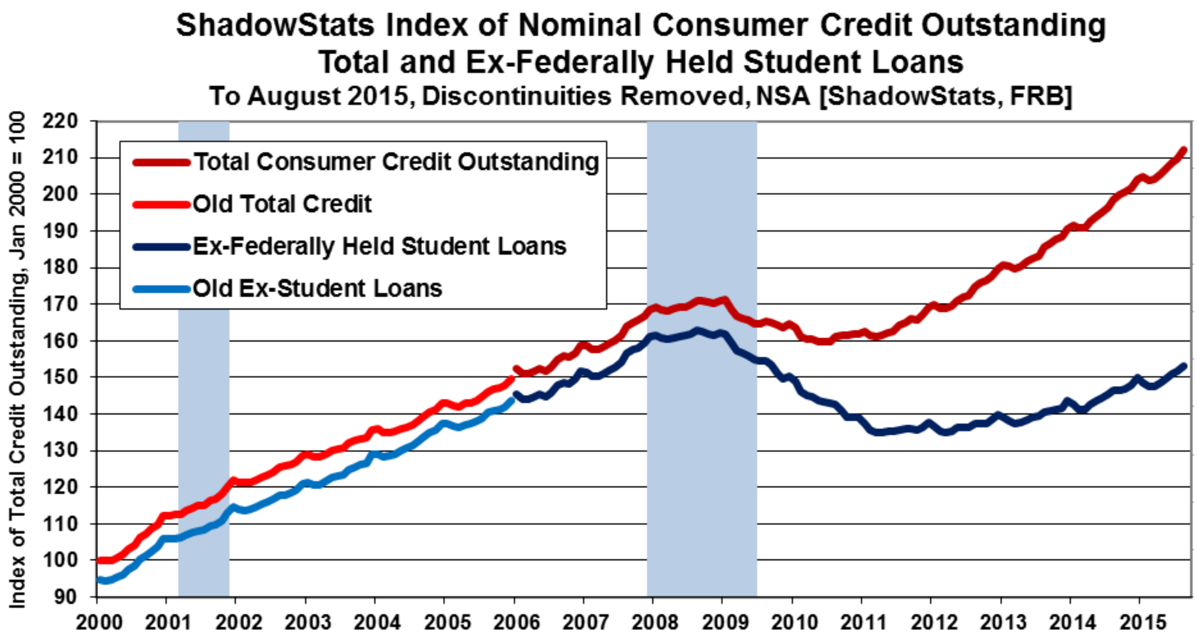
Smoothed for irregular, short-term volatility, the two series remain at levels seen typically in recessions. Suggested in *Graph 7*—plotted for the last 45 years—the latest readings of confidence and sentiment generally have not recovered levels seen preceding most formal recessions of the last four decades. Broadly, the consumer measures remain well below, or are inconsistent with, periods of historically-strong economic growth seen in 2014 and the strong, headline upturn in second-quarter 2015 GDP growth.

The last two graphs in this section address consumer borrowing. Debt expansion can help make up for a shortfall in income growth. Shown in *Graph 8* 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 second-quarter 2015, the graph reflects the most-recent detail available from the Federal Reserve's flow-of-funds data.

The slight upturn seen in the series in the two most-recent quarters, as also seen with the monthly 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 *Graph 9*.

Graph 8: Household Sector, Real Credit Market Debt Outstanding

Graph 9: Nominal Consumer Credit Outstanding through July 2015



Through August 2015 reporting, *Graph 9* of monthly Consumer Credit Outstanding is a subcomponent of *Graph 8* 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. Although in slow uptrend, 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, and the August 2015 increase reflects a seasonal jump in loan activity tied to the beginning of the school year.

Producer Price Index (PPI)—September 2015—PPI Fell by 0.54% (-0.54%), Despite Continued Boost from Nonsensical Falling-Energy-Prices Inflation. The headline decline of 0.54% (-0.54%) in September PPI Final Demand inflation reflected a drop of 1.18% (-1.18%) in monthly Final Demand Goods inflation, balanced with a decline of 0.36% (-0.36%) in the dominant Final Demand Services inflation sector.

