

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

COMMENTARY NUMBER 368
April Inflation, Retail Sales, Trade Deficit

May 13, 2011

April Year-to-Year Consumer Inflation: 3.2% (CPI-U), 3.6% (CPI-W), 10.7% (SGS)
Fed's Dollar Debasement Efforts Boost Three-Month CPI Inflation into 6% to 7% Range
Official Double-Digit Consumer Inflation Possible in Third-Quarter
With Rising Prices Dominating Sales Gains, "Core" Retail Sales Were Unchanged in April

PLEASE NOTE: The next regularly scheduled Commentary is for Tuesday, May 17th. It will cover April housing starts and industrial production.

—Best wishes to all, John Williams

Opening Comments and Executive Summary. Inflation fears are mounting quickly, as consumers feel a tightening financial squeeze and as the government's statistics show an increasingly serious problem with consumer and wholesale prices. The extreme monetary and fiscal actions taken by the federal government and the Federal Reserve to prevent a systemic collapse in September 2008 all had an ultimate cost: inflation. Yet in mid-2011 the systemic liquidity crisis still is ongoing and the bottom-bouncing economy has started to teeter anew into the abyss of a "double-dip" for the most severe and protracted economic downturn since the Great Depression. It is these concerns—particularly the banking-system's

liquidity issues—that have forced the Fed into QE2 and likely have the Fed set for some form of QE3 in the not-too-distant future.

It is these actions by the Fed to debase the U.S. dollar that have been primarily responsible for pushing annual inflation in the headline CPI-U measure above 3% for the first time since September 2008. When Mr. Bernanke began to destabilize the U.S. dollar with his jawboning, before introducing QE2 in late-2010, annual headline inflation was around 1.1%. That hit 3.2% in today's (May 13th) reporting for April 2011. (The wage-earner-based CPI-W hit 3.6%.) Annualized consumer inflation for the last three months (versus the prior three-month period) has moved into the 6% to 7% range, making annualized double-digit inflation a good bet by the end of third-quarter 2011, despite near-term extreme volatility in U.S. dollar-based oil and gasoline prices. Even "core" inflation (net of food and energy) is creeping higher.

Where consumer incomes generally are not rising at pace that will keep up with officially reported inflation, many households are suffering a liquidity squeeze and increasingly have been forced to cut back on less-necessary spending. That was reflected in April's retail sales, where all the reported gains were in sales at grocery stores and gas stations, reflecting the gains in food and gasoline prices, not in generally greater physical consumption of goods and services.

