John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 352
January PPI, Production, Housing Starts

February 16, 2011

PPI Gain Was Stronger than Expected with Mounting "Core" Problems, Yet Increase Was Muted by Revised Seasonal Factors

Industrial Production Likely Faces Major Downward Revisions in March

Housing Starts Still Bottom-Bouncing/Weakening

PLEASE NOTE: This morning's update on PPI, production and housing will be followed by a major Commentary *tomorrow, Thursday, February 17th, after the release of the January Consumer Price Index.*

-- *Best wishes to all, John Williams*

Seasonal-Factor Issues Continue to Plague Monthly Reporting. Despite generally weak economic results and stronger-than-expected inflation, ongoing distortions with seasonal-adjustments, resulting from the extreme severity of the economic downturn discussed in recent writings (see *Commentary No. 349*), helped to overstate industrial production activity and to understate inflation in the producer price index (PPI) in today's (February 16th) reporting. Good-quality seasonal adjustments are characterized by general stability, whether re-estimated monthly or annually, where the adjustments are supposed to smooth out regular seasonal variations in activity tied to holidays, etc. When the seasonals instead are attempting to smooth irregularly volatile activity due to economic upheaval (or extreme oil price swings), the seasonals are unstable, and the resulting, adjusted month-to-month reporting is of little meaning.

The PPI went through its annual seasonal-factor revisions (and survey redefinitions) with the January report, and the revisions showed anything but stability. December 2010 monthly PPI inflation revised from 1.1% to 0.9%, while January 2010 number (related to January 2011 seasonals) revised from 1.3% to 1.1%. The monthly revisions and reporting for December 2010 and January 2011 reflected distortions from unstable seasonals, particularly in the areas of food and energy.

The PPI will not go through another annual revision for a year. Industrial production, however, will go through a major revision on March 25th, with history revised back to 1972. The upcoming data should show significant downside revisions to prior reporting, suggesting a longer and deeper economic contraction than popularly is recognized, along with a shallower bounce or short-lived "recovery" in the current numbers.

January PPI Gain Likely Would Have Been 1.0% Instead of 0.8% But For New and Unstable Seasonal Factors. As reported this morning by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) in January 2011 rose by 0.8% (up 0.8% before seasonal adjustment) month-to-month, following seasonal-adjustment revisions that reduced initial December monthly inflation from 1.1% to 0.9% (up by 0.6% before seasonal adjustment -- the unadjusted number was not affected by revisions). Nonetheless, the annualized, seasonally-adjusted PPI inflation for the last three months (ended January) accelerated to 10.0%, up from an annualized pace of 6.1% in the prior three months ended October. Unadjusted and year-to-year, January 2011's PPI inflation was 3.6% versus 4.0% December.

The monthly PPI finished goods increase reflected the Fed's dollar-debasement-induced upside pressures on gasoline prices, although subdued reporting of food inflation continued to run counter to anecdotal evidence of Fed-induced spikes there. The 0.5% "core" PPI inflation rate for January (up from an unrevised 0.2% in December) also was an upside surprise for the markets, as the effects of higher oil prices spread into broader areas of economic activity.