Separately, a pattern of upside revisions to prior reporting continued, where the Bureau of Labor Statistics (BLS) standardly revises PPI reporting for the fifth month back from the headline detail. Last month, headline monthly April 2015 PPI inflation revised higher by 0.2%, down by 0.1% (-0.1%) month-to-month, having previously contracted by 0.3% (-0.3%) in initial reporting. This month, headline monthly reporting for May 2015 PPI inflation also revised higher by 0.2%, now up by 0.6%, having been up previously by 0.4%.

Beyond meaningfully-large, prior-period revisions, though, much of the headline PPI reporting—particularly on the services sides—is nonsensical, an academic game that has little application in the real world business activity. A continued drop in energy prices dominated the 1.2% (-1.2%) decline in headline September goods inflation. Consider, though, that the drop of 0.4% (-0.4%) in the services sector was muted by a 12.4% monthly surge in margins (services "inflation") for automotive fuels and lubricants, also tied to collapsing gasoline and petroleum-related prices. Simply put, collapsing oil prices hit goods inflation in the PPI, but they also generate higher services inflation that has no underlying reality other than in misdefined BLS inflation concepts.

Separately, per the BLS's PPI press release, "over a quarter of the September decline in the index for final demand services is attributable to prices for securities brokerage, dealing, investment advice, and related services, which dropped 4.3%."

Although the headline detail on investment banking and security dealing services showed a monthly decline of 5.9% (-5.9%) in September margins, that followed headline monthly gains of 6.7% in August, and 2.7% in July, with September 2015 up by 6.2% year-to-year. There seems to have been an issue with "other securities dealing services," down by 22.9% (-22.9%) for the month, but up by 71.1% year-to-year. The headline reporting here is indicative of highly unstable surveying and likely a very poorly defined and weighted index.

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—but temporarily—move initially in the opposite direction of related prices, such as "inflationary" rising margins created by falling oil and gasoline prices.

September 2015 Headline PPI Detail. The seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for September 2015 fell by 0.54% (-0.54%), versus an unrevised, unchanged 0.00% reading in August, unrevised gains of 0.18% in July and 0.36% in June, and an upwardly revised 0.55% gain in May. The broad impact of seasonal adjustments on the headline PPI reporting largely was positive in September, with the unadjusted monthly September index down by 0.72% (-0.72%).

On a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year PPI Final Demand inflation dropped by 1.08% (-1.08%) in September 2015, versus unrevised declines of 0.81% (-0.81%) in August 2015, 0.81% (-0.81%) in July 2015, 0.72% (-0.72%) in June 2015, and a revised, narrower annual decline of 0.81% (-0.81%) in May 2015.

For the three major subcategories of September 2015 Final Demand PPI, headline monthly Goods inflation fell by 1.18% (-1.18%), Services inflation fell by 0.36% (-0.36%), and Construction inflation was unchanged at 0.00% for the month.

<u>Final Demand Goods (Weighted at 34.67%).</u> Running somewhat in parallel with the old Finished Goods PPI series, headline month-to-month Final Demand Goods inflation dropped by 1.18% (-1.18%) in September 2015, versus a decline of 0.63% (-0.63%) in August. There was positive impact on the aggregate headline September reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, September Final Demand Goods inflation fell by 1.45% (-1.45%) for the month.

Unadjusted, year-to-year goods inflation was down by 5.15% (-5.15%) in September 2015, versus an annual contraction of 4.09% (-4.09%) in August 2015.

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

- "Foods" inflation dropped month-to-month by 0.84% (-0.84%), having risen by 0.34% in August, with September's headline decline narrowed by seasonal adjustments. Unadjusted, September foods inflation fell by 1.00% (-1.00%) in the month. Unadjusted and year-to-year, September 2015 foods inflation fell by 2.95% (-2.95%), versus a decline of 2.20% (-2.20%) in August 2015.
- "Energy" inflation fell by 5.93% (-5.93%) in September 2015, following a headline decline of 3.25% (-3.25%) in August, with the September decline narrowed by seasonal adjustments. Unadjusted, monthly September energy inflation fell by 6.47% (-6.47%). Unadjusted and year-to-year, the annual contraction in energy prices widened to 23.70% (-23.70%) in September 2015, versus an annual decline of 19.63% (-19.63%) in August 2015.
- "Less foods and energy" ("Core" goods) monthly inflation was unchanged at 0.00% in September 2015, versus a decline of 0.18% (-0.18%) in August. Seasonal adjustments were positive for monthly core inflation, with an unadjusted decline of 0.18% (-0.18%) in September. Unadjusted and year-to-year, September 2015 core inflation slowed to a gain of 0.18%, versus a year-to-year annual gain in August 2015 of 0.37%.