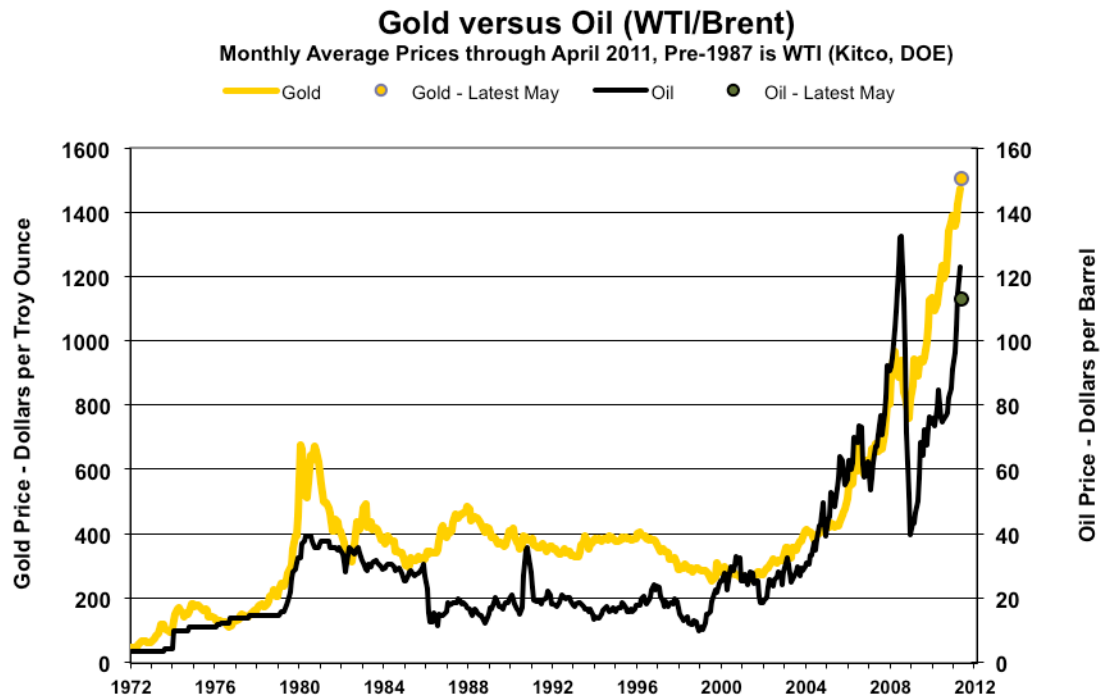
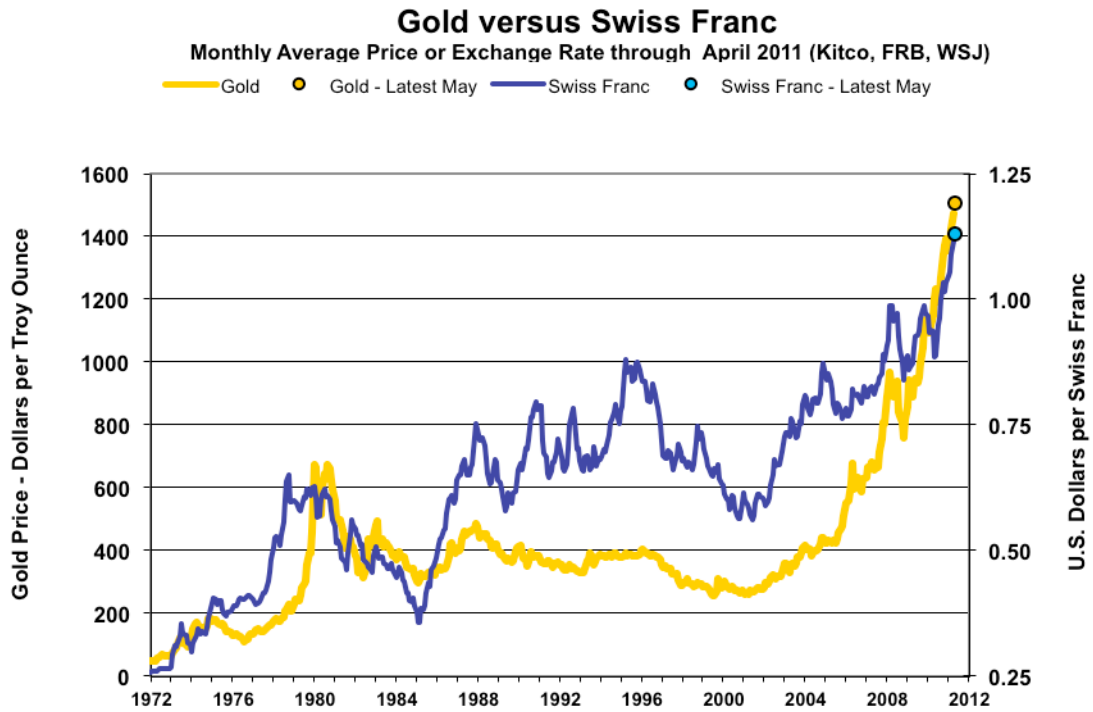
Keep in mind that official consumer inflation numbers no longer reflect what an individual needs in income or investment return to maintain a constant standard of living. The Bureau of Labor Statistics (BLS)—under Congressional direction—has altered the CPI in recent years so as no longer measure the cost of maintaining a constant standard of living. Those issues are addressed in the SGS-Alternate Consumer Inflation Measures, where, based on reporting of 1990, the April 2011 official annual inflation rate of 3.2%, would have been about 6.5% without altered methodologies, and where, based on reporting of 1980, the April 2011 annual inflation rate would have been about 10.7%.

