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

COMMENTARY NUMBER 766
October Retail Sales, Producer Price Index, Updated Consumer Liquidity

November 13, 2015

Net of Prior-Period Revisions, Nominal October Retail Sales Fell by 0.1% (-0.1%)

Annual Sales Growth Slowed Sharply, Intensifying Imminent-Recession Warning

Net of Inflation Adjustment, Real Retail Sales Likely Declined Month-to-Month, Possibly Trending into a Quarterly Contraction

Aggregate Headline PPI Drop of 0.36% (-0.36%) Was Nonsense, Reflecting Counterintuitive Inflation Definitions, Where Rising Gasoline Prices Reduced Services Inflation

Resurgent Construction Costs Will Take a Toll on Headline Inflation-Adjusted Construction Spending

Weak Retail Sales and Falling Wholesale Inflation Did Not Reinforce "Certainty" of December FOMC Rate-Boost

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PLEASE NOTE: The next regular Commentary*, scheduled for Tuesday, November 17th, will review the October 2015 Consumer Price Index (CPI), Industrial Production, Real Retail Sales and Earnings, followed by a Commentary on November 18th covering October Housing Starts.*

Best wishes to all! — John Williams

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OPENING COMMENTS AND EXECUTIVE SUMMARY

Data in the Week Ahead Should Do Much to Pummel Fourth-Quarter GDP Growth Prospects. The headline reporting of October 2015 nominal retail sales generally was worse than expected and—in conjunction with at least a near-term uptick in headline CPI inflation—opens the possibility of a fourth-quarter contraction in real retail sales, along with some continued downside revision pressures on third-quarter GDP growth in its second estimate of November 24th.

Discussed in the *Week Ahead* section, similar reporting and revision pressures are likely from pending headline detail on October industrial production, and possibly, with the ever-unstable housing starts series, which remains in a broad pattern of low-level stagnation.

To the extent the Federal Open Market Committee (FOMC) still is considering the economy has part of its rate-hike considerations, there likely will be little news in the near future to support what increasingly is touted as a rate-hike "certainty" at the December 16th FOMC meeting.

Commentary No. 768 of November18th will review the major economic releases for October with an assessment then as to headline GDP impact, any shifting economic sentiment in the financial markets, and any shifting sentiment on the FOMC or on systemic financial stability.

Today's *Commentary* (November 13th). The balance of these *Opening Comments* and today's relatively brief *Commentary* provides summary coverage of headline October nominal Retail Sales and the Producer Price Index (PPI), along with an updated review of consumer liquidity conditions.

In the *Hyperinflation Watch*, the *Hyperinflation Outlook Summary* has not been changed since its November 4th revisions.

The *Week Ahead* provides an assessment of next week's likely reporting of the October Consumer Price Index (CPI) and related Real Retail Sales and Real Earnings, October Industrial Production and Housing Starts.

Nominal Retail Sales—October 2015—Sales of $447,255 Million Were Within $1 Million of Being "Unchanged" for the Month. Headline nominal retail sales, before inflation adjustment, were weak in October, and annual growth slowed sharply. Further, real retail sales, after inflation adjustment, most likely contracted for the month, net of a probable hike in headline inflation. Based solely on the initial October reporting, real retail sales also appear headed into a fourth-quarter 2015 contraction.

Nominal October retail sales could be considered flat-to-minus for the month, despite the headline 0.1% gain. At the second decimal point, headline nominal October sales rose by 0.05%, a change that would

have rounded to 0.0% at the first decimal point, had guesstimated monthly sales been just $1 million less. Net of revisions to September (now in a small contraction), October's headline change would have been a monthly decline of 0.10% (-0.10%).

Assuring an intensified signal of imminent recession, once October inflation detail is in place, year-to-year change in nominal retail sales narrowed to 1.69% in October 2015, versus a downwardly revised annual gain of 2.20% in September 2015. Part of the narrowing in October annual growth was due to an upside revision of 0.15% in October 2014 sales, which had the effect of distorting and boosting the headline October 2015 monthly gain, with implied changes to seasonal adjustments. Without the inconsistent shifting in seasonals, the October 2015 headline change would have been a monthly contraction of about 0.1% (-0.1%) instead of the headline 0.1% gain (see explanation in *Seasonal-Factor Distortions and Other Reporting Instabilities* in the *Reporting Detail* section).

Structural Liquidity Issues Constrain Consumer Economic Activity. Discussed in the next major section, updating consumer liquidity issues, the primary constraints on current retail sales activity remain intense, structural-liquidity woes besetting the consumer. Without real growth in income, and without the ability and/or willingness to offset declining purchasing power with debt expansion, the consumer lacks the ability to fuel traditional, consumption-based growth or recovery in U.S. economic activity, including retail sales, real or nominal. 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—October 2015. In the context of a downside revision to previously-reported September and August activity, and an upside revision to October 2014, October 2015 sales rose by a headline 0.1%, at the first decimal point. At the second decimal point, headline October retail sales showed a statistically-insignificant, seasonally-adjusted gain of 0.05%. Net of prior-period revisions, nominal October retail sales declined by 0.10% (-0.10%) month-to-month.

Such followed a statistically-insignificant, revised monthly contraction of 0.02% (-0.02%) in September, and a revised monthly gain of 0.01% in August. Headline October retail sales effectively were unchanged from July's reporting.

Year-to-Year Annual Change. Year-to-year nominal change in October 2015 retail sales was a statistically-significant increase of 1.69%, versus a downwardly revised 2.20% annual gain in September 2015, and a revised 2.02% annual gain in August 2015.

Annualized Quarterly Changes. With the October headline reporting, the pace of annualized contraction in nominal first-quarter 2015 retail sales deepened to 4.23% (-4.23%), the worst quarter-to-quarter showing since the economic collapse, with annualized second-quarter 2015 retail sales growth unrevised at 6.81%, and annualized third-quarter 2015 growth at a downwardly revised 4.57%. Based solely on October's reporting, annualized fourth-quarter 2015 growth is on track for a nominal gain of 0.15%.

Net of inflation, the annualized pace of contraction in first-quarter 2015 real retail sales deepened to 1.21% (-1.21%), while the quarterly change in second-quarter real retail sales held at an unrevised gain of 3.72%. Third-quarter detail revised lower to a 2.94% annualized gain. The initial fourth-quarter trend will be assessed in the CPI-U *Commentary*, where headline, real quarterly growth could turn negative (see *Week Ahead*). Adjusted for realistic inflation (see *Commentary No. 759* 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.

October 2015 Real (Inflation-Adjusted) Retail Sales. The nominal gain of 0.05% in October 2015 retail sales was before accounting for inflation. The change in real retail sales for October will be published along with the headline estimate of consumer inflation for October 2015 in *Commentary No. 767* of Tuesday, November 17th. Barring a negative surprise to what likely will be a positive upside move in the October CPI-U, the headline monthly change in real October retail sales likely will be a headline contraction, with annual real retail sales growth generating a sharply intensified signal of imminent recession (see *Week Ahead* section).

Consumer Liquidity Conditions Continue to Thwart Sustainable Economic Growth and Systemic Stability. Updating the detailed review of consumer liquidity circumstances in *Commentary No. 758*, as well as consumer conditions otherwise discussed regularly in these *Commentaries*, structural liquidity woes continue to constrain economic activity, 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 broad, 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 both nominal and 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.

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. 763*).

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

Shown first, though, in *Graph 1*, is the latest monthly real median household income detail through September 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. Generally, the income series had been in low-level stagnation, with the recent uptrend boosted by dropping gasoline prices.

