

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

**COMMENTARY NUMBER 373**  
**May Inflation, Retail Sales, Production**

**June 15, 2011**

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**Economy Falters as Inflation Surges**

**May's Annual Consumer Inflation: 3.6% (CPI-U), 4.1% (CPI-W), 11.2% (SGS)**

**Real Retail Sales Contracted in Both April and May**

**Stalled Industrial Production Continued**

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*PLEASE NOTE: The next regularly scheduled Commentary is for tomorrow, Thursday, June 16th, covering May housing starts. Next week's Commentary will be on Friday, June 24th, covering the second revision to first-quarter GDP, May new orders for durable goods and May home sales.*

*—Best wishes to all, John Williams*

**Opening Comments and Executive Summary.** U.S. economic data continue to show contracting or stalling activity, while reported annual inflation quickly is moving toward the 2008 near-term peak. The high inflation levels of the 1970s are not far behind and could be seen officially by year-end. With the deepening economic crisis intensifying the systemic-solvency and federal-fiscal crises, the Federal Reserve remains highly likely to move, overtly or covertly, into QE3 before the end of third-quarter 2011, with a Treasury funding crisis likely to follow the eventual lifting of the federal debt ceiling in August.

While the debt-ceiling crisis likely will go down to the wire, as it has before, it is difficult to imagine either side allowing an actual default on U.S. Treasury debt. If there were a default, such could accelerate the collapse and abandonment of the U.S. dollar, and would accelerate the onset of a U.S. hyperinflation.

***Inflation Jumps.*** Muting the reported, seasonally-adjusted CPI inflation rate in recent months have been the downside seasonal adjustments to gasoline prices. For example, although today's news reports (June 15th) tout declining gasoline prices for helping to keep inflation in check, gasoline prices actually rose in May by 3.6% (the common experience), but that was turned into a monthly decline of 2.0% by the seasonals. These seasonal factors turn neutral in next month's reporting and then begin to inflate reported gasoline prices starting with July's reporting.