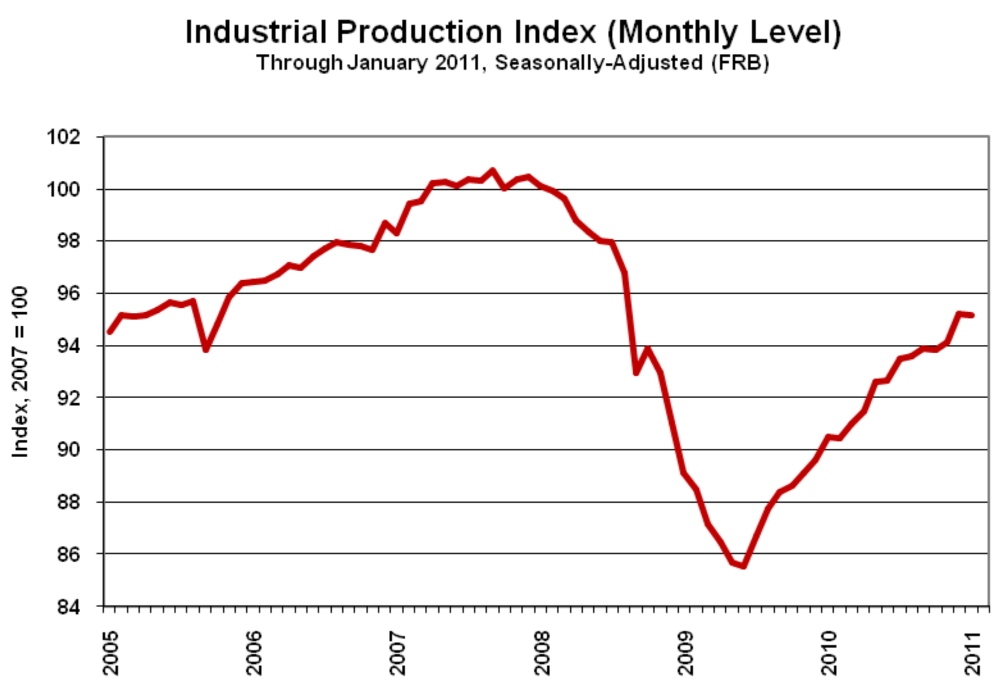
Separately, on a monthly basis, seasonally-adjusted January 2011 intermediate goods rose by 1.1% (up by a revised 0.9% -- initially 1.0% -- in December), with January crude goods prices jumping up by 3.3% (up by a revised 6.5% -- initially 4.0% -- in December). Year-to-year inflation in January intermediate goods was up by 6.0% (a 6.5% gain in December), with January annual inflation in crude goods at 10.0% (up by 15.5% in December).

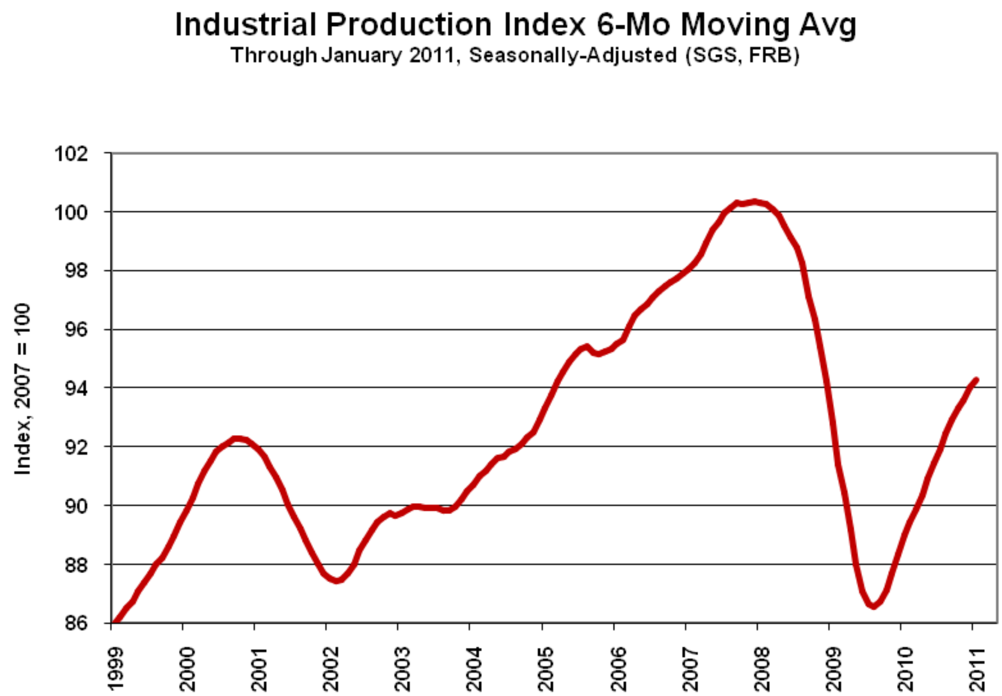
January Industrial Production Continued Topping Out. As noted in the opening comments, seasonal adjustments in the industrial production series remain unstable, and the series likely faces major revisions next month. Consistent and stable adjustments would have shown much weaker production growth late in 2010, with January 2011 virtually flat against December, instead of showing an upward revision to December production with the small January contraction reported this morning. The severe unseasonable-weather spike to December 2010 industrial production from reported utilities activity was partially offset in today's January reporting.

As to the specific production data, the Federal Reserve Board reported that seasonally-adjusted January 2011 industrial production declined for the month by 0.06% (a 0.28% gain before revisions to December's initial reporting, which were in the context of revisions to a number of prior months). December's revised production showed a 1.16% (previously 0.84%) gain.