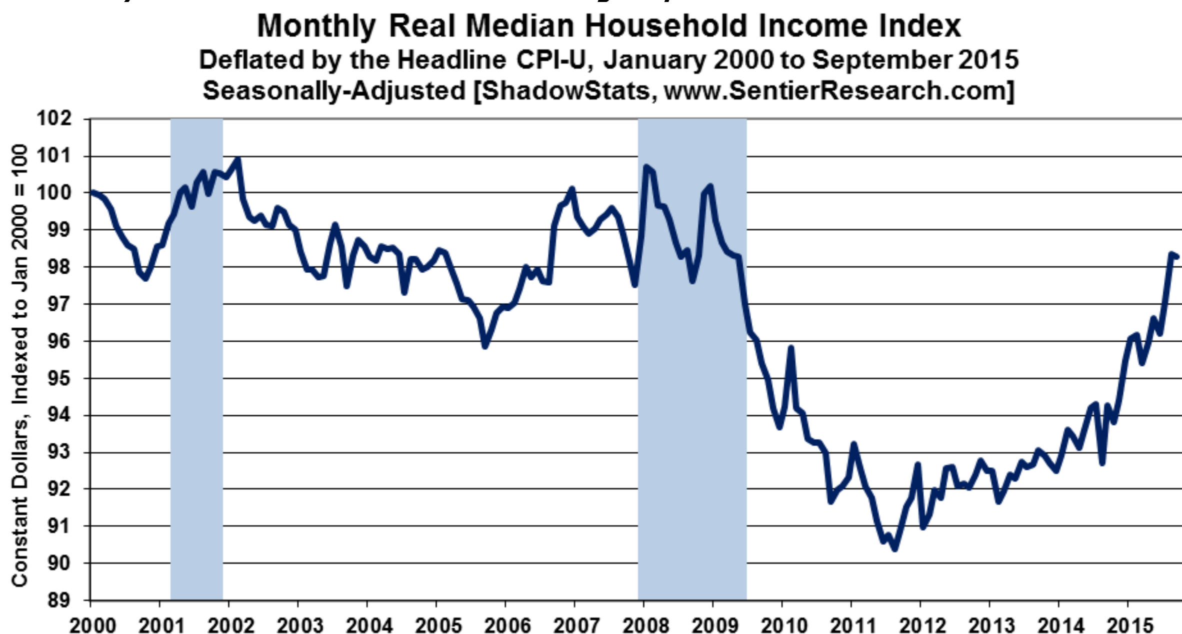
In the monthly detail, real median monthly household income gained, driven largely by collapsing gasoline prices and CPI-U inflation, but that process reversed itself somewhat in September. Where negative inflation boosts the level of real growth relative to nominal growth, much of the recent relative "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. 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.

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 had recovered the lowest level seen during the formal recession, before backing off in September, but it remains below the pre-recession highs for both the formal 2007 and 2001 recessions.

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 September 2015



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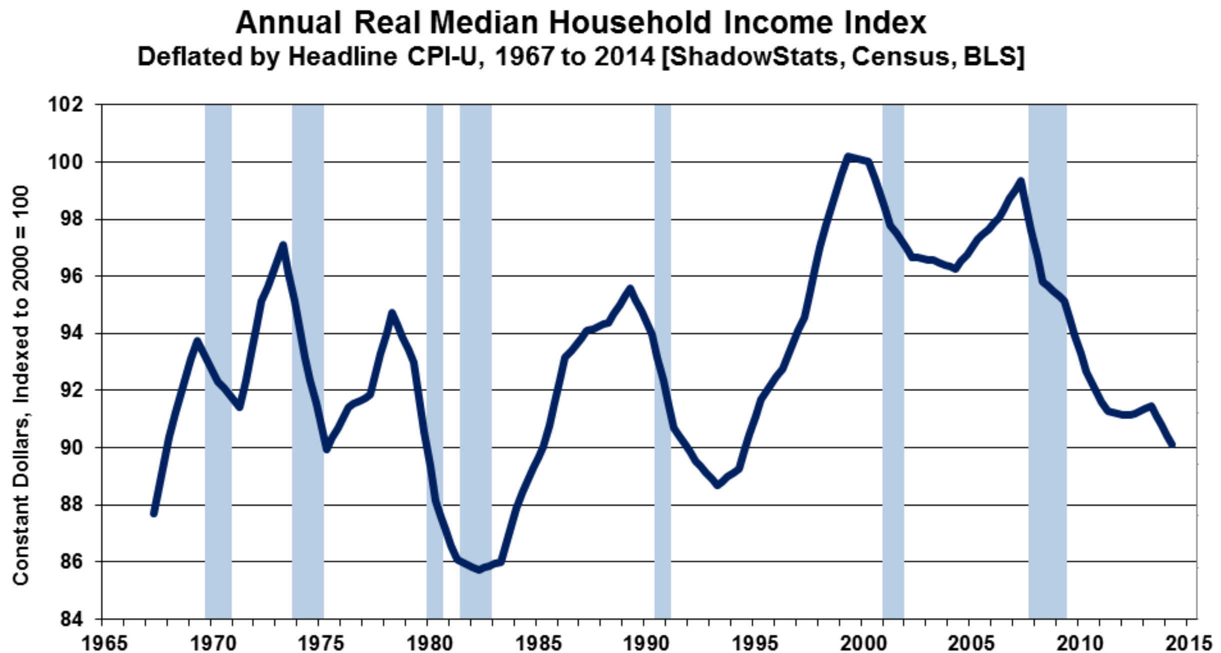
Graph 2: Annual Real Median U.S. Household Income through 2014



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*).

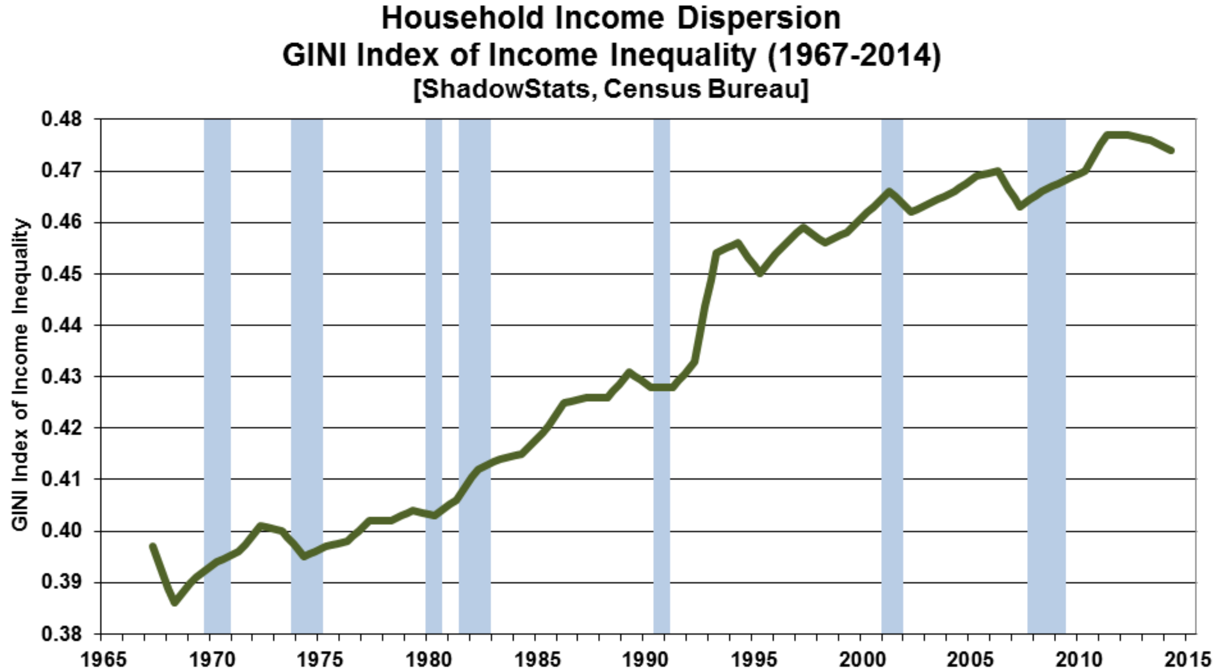
Such also broadly is consistent with real average weekly earnings, as reported by the Bureau of Labor Statistics (*Commentary No. 759*). That be updated through October 2015 in the *Commentary No 767*.

