

John Williams'
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April Trade Deficit, Bernanke Shift

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Earthquake-Diminished Imports of Auto Parts Narrowed April Deficit

Trade Revisions Showed Somewhat Deeper Historical Shortfalls

Mr. Bernanke Begins to Unfurl His Warning Flag

PLEASE NOTE: The next regularly scheduled Commentary is for Wednesday, June 15th. It will cover the May CPI, PPI, retail sales and industrial production. A further Commentary on Thursday, June 16th will assess May housing starts data.

—Best wishes to all, John Williams

Opening Comments and Executive Summary. Federal Reserve Chairman Ben Bernanke's remarks to the International Monetary Conference in Atlanta on June 7th took a marked shift towards a cautionary note on the U.S. economy. Despite the mixed language in his comments on how well Fed policy has been working, I take the more-negative economic tone as an early warning of an eventual QE3 (third-quarter 2011). Included in Mr. Bernanke's thoughts were such items as:

"U.S. economic growth so far this year looks to have been somewhat slower than expected."

“Until we see a sustained period of stronger job creation, we cannot consider the recovery to be truly established.”

He also gave an interesting example of how today’s “recovered” economy still is worse off than the worst of the unusually severe 1981-82 recession:

“Developments in the labor market will be of particular importance in setting the course for household spending. As you know, the jobs situation remains far from normal. For example, aggregate hours of production workers—a comprehensive measure of labor input that reflects the extent of part-time employment and opportunities for overtime as well as the number of people employed—fell, remarkably, by nearly 10 percent from the beginning of the recent recession through October 2009. Although hours of work have increased during the expansion, this measure still remains about 6-1/2 percent below its pre-recession level. For comparison, the maximum decline in aggregate hours worked in the deep 1981-82 recession was less than 6 percent. Other indicators, such as total payroll employment, the ratio of employment to population, and the unemployment rate, paint a similar picture. Particularly concerning is the very high level of long-term unemployment—nearly half of the unemployed have been jobless for more than six months. People without work for long periods can find it increasingly difficult to obtain a job comparable to their previous one, as their skills tend to deteriorate over time and as employers are often reluctant to hire the long-term unemployed.”

The pattern described there likely mirrors what the now “fully-recovered” GDP reporting will look like after major downside revisions to historical GDP are published in the July 29th annual revisions.

The Fed Chairman’s comments on Wednesday were followed by the Fed’s *Beige Book* on Thursday (June 8th). The Fed’s regular anecdotal reporting of business activity opened with news that the economy had begun to falter anew in certain districts:

“Reports from the twelve Federal Reserve Districts indicated that economic activity generally continued to expand since the last report, though a few Districts indicated some deceleration. Some slowing in the pace of growth was noted in the New York, Philadelphia, Atlanta, and Chicago Districts. In contrast, Dallas characterized that region’s economy as accelerating [oil-price related]. Other Districts indicated that growth continued at a steady pace.”

April Trade Numbers Skewed by Japanese Earthquake. The effects of the Japanese earthquake reduced U.S. imports of parts for automobile assembly, and the April trade deficit narrowed unexpectedly as a result. The data were released in the context of various annual revisions, which showed the trade deficits of first-quarter 2011 and the years 2010 and 2009 to have been somewhat deeper than previously reported. Assuming no quick bounce-back in auto-part imports in May, the April and May trade numbers—supposedly used by the Bureau of Economic Analysis (BEA) in its “advance” estimate of second-quarter 2011 GDP—would offer an upside growth contribution to the “advance” GDP.

With next week’s reporting covering most of the major economic and inflation data remaining to be reported for May, next week’s *Commentaries* will offer a full update to the generally-unchanged economic and inflation outlooks.

Hyperinflation Watch—Third-Quarter QE3 Remains Likely. As discussed above, with official economic data indicating new troubles, Mr. Bernanke appears to be laying the groundwork for acknowledging that the economy is not in a sustainable recovery. He would use that story as cover for a new round of quantitative-easing aimed supporting systemic liquidity. Market reaction to or anticipation of such action would tend to accelerate dollar depreciation, rising oil prices, and flight to gold and silver. The weakening economy also still has horrendous implications for U.S. fiscal conditions and for U.S. Treasury funding needs. On top of that, the SGS-Ongoing M3 estimate appears to be picking up as Treasury spending ends up deposited in recipients' bank accounts. Even so, bank-lending still shows no serious improvement, reflective of the ongoing systemic-solvency crisis. The broad inflation and economic outlooks discussed in [Hyperinflation Special Report \(2011\)](#) continue unabated.