<u>Final Demand Services (Weighted at 63.31% of the Aggregate).</u> Headline monthly Final Demand Services inflation fell by 0.36% (-0.36%) in September 2015, offsetting a headline gain of 0.36% in August. The overall seasonal-adjustment impact on headline September services inflation was neutral,

with an unadjusted monthly September decline also of 0.36% (-0.36%). Year-to-year, unadjusted September 2015 services inflation was 1.01%, versus an annual gain of 1.00% in August 2015.

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

- "Services less trade, transportation and warehousing" inflation, or the "Other" category, showed negative monthly inflation of 0.27% (-0.27%) in September 2015, versus a gain of 0.18% in August. Seasonal-adjustment impact on the adjusted September detail was positive, where the unadjusted monthly change was a decline of 0.37% (-0.37%). Unadjusted and year-to-year, September 2015 "other" services inflation was 1.02%, versus 1.20% in August 2015.
- "Transportation and warehousing" inflation fell month-to-month by 0.70% (-0.70%) in September 2015, having been down by 0.69% (-0.69%) in August. Seasonal adjustments had positive impact on the headline September number, where the unadjusted monthly September reading showed a decline of 1.90% (-1.90%). Unadjusted and year-to-year, September 2015 transportation inflation fell by 3.32% (-3.32%), versus an annual contraction of 3.02% (-3.02%) in August 2015.
- "Trade" inflation fell by 0.36% (-0.36%) month-to-month in September 2015, having gained 0.90% in August 2015. Seasonal adjustments had a negative impact here, where unadjusted monthly inflation fell by 0.18% (-0.18%) in September. Unadjusted and year-to-year, September 2015 trade inflation rose by 2.09%, having increased by 1.63% in August 2015.

<u>Final Demand Construction (Weighted at 2.02% of the Aggregate).</u> 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 was unchanged at 0.00% in September 2015, having declined by 0.09% (-0.09%) in August. The impact of seasonal factors on the September reading was neutral. On an unadjusted basis, month-to-month September 2015 construction inflation also was unchanged at 0.00%.

On an unadjusted basis, year-to-year construction inflation held at 1.80% in September 2015, the same level as in August 2015.

- "Construction for private capital investment" headline monthly inflation in September 2015 also was unchanged at 0.00%, following a month-to-month decline of 0.18% (-0.18%) in August. As usual, seasonal adjustments also had neutral impact here, where the unadjusted monthly inflation was unchanged at 0.00% in September. Unadjusted and year-to-year, September 2015 private construction inflation was up by 1.81%, the same level as in August 2015.

- "Construction for government" inflation declined month-to-month by 0.09% (-0.09%) in September 2015, for the second month. Seasonal adjustments also had neutral impact here, where unadjusted monthly September inflation also was down by 0.09% (-0.09%). Unadjusted and year-to-year, September 2015 government construction inflation was up by 1.80%, versus 1.89% in August 2015.

[The* Reporting Detail *includes some expanded information on the Retail Sales and PPI numbers.]

____

HYPERINFLATION WATCH

HYPERINFLATION OUTLOOK SUMMARY

Broad Outlook Is Unchanged: Economy Remains in Downturn; Questions Mount on Systemic Stability; Dollar Faces Massive Decline with Ongoing Implications for Hyperinflation. This *Summary* has not been changed since *Commentary No. 754* of September 24th, other than for updated internal references or links and minor language corrections.

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 in the wake of an extraordinary rally seen since June 2014, and in the context of a renewed economic downturn, ongoing domestic fiscal imbalances and ongoing financial-system instabilities. Financial-system concerns likely are the primary reason behind the inability or unwillingness of the Federal Reserve's Federal Open Market Committee (FOMC) to raise interest rates. Those factors have implications for a meaningful upturn in domestic inflation, eventually evolving into a great hyperinflationary crisis.

