

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

**COMMENTARY NUMBER 378**  
**June Retail Sales, PPI, May Trade Deficit**

**July 14, 2011**

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**At Best, Inflation-Adjusted Retail Sales Showed No Growth in Second-Quarter 2011**

**Trade Data Should Offer a Positive Contribution to Second-Quarter GDP Growth**

**Wholesale Inflation Spreading to Broad Economy,  
Despite Short-Lived Dip in Oil and Gasoline Prices**

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*PLEASE NOTE: The next regular Commentary is scheduled for tomorrow, Friday, July 15th. It will cover June CPI and industrial production.*

*—Best to all, John Williams*

**Opening Comments and Executive Summary.** The general outlook for an intensifying downturn in U.S. economic activity, along with an escalating pace of consumer inflation, remains in place despite June reporting of a minimal monthly gain in retail sales and a monthly inflation decline for finished goods in the producer price index. A full economic and inflation update will follow in tomorrow's (July 15th) *Commentary*, following the releases of the June consumer price index and industrial production.

**June Retail Sales.** The reported 0.1% seasonally-adjusted monthly gain in June 2011 retail sales was statistically indistinguishable from a monthly contraction. It also is at fair risk of being offset by June

CPI-U inflation in tomorrow's reporting. Where consensus expectations appear to be for a 0.1% monthly contraction in the seasonally-adjusted CPI-U, reporting risk is to the upside of that consensus. Even with a consensus CPI, real (inflation-adjusted) retail sales would be flat, quarter-to-quarter, for second-quarter 2011. That is not a positive indicator for the upcoming "advance" estimate of second-quarter GDP on July 29th. At best, real consumer spending has stalled, along with officially-estimated real disposable income.

**May Trade Deficit.** With negative implications for the exchange-rate value of the U.S. dollar, the monthly trade deficit widened to \$50.2 billion in May 2011, up from \$43.6 billion in April 2011, and up from \$42.2 billion in May 2010. The May 2011 reading was the largest monthly trade shortfall reported since October 2008. Where April 2011 imports had been depressed by an earthquake-induced reduction in U.S. imports of auto parts from Japan, the May number showed little catch-up in that area.

The deterioration in May's trade shortfall reflected both a decline in exports as well as a surge in imports. The import gain included some strength from higher oil prices as well as from increased physical volume of imported oil. With the April and May reporting, the seasonally- and inflation-adjusted numbers now are in place for the guesstimated net-export account contribution to the "advance" estimate of second-quarter GDP growth (July 29th). The trade data suggest a positive contribution to that GDP estimate.

**June PPI.** The seasonally-adjusted producer price index fell by 0.4% month-to-month in June 2011, due largely to the short-lived dip in oil and gasoline prices. Nonetheless, the so-called "core" monthly measure picked up to 0.3% from 0.2% in May, as the impact of higher energy costs spread into the broad economy. Year-to-year finished-goods inflation softened to 7.0% in June, from 7.3% in May, but annual inflation rates jumped to 11.0% for intermediate goods and to 26.2% for crude goods.

**Hyperinflation Watch—U.S. Default and/or Downgrade Still Unlikely.** A deficit-reduction gridlock in Washington and increasing threats of a U.S. default and/or downgrades to U.S. debt only encourage flight from the U.S. dollar and rapidly diminish already-already-impaired global confidence in the world's reserve currency. Although an actual U.S. default or rating downgrade remains unlikely, the damage from the ongoing fiscal catastrophe, and from hints of a possible QE3 (yes, the economy will be that weak) by Fed Chairman Bernanke, to U.S. dollar confidence should endure. In the event of an actual default or downgrade, the United States' position as the elephant in the bathtub of sovereign risk likely would cause the U.S. dollar to plummet against all major currencies, irrespective of any ongoing concerns related to euro-area debt.

The broad inflation and economic outlooks discussed in the [Hyperinflation Special Report \(2011\)](#) continue to unfold. A more complete review will follow in tomorrow's *Commentary*.

## REPORTING DETAIL

### RETAIL SALES (JUNE 2011)

**Quarterly Real (Inflation-Adjusted) Retail Sales Likely Were No Better than Flat in Second-Quarter.** As with the nonfarm payroll numbers, the retail sales numbers undergo concurrent seasonal-factor adjustment, where current and historical seasonal factors are revised every month. The stability of the seasonal-adjustment process, however, has been disrupted by the unprecedented depth and length of the current economic downturn in the post-World War II era (the period of modern economic reporting), as discussed in the [Hyperinflation Special Report \(2011\)](#). These issues have distorted monthly reporting for a number of key series, leaving the markets effectively flying blind on actual underlying economic activity. That said, the latest seasonal recalculations appear to have boosted June retail sales from what would have been a statistically meaningless and small decline, to a statistically meaningless and small gain. While the monthly gain was statistically indistinguishable from a contraction, it was enough to have had some impact on the financial markets.