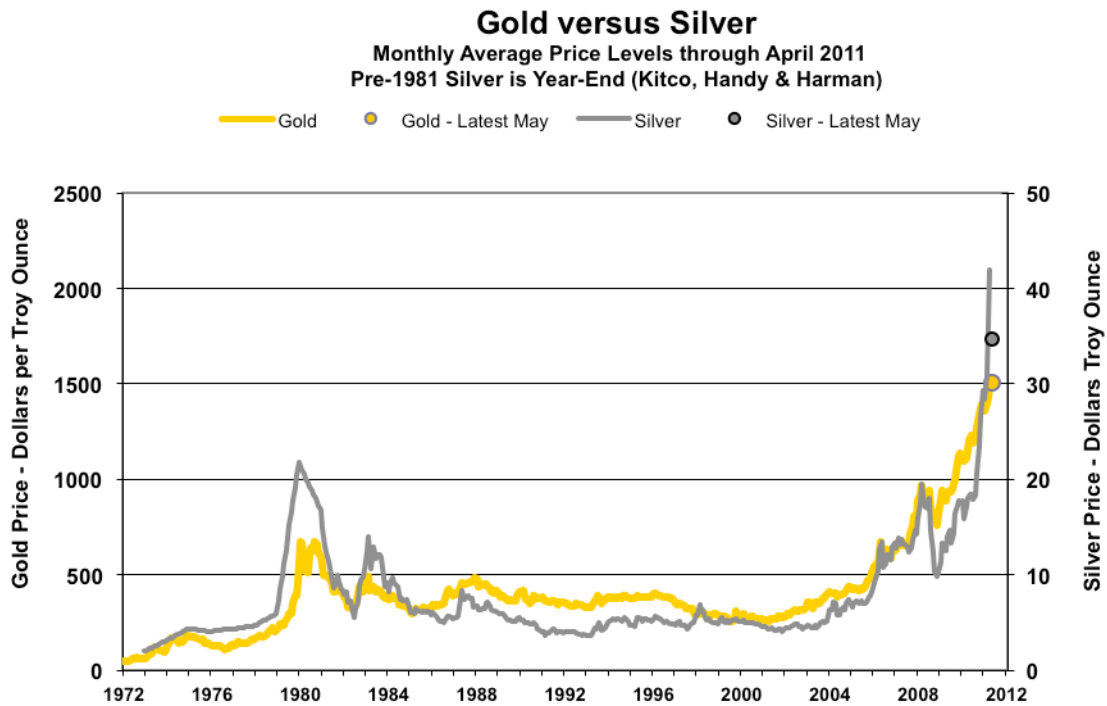
At the wholesale level, annualized three-month PPI inflation is in double-digits, up by 13.1% as of April's reporting. Annual inflation rose to 6.8%, a post-September 2008 high, with "core" inflation on the rise.

In other reporting of the last week, the March trade deficit widened sharply, due at least partially to higher prices for imported oil. The net trade deficit deterioration should add to the fundamental selling pressures against the U.S. dollar. Net of inflation, however, the first-quarter's deficit was about as suggested last month, so there likely will be no major change from the trade factors in the May 26th revision to the first-quarter 2011 GDP estimate.

Hyperinflation Watch—Underlying Fundamentals Unchanged As Inflation Woes Mount. The broad inflation and economic outlooks discussed in [Hyperinflation Special Report \(2011\)](#) continue unabated. The underlying pace of official inflation is accelerating, and could move into double-digits in third-quarter 2011. Preceding or coincident with that likely will have been some move to QE3 by the Fed and intense—if not panicked—selling of the U.S. dollar and dollar-denominated assets. Such a circumstance could be a base from which a hyperinflation might begin to unfold with some rapidity.

The wild market gyrations in certain commodity prices during the last week or two should stabilize at some point, with oil, gold and silver fully resuming their long-term uptrends. The underlying fundamentals here of persistent U.S. dollar debasement; a federal government with its fiscal conditions out of control; a U.S. economy not in recovery but heading into renewed contraction; all remain in play.





REPORTING DETAIL

Annual CPI-U Inflation Tops 3%, Straining Consumer Finances. The ongoing effects of the Federal Reserve's actions to debase the U.S. dollar have been the primary force behind pushing headline annual consumer inflation above 3% to a two-plus year high. When Mr. Bernanke began jawboning the U.S. dollar down against other currencies, before introducing QE2 in late-2010, annual headline inflation was around 1.1%. That hit 3.2% in today's (May 13th) reporting for the April 2011 CPI-U, along with a slow upturn in "core" inflation (net of food and energy prices). With annualized consumer inflation for the last three months (versus the prior three-month period) having moved into the 6% to 7% range, double-digit inflation is a good bet by the end of third-quarter 2011, despite near-term extreme volatility in U.S. dollar-based oil and gasoline prices. The fundamental pressures against the U.S. currency, and non-economic-demand-driven inflationary pressures, are likely to accelerate in the months ahead.