Indeed, symptomatic of a financial system in serious distress, the FOMC remains unable or unwilling to move decisively on raising interest rates, to move the financial system towards monetary normalcy. Continued inaction or waffling by the Fed has begun to shift the focus and concerns of domestic and global investors away from what appears increasingly to be perpetual moribund economic activity into the areas of systemic instabilities, prospective or otherwise, that are so troubling to the U.S. central bank (see *Commentary No. 750* and *Commentary No. 754*). Fed policy inaction, if anything, has exacerbated the long-term economic stagnation and renewed business downturn, where the quantitative easings always were intended as covert bailouts for the banking system, under the political cover of a weak economy (see for example, the *Monetary Conditions* section of *Commentary No. 756*).

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 into 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, and despite some fluttering, into August. Initially, the rally reflected 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, and more recently to confirm fears 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 (such did not happen). 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*, *Commentary No. 751* and *Commentary No. 755*), with a variety of key indicators, such as industrial production, real retail sales and revenues of the S&P 500 companies continuing to show 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 recession likely will be December 2014.

As market expectations move towards an imminent, new recession, such not only should reduce expectations for a significant tightening in Fed policy, but also should 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 should 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.

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. Fed tightening likely is not now on the horizon until after the 2016 presidential election. Suggestions that all was right again with world were nonsense. The Fed's games likely now will be played out as far as possible, with hopes, once again, of avoiding a financial-system collapse.

Inaction by the FOMC on September 17th was 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 now of higher rates before year-end or next year, banking-system issues (not the economy) may keep the "pending" interest rate hike in a continual state of suspension. The economy certainly will supply continuing political cover for the Fed's "inaction," with the U.S. central bank having lost control of the system.

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 political system, 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 update in *Opening Comments*). Sharply-negative economic reporting shocks, versus softening consensus forecasts, remain a heavily-favored, proximal trigger for intensifying the pending dollar debacle (see *Opening Comments* of *No. 756*).

- ***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 that is within a month of being in crisis (see *Opening Comments* of *No. 756*).

- ***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 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 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 remain nil. Issues such as non-recovered, faltering economic activity, the consumer liquidity crisis and the nation's long-range solvency issues 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. Slack demand for U.S. Treasuries always can be taken up by the Federal Reserve's renewed monetization of the debt.

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.

REPORTING DETAIL

NOMINAL RETAIL SALES (September 2015)

Nominal Retail Sales Were Stagnant. In the context of a downside revision to prior reporting for August, the headline nominal gain of 0.10% in September 2015 retail sales was somewhat weaker than expected by the markets. Without the prior-period revisions, headline September sales would have been "unchanged" for the month. That was before adjustment for tomorrow's September CPI-U inflation, which likely will be minimally on the downside, providing a relative boost to the inflation-adjusted, real retail sales for the month (see *Week Ahead*).

Nonetheless, annual real growth in the series should continue generating a solid signal for a formal, new recession. Adjusting for realistic inflation (see *Commentary No. 752* and *No. 742 Special Commentary: A World Increasingly Out of Balance*), real retail sales and the broad economy never truly recovered from the economic collapse into 2008 and 2009.

***Structural Liquidity Issues Constrain Consumer Economic Activity*.** Discussed fully in the *Opening Comments*, the primary underlying issues restraining 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, real or otherwise. 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—September 2015*.** In the context of a downside revision to August and an upside revision to July retail sales activity, September 2015 sales rose by a headline 0.1%, at the first decimal point. At the second decimal point, as reported today, October 14th by the Census Bureau, September 2015 retail sales showed a statistically-insignificant, seasonally-adjusted gain of 0.10% +/- 0.58% (this and all other confidence intervals are expressed at the 95% level). Net of prior-period revisions, nominal September retail sales was declined by 0.01% (-0.01%) month-to-month.

Such followed a statistically-insignificant, revised monthly change of 0.03% +/- 0.24% [previously up by 0.19%] in August, and a revised monthly gain of 0.76% [previously up by 0.71%, initially up by 0.56%] in July.

Year-to-Year Annual Change. Year-to-year nominal retail sales in September 2015 increased by a statistically-significant 2.36% +/- 1.53%, versus a downwardly revised 2.04% [previously 2.16%] annual gain in August 2015, and an upwardly revised annual gain of 2.65% [previously up by 2.59%, intially up by 2.43%] in July 2015.

Annualized Quarterly Changes. The pace of annualized nominal retail sales decline in first-quarter 2015 remained at 4.04% (-4.04%), the worst quarter-to-quarter showing since the economic collapse, with annualized second-quarter 2015 retail sales unrevised at 6.81%. Based on the initial full reporting for third-quarter 2015, annualized nominal third-quarter growth was 4.80% [previously 4.76%, based on just July and August 2015 reporting, initially 3.94%, based just on initial July reporting].