Year-to-year change in January 2011 production was 5.15%, down from a revised 6.27% (previously 5.91%) in December, and down from the revised near-term peak of 8.35% in June. As with retail sales, the relatively high volatility in annual growth is due largely to the pattern of collapsing activity a year ago (a May 2009 trough), followed by cash-for-clunkers-boosted production. The year-to-year contraction of 12.86% seen in May 2009 was the steepest annual decline in production growth since the shutdown of war-time production following World War II.

The graph following shows recent monthly detail, with a fair shot that the September or October numbers, after revisions, still will have marked the turning point of renewed decline in the production series, despite the year-end jump in reported activity.





The "recovery" in production is shown in the preceding graph, where month-to-month volatility is smoothed using a six-month moving average. For the last 25 months, the production index has averaged 90.42, around which the series has been fluctuating, although it consistently has been moving higher in recent months. January's six-month moving average was at 94.3 versus 95.1 for the single month. Production activity had leveled off at a low-level plateau of activity that at one point effectively wiped out the last eight years of growth in industrial production.

The bump up in December likely will reverse-out in the benchmark revision to the series on March 25th. Despite ongoing upside gains generated by short-lived stimulus and seasonal-factor distortions, the series likely still is bottom-bouncing and should begin to soften anew, significantly, in the oncoming months.

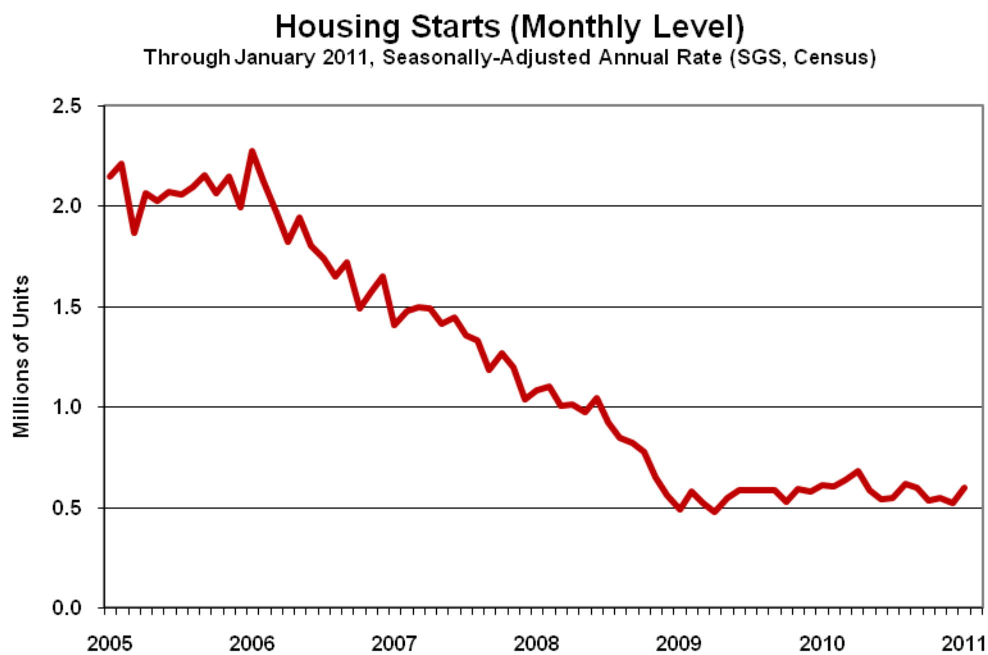
January Housing Starts Gain Was Not Statistically Meaningful And Reflected Downside Prior-Period Revisions. The housing market is showing no rebound, despite a "positive" monthly report on January housing. The gain was within the normal reporting volatility of the series and received a relative boost from negative prior-period revisions.