Notes on Different Measures of the Consumer Price Index

The Consumer Price Index (CPI) is the broadest inflation measure published by U.S. Government, through the Bureau of Labor Statistics (BLS), Department of Labor:

*The **CPI-U (Consumer Price Index for All Urban Consumers)** is the monthly headline inflation number (seasonally adjusted) and is the broadest in its coverage, representing the buying patterns of all urban consumers. Its standard measure is not seasonally adjusted, and it never is revised on that basis except for outright errors.*

*The **CPI-W (CPI for Urban Wage Earners and Clerical Workers)** covers the more-narrow universe of urban wage earners and clerical workers and is used in determining cost of living adjustments in government programs such as Social Security. Otherwise its background is the same as the CPI-U.*

*The **C-CPI-U (Chain-Weighted CPI-U)** is an experimental measure, where the weighting of components is fully substitution based. It generally shows lower annual inflation rate than the CPI-U and CPI-W. The latter two measures once had fixed weightings—so as to measure the cost of living of maintaining a constant standard of living—but now are quasi-substitution-based.*

*The **SGS Alternative CPI-U Measures** are attempts at adjusting reported CPI-U inflation for the impact of methodological change of recent decades designed to move the concept of the CPI away from being a measure of the cost of living needed to maintain a constant standard of living.*

CPI-U. The BLS reported today (May 13th) that the seasonally-adjusted April 2011 CPI-U rose by 0.42% (up by 0.64%, unadjusted) for the month. That followed an increase of 0.55% (up by 0.98%, unadjusted) in March. The April reporting reflected an unadjusted monthly increase in gasoline prices of 7.5%, which was reduced to a 3.3% monthly gain by ongoing happy seasonal adjustments.

The pace of annualized, seasonally-adjusted, CPI-U inflation continued to accelerate in the most recent three months (ended April) to 6.01% inflation, versus 5.22% in first-quarter 2011.

April's unadjusted year-to-year CPI-U inflation surged once again, to 3.16%, the strongest pace of annual inflation since September 2008. April's annual inflation rate was up from 2.68% in March.

Year-to-year inflation would increase or decrease in next month's May 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.14% contraction in the adjusted monthly level reported for May 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for May 2011, the difference in May's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from April 2011's reported annual inflation rate of 3.16%. Annual CPI-U inflation should move to top 4% in the next several months. The CPI-W already was at 3.64% as of today's reporting.

CPI-W. The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose in April 2011 by 0.50% (up 0.78%% unadjusted), following March's adjusted monthly increase of 0.62% (up 1.14% unadjusted).

The pace of annualized, seasonally-adjusted, CPI-W inflation continued to accelerate in the most recent three months (ended April) to 7.01% inflation, versus 6.04% in first-quarter 2011.

Unadjusted, April 2011's year-to-year CPI-W inflation was 3.64%, against a 3.04% annual increase in March.

C-CPI-U. The Chain-Weighted CPI-U—the fully substitution-based series that gets touted by CPI opponents and inflation apologists, including the recent presidential deficit commission, as the replacement for the CPI—is reported only on an unadjusted basis. Year-to-year inflation increased to 2.92% in April 2011 versus 2.46% in March.

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 6.5% in April 2011, up from 6.0% in March, while the SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 10.7% (10.69 % for those using the extra digit) in April, from about 10.2% in March.

The SGS-Alternate Consumer Inflation Measure adjusts on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made by the BLS (the series is not recalculated). Over the decades, the BLS has altered the meaning of the CPI from being a measure of the cost of living needed to maintain a constant standard of living, to something that no longer reflects the constant-standard-of-living concept. Roughly five percentage points of the additive SGS adjustment reflect the BLS's formal estimate of the annual impact of methodological changes; roughly two percentage points reflect changes by the BLS, where SGS has estimated the impact not otherwise published by the BLS.