Net of inflation, the real retail sales change in first-quarter 2015 remained at an annualized quarterly contraction of 1.02% (-1.02%). The quarterly change in second-quarter real retail sales will be an unrevised gain of 3.72%. Third-quarter detail will be assessed in the tomorrow's October 15th CPI-U *Commentary*, but it should be solidly in positive territory.

September Core Retail Sales—Core Sales Growth. Reflecting an environment of still should be generally rising food prices and an unadjusted monthly decline of 9.14% (-9.14%) in gasoline prices [Department of Energy], seasonally-adjusted monthly grocery-store sales fell by 0.34% (-0.34%) in September 2015, with gasoline-station sales down by 3.24% (-3.24%) for the month.

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

<u>Version I:</u> September 2015 versus August 2015 seasonally-adjusted retail sales series—net of total grocery store and gasoline station sales—reflected a monthly gain of 0.51%, versus the official headline aggregate sales increase of 0.10%.

<u>Version II:</u> September 2015 versus August 2015 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—reflected a monthly gain of 0.41%, versus the official headline aggregate sales increase of 0.10%.

Real (Inflation-Adjusted) Retail Sales—September 2015. The nominal gain of 0.10% in September 2015 retail sales was before accounting for inflation. The change in real retail sales for September will be published along with the headline estimate of consumer inflation for September 2015 in tomorrow's *Commentary No. 759* of Thursday, October 15th. Barring an upside surprise to what likely will be a headline monthly contraction in the September CPI-U, the headline monthly change in real September retail sales likely will be somewhat stronger than the headline nominal gain of 0.10% (see *Week Ahead* section). Real annual growth, however, should continue to signal imminent recession.

Seasonal-Factor Distortions and Other Reporting Instabilities. The usual seasonal-factor distortions were at play, again, in the September 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 August 2014 and September 2014 were revised, along with the publication of the September 2015 data and revised detail on July 2015 and August 2015. Although minimal in today's headline detail, 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 the headline September 2015 detail. The revisions were not due to the availability of any new historical data back in 2014, but due rather to just the inconsistent shifts in the published seasonal adjustments. Only the new headline levels for August and September 2014 and for July and August 2015 were published on a basis consistent with the August 2015 number.

Specifically, the level of August 2014 revised lower by 0.01% (-0.01%), following a downside revision of 0.11% (-0.11%) last month. September 2014 also revised lower by 0.01% (-0.01%), suggestive of negligible relative shifts in both the current August and September 2015 seasonals, from where they were implied to be last month and from what they likely would have been closer to in the old fixed-seasonal adjustment system. This time around, the net impact appears to have been effectively neutral for the headline September 2015 reporting, from the shifting but unreported seasonal factors.

Most commonly in the last year, the year-ago number has 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 cloud relative activity in the July 2015-to-September 2015, and in the August 2014-to-September 2014 periods, five months that are published on a non-comparable basis with all other historical data.

PRODUCER PRICE INDEX—PPI (September 2015)

September PPI Fell by 0.54% (-0.54%), Despite Continued Boost from Nonsensical Upside Inflation Pressures from Falling Energy Prices. The headline decline of 0.54% (-0.54%) in September PPI Final Demand inflation reflected a drop of 1.18% (-1.18%) in monthly Final Demand Goods inflation, balanced with a decline of 0.36% (-0.36%) in the dominant Final Demand Services inflation sector.

Separately, a pattern of upside revisions to prior reporting has continued, where the Bureau of Labor Statistics (BLS) standardly revises PPI reporting for the fifth month back from the headline detail. Last month, headline monthly April 2015 PPI inflation revised higher by 0.2%, down by 0.1% (-0.1%) month-to-month, having previously contracted by 0.3% (-0.3%) in initial reporting. This month, headline monthly reporting for May 2015 PPI inflation also revised higher by 0.2%, now up by 0.6%, having been up previously by 0.4%.