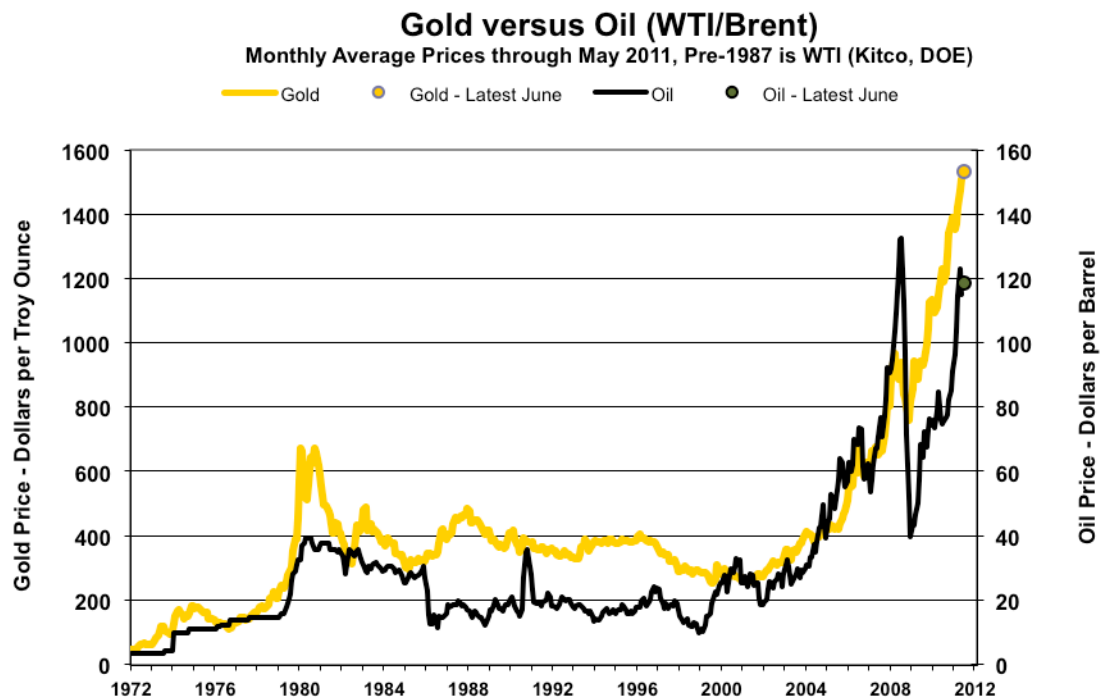
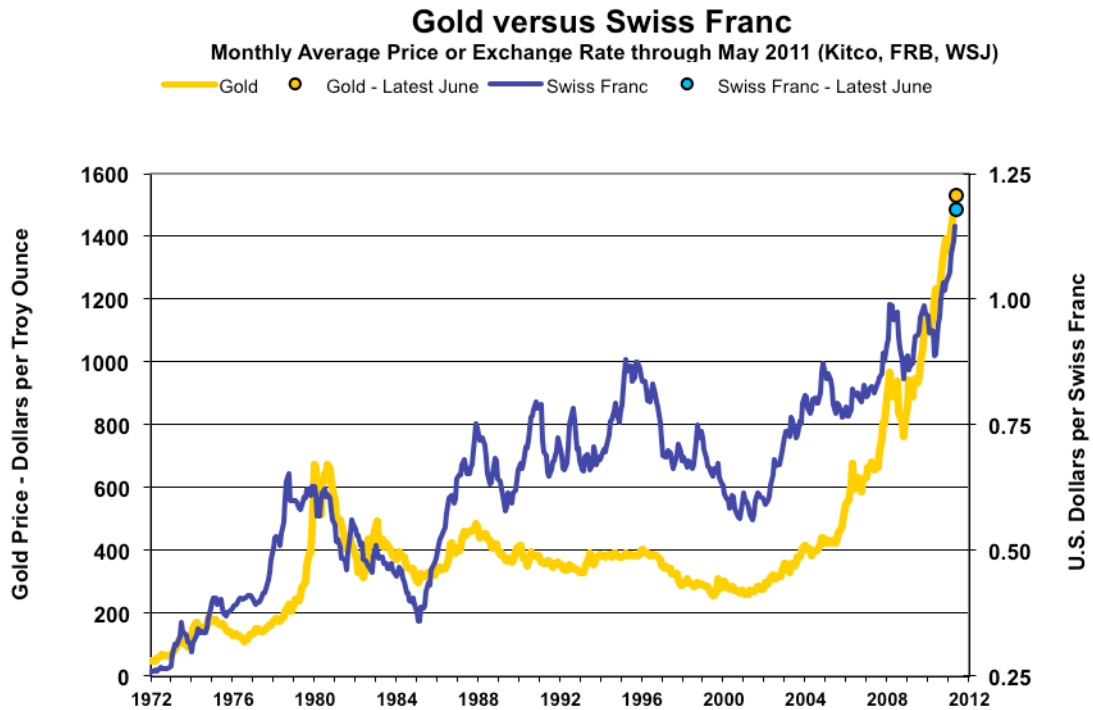
Even with "declining" gasoline prices, today's CPI report was not good news for those hoping for contained inflation. The 0.2% adjusted monthly increase in the May CPI-U included a 0.3% increase in "core" inflation (net of food and energy prices), the inflation concept so heavily touted by the Fed. The more meaningful annual inflation rates, though, were the story. May CPI-U annual inflation jumped to an uncomfortable 3.6% from 3.2% in April, while the CPI-W rose to 4.1% from 3.6%.