Income Variance. Estimates of income dispersion, or inequality, are shown through 2014 (again, the latest detail available) 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.

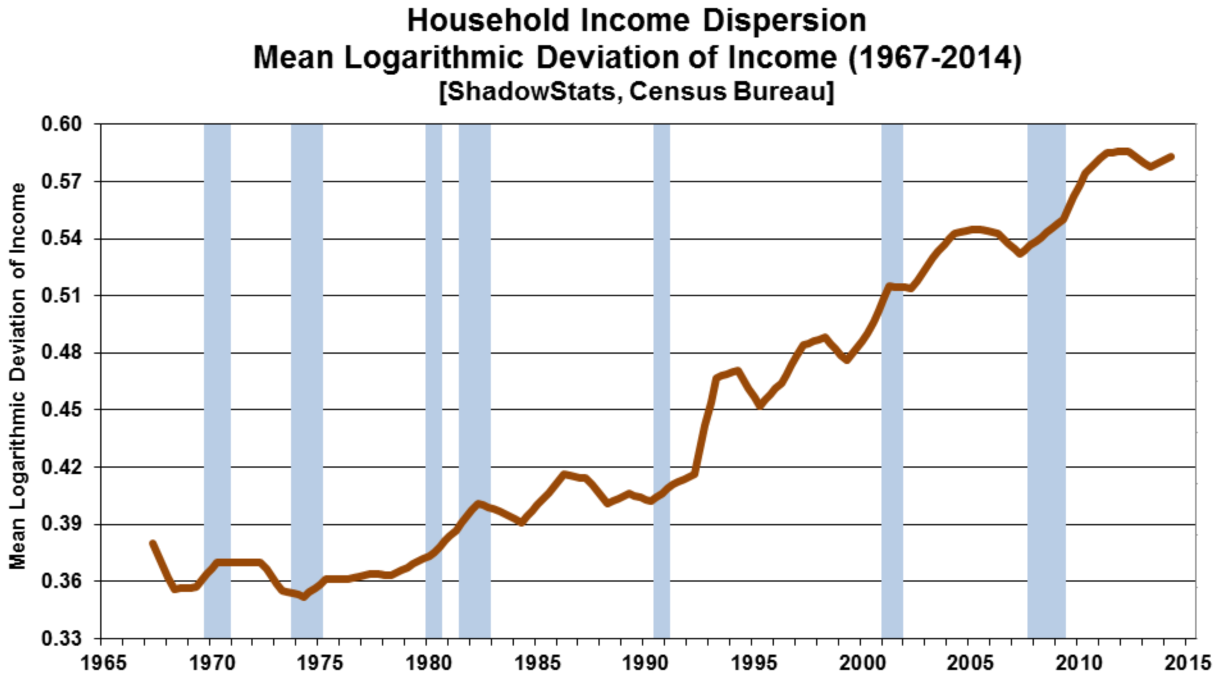
Rising and near-record income dispersion levels usually foreshadow economic and financial-market turmoil. Despite—or perhaps due to—the ongoing nature of the economic and systemic-solvency crises,

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 October reading for the Conference Board's Consumer-Confidence measure and the early-November reading for 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 September consumer credit outstanding (*Graph 9*).

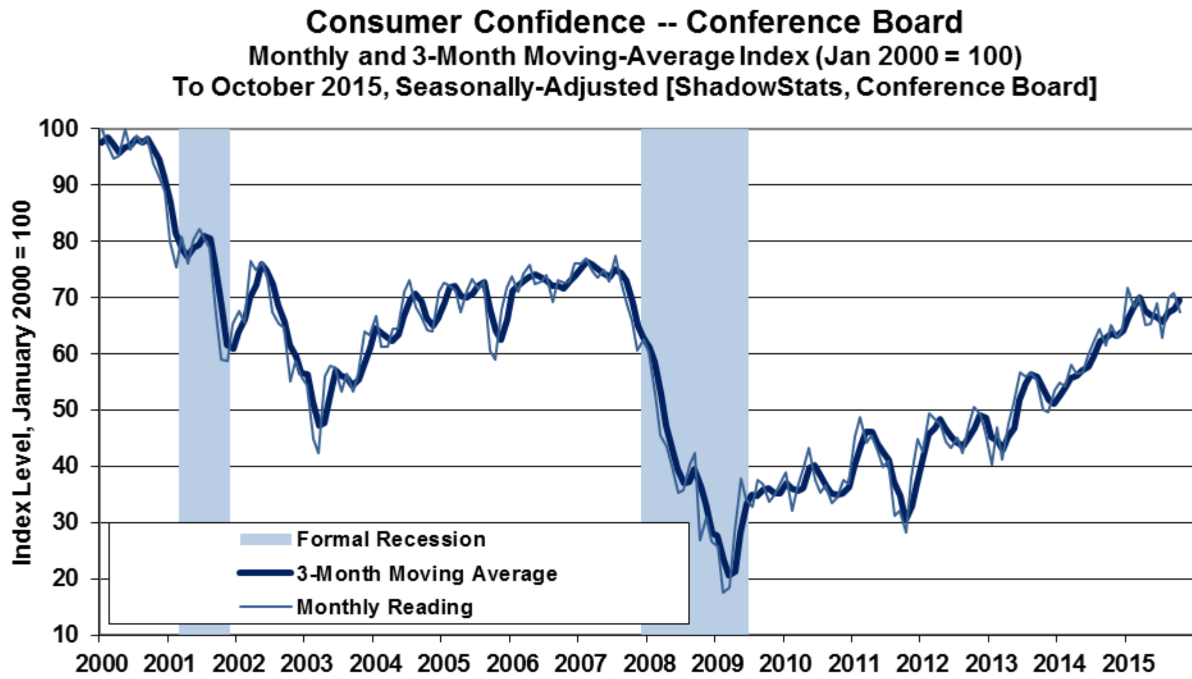
For purposes of showing the Consumer Confidence and Consumer Sentiment measures on a comparable basis, *Graphs 5* to *7* reflect both measures re-indexed to January 2000 = 100 for the monthly reading. Standardly reported, the Conference Board's Consumer Confidence Index is set with 1985 = 100, while the University of Michigan's Consumer Sentiment Index is set with January 1966 = 100.

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 October 2015 moved in opposite directions, with confidence down sharply and sentiment up for the month. Sentiment had fallen sharply in September, reflecting market turmoil, but confidence had rallied in September. The early-November reading for Sentiment (as released today, November 13th) rallied anew, regaining August's level.