REPORTING DETAIL

Temporary April Trade Deficit Improvement Suggests Possible Boost to Second-Quarter GDP “Advance” Estimate. The April report on the U.S. trade balance included revisions back through 2009. While prior-period revisions show the historical trade shortfall to have been somewhat greater than previously report, those revisions likely will not impact GDP reporting other than in the July 29th annual revisions, at which time the “advance” estimate of second-quarter 2011 GDP also will be published.

The April data are the first of only two months of information that will be used in guesstimating second-quarter GDP growth. Given that the reported inflation- and seasonally-adjusted April merchandise trade deficit improved versus the revised first-quarter data, such suggests an initial, relatively positive trade contribution to the second-quarter GDP. That assumes that GDP reporting will resume reflecting the trade data (reported trade patterns were not reflected in the first-quarter GDP estimate). As surrogate Japanese auto production in the United States returns to normal, the related trade numbers should prove to be unusually volatile.

Indeed the narrowing of the April deficit was due largely to the reduced imports of Japanese auto parts. As that circumstance rights itself, those imports will surge anew, assuming there actually is any meaningful unfilled demand for new automobiles.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported this morning, Thursday (June 9th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for April 2011 narrowed to \$43.7 billion from a revised \$46.8 (previously \$48.2) billion in March. The April 2011 deficit also widened from a revised \$41.5 (previously \$40.6) billion a year ago. The revised numbers were in the context of one of a series of regular annual revisions. The revised summary goods and services deficits are: \$140.8 (previously \$140.6) billion for first-quarter 2011; \$500.0 (previously \$495.7) billion for 2010; \$381.3 (\$374.9) billion for 2009.

Against a revised March 2011, the April trade balance showed higher exports but weaker imports, with after-effects of the Japanese earthquake reducing imported auto parts. Oil did not help to boost imports, either, where higher oil prices were offset by reduced volume. Specifically, for the month of April 2011, the not-seasonally-adjusted average price of imported oil was \$103.18 per barrel, up from \$93.76 in March 2011, and up from \$77.13 in April 2010. In terms of not-seasonally-adjusted physical oil imports, April 2011 volume averaged 8.408 million barrels per day, down from 9.520 million in March 2011 and down from 9.829 million in April 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 April 2011 merchandise trade deficit came in at \$44.2 billion, down from a revised \$49.7 (previously \$50.1) billion in March.

Based on one month's reporting, the real second-quarter 2011 merchandise deficit annualizes out to \$530.8 billion, versus a revised \$604.9 (previously \$598.4) billion in the first-quarter, and against a revised \$557.0 (previously \$545.0) billion in fourth-quarter 2010. Again, revisions likely will not be reflected in GDP reporting until the July 29th annual GDP revisions.

Week Ahead. Though still not widely acknowledged, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations fully 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.

Retail Sales (May 2011). Due for release on Tuesday, June 14th, May retail sales face a downside reporting risk versus what likely will be relatively soft expectations. Whatever gain may be reported likely will be more than offset by May CPI-U inflation.

Producer Price Index—PPI (May 2011). Due for release on Tuesday, June 14th, the headline number from the regularly volatile PPI series should be relatively soft, given a temporary reduction oil prices that will be exacerbated by oil-price-dampening seasonal-factor adjustments. Nonetheless there is some risk for an upside surprise versus likely tepid consensus expectations, as inflationary pressures increasingly pass outside the direct energy sector.

Consumer Price Index—CPI (May 2011). Due for release on Wednesday, June 15th, the CPI headline number also is at risk of surprising likely muted consensus expectations on the upside. Despite the temporary decline in average monthly oil prices in May, gasoline prices still averaged 2.8% higher versus April, per the Department of Energy. While that will be turned negative by the government's gasoline-price-muting seasonal-factors, higher food prices and otherwise spreading inflationary pressures in the broad economy should keep the CPI-U in positive territory.

Year-to-year inflation would increase or decrease in 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%. A month-to-month gain of 0.3% in the May 2011 CPI-U, for example, would move annual CPI-U inflation to the 3.4% to 3.5% range. Annual CPI-U inflation should move above 4% in the next several months. The narrower CPI-W already was at 3.64% in April's reporting.

Industrial Production (May 2011). Due for release on Wednesday, June 15th, May's industrial production could show an outright monthly contraction, as the apparent "stall" in recent activity rolls into renewed downturn. A downside reporting surprise again is a fair bet for what likely will be moderately positive consensus expectations.

Residential Construction (May 2011). Due for release on Thursday, June 16th, May housing starts should continue to decline, still pushing towards or setting new historic lows. As has been the case for many months, any reported upside monthly movement likely will remain statistically indistinguishable from a monthly contraction.