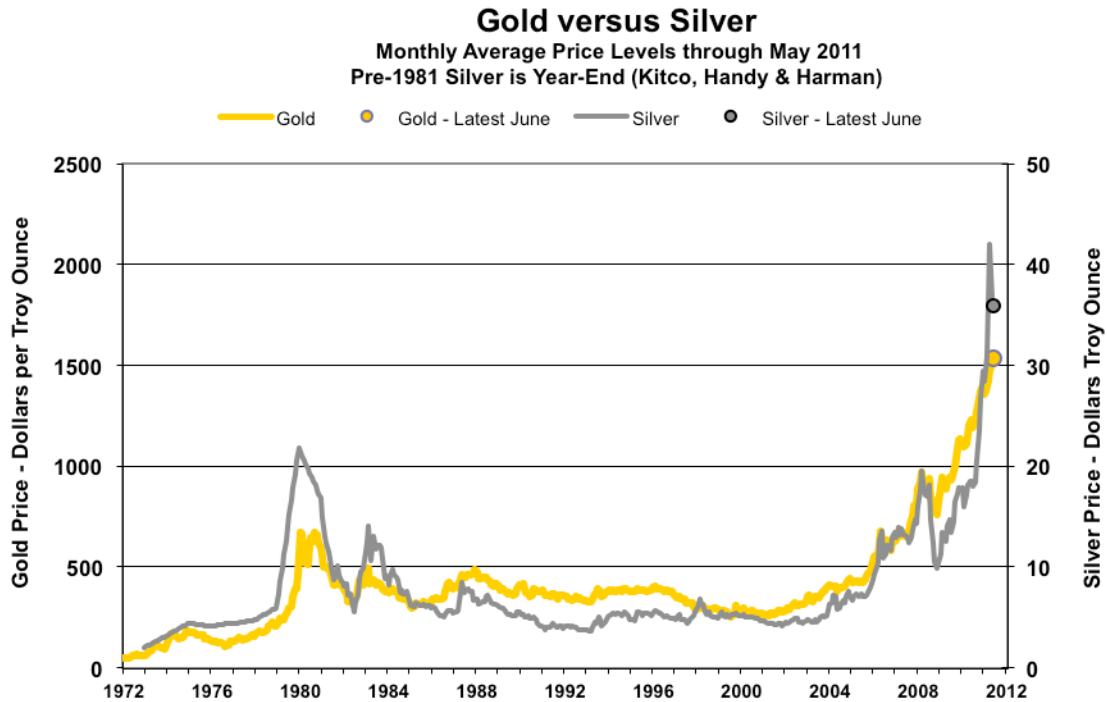
The May PPI gained 0.8% month-to-month, despite an actual monthly decline oil prices that was exacerbated by related seasonal factors. Nonetheless, annual PPI inflation rose to a post-2008 high of 7.3%. The decline in oil prices appears to have been limited, with prices now above May's averages. Heavy selling against the U.S. dollar would tend to provide further upside pressures on oil prices and other commodities denominated in the dollar.

***Consumer Activity Falters.*** With their liquidity squeezed by rising costs and lack of income and credit growth, consumers have cut back on consumption. Based on government reporting, both May and revised April real (inflation-adjusted) retail sales contracted on a monthly basis. Likely further weakness in June would lead to a quarterly contraction in real retail sales for the second quarter.

May industrial production gained 0.1% for the month, but with revisions, this series has shown little growth in 2011. Activity in the production sector has stalled. The Fed blamed April and May weakness on earthquake-induced disruptions to the supply chain of assembly-parts from Japan for U.S. "production." At one time, the United States produced its own parts, which was a much healthier economic circumstance than today's more-common assembly operations of parts manufactured outside the U.S. While the "disruptions" were a factor in soft activity, they also conveniently helped to bring down unwanted inventory levels. With consumption down and inventories up, reduced production usually follows irrespective of any "disruptions."

***Hyperinflation Watch—Watch the Dollar.*** The broad inflation and economic outlooks discussed in [\*Hyperinflation Special Report \(2011\)\*](#) continue unabated, with the economy and reported inflation playing out about as expected. The regular gold-related graphs follow. Various short-term market moves against oil, gold and silver and in favor of the dollar, along with official encouragement of such moves, appear to have run their courses, at least temporarily. As discussed in the *Report*, key to near-term developments for gold, silver and oil is the U.S. dollar, which remains vulnerable to a massive sell-off with little or no further warning. Over the long haul, precious metals and the stronger major currencies remain the strongest hedges against the ultimate collapse of U.S. dollar's purchasing power.





## REPORTING DETAIL

### CONSUMER PRICE INDEX (MAY 2011)

**Annual CPI-W Inflation Tops 4%, CPI-U Inflation Jumps by 0.4% to 3.6%, with Consumer Purchasing Power Taking the Hit.** Reflecting the ongoing effects of the Federal Reserve's actions to debase the U.S. dollar, official annual consumer inflation jumped by 0.4% to 0.5% in May, as the impact of inflation driven by recent Federal Reserve activity reportedly began to spread outside of the Fed's gimmicked "core" concept. Headline news that dropping gasoline prices kept inflation tame in May was the usual Fed/Wall Street hype and nonsense. Although average oil prices temporarily were lower in May, gasoline prices actually rose; it was just the BLS's seasonal adjustments that turned gasoline prices lower in the monthly inflation calculation.

Likely disquieting to those who concentrate on inflation net of food and energy prices, the monthly “core” CPI-U rose by 0.3% in May, versus a 0.2% gain in April, with annual “core” inflation rising to 1.5% in May versus 1.3% in April. Where oil permeates U.S. economic activity, higher oil prices will lead to increase inflationary pressures across many levels of economic activity, from transportation costs to the prices of fertilizers and pharmaceuticals.