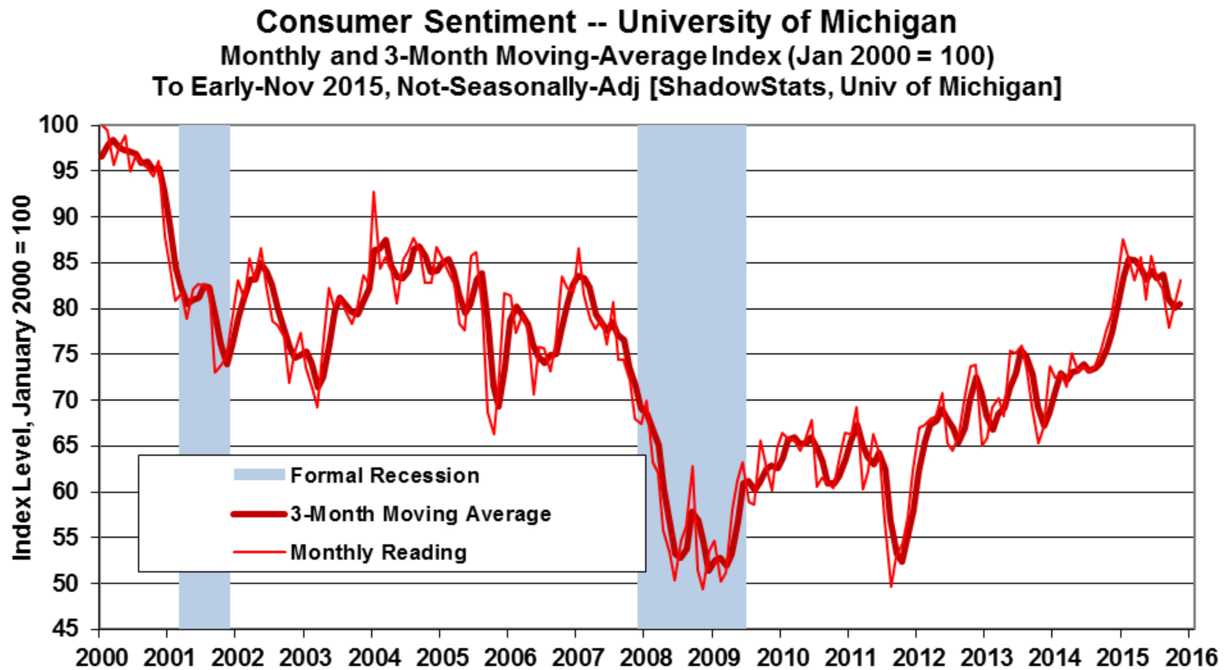
Both series continued to move lower or to hold off near-term peaks, though, smoothed for their three-month and six-month moving-average readings. The Confidence and Sentiment series tend to mimic the tone of headline economic reporting in the press (see discussion in *Commentary No. 764*), and often are highly volatile month-to-month, as a result. With increasingly-negative, headline financial and economic reporting and circumstances at hand and ahead, successive negative hits to both the confidence and sentiment readings remain highly likely in the months ahead.

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 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.

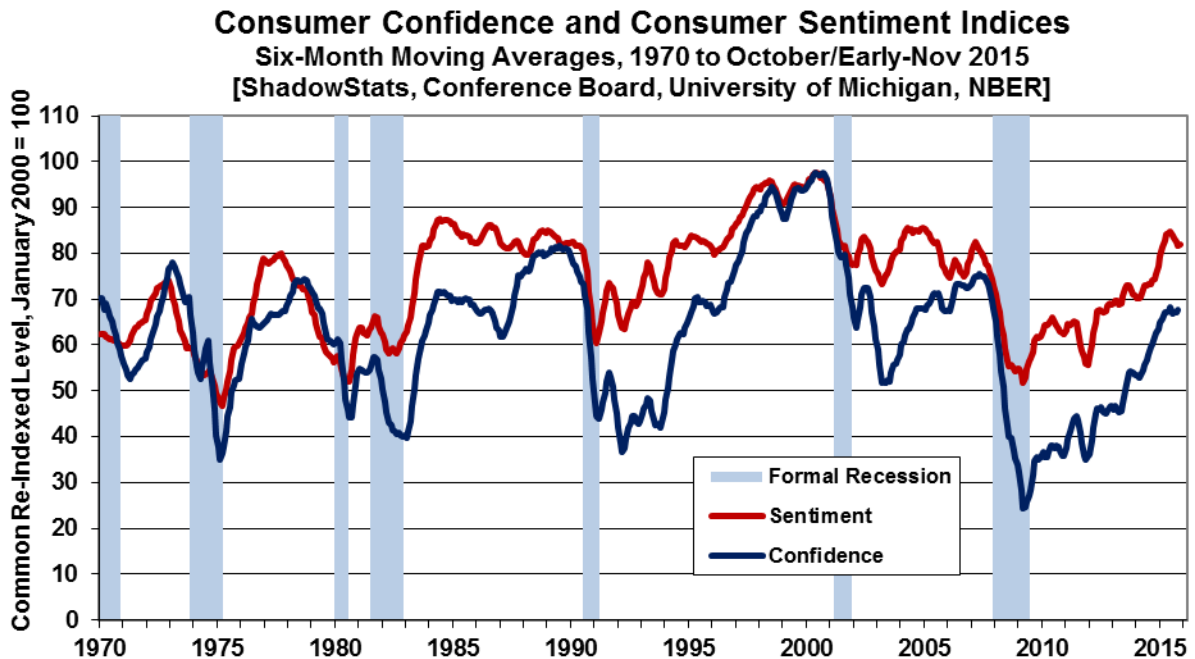
Graph 5: Consumer Confidence to October 2015



Graph 6: Consumer Sentiment to Early-November 2015



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



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*.

Through September 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 recovered since the onset of the recession. These disaggregated data are available and plotted only on a not-seasonally-adjusted basis, and the August and September 2015 levels reflect some seasonal strength in loan activity tied to the beginning of the school year.

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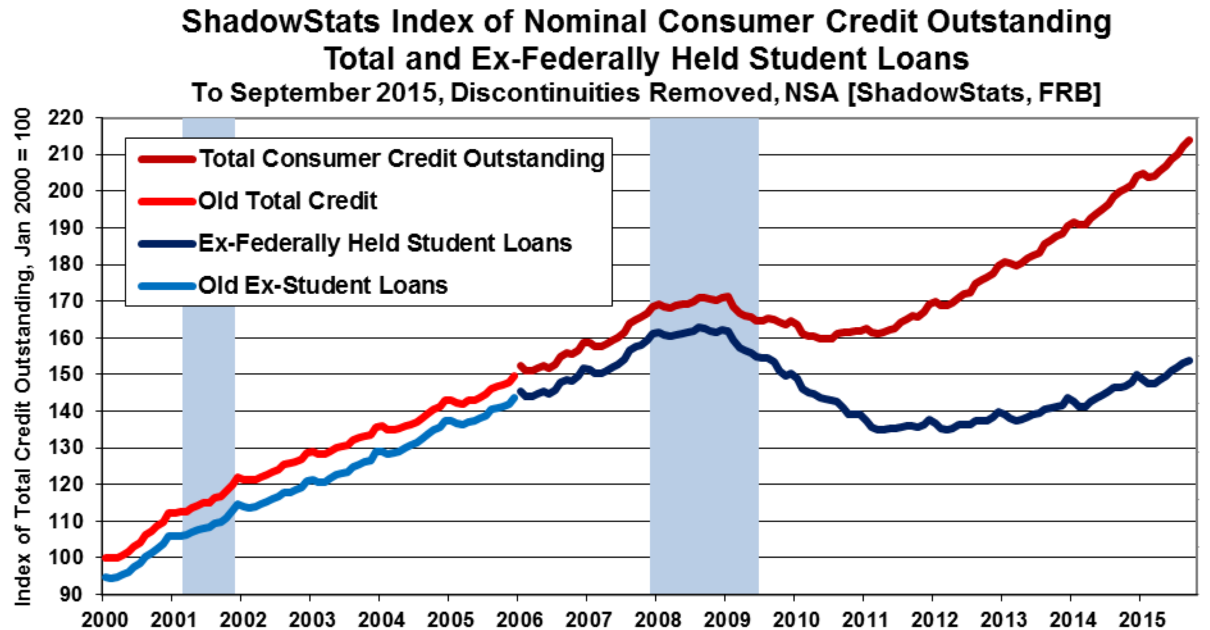
Graph 8: Household Sector, Real Credit Market Debt Outstanding

Graph 9: Nominal Consumer Credit Outstanding through September 2015



Producer Price Index (PPI)—October 2015—Wholesale Inflation Fell 0.36% (-0.36%), Depressed by Strong Energy Prices Perversely Pummeling Trade Services Inflation. The headline contraction of 0.36% (-0.36%) in October 2015 PPI Final Demand inflation reflected a drop of 0.37% (-0.37%) in monthly Final Demand Goods inflation, plus a decline of 0.27% (-0.27%) in the dominant Final Demand

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Services inflation sector and a minimally-weighted offsetting gain of 0.97% in Final Demand Construction inflation. Despite the usual distorted, headline detail out of the services sector, strings of headline monthly declines in prices indices for both the construction sector, and durable goods manufacturing sector, reversed in October, suggestive of less-positive or more-negative growth rates in upcoming reporting of real construction spending and in real new orders for durable goods.