Beyond meaningfully-large, prior-period revisions, though, much of the headline PPI reporting—particularly on the services sides—is nonsensical, an academic game that has little application in the real world business activity. A continued drop in energy prices dominated the 1.2% (-1.2%) decline in headline September goods inflation. Consider, though, that the drop of 0.4% (-0.4%) in the services sector was muted by a 12.4% monthly surge in margins (services "inflation") for automotive fuels and lubricants, also tied to collapsing gasoline and petroleum-related prices. Simply put, collapsing oil prices hit goods inflation in the PPI, but they also generate higher services inflation that has no underlying reality other than in misdefined BLS inflation concepts.

Separately, per the BLS's PPI press release, "over a quarter of the September decline in the index for final demand services is attributable to prices for securities brokerage, dealing, investment advice, and related services, which dropped 4.3%."

Although the headline detail on investment banking and security dealing services showed a monthly decline of 5.9% (-5.9%) in September margins, that followed headline monthly gains of 6.7% in August, and 2.7% in July, with September 2015 up by 6.2% year-to-year. There seems to have been an issue with "other securities dealing services," down by 22.9% (-22.9%) for the month, but up by 71.1% year-to-year. The headline reporting here is indicative of highly unstable surveying and likely a very poorly defined and weighted index.

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

September 2015 Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported this morning, October 14th, that the seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for September 2015 fell by 0.54% (-0.54%), versus an unrevised, unchanged 0.00% reading in August, unrevised gains of 0.18% in July and 0.36% in June, and a revised 0.55% [first reported as a 0.37%] gain in May.

The broad impact of seasonal adjustments on the headline PPI reporting largely was positive in September, with the unadjusted monthly September index down by 0.72% (-0.72%).

On a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year PPI Final Demand inflation dropped by 1.08% (-1.08%) in September 2015, versus unrevised declines of 0.81% (-0.81%) in August 2915, 0.81% (-0.81%) in July 2015, 0.72% (-0.72%) in June 2015, and a revised annual decline of 0.81% (-0.81%) [previously down by 0.99% (-0.99%)] in May 2015.

For the three major subcategories of September 2015 Final Demand PPI, headline monthly Goods inflation fell by 1.18% (-1.18%), Services inflation fell by 0.36% (-0.36%), and Construction inflation was unchanged at 0.00% for the month.

<u>Final Demand Goods (Weighted at 34.67%).</u> Running somewhat in parallel with the old Finished Goods PPI series, headline month-to-month Final Demand Goods inflation dropped by 1.18% (-1.18%) in September 2015, versus a decline of 0.63% (-0.63%) in August. There was positive impact on the aggregate headline September reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, September Final Demand Goods inflation fell by 1.45% (-1.45%) for the month.

Unadjusted, year-to-year goods inflation was down by 5.15% (-5.15%) in September 2015, versus an annual contraction of 4.09% (-4.09%) in August 2015.

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

- "Foods" inflation dropped month-to-month by 0.84% (-0.84%), having risen by 0.34% in August, with September's headline decline narrowed by seasonal adjustments. Unadjusted, September foods inflation fell by 1.00% (-1.00%) in the month. Unadjusted and year-to-year, September 2015 foods inflation fell by 2.95% (-2.95%), versus a decline of 2.20% (-2.20%) in August 2015.
- "Energy" inflation fell by 5.93% (-5.93%) in September 2015, following a headline decline of 3.25% (-3.25%) in August, with the September decline narrowed by seasonal adjustments. Unadjusted, monthly September energy inflation fell by 6.47% (-6.47%). Unadjusted and year-to-

year, the annual contraction in energy prices widened to 23.70% (-23.70%) in September 2015, versus an annual decline of 19.63% (-19.63%) in August 2015.

- "Less foods and energy" ("Core" goods) monthly inflation was unchanged at 0.00% in September 2015, versus a decline of 0.18% (-0.18%) in August. Seasonal adjustments were positive for monthly core inflation, with an unadjusted decline of 0.18% (-0.18%) in September. Unadjusted and year-to-year, September 2015 core inflation slowed to a gain of 0.18%, versus a year-to-year annual gain in August 2015 of 0.37%.

Final Demand Services (Weighted at 63.31% of the Aggregate). Headline monthly Final Demand Services inflation fell by 0.36% (-0.36%) in September 2015, offsetting a headline gain of 0.36% in August. The overall seasonal-adjustment impact on headline September services inflation was neutral, with an unadjusted monthly September decline also of 0.36% (-0.36%). Year-to-year, unadjusted September 2015 services inflation was 1.01%, versus an annual gain of 1.00% in August 2015.