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### ***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.*

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**CPI-U.** The BLS reported today (June 15th) that the seasonally-adjusted May 2011 CPI-U rose by 0.17% (up by 0.47%, unadjusted) for the month. That followed an increase of 0.42% (up by 0.64%, unadjusted) in April. The May reporting reflected an unadjusted monthly increase in gasoline prices of 3.6%, which was turned into a monthly contraction of 2.0% by the ongoing happy seasonal adjustments of the BLS. Those gasoline-price-suppressing adjustments have run their course for a while, though. The seasonals turn neutral in June and begin boosting adjusted gasoline prices in July.

The pace of annualized, seasonally-adjusted CPI-U inflation slowed slightly in the most recent three months (ended May) to 5.67%, versus 6.01% in the three months ended April.

May’s unadjusted year-to-year CPI-U inflation surged once again, to 3.57%, the strongest pace of annual inflation since October 2008. May’s annual inflation rate was up from 3.16% in April.

Year-to-year inflation would increase or decrease in next month’s June 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.17% gain in the adjusted monthly level reported for June 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To

approximate the annual inflation rate for June 2011, the difference in June's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from May 2011's reported annual inflation rate of 3.57%. Annual CPI-U inflation should move to top 4% in the next couple of months. The CPI-W broke that barrier, hitting 4.12% in today's reporting.

**CPI-W.** The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose in May 2011 by 0.14% (up 0.55% unadjusted), following April's adjusted monthly increase of 0.50% (up 0.78% unadjusted).

The pace of annualized, seasonally-adjusted CPI-W inflation also slowed slightly, due gasoline-price-suppressing seasonals, to 6.56% in the most recent three months (ended May), versus 7.01% in the three months ended April.

Unadjusted, May 2011's year-to-year CPI-W inflation was 4.12%, against a 3.64% annual increase in April.

**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 3.28% in May 2011 versus 2.92% in April.

**Alternate Consumer Inflation Measures.** Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 6.9% in May 2011, up from 6.5% in April, while the SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 11.2% (11.15% for those using the extra digit) in May, from about 10.7% in April.

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.

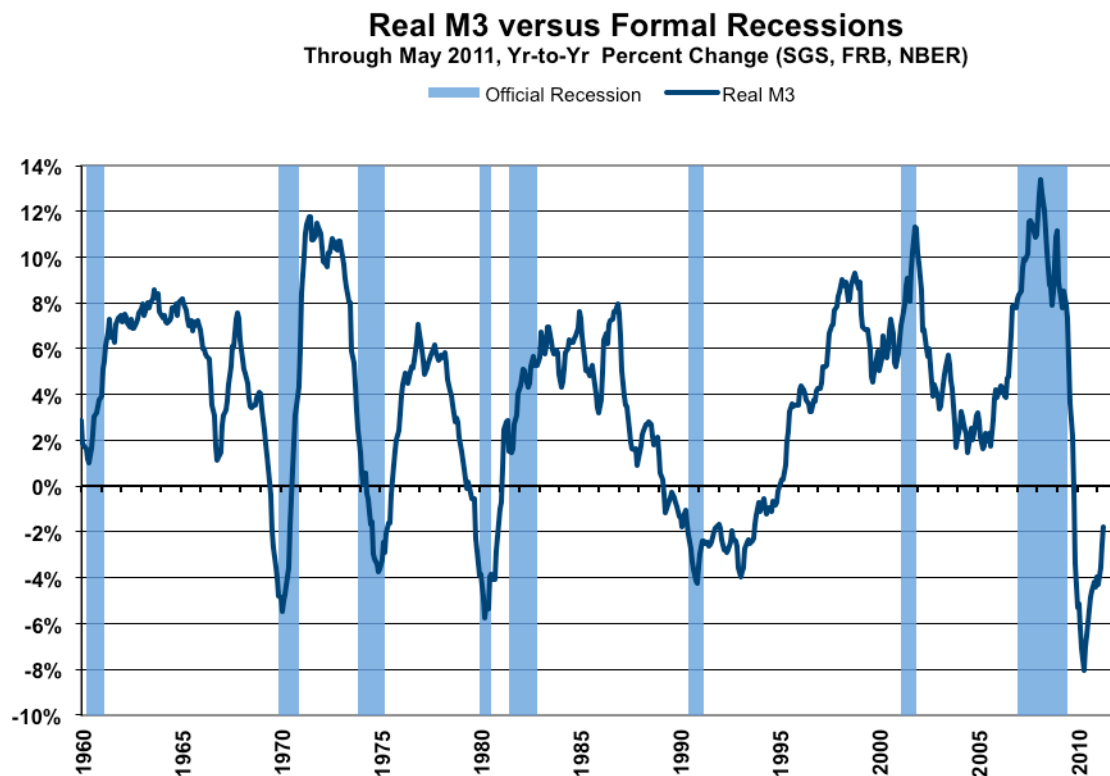
**Gold and Silver Highs Adjusted for CPI-U/SGS Inflation.** Despite the June 6th historic-high gold price of \$1,549.00 per troy ounce (London afternoon fix) and the multi-decade high silver price of at \$48.70 per troy ounce (London fix of April 28th), gold and silver prices have yet to approach their 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 \$2,469 per troy ounce, based on May 2011 CPI-U-adjusted dollars, \$8,442 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 May 2011 CPI-U inflation, the 1980 silver