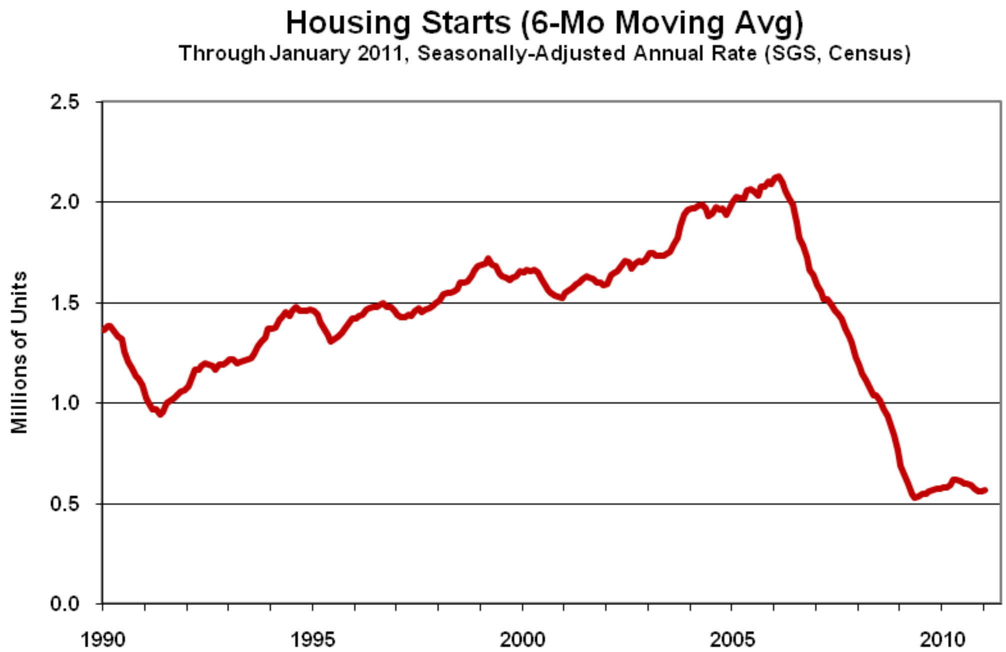
As to specific details, the Census Bureau reported today a statistically-insignificant gain in January 2011 housing starts, up by 14.6% (up by 12.7% before prior-period revisions) +/- 18.3% (95% confidence interval) on a seasonally-adjusted month-to-month basis. December's starts were revised to a 5.1% (previously 4.3%) decline.

Year-to-year change in January starts was a statistically-insignificant decline of 2.6% +/- 11.4% (95% confidence interval), following a revised annual decline of 9.7% (previously 8.2%) in December.

Although the pattern of housing starts generally remains one of bottom-bouncing at an historically low-level plateau of activity, as seen over the last 25 months, recent activity has started to slow anew, meaningfully. Significantly weaker monthly numbers remain likely in the months ahead. Since December 2008, housing starts have been bottom-bouncing, averaging a seasonally-adjusted annual rate of 570,000. In those 25 months, all monthly readings have been within the normal range of monthly volatility for the series around that average, with the January 2011 monthly reading of 596,000, above average. More significantly, the six-month moving-average for the series, as of January, stood at 569,000, slightly below the average level of the more than two years of bottom-bouncing. Housing starts appear to have begun rolling down hill, once again, and such should be reflected quite clearly in the next several months of reporting.

The "recovery" in housing is shown in these graphs. The first graph reflects the level of monthly activity in terms of the annualized monthly rate of housing starts, which is randomly volatile and subject to large revisions on a monthly basis. The second graph shows the six-month moving average, which tends to smooth out that monthly volatility.





Week Ahead. Given the unfolding reality of an intensifying double-dip recession and more-serious inflation problems than generally are anticipated by the financial markets, risks to reporting will tend towards higher-than-expected inflation and weaker-than-expected economic reporting in the months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Consumer Price Index -- CPI (January 2011). Due for release tomorrow, Thursday, February 17th, the January 2011 CPI once again should reflect not only higher gasoline prices, but also upside inflation pressures from other dollar-denominated commodity prices spiked by the Federal Reserve's U.S. dollar-debasement policy, as well as from some spreading oil-price impact into the broad "core" economy. Odds favor a possible upside reporting surprise, where the consensus estimate is for 0.3% per Briefing.com.

The monthly numbers also will undergo annual seasonal-adjustment revisions, which can shift around inflation patterns of the last year.

Not-seasonally-adjusted, year-to-year inflation would increase or decrease in the January 2011 reporting, dependent on the reported seasonally-adjusted monthly change, versus the 0.17% adjusted monthly gain seen in January 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for January 2011, the difference in January's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from December 2010's reported annual inflation rate of 1.50%. A monthly increase of 0.3%, for example, would yield a year-to-year January 2011 inflation rate of about 1.6%.