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

- "Services less trade, transportation and warehousing" inflation, or the "Other" category, showed negative monthly inflation of 0.27% (-0.27%) in September 2015, versus a gain of 0.18% in August. Seasonal-adjustment impact on the adjusted September detail was positive, where the unadjusted monthly change was a decline of 0.37% (-0.37%). Unadjusted and year-to-year, September 2015 "other" services inflation was 1.02%, versus 1.20% in August 2015.
- "Transportation and warehousing" inflation fell month-to-month by 0.70% (-0.70%) in September 2015, having been down by 0.69% (-0.69%) in August. Seasonal adjustments had positive impact on the headline September number, where the unadjusted monthly September reading showed a decline of 1.90% (-1.90%). Unadjusted and year-to-year, September 2015 transportation inflation fell by 3.32% (-3.32%), versus an annual contraction of 3.02% (-3.02%) in August 2015.
- "Trade" inflation fell by 0.36% (-0.36%) month-to-month in September 2015, having gained 0.90% in August 2015. Seasonal adjustments had a negative impact here, where unadjusted monthly inflation fell by 0.18% (-0.18%) in September. Unadjusted and year-to-year, September 2015 trade inflation rose by 2.09%, having increased by 1.63% in August 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 was unchanged at 0.00% in September 2015, having declined by 0.09% (-0.09%) in August. The impact of seasonal factors on the September reading was neutral. On an unadjusted basis, month-to-month September 2015 construction inflation also was unchanged at 0.00%.

On an unadjusted basis, year-to-year construction inflation held at 1.80% in September 2015, the same level as in August 2015.

- "Construction for private capital investment" headline monthly inflation in September 2015 also was unchanged at 0.00%, following a month-to-month decline of 0.18% (-0.18%) in August. As usual, seasonal adjustments also had neutral impact here, where the unadjusted monthly inflation was unchanged at 0.00% in September. Unadjusted and year-to-year, September 2015 private construction inflation was 1.81%, the same level as in August 2015.

- "Construction for government" inflation declined month-to-month by 0.09% (-0.09%) in September 2015, for the second month. Seasonal adjustments also had neutral impact here, where unadjusted monthly September inflation also was down by 0.09% (-0.09%). Unadjusted and year-to-year, September 2015 government construction inflation was 1.80%, versus 1.89% in August 2015.

Discussed in *Commentary No. 756*, ShadowStats uses the Final Demand Construction index for deflating headline activity in the monthly construction-spending series. The November 2nd release of September 2015 U.S. Construction Spending detail will be covered in ShadowStats *Commentary No. 764* of November 4th.

PPI-Inflation Impact on Pending Reporting of New Orders for Durable Goods. As to the upcoming reporting of September 2015 new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods declined for the eighth month, but at a slower pace than in August, dropping by 0.06% (-0.06%) in September 2015, versus an August decline of 0.24% (-0.24%). Annual inflation was down by 0.48% (-0.48%) in September 2015, the same annual pace of decline seen in August 2015. September 2015 durable goods orders will be reported on October 27th and covered in ShadowStats *Commentary No. 762* of that date.

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, 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 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—may have 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 still somewhat higher in August, despite a headline monthly decline in gasoline prices and a minimal decline in the headline monthly CPI-U. Although gasoline prices appear to be in the process of bottoming out again, the sharp decline in September gasoline prices should be enough, to pull the annual CPI-U inflation slightly negative, year-to-year.

Upside inflation pressures should mount anew, once oil prices begin to rebound meaningfully. Again, that process eventually should accelerate, along with a pending sharp downturn in the exchange-rate value of the U.S. dollar. Those 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:

Updated - Consumer Price Index—CPI (September 2015). The Bureau of Labor Statistics (BLS) plans to release the September 2015 CPI tomorrow, Thursday, October 15th. The headline September CPI-U should be down month-to-month by perhaps 0.2% (-0.2%), reflecting a sharp monthly decline in gasoline prices. The corresponding year-to-year annual inflation rate likely will notch lower, too, into minimally-negative territory. Market expectations for headline September CPI inflation, which are in the range of a monthly decline of 0.2% (-0.2%) to 0.3% (-0.3%), are not unreasonable.