price peak would be \$144 per troy ounce and would be \$491 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 May CPI-U report and the latest May SGS-Ongoing M3 Estimate, the annual contraction in real M3 for May 2011 was 1.8%, versus a 2.5% annual contraction in April.



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.

## PRODUCER PRICE INDEX (MAY 2011)

**Annual PPI Inflation Rose to 7.3% in May.** As reported yesterday, June 14th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) rose in May 2011 by 0.2% (up by 0.6% before seasonal adjustment) month-to-month, following a monthly increase of 0.8% in April (up by 1.2% before seasonal adjustment). The adjusted monthly PPI finished goods reflected “core” inflation, also up 0.2%, with upside pressures from energy (despite declining oil prices and negative seasonals) offset largely by declining food prices.

Annualized, seasonally-adjusted PPI inflation for the three months ended May 2011 dropped to 7.0% from 13.1% reported in April. Unadjusted and year-to-year, May 2011's PPI inflation jumped to 7.3%—the highest level since September 2008—up from 6.8% in April. 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.

Separately, on a monthly basis, seasonally-adjusted May 2011 intermediate goods rose by 0.9% (up by 1.3% in April), with May's crude goods prices down by 4.1%, after rising by 4.0% in April.

Year-to-year inflation in May intermediate goods was up by 10.3% (a 9.4% gain in April), with May's annual inflation in crude goods at 22.8%% (up by 23.7% in April).

## RETAIL SALES (MAY 2011)

**With Revisions, Real Retail Sales Were Down for a Second Month.** Given downside revisions to prior estimates of March and April 2011 monthly retail sales, and with the initial reporting of May retail sales in outright monthly contraction, inflation- and seasonally-adjusted sales contracted in both April and May. Any further real weakness in June should tip second-quarter real retail sales into contraction versus the first-quarter, a circumstance that would not bode well for quarterly GDP reporting.

**Nominal (Not-Adjusted-for-Inflation) Retail Sales.** Yesterday's (June 14th) May 2011 retail sales report—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly decline of 0.24% (down by 0.57% before prior-period revisions) +/- 0.6% (95% confidence interval), versus a revised April monthly gain of 0.28% (previously a 0.51% increase). At work here remain extreme seasonal-factor distortions as discussed in the [Hyperinflation Special Report \(2011\)](#).