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. Two months ago, 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. Last month, headline monthly reporting for May 2015 PPI inflation revised higher by 0.2%, now up by 0.6%, having been up previously by 0.4%. This month, headline monthly reporting for June 2015 PPI inflation also revised higher by 0.2%, now up by 0.4%, having been up previously by 0.2%.

In the realm of reporting methodology outside of common experience, according to the BLS, 70% of the dominant 0.3% (-0.3%) decline in the October 2015 services sector was tied to "Trade Services," where over half that decline was due to a decline in margins for fuels and lubricants of 15.8% (-15.8%). The decline in margins was due to rising oil-related costs in prices with a lag in costs being passed on to the next level of consumption. Seasonally-adjusted gasoline prices rose by 3.8% in the month, while unadjusted crude petroleum product rose by 8.2% in the month.

Discussed in *Inflation that Is More Theoretical than Real World?* (see the *Reporting Detail* section), such conditions usually signal and lead to higher prices at both wholesale and retail levels and the concept is misleading in its nature as a purported inflation measure, when such activity in margins signals deflation. 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, as seen in the headline October detail.

October 2015 Headline PPI Detail. The seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for October 2015 declined by 0.36% (-0.36%), versus an unrevised contraction of 0.54% (-0.54%) in September, an unrevised "unchanged" at 0.00% reading in August, and a revised "unchanged" at 0.00% reading in July.

The broad impact of seasonal adjustments on the headline PPI reporting largely was negative in October, with the unadjusted monthly October index down by 0.27% (-0.27%).

On a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year PPI Final Demand inflation contracted by 1.62% (-1.62%) in October 2015, versus unrevised declines of 1.08% (-1.08%) in September 2015, 0.81% (-0.81%) in August 2915, 0.81% (-0.81%) in July 2015 and a revised annual decline of 0.54% (-0.54%) in June 2015.

For the three major subcategories of October 2015 Final Demand PPI, headline monthly Goods inflation fell by 0.37% (-0.37%), Services inflation fell by 0.27% (-0.27%), and Construction inflation rose by 0.97% for the month.

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 0.37% (-0.37%) in October 2015, versus a decline of 1.18% (-1.18%) in September 2015. There was positive impact on the aggregate headline October reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, October Final Demand Goods inflation fell by 0.55% (-0.55%) for the month.

Unadjusted, year-to-year goods inflation was down by 4.84% (-4.84%) in October 2015, versus an annual contraction of 5.15% (-5.15%) in September 2015.

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

- "Foods" inflation dropped month-to-month by 0.76% (-0.76%) in October 2015, following a headline decline of 0.84% (-0.84%) in September, with October's headline decline narrowed by seasonal adjustments. Unadjusted, October foods inflation fell by 1.18% (-1.18%) in the month. Unadjusted and year-to-year, October 2015 foods inflation dropped by 4.25% (-4.25%), versus a decline of 2.95% (-2.95%) in September 2015.
- "Energy" inflation was "unchanged" at 0.00% in October 2015, following a headline decline of 5.93% (-5.93%) in September 2015, with the October 0.00% boosted by seasonal adjustments. Unadjusted, monthly October energy inflation fell by 3.10% (-3.10%). Unadjusted and year-to-year, the annual contraction in energy prices narrowed to 21.49% (-21.49%) in October 2015, from an annual decline of 23.70% (-23.70%) in September 2015.
- "Less foods and energy" ("Core" goods) monthly inflation fell by 0.27% (-0.27%) in October 2015, versus "unchanged" at 0.00% in September. Seasonal adjustments were negative for monthly core inflation, with an unadjusted gain of 0.18% in October. Unadjusted and year-to-year, October 2015 core inflation showed a contraction of 0.09% (-0.09%), versus an annual gain of 0.18% in September 2015.

Final Demand Services (Weighted at 63.31% of the Aggregate). Headline monthly Final Demand Services inflation fell by 0.27% (-0.27%) in October 2015, versus a 0.36% (-0.36%) drop in September. The overall seasonal-adjustment impact on headline October services inflation was negative, with an unadjusted monthly October decline of 0.09% (-0.09%). Year-to-year, unadjusted October 2015 services inflation was 0.09%, versus an annual gain of 1.01% in September 2015.

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

- "Services less trade, transportation and warehousing" inflation, or the "Other" category, showed negative monthly inflation of 0.09% (-0.09%) in October 2015, versus a drop of 0.27% (-0.27%) in September. Seasonal-adjustment impact on the adjusted October detail was neutral, where the unadjusted monthly change also was a decline of 0.09% (-0.09%). Unadjusted and year-to-year, October 2015 "other" services inflation was 0.83%, versus an annual gain of 1.02% in September 2015.

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- “Transportation and warehousing” inflation rose month-to-month by 0.09%, having been down by 0.70% (-0.70%) in September 2015. Seasonal adjustments had negative impact on the headline October number, where the unadjusted monthly October reading showed a gain of 0.44%. Unadjusted and year-to-year, October 2015 transportation inflation fell by 2.90% (-2.90%), versus an annual contraction 3.32% (-3.32%) in September 2015.
- “Trade” inflation fell by 0.71% (-0.71%) month-to-month in October 2015, having declined by 0.36% (-0.36%) in September. Seasonal adjustments had a negative impact here, where unadjusted monthly inflation fell by 0.27% (-0.27%) in October. Unadjusted and year-to-year, October 2015 trade inflation fell by 0.71% (-0.71%), having increased by 2.09% in September 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 gained 0.97% in October 2015, having been “unchanged” at 0.00% in September. The impact of seasonal factors on the October reading was neutral. On an unadjusted basis, month-to-month October 2015 construction inflation also was a gain of 0.97%.

On an unadjusted basis, year-to-year construction inflation rose to 2.33% in October 2015, from 1.80% in September 2015.

- “Construction for private capital investment” headline monthly inflation in October 2015 was a gain of 0.98%, following “unchanged” at 0.00% in September. As usual, seasonal adjustments also had neutral impact here, where the unadjusted monthly inflation was 0.98% in October. Unadjusted and year-to-year, October 2015 private construction inflation was 2.25%, up versus 1.81% in September 2015.

- “Construction for government” inflation rose month-to-month by 0.97% in October 2015, having declined month-to-month by 0.09% (-0.09%) in September. Seasonal adjustments had positive impact, where unadjusted monthly October inflation was up by 0.88%. Unadjusted and year-to-year, October 2015 government construction inflation was 2.15%, versus 1.80% in September 2015.

[The* Reporting Detail *section includes expanded material on October nominal Retail Sales and the Producer Price Index.]

