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

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February Retail Sales, January Trade Deficit

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February Retail Sales Gain of Questionable Reporting Quality

January Trade Deficit Suggests Downside Pressure on First-Quarter GDP Growth

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PLEASE NOTE: The posting of this Commentary *was delayed somewhat by a member of staff receiving a tsunami warning here in California. The next regular* Commentary *is scheduled for Thursday, March 17th, following releases of February CPI and Industrial Production, including assessments of the prior day's Housing Starts and PPI reports. The* Hyperinflation Special Report (2011) *should be published on Monday (March 14th; updated circumstances will be posted at www.shadowstats.com, left column, above the current* Commentaries*.*

—Best wishes to all, John Williams

Markets Are Flying Blind. In terms of meaningful economic reporting, the financial markets continue to be flying blind, at the moment. Economic data of questionable significance continue to flow from the government's statistical bureaus, including this morning's (March 11th) report of February retail sales. There will be a full review of the economic outlook in the *Hyperinflation* update, and the constant-dollar February retail sales will be assessed in the March 17th *Commentary*, following the CPI release.

On its surface, the February retail sales report was positive on a nominal (not-adjusted for inflation) basis, as well as likely in real (inflation-adjusted) terms. The reporting-quality problems remain in unstable monthly seasonal-factor adjustments. Seasonal patterns have been warped by the depth and duration of an economic downturn that is unprecedented in the post-World War II era of modern economic reporting. The retail data will be revised in a pending annual benchmark revision, scheduled for April 29th. At that time, retail sales levels and growth of at least the last year should be subject to major downside revisions, showing a weaker economy than has been recognized previously. As with the recent, major downside revisions to payroll employment, and the pending downside revisions to industrial production later in March, the retail sales downgrade will be a precursor to major downside revisions in GDP history of the last several years, which are due for release in late July.

While there also are seasonal-adjustment issues with the trade data, the reported January 2011 deficit has set up a potential dampening of growth to be reported in first-quarter 2011 GDP, at the end of April.

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Today's (March 11th) February 2011 retail sales report—issued by the Census Bureau—indicated a statistically-significant, seasonally-adjusted monthly gain of 0.97% (up 1.46% net of prior-period revisions) +/- 0.6% (95% confidence interval), versus a revised 0.71% January monthly gain (previously an increase of 0.34%).

On a year-to-year basis, February 2011 retail sales were reported up by 8.87% from February 2010, versus a revised year-to-year January 2011 gain of 8.08% (previously 7.76%).

The Census Bureau plays games with the monthly seasonal factors and revisions to year-ago data, where only a limited number of the revisions are published. That leaves the monthly data in the published historical series inconsistent, month-over-month, for the last several years. Shifting patterns of seasonals can shift adjusted growth from earlier periods into the current reporting, without the earlier revisions being published. Ongoing distortions basically are from the same concurrent seasonal-factor adjustment problems (unprecedented business-cycle effects overwhelming the traditional seasonal patterns of activity) and sampling issues (companies out business that no longer are reporting, but still are being counted) with sales or employees on payrolls. (See *Commentary No. 349* and *Commentary No. 355*).

Real (Inflation-Adjusted) Retail Sales. While much of February's reported monthly retail sales gain was due to inflation, real retail sales for the month most likely were positive. Chances are good for next Thursday's (March 17th) report on February CPI-U to show monthly inflation greater than the 0.4% consensus estimate (see *Week Ahead)*. Inflation-adjusted February retail sales will be assessed following that release.

Core Retail Sales. Assuming that 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 predilection for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

Version I: February 2011 versus January 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was up by 1.0% versus an official aggregate gain of 1.0%.

Version II: February 2011 versus January 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations—was a gain of 0.8% versus the aggregate gain of 1.0%.

Widening of January 2011 Trade Deficit Suggests Downside Pressure on First-Quarter 2011 GDP. The January 2011 trade deficit widened sharply against the December and fourth-quarter 2010 trade shortfalls. The deterioration in both real and nominal terms was enough that if February and March came in at the same level, the fourth-quarter trade gains currently in the GDP would be reversed completely. The significance there is that the purported fourth-quarter trade gains accounted for more than the entire growth reported for fourth-quarter GDP.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. For January 2011, the Bureau of Economic Analysis (BEA) and the Census Bureau reported yesterday (March 10th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services in January 2011 widened to $46.3 billion from a revised $40.3 (previously $40.6) billion in December 2010. The January 2011 deficit also widened from $34.6 billion a year ago.

Against December 2010, the January trade balance showed gains in both exports and imports, with the import pick-up much stronger than the export increase, due partially to oil activity. Oil imports reflected both higher prices and physical import volume. Specifically, for the month of January 2011, the not-seasonally-adjusted average price of imported oil was $84.34 per barrel, up from $79.78 in December 2010, and up from $73.89 in January 2010. In terms of not-seasonally-adjusted physical oil imports, January 2011 volume averaged 9.376 million barrels per day, versus 9.115 million in December 2010 and 7.912 million in January 2010.

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of rising oil prices and other inflation (2005 chain-weighted dollars as used in reporting real GDP), the reported January 2011 merchandise trade deficit still widened sharply to $49.5 billion, from $46.0 billion in December. The first reporting from first-quarter 2011, the January deficits annualizes out to $594.1 billion. That is up meaningfully from the fourth-quarter goods deficit, which was at a revised annualized pace of $543.3 (previously $543.2 billion).

If the January deficit pace were to hold for the balance of the first-quarter, that effectively would offset fully the fourth-quarter GDP gains that resulted from a narrowing in the fourth-quarter trade balance.

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 month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Residential Construction (February 2011). February housing starts are due for release on Wednesday, March 16th. They likely will continue to show a pattern of renewed contraction, with any unexpected gain unlikely to be statistically significant.

Producer Price Index—PPI (February 2011). The February PPI is due for release on Wednesday, March 16th. There is a fair shot of an upside reporting surprise (0.6% consensus estimate per Briefing.com), as this regularly-volatile series should begin to show mounting inflationary pressures beyond the direct impact of rising oil prices.

Consumer Price Index—CPI (February 2011). The February CPI is due for release on Thursday, March 17th. Briefing.com indicates a consensus expectation of a 0.4% headline number, the same as in January. Reporting risks are to the upside. While the biggest portion of impact from recent rising gasoline prices should show up in the March CPI, "core" inflation also should start to show upside movement.

Year-to-year inflation would increase or decrease in February 2011 CPI-U reporting, dependent on the seasonally-adjusted monthly change, versus the 0.05% adjusted monthly gain seen in February 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for February 2011, the difference in February's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from January 2011's reported annual inflation rate of 1.63%. A consensus result of a 0.4% monthly increase would yield an annual CPI inflation rate of about 2.0%.

Industrial Production (February 2011). February's index of industrial production is due for release on Thursday, March 17th. Expectation (Briefing.com) is for a 0.6% increase, following January's 0.1% decline. Reporting risk should be to the downside. Irrespective of the initial reporting, the entire series will go through a benchmark revision on March 25th.

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