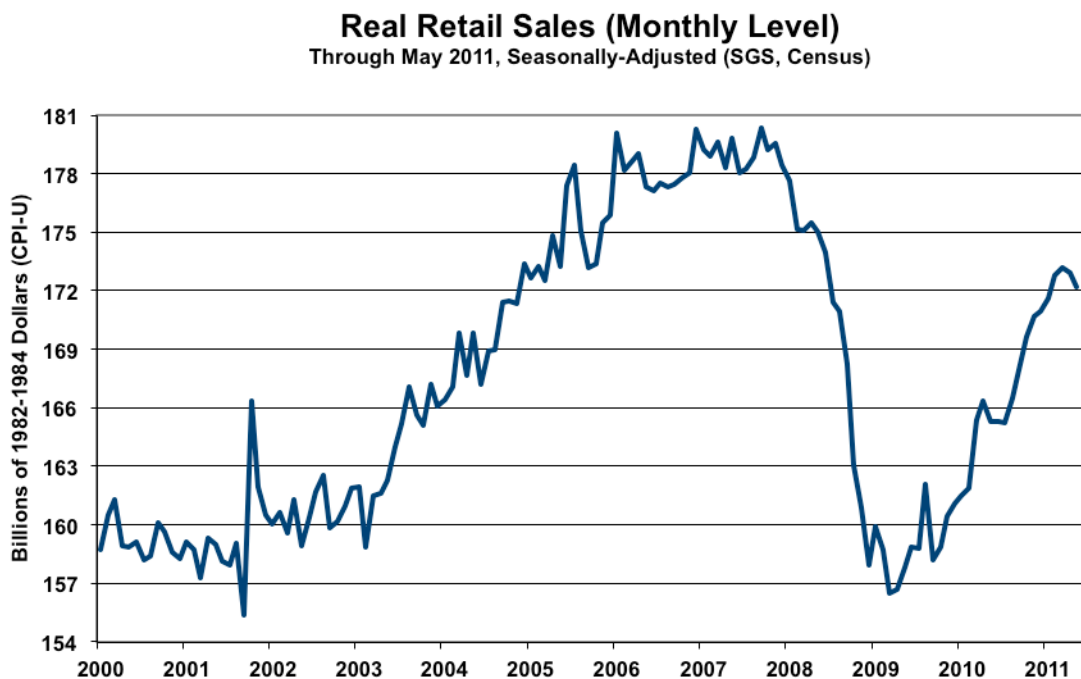
On a year-to-year basis, May 2011 retail sales were reported up by 7.73% from May 2010, versus a revised year-to-year April 2011 gain of 7.27% (previously 7.57%).

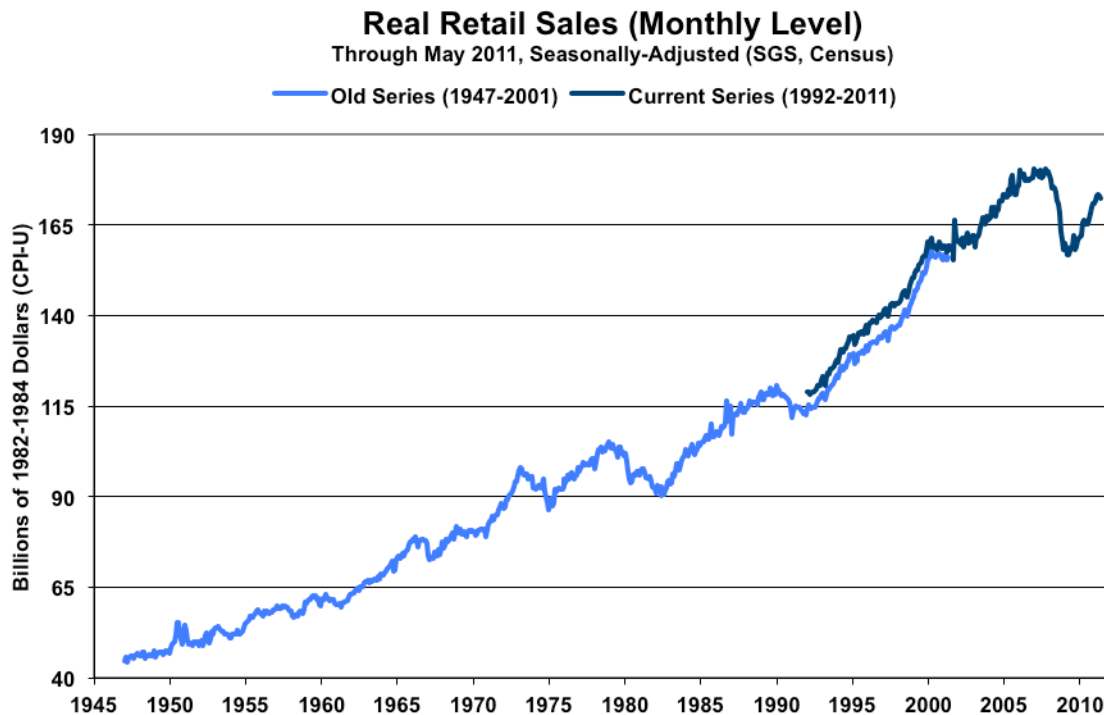


***Real (Inflation-Adjusted) Retail Sales.*** Based on the May 2011 CPI-U reporting, inflation- and seasonally-adjusted monthly May 2011 retail sales declined by 0.40%, where, before inflation adjustment, the current number was down by 0.24%. Real April sales revised to a decline of 0.14% (previously a gain of 0.09%).