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HYPERINFLATION WATCH

HYPERINFLATION OUTLOOK SUMMARY (of November 4, 2015)

U.S. Dollar Is Living on Borrowed Time. Other than for internal links and minor language corrections, this *Summary* last was updated on November 4th, covering recent developments with the Federal Reserve, with domestic political and fiscal conditions and with evolving economic conditions. There has been no fundamental shift in the broad outlook, just some general movement forward in variety of related areas. With future updates, new comments will be concentrated in the *Recent Developments* section. The prior *Hyperinflation Outlook Summary* is available in *Commentary No. 762*.

Recent Developments. Discussed in *Commentary No. 763* of October 29th and *Commentary No. 764* of November 4th, where initial third-quarter GDP growth came in at 1.5%, slowing sharply from second-quarter activity of 3.9%, downside revisions now loom for the third-quarter number. In the context of an ongoing contraction in underlying economic reality, as seen for example with corporate revenues and industrial production, headline third-quarter GDP reporting likely will slow much further in its pending monthly revisions, accelerating the pace of broad market recognition of a "new" recession.

A widening trade deficit and slowing economic activity have significant negative implications, ranging from selling pressure on the U.S. dollar, to unexpected and additional widening of the federal budget deficit and U.S. Treasury funding needs, to increased political volatility in what already is shaping up as an extraordinarily-significant presidential election year.

When Main Street U.S.A. suffers enough financial and other pain, the common reaction, historically, has been to dump those running the system. That pain threshold was crossed some time ago, and the year ahead assuredly will not be a happy one for many incumbents or for those who are counting on politics as usual.

That said, a heavily politics-as-usual new budget deal was just forced into place. With promised higher deficit spending, and with no debt limit to contain continuing excesses until after the election, who is going to fund the expanded spending ahead? Who is going to buy the proffered U.S. Treasury securities? Recent big buyers such as China, Japan and the Federal Reserve either are selling for a variety of reasons or otherwise are sitting on their hands.

The U.S. Dollar is living on borrowed time, and the confluence of the factors raised here remains likely to push the U.S. dollar into a heavy sell-off.

Discussed in *Commentary No. 763* and *Commentary No. 765*, the weak economy continues as political cover for the Federal Reserve and for continued FOMC inaction, masking serious other problems in the domestic and global financial systems. One likely major concern has to be for continued stability and liquidity of the market for U.S. Treasury securities. Beyond domestic and global banks, the biggest beneficiary of QE3 was the U.S. Treasury.

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As previously noted, if the FOMC were to keep holding back on its rate increase until after the economy improved, the wait for a rate hike would be quite protracted. From a practical standpoint, meaningful FOMC action still appears to be on hold until after the 2016 presidential election. In the event of any funding issues for the Treasury, however, flailing domestic economic activity still will be able to provide cover for expanded quantitative easing, and for the Fed resuming its role as buyer of last resort of an increasingly unwanted supply of U.S. Treasury securities.

Of such circumstances are currency crises created.

Nothing has changed here, including the ShadowStats broad outlook for ongoing economic stagnation and downturn, intensifying systemic instabilities and a looming massive decline in the U.S. dollar. Along with the pending dollar crisis are the ongoing implications ultimately for severe inflation, for a domestic hyperinflation.

Background Documents to this Summary. Underlying this *Summary* as general background 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 weekly *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 continues to face a massive decline in the wake of the 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, including possible Treasury-funding issues, likely are behind the 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.

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, not as stimuli for the economy. Instead, the weak economy regularly was used as political cover for the effective banking-system bailouts (see for example, the *Monetary Conditions* section in *Commentary No. 765*).

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*.

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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 and September, there was some temporary easing of the dollar's strength in October (see *Commentary No. 759*). 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 once again, 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), or now by the end of the year. Coincident, with these events, ongoing and 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. 763*), 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. Again, 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.

Continued inaction by the FOMC is 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 or other systemic-liquidity 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. 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 for, 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.

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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 *Commentary No. 764*). Sharply-negative economic reporting shocks, versus softening consensus forecasts, 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, with the White House and Congress recently having placed any official solvency concerns on hold until after the November 2016 election. What remains to be seen is for how long the concerns of the global financial markets will remain on hold.

- ***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

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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.

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REPORTING DETAIL

NOMINAL RETAIL SALES (October 2015)

October's $447,255 Million in Retail Sales Was Within $1 Million of Being "Unchanged" for the Month. Headline nominal retail sales, before inflation adjustment, were weak in October, and annual growth slowed sharply. Further, real retail sales, after inflation adjustment, most likely contracted for the month, net of a probable hike in headline inflation. Based solely on the initial October reporting, real retail sales also appear headed into a fourth-quarter 2015 decline.

Nominal October retail sales could be considered flat-to-minus for the month, despite the headline 0.1% gain. At the second decimal point, headline nominal October sales rose by 0.05%, a change that would have rounded to 0.0% at the first decimal point, had guesstimated monthly sales been just $1 million less. Net of revisions to September (now in a small contraction), October's headline change would have been a monthly decline of 0.10% (-0.10%).

Assuring an intensified signal of imminent recession, again, once October inflation detail is in place, year-to-year change in nominal retail sales narrowed to 1.69% in October 2015 versus a downwardly revised annual gain of 2.20% [previously 2.36%] in September 2015. Part of the narrowing in October growth was due to an upside revision of 0.15% in October 2014 sales, which had the effect of distorting and boosting the headline October 2015 monthly gain, with implied changes to seasonal adjustments. Without the inconsistent shifting in seasonals, the October 2015 headline change would have been a monthly contraction of 0.1% (-0.1%) instead of the 0.1% gain (see explanation in *Seasonal-Factor Distortions and Other Reporting Instabilities*).

***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—October 2015*.** In the context of a downside revision to previously-reported September and August activity, and an upside revision to October 2014, October 2015 sales rose by a headline 0.1%, at the first decimal point, as reported by the Census Bureau this morning (November 13th). At the second decimal point, October 2015 retail sales showed a statistically-insignificant, seasonally-adjusted gain of 0.05% +/- 0.58% (this and all other confidence

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intervals are expressed at the 95% level). Net of prior-period revisions, nominal October retail sales declined by 0.10% (-0.10%) month-to-month.

Such followed a statistically-insignificant, revised monthly contraction of 0.02% (-0.02%) +/- 0.24% [previously up by 0.10%] in September, and a revised monthly gain of 0.01% [previously up by 0.03%, initially up by 0.19%] in August. Headline October retail sales effectively were unchanged from July's reporting.

Year-to-Year Annual Change. Year-to-year nominal change in October 2015 retail sales was a statistically-significant increase of 1.69% +/- 1.53%, versus a downwardly revised 2.20% [previously 2.36%] annual gain in September 2015, and a revised 2.02% [previously 2.04%, initially 2.16%] annual gain in August 2015.

Annualized Quarterly Changes. With October headline reporting, the pace of annualized nominal retail sales decline in first-quarter 2015 deepened to 4.23% (-4.23%) [previously at 4.04% (-4.04%)], the worst quarter-to-quarter showing since the economic collapse, with annualized second-quarter 2015 retail sales growth unrevised at 6.81%, and annualized third-quarter 2015 growth at a revised 4.57% [previously 4.80%]. Based solely on October's reporting, annualized fourth-quarter 2015 growth is on track for a nominal gain of 0.15%.

Net of inflation, the annualized pace of contraction in first-quarter 2015 real retail sales deepened to 1.21% (-1.21%) [previously down by 1.02% (-1.02%)]. The quarterly change in second-quarter real retail sales held at an unrevised gain of 3.72%. Third-quarter detail revised to 2.94% [previously 3.17%] annualized gain. The initial fourth-quarter trend will be assessed in the CPI-U *Commentary*, where headline, real quarterly growth could turn negative (see *Week Ahead*). Adjusted for realistic inflation (see *Commentary No. 759* 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.