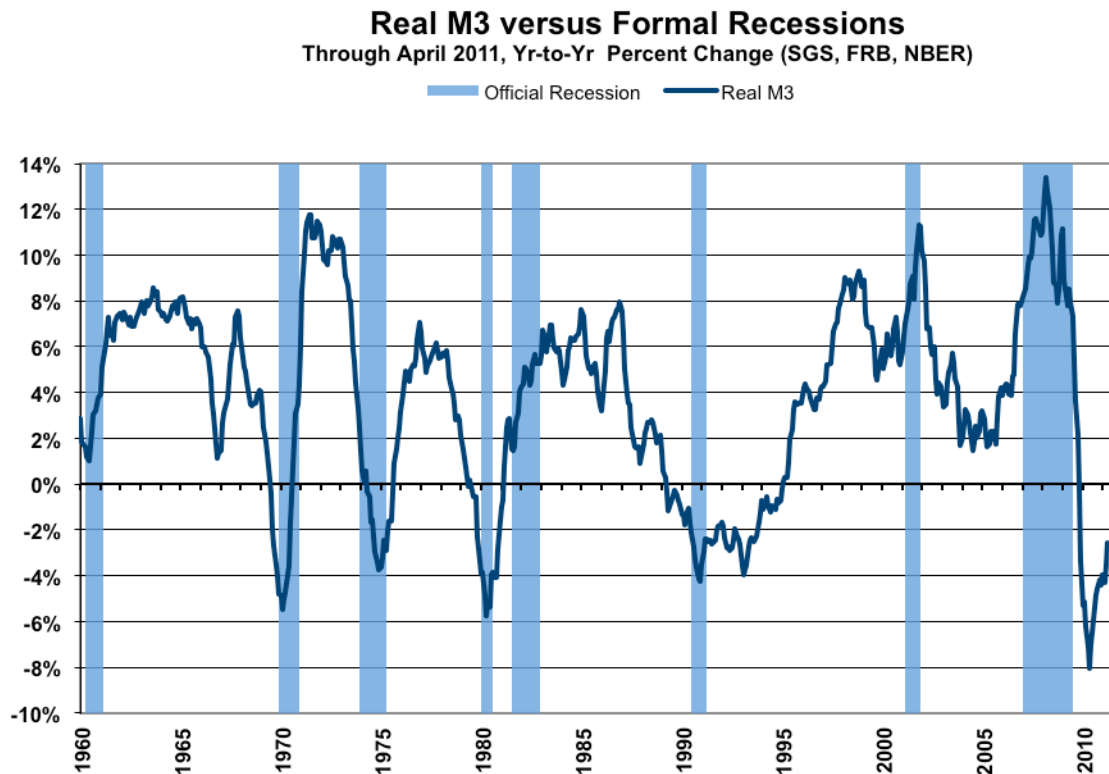
Gold and Silver Highs Adjusted for CPI-U/SGS Inflation. Despite the May 4th historic-high gold price of \$1,541.00 per troy ounce (London afternoon fix) and a new multi-decade high silver price of at \$48.70 per troy ounce (London fix of April 28th), gold and silver prices have yet to approach their 1980 historic levels, adjusted for inflation. The earlier all-time high of \$850.00 (London afternoon fix, per Kitco.com) of January 21, 1980 would be \$2,457 per troy ounce, based on April 2011 CPI-U-adjusted dollars, \$8,386 per troy ounce based on SGS-Alternate-CPI-adjusted dollars (all series not seasonally adjusted).

In like manner, the all-time high price for silver in January 1980 of \$49.45 per troy ounce (London afternoon fix, per silverinstitute.org), although approached recently, still has not been hit since 1980, including in terms of inflation-adjusted dollars. Based on April 2011 CPI-U inflation, the 1980 silver price peak would be \$143 per troy ounce and would be \$488 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

As shown on page 43 of the [Hyperinflation Special Report \(2011\)](#), over the decades, the price of gold has compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, while it has effectively fully compensated for the loss of purchasing power of the dollar based on the SGS-Alternate Consumer Price Measure (1980 Methodologies Base).

Real Money Supply M3. The signal of the still unfolding double-dip recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), most recently discussed in the [Hyperinflation Special Report \(2011\)](#), continues and is graphed below. Based on the April CPI-U report

and the latest April SGS-Ongoing M3 Estimate, the annual contraction in real M3 for April 2011 was 2.6%, versus a 3.6% annual contraction in March.



The signal for a downturn or an intensified downturn is generated when annual growth in real M3 first turns negative in a given cycle; the signal is not dependent on the depth of the downturn or its duration. The current downturn signal was generated in December 2009. The broad economy tends to follow in downturn or renewed deterioration roughly six-to-nine months after the signal, as has appeared to have started in recent months. Increasing weakness in a number of series should become evident in the months ahead, with the scheduled July benchmark revisions to GDP likely to show much weaker economic activity for the last year or two than currently is reported. Such eventually will lead to recognition of a double-dip recession.

PPI Gain in April Muted Again by Seasonal Adjustments. As reported yesterday, May 12th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) rose in April 2011 by 0.8% (up by 1.2% before seasonal adjustment) month-to-month, following a monthly increase of 0.7% in February (up by 1.3% before seasonal adjustment). The adjusted monthly PPI finished goods again largely reflected upside pressures from energy and increasing “core”

prices, with a renewed gain indicated for food prices. The higher prices generally reflected ongoing impact of the Fed's dollar-debasement policies. With reported monthly inflation heavily reduced by seasonal adjustments to energy costs, the heaviest impact from rising oil prices is still ahead, despite recent gyrations in oil market prices.