May's real retail sales rose at a year-to-year pace of 4.14%, versus a revised 4.02% (previously 4.32%) annual gain reported for April.

The ongoing “recovery” in real retail sales is reflected in the following graphs, which show the latest monthly levels of inflation- and seasonally-adjusted activity. The first of these shows close historical detail for the period beginning in 2000, the second shows the same data in historical context since World War II.





Using the SGS Alternate-CPI Inflation estimates for deflation of the retail series would not have shown 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 suffer from the ongoing consumer liquidity squeeze, these data have started to turn down in 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 become 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:* May 2011 versus April 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was down by 0.3% versus an official aggregate decline of 0.2%.

*Version II:* May 2011 versus April 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations—was down by 0.2% versus the aggregate decline of 0.2%.

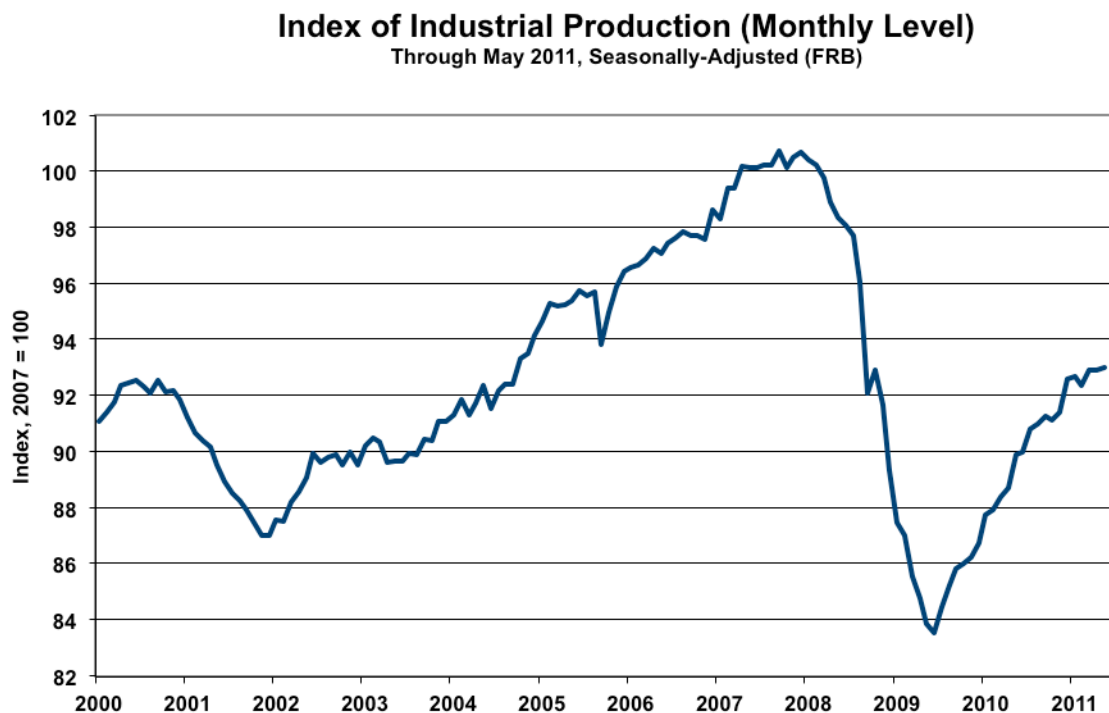
## PRODUCTION

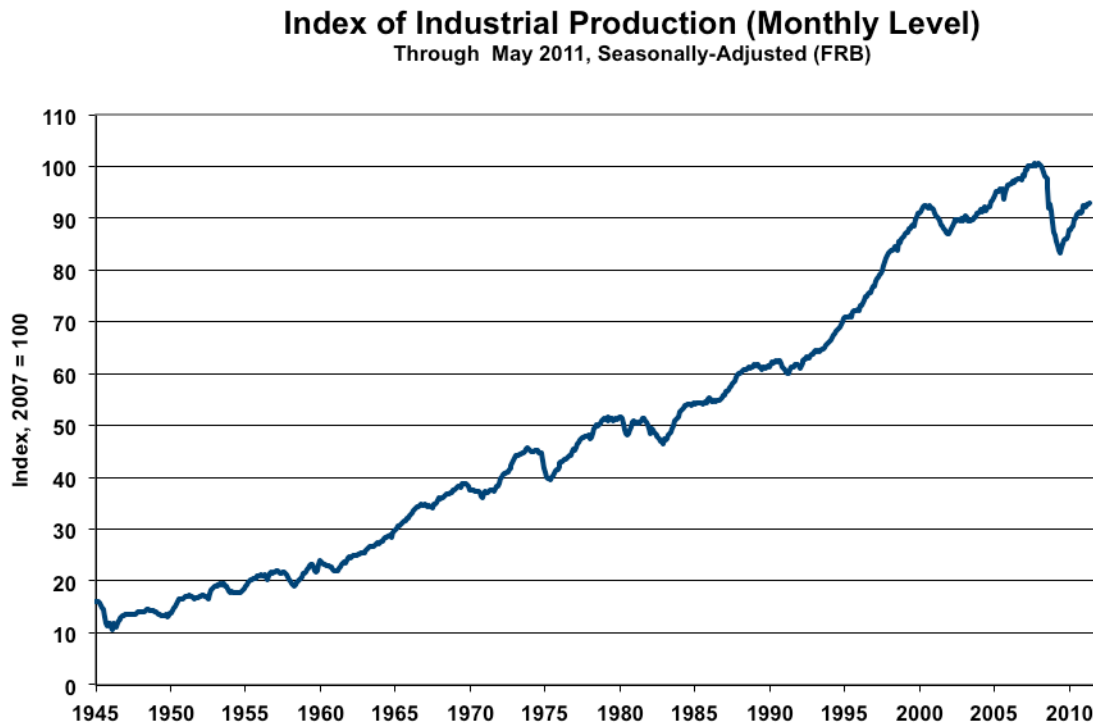
**Industrial Production Remained Stalled in May.** This morning's (June 15th) Federal Reserve Board release of seasonally-adjusted May 2011 industrial production showed a monthly gain of 0.10% (a decline of 0.12% net of prior-period revisions) versus April. In turn, monthly change in April production was virtually flat, down a revised 0.03% (previously down by 0.01%). The Fed blamed earthquake-induced disruptions to the supply chain of assembly-parts from Japan for U.S. "production." While this was a factor, the "disruptions" also help to bring down unwanted inventory levels.

Year-to-year growth in May 2011 production was 3.42%, slower than the revised 4.71% (previously 4.95%) in April, and down from the recent relative peak year-to-year change of 7.75% in June 2010. The year-to-year contraction of 14.83% seen in June 2009 was the steepest annual decline in production growth since the shutdown of war-time production following World War II.

The "recovery" in industrial production is reflected in the following graphs. Both graphs show the monthly level of the production index. The first of these shows close historical detail for the period beginning in 2000, the second shows the same data in historical context since World War II.