The average gasoline price moved lower in September 2015, by 9.14% (-9.14%) for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). While BLS seasonal adjustments to gasoline prices in September traditionally are sharply on the plus-side, they are enough only to narrow the current drop in gasoline prices to about 8.5% (-8.5%) on a seasonally-adjusted basis. That one factor is enough to reduce the headline monthly CPI-U change by 0.35% (-0.35%). Higher food and "core" (net of food and energy) inflation partially should offset the impact of the lower gasoline prices, leaving the headline CPI-U down by 0.1% (-0.1%) to 0.2% (-0.2%) for the month, although declining retail grocery store sales and a headline contraction in September wholesale food inflation are suggestive of a negative CPI contribution for food.

***Annual Inflation Rate*.** Year-to-year, CPI-U inflation would increase or decrease in the September 2015 reporting, depending on the seasonally-adjusted monthly change, versus the adjusted, headline inflation gain of 0.09% for September 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2015, the difference in September's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the August 2015 positive annual inflation rate of 0.20%. For example, a seasonally headline monthly contraction of 0.2% (-0.2%) in September 2015 CPI-U would leave annual September 2015 inflation down by about 0.1% (-0.1%) [- 0.2% - 0.09% + 0.20% ≈ -0.1%], depending on the rounding.

Social Security Cost of Living Adjustment (COLA) Likely Will Be Zero, Reflecting Annual Contractions in the CPI-W. Discussed in *Commentary No. 757*, annual CPI-W inflation in third-quarter 2015 likely will be around a negative 0.3% (-0.3%). That means there would be no COLA increase in 2016 for Social Security recipients. Inflation reality as reflected in common experience, versus the government's successful efforts at artificially-reducing COLA adjustments, have been discussed in the *Public Commentary on Inflation Measurement* and will be reviewed anew in tomorrow's *Commentary No. 759*, covering the September CPI detail.

Updated - Real Retail Sales (September 2015). Based on today's headline reporting of a 0.10% monthly gain in nominal (not-adjusted-for-inflation) September Retail Sales (see coverage in the *Reporting Detail* and *Opening Comments*), real (inflation-adjusted) Retail Sales for September will be published in tomorrow's, October 15th *Commentary No. 759*, in conjunction with the detail on headline September CPI-U, just discussed. Given expectations and the likelihood of a small headline monthly decline in the September CPI-U, September real retail sales likely will be somewhat more-positive than the headline nominal monthly gain of 0.10%.

Nonetheless, real retail sales remain weak, with annual growth still signaling a contracting, broad economy. Constraining real retail sales activity, the consumer remains in an extreme liquidity bind with weakening confidence, also discussed in the *Opening Comments*. Continued softness in these numbers should intensify consensus expectations shifting towards renewed economic contraction, a "new" recession. Such should include a downgrading of still-positive but rapidly-softening expectations for the initial estimate of third-quarter 2015 GDP on October 29th.

Updated - Index of Industrial Production (September 2015). On Friday, October 16th, the Federal Reserve Board will release its estimate of the Index of Industrial Production for September 2015. While market expectations for a monthly contraction have deepened slightly to around 0.3% (-0.3%), the headline reporting detail remains a good bet to come in below consensus, along with downside revisions to prior-period reporting.

As one of the traditional markers of the onset of formal recession, a continued downtrend in these numbers should intensify the shift in consensus expectations towards renewed economic contraction, again, including a downgrading of the still-positive but rapidly-softening expectations for the initial estimate of third-quarter 2015 GDP on October 29th.

Residential Construction—Housing Starts (September2015). The Census Bureau will release September 2015 residential construction detail on Tuesday, October 20th. In line with common-reporting experience of recent years, monthly results are likely to be unstable and not statistically meaningful, holding in a general pattern of down-trending stagnation. Wherever consensus expectations settle, they also likely will not be statistically significant.

Irrespective of the generally meaningless headline detail, the broad pattern of housing starts should remain consistent with the low-level, albeit slightly up-trending, stagnation, seen in the series at present, where current activity still is down by about 50% from its pre-recession high. Such is particularly evident with the detail viewed in the context of a six-month moving average. 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 major monthly economic series, the monthly headline reporting detail here simply is worthless. The series best is viewed in terms of a six-month moving average. Again, not only is month-to-month reporting volatility frequently extreme, but also those headline monthly growth rates rarely come close to being statistically significant.