October Core Retail Sales—Core Sales Growth. Reflecting an environment that still should be seeing rising food prices and a seasonally-adjusted gain in gasoline prices, although there was an unadjusted monthly decline of 3.05% (-3.05%) in gasoline prices [Department of Energy], seasonally-adjusted monthly grocery-store sales were down by 0.08% (-0.08%) in October 2015, with gasoline-station sales down by 0.87% (-0.87%) for the month.

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

Version I: October 2015 versus September 2015 seasonally-adjusted retail sales series—net of total grocery store and gasoline station sales—reflected a monthly gain of 0.16%, versus the official headline aggregate sales increase of 0.05%.

Version II: October 2015 versus September 2015 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—reflected a monthly gain of 0.13%, versus the official headline aggregate sales increase of 0.05%.

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Real (Inflation-Adjusted) Retail Sales—October 2015. The nominal gain of 0.05% in October 2015 retail sales was before accounting for inflation. The change in real retail sales for October will be published along with the headline estimate of consumer inflation for October 2015 in *Commentary No. 767* of Tuesday, November 17th. Barring a negative surprise to what likely will be a positive upside move in the October CPI-U, the headline monthly change in real October retail sales likely will be a headline contraction, with annual real retail sales growth generating a sharply intensified signal of imminent recession (see *Week Ahead* section).

Seasonal-Factor Distortions and Other Reporting Instabilities. The usual seasonal-factor distortions were at play, again, in the October 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 September 2014 and October 2014 were revised, along with the publication of the October 2015 data and revised detail on August 2015 and September 2015. 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 October 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 September and October 2014 and for August and September 2015 were published on a basis consistent with the October 2015 number.

Specifically, the level of September 2014 revised higher by 0.01%, having revised lower last month by 0.01% (-0.01%). October 2014, however, revised higher by 0.15%, suggestive of positive shift October 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.

As in reporting of the prior year, and again in the headline October 2015 data, the year-ago number most commonly 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. Instead of October 2015 sales being up by 0.05%, they would have been down by about 1.0% (-1.0%), but for the inconsistent seasonal shifts in the published historical data. 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.

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PRODUCER PRICE INDEX—PPI (October 2015)

October PPI Fell 0.36% (-0.36%), Depressed by Strong Energy Prices Perversely Pummeling Trade Services Inflation. The headline contraction of 0.36% (-0.36%) in October 2015 PPI Final Demand inflation reflected a drop of 0.37% (-0.37%) in monthly Final Demand Goods inflation, plus a decline of 0.27% (-0.27%) in the dominant Final Demand Services inflation sector and a minimally-weighted offsetting gain of 0.97% in Final Demand Construction inflation. Despite the usual distorted, headline detail out of the services sector, strings of headline monthly declines in prices indices for both the construction sector, and durable goods manufacturing sector, reversed in October, suggestive of less-positive or more-negative growth rates in upcoming reporting of real construction spending and in real new orders for durable goods.

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. Two months back, 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. Last month, headline monthly reporting for May 2015 PPI inflation revised higher by 0.2%, now up by 0.6%, having been up previously by 0.4%. This month, headline monthly reporting for June 2015 PPI inflation also revised higher by 0.2%, now up by 0.4%, having been up previously by 0.2%.

In the realm of reporting methodology outside of common experience, according to the BLS, 70% of the dominant 0.3% (-0.3%) decline in the October 2015 services sector was tied to “Trade Services,” where over half that decline was due to a decline in margins for fuels and lubricants of 15.8% (-15.8%). The decline in margins was due to rising oil-related costs in prices with a lag in costs being passed on to the next level of consumption. Seasonally-adjusted gasoline prices rose by 3.8% in the month, while unadjusted crude petroleum product rose by 8.2% in the month.

As discussed in *Inflation that Is More Theoretical than Real World?*, such conditions usually signal and lead to higher prices at both wholesale and retail levels and the concept used is misleading in its nature as a purported inflation measure, when such activity in margins signals deflation. 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.

October 2015 Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported this morning, November 13th, that the seasonally-adjusted, month-to-month, headline Producer Price Index (PPI) Final Demand inflation for October 2015 declined by 0.36% (-0.36%), versus an unrevised contraction of 0.54% (-0.54%) in September, an unrevised "unchanged" at 0.00% reading in August, and a revised "unchanged" at 0.00% reading [previously a gain of 0.18%] in July.

The broad impact of seasonal adjustments on the headline PPI reporting largely was negative in October, with the unadjusted monthly October index down by 0.27% (-0.27%).

On a not-seasonally-adjusted basis—all annual growth rates are expressed unadjusted—year-to-year PPI Final Demand inflation contracted by 1.62% (-1.62%) in October 2015, versus unrevised declines of 1.08% (-1.08%) in September 2015, 0.81% (-0.81%) in August 2915, 0.81% (-0.81%) in July 2015 and a revised annual decline of 0.54% (-0.54%) [previously down by 0.72% (-0.72%)] in June 2015.

For the three major subcategories of October 2015 Final Demand PPI, headline monthly Goods inflation fell by 0.37% (-0.37%), Services inflation fell by 0.27% (-0.27%), and Construction inflation rose by 0.97% for the month.

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 0.37% (-0.37%) in October 2015, versus a decline of 1.18% (-1.18%) in September 2015. There was positive impact on the aggregate headline October reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, October Final Demand Goods inflation fell by 0.55% (-0.55%) for the month.

Unadjusted, year-to-year goods inflation was down by 4.84% (-4.84%) in October 2015, versus an annual contraction of 5.15% (-5.15%) in September 2015.

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

- "Foods" inflation dropped month-to-month by 0.76% (-0.76%) in October 2015, following a headline decline of 0.84% (-0.84%) in September, with October's headline decline narrowed by seasonal adjustments. Unadjusted, October foods inflation fell by 1.18% (-1.18%) in the month. Unadjusted and year-to-year, October 2015 foods inflation dropped by 4.25% (-4.25%), versus a decline of 2.95% (-2.95%) in September 2015.

- "Energy" inflation was "unchanged" at 0.00% in October 2015, following a headline decline of 5.93% (-5.93%) in September 2015, with the October 0.00% boosted by seasonal adjustments. Unadjusted, monthly October energy inflation fell by 3.10% (-3.10%). Unadjusted and year-to-year, the annual contraction in energy prices narrowed to 21.49% (-21.49%) in October 2015, from an annual decline of 23.70% (-23.70%) in September 2015.
- "Less foods and energy" ("Core" goods) monthly inflation fell by 0.27% (-0.27%) in October 2015, versus "unchanged" at 0.00% in September. Seasonal adjustments were negative for monthly core inflation, with an unadjusted gain of 0.18% in October. Unadjusted and year-to-year, October 2015 core inflation showed a contraction of 0.09% (-0.09%), versus an annual gain of 0.18% in September 2015.

Final Demand Services (Weighted at 63.31% of the Aggregate). Headline monthly Final Demand Services inflation fell by 0.27% (-0.27%) in October 2015, versus a 0.36% (-0.36%) drop in September. The overall seasonal-adjustment impact on headline October services inflation was negative, with an unadjusted monthly October decline of 0.09% (-0.09%). Year-to-year, unadjusted October 2015 services inflation was 0.09%, versus an annual gain of 1.01% in September 2015.