Annualized, seasonally-adjusted PPI inflation for the three months ended April 2011 held at 13.1% the same level as in first-quarter 2011. Unadjusted and year-to-year, April 2011's PPI inflation jumped to 6.8%—the highest level since September 2008—up from 5.8% in March.

Separately, on a monthly basis, seasonally-adjusted April 2011 intermediate goods rose by 1.3% (up by 1.5% in March), with April's crude goods prices up by 4.0%, after falling by 0.5% in March.

Year-to-year inflation in April intermediate goods was up by 9.4% (an 8.9% gain in March), with April's annual inflation in crude goods at 23.7% (up by 16.4% in March).

“Core” Real Retail Sales Were Unchanged. As discussed in [Commentary No. 366](#), the benchmark retail sales revision showed a weaker pattern of activity in recent years, in line with other downside benchmark revisions to nonfarm payrolls and industrial production. The most recent reporting patterns remained in play, however, continuing what had been overly optimistic upside biases that otherwise were shown to be wrong by the better-quality and more-complete data for 2009. Accordingly, similar downside revisions are likely again next year for 2010's results.

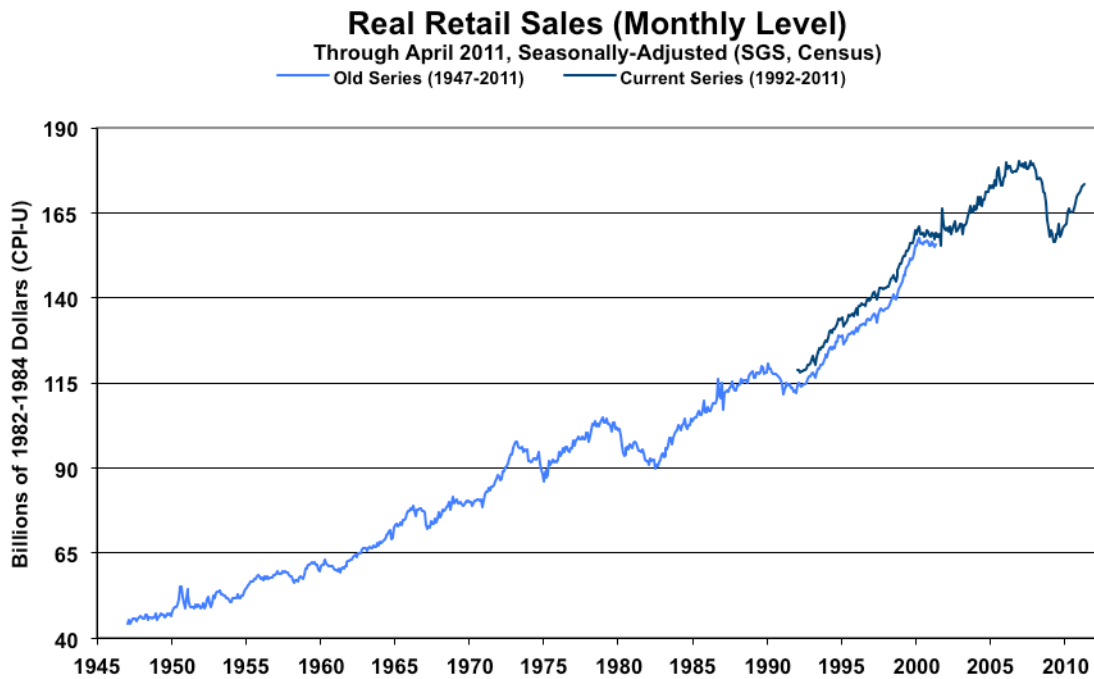
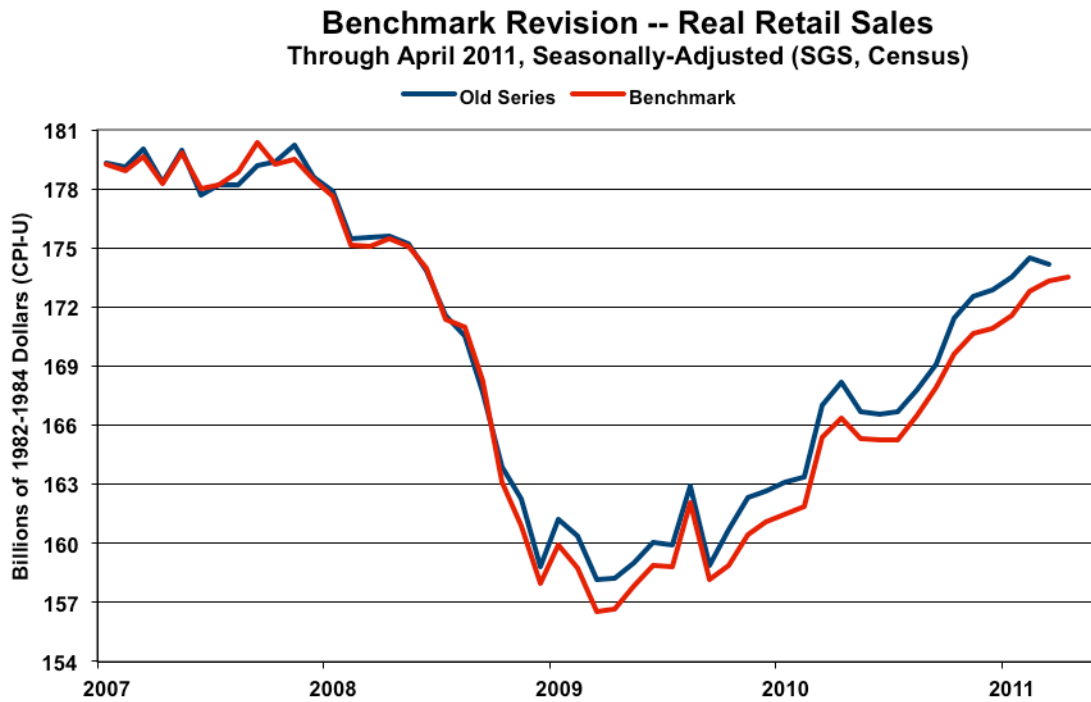
The reported monthly gain in April retail sales was due largely to rising prices. As noted below, the “core” pace retail sales—net of food and energy sales—was unchanged for the month.