For the last 33 months, the production index has averaged 89.0, around which the series has fluctuated. Although it had been moving higher, it has started to flatten out in recent months. The May reading was at 93.0, just 0.4% above where it was in December 2010.





**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.

***Residential Construction (May 2011).*** Due for release tomorrow, 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.

***Home Sales (May 2011).*** May existing home sales (National Association of Realtors) are due for release on Tuesday, June 21st, followed by new home sales (Census Bureau) on Thursday, June 23rd. As with the likely continuing broad deterioration in housing starts, these volatile series should remain extremely weak, with any positive monthly change (new homes) again lacking statistical significance. Also, as usual, given the extreme volatility, reporting error and revisions in these series, given the poor-quality seasonal adjustments, given continuing negative anecdotal evidence, and given ongoing massive distortions from increasingly volatile foreclosure activity, the monthly movements in these numbers (particularly to the upside) remain meaningless.

***Gross Domestic Product—GDP (First-Quarter 2011—Second Revision or Third Estimate).*** The second revised estimate of first-quarter GDP is due for release from the Bureau of Economic Analysis (BEA) on Friday, June 24th. Changes at the second revision are not likely to be much more than statistical noise around the first revision, which showed headline, annualized real growth of 1.8%. Annual GDP revisions, however, are due on July 29th, along with the “advance” estimate of second-quarter GDP. A lowered level of first-quarter GDP is likely as an artifact of the pending major downside revisions to previously-reported GDP activity. The BEA, however, usually tries to keep the annualized quarter-to-quarter growth rate of the last quarter before the revisions (first-quarter 2011 GDP in this case) as close to the prior reporting as possible. Such helps divert media attention some from earlier downside changes.

***New Orders for Durable Goods (May 2011).*** Due for release on Friday, June 24th, May’s new orders for durable goods likely will not show a meaningful monthly change, with odds slightly favoring a decline in this irregularly volatile series.

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