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

- "Services less trade, transportation and warehousing" inflation, or the "Other" category, showed negative monthly inflation of 0.09% (-0.09%) in October 2015, versus a drop of 0.27% (-0.27%) in September. Seasonal-adjustment impact on the adjusted October detail was neutral, where the unadjusted monthly change also was a decline of 0.09% (-0.09%). Unadjusted and year-to-year, October 2015 "other" services inflation was 0.83%, versus an annual gain of 1.02% in September 2015.
- "Transportation and warehousing" inflation rose month-to-month by 0.09%, having been down by 0.70% (-0.70%) in September 2015. Seasonal adjustments had negative impact on the headline October number, where the unadjusted monthly October reading showed a gain of 0.44%. Unadjusted and year-to-year, October 2015 transportation inflation fell by 2.90% (-2.90%), versus an annual contraction 3.32% (-3.32%) in September 2015.
- "Trade" inflation fell by 0.71% (-0.71%) month-to-month in October 2015, having declined by 0.36% (-0.36%) in September. Seasonal adjustments had a negative impact here, where unadjusted monthly inflation fell by 0.27% (-0.27%) in October. Unadjusted and year-to-year, October 2015 trade inflation fell by 0.71% (-0.71%), having increased by 2.09% in September 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 gained 0.97% in October 2015, having been "unchanged" at 0.00% in September. The impact of seasonal factors on the October reading was neutral. On an unadjusted basis, month-to-month October 2015 construction inflation also was a gain of 0.97%.

On an unadjusted basis, year-to-year construction inflation rose to 2.33% in October 2015, from 1.80% in September 2015.

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- "Construction for private capital investment" headline monthly inflation in October 2015 was a gain of 0.98%, following "unchanged" at 0.00% in September. As usual, seasonal adjustments also had neutral impact here, where the unadjusted monthly inflation was 0.98% in October. Unadjusted and year-to-year, October 2015 private construction inflation was 2.25%, up versus 1.81% in September 2015.

- "Construction for government" inflation rose month-to-month by 0.97% in October 2015, having declined month-to-month by 0.09% (-0.09%) in September. Seasonal adjustments had positive impact, where unadjusted monthly October inflation was up by 0.88%. Unadjusted and year-to-year, October 2015 government construction inflation was 2.15%, versus 1.80% in September 2015.

Discussed in *Commentary No. 764*, ShadowStats uses the Final Demand Construction index for deflating headline activity in the monthly construction-spending series. The December 1st release of October 2015 U.S. Construction Spending will be covered in ShadowStats *Commentary No. 771* of December 4th.

PPI-Inflation Impact on Pending Reporting of New Orders for Durable Goods. As to the upcoming reporting of October 2015 new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods increased for the first time nine months, up by 0.12%, having declined by 0.06% (-0.06%) in September. Annual inflation continued to decline, however, down by 0.78% (-0.78%) in October 2015, versus a decline of 0.48% (-0.48%) in September 2015. October 2015 durable goods orders will be reported on November 25th and covered in ShadowStats *Commentary No. 770* 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, general trend to the downside, amidst mixed reporting in headline data, market expectations for business activity nonetheless can gyrate some with the latest economic hype in the popular media. That general effect holds the consensus outlook still at overly-optimistic levels, with current expectations still exceeding any potential, underlying economic reality. Where the net trend still has been towards weakening expectations, movement towards recession recognition has been at something of an accelerating pace.

Headline reporting of the regular monthly economic numbers increasingly should turn lower in the weeks and months ahead, along with likely downside revisions and otherwise much weaker-than-expected

reporting for at least the next several quarters of GDP (and GDI and GNP) into 2016, including the November 24th first revision to the "advance" third-quarter 2015 GDP estimate.

CPI-U consumer inflation—intermittently driven lower this year by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low. Annual CPI-U turned minimally positive in June 2015, for the first time in six months, notched somewhat higher in July and August, with a minimal fallback in September, tied to renewed weakness in gasoline prices. Gasoline prices appear to be bottoming out, again, with a combination of temporarily-stable gasoline prices and related, positive seasonal adjustments on track to boost headline October 2015 CPI-U, as noted in the *Pending Releases* (see *CPI* comments).

Significant upside inflation pressures should mount anew, once oil prices 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:

Consumer Price Index—CPI (October 2015). The Bureau of Labor Statistics (BLS) plans to release the October 2015 CPI on Tuesday, November 17th. The headline October CPI-U should increase month-to-month by perhaps 0.1% to 0.2%, reflecting a decline in unadjusted gasoline prices being boosted into positive territory by seasonal adjustments. The corresponding year-to-year annual inflation rate likely would notch higher, as well, from a minimally-negative level into positive territory. Market outlook for the headline October CPI appears to be near and likely will settle around 0.2%, which is not an unreasonable number.

The average gasoline price moved lower in October 2015, by 3.05% (-3.05%) for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). Where BLS seasonal adjustments to

gasoline prices in October traditionally are sharply on the plus-side, they should boost gasoline prices into positive territory, to about a 1.2% monthly gain on a seasonally-adjusted basis. That one factor is enough to increase the headline monthly CPI-U change by about 0.05%. Higher food and "core" (net of food and energy) inflation partially should supplement the adjusted gains in gasoline prices, pushing the headline CPI-U up by an aggregate 0.1% to 0.2% for the month.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in the October 2015 reporting, dependent on the seasonally-adjusted monthly change, versus the adjusted, headline inflation gain of 0.05% for October 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for October 2015, the difference in October's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the minimal September 2015 negative annual inflation rate of 0.04% (-0.04%). For example, a seasonally headline monthly gain of 0.1% in October 2015 CPI-U would be needed to move the annual October 2015 inflation back into minimally-positive territory of about 0.01% (0.10% - 0.05% + [-0.04%]), depending on rounding. A headline monthly gain of 0.2% would push annual inflation to about 0.1%.

Real Retail Sales (October 2015). Based on today's headline reporting of a 0.05% monthly gain in nominal (not-adjusted-for-inflation) October Retail Sales (see coverage in the *Reporting Detail* and *Opening Comments*), real (inflation-adjusted) Retail Sales for October will be published in *Commentary No. 767*, on November 17th, in conjunction with the detail on headline October CPI-U, just discussed. Given the likelihood of a headline monthly gain in the October CPI-U, October real retail sales should decline month-to-month, with a sharp slowing in real year-to-year change, deep into recession-signal territory. Further, the real October detail likely will set the trend in fourth-quarter 2015 retail sales in a negative direction, suggestive of an outright, headline quarter-to-quarter contraction.

Constraining real retail sales activity, the consumer remains in an extreme liquidity bind with weakening confidence, as discussed in the *Opening Comments*. Continued softness in these numbers should intensify the shift in consensus expectations towards renewed economic contraction, a "new" recession. The headline October retail sales reporting was suggestive of some downside revision to third-quarter 2015 GDP in its November 24th second estimate, as well as indicative of a developing fourth-quarter 2015 GDP contraction.

Index of Industrial Production (October 2015). Also on Tuesday, November 17th, the Federal Reserve Board will release its estimate of the Index of Industrial Production for October 2015. Headline reporting detail remains a good bet to come in below what likely will be a minimally-positive consensus, along with continuing downside revisions to prior-period reporting. A net monthly decline of 0.3% (-0.3%) versus the initial headline reporting of September 2015 would be enough to turn the series negative year-to-year for the first time since the economic collapse.

As one of the traditional markers of the onset of formal recession, a continued downtrend in these numbers should intensify further the shift in consensus expectations towards renewed economic contraction. As with the retail sales reporting, headline production detail should be suggestive of some downside revision to third-quarter 2015 GDP in its November 24th second estimate, as well as indicative

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of an unfolding fourth-quarter 2015 GDP contraction.

Residential Construction—Housing Starts (October 2015). The Census Bureau will release October 2015 residential construction detail on Wednesday, November 18th. 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 47% 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.

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