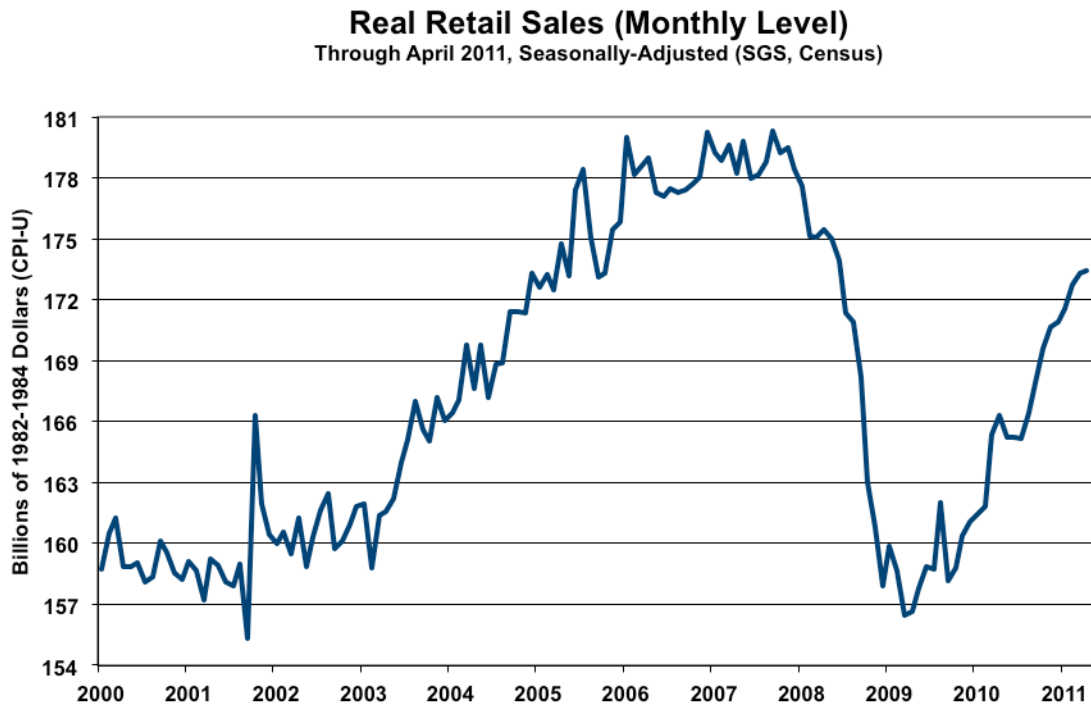
Nominal (Not-Adjusted-for-Inflation) Retail Sales. Yesterday's (May 12th) April 2011 retail sales report—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.51% (unchanged versus prior-period benchmark revisions) +/- 0.6% (95% confidence interval), versus a revised March monthly gain (post-benchmark reporting and prior-period reporting) of 0.87%. March initially was reported with an increase of 0.39%. At work here remain extreme seasonal-factor distortions as discussed in the [Hyperinflation Special Report \(2011\)](#).

On a year-to-year basis, April 2011 retail sales were reported up by 7.57% from April 2010, versus a benchmark-revised year-to-year March 2011 gain of 7.63%.

Real (Inflation-Adjusted) Retail Sales. Based on the April 2011 CPI-U reporting, inflation- and seasonally-adjusted monthly April 2011 retail sales increased by 0.09%, where, before inflation adjustment, the current number was up by 0.51%. Real March sales revised to an increase of 0.32% (a revamped gain of 0.87% before inflation adjustment).

April's real retail sales rose at a year-to-year pace of 4.32%, slowing from a revised 4.81% annual gain reported for March.





The ongoing “recovery” in real retail sales is reflected in the preceding graphs. The first graph is updated to show the recent benchmark revision adjusted for the latest monthly estimate and monthly revisions. The two subsequent plots both show the latest monthly levels (including all revisions) of seasonally-adjusted activity. The first of those shows the data in historical context since World War II. The second shows the same numbers in clearer detail for the current period beginning in 2000.

Using the SGS Alternate-CPI Inflation estimates for deflation of the retail series would not show an ongoing rise in activity for the last year or so. It is my preference here, and wherever otherwise possible, to use the official estimates (the series here is as calculated by the St. Louis Fed), since that eliminates a level of argument over what is being reported. As official consumer inflation picks up, and as overall retail sales suffers from the ongoing consumer liquidity squeeze, these data also should turn down, confirming what will become eventually an official and formal double-dip recession.

There has been no change in underlying fundamentals that would support a sustainable turnaround in personal consumption or in general economic activity—no recovery—just general bottom-bouncing. Accordingly, real retail sales levels in the months ahead should turn increasingly negative.

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: April 2011 versus March 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was unchanged (up by 0.03%) versus an official aggregate gain of 0.5%.

Version II: April 2011 versus March 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations—was unchanged (up by 0.02%) versus the aggregate gain of 0.5%.

March Trade Deficit Appears Neutral for GDP Revision. While the greater-than-expected increase in the March trade deficit was fundamentally negative for the foreign-exchange value of the U.S. dollar, some of the gain was from higher oil prices, which muted the net trade deterioration in real or inflation-adjusted terms. Accordingly, the inflation-adjusted number was in line with last month's estimates, with likely negligible impact on the first-revision to the first-quarter 2011 GDP estimate.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported Wednesday (May 11th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for March 2011 widened to \$48.2 billion from a revised \$45.4 (previously \$45.8) billion in February. The March 2011 deficit also widened from \$39.7 billion a year ago.

Against February 2011, the March trade balance showed gains in both exports and imports, with the import jump much larger than that for exports. Part of the import gain was in oil, reflecting both higher prices and rising physical volume. Specifically, for the month of March 2011, the not-seasonally-adjusted average price of imported oil was \$93.76 per barrel, up from \$87.17 in February 2011, and up from \$74.32 in March 2010. In terms of not-seasonally-adjusted physical oil imports, March 2011 volume averaged 9.520 million barrels per day, versus 8.656 million in February 2011, but it was down from 9.660 million in March 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 March 2011 merchandise trade deficit came in at \$50.1 billion, up from a revised \$49.3 (previously \$49.5) billion in February.

The real first-quarter 2011 merchandise deficit now annualizes out to \$598.4 billion (\$598.3 billion was the estimate based only on initial January and February reporting available for the "advance" GDP). That remains up meaningfully from the fourth-quarter goods deficit, which was at a revised annualized pace of \$545.0 (previously \$543.3) billion. Recent net-export accounting in the GDP appears to have ignored the underlying monthly trade data as reported here, with the reported quarterly trade deterioration suggesting the advance GDP estimate for first-quarter 2011 should be weaker than has been estimated officially. The full first-quarter trade numbers, however, are not enough different from earlier reporting to suggest a major revision.

Week Ahead. Though not yet commonly recognized, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-

than-expected economic results in the month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions, benchmark or otherwise.

Residential Construction (April 2011). Due for release on Tuesday, May 17th, April housing starts should continue to decline, pushing towards or setting new historic lows. As usual, any reported upside movement likely will remain statistically indistinguishable from a contraction.

Industrial Production (April 2011). Due for release on Tuesday, May 17th, April industrial production increasingly should reflect a slowing economy, with a downside reporting surprise a fair bet for what likely will reasonably strong consensus expectations.