Depending on June CPI-U reporting, due tomorrow (July 15th), real (inflation-adjusted) retail sales in second-quarter 2011 likely fared no better than an unchanged level versus the first-quarter. An upside CPI surprise could generate a contraction in quarterly real retail sales. What looms here is not a plus for pending second-quarter GDP reporting (July 29th).

**Nominal (Not-Adjusted-for-Inflation) Retail Sales.** Today's (July 14th) report on June 2011 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly increase of 0.14% (up by 0.17% before prior-period revisions) +/- 0.6% (95% confidence interval), versus a revised May decline of 0.12% (previously down by 0.24%). Most of the narrowing in the reported monthly decline in May was due to a 0.09% downward revision to April's sales level.

On a year-to-year basis, June 2011 retail sales were reported up by 8.06%, versus a revised year-to-year May 2011 gain of 7.79% (previously 7.73%).

**Real (Inflation-Adjusted) Retail Sales.** Details on real retail sales for June will be published in tomorrow's (July 15th) *Commentary*, along with detail on the June 2011 CPI-U reporting. Even with a consensus seasonally-adjusted 0.1% monthly contraction in the June CPI-U, quarterly real retail sales would be unchanged for second-quarter 2011. Odds favor an upside CPI surprise for June, and a possible real retail sales quarterly contraction.

**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:* June 2011 versus May 2011 seasonally-adjusted retail sales—net of total grocery store and gasoline station revenues—was up by 0.3% versus an official aggregate gain of 0.1%.

*Version II:* June 2011 versus May 2011 seasonally-adjusted retail sales—net of the monthly change in revenues for grocery stores and gas stations— was up by 0.3% versus an official aggregate gain of 0.1%.

## PRODUCER PRICE INDEX (JUNE 2011)

### **Despite Short-Lived Dip in Oil and Gasoline Prices, Inflation Is Spreading into the Broad Economy.**

As reported this morning, July 14th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for June 2011 fell by 0.4% (down by 0.7% before seasonal adjustment) month-to-month, following a monthly increase of 0.2% (up by 0.6% before seasonal adjustment) in May. The adjusted, monthly June PPI finished goods number, once again reflected above-consensus “core” inflation, up 0.3%, versus a 0.2% gain April, with inflationary pressures from higher energy costs spreading into the broad economy.

Annualized, seasonally-adjusted PPI inflation for the three months ended June 2011 slowed to 2.4% from 7.0% reported in May. Unadjusted and year-to-year, June 2011's PPI inflation was 7.0%, versus 7.3% in May. Year-to-year inflation in intermediate and crude goods, though, rose (see below). The recent run-up in prices generally has reflected ongoing impact of the Fed's dollar-debasement policies, not surging economic demand. With both oil and gasoline prices appearing to have bottomed in the last month, and with seasonal factors pushing reported energy prices higher in the next several months, the PPI should resume its pattern of seasonally-adjusted monthly increases with the July's reporting.

Separately, on a monthly basis, seasonally-adjusted June 2011 intermediate goods were unchanged, versus a 0.9% gain in May, with June's crude goods prices down by 0.6%, after falling 4.1% in May. Year-to-year inflation in June intermediate goods was 11.0%, up from 10.3% in May, with June's annual inflation in crude goods at 26.2%, up from May's 22.8% gain.

## TRADE DEFICIT (MAY 2011)

**Combined April and May Trade Numbers Suggest a Positive Contribution to “Advance” Second-Quarter GDP.** Although the May trade deficit was the worst monthly showing since October 2008, the narrowed deficit in April (due largely to reduced imports of Japanese auto parts) and adjustment for inflation—including rising oil prices—left the partial second-quarter numbers as likely positive contributors to the initial estimate of second-quarter 2011 GDP growth (due for release on July 29th).

**Nominal (Not-Adjusted-for-Inflation) Trade Deficit.** The Bureau of Economic Analysis (BEA) and the Census Bureau reported Tuesday (July 12th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for May 2011 widened to \$50.2 billion from a revised \$43.6 (previously \$43.7) billion in April. The May 2011 deficit also widened from \$42.2 billion a year ago.

Against April, the May trade balance showed a decline in exports as well as an increase in imports. Oil helped to boost the imports, where the effect of still-rising oil prices was enhanced by increasing physical import volume. Specifically, for the month of May 2011, the not-seasonally-adjusted average price of imported oil was \$108.70 per barrel, up from \$103.18 in April 2011, and up from \$76.95 in May 2010. In terms of not-seasonally-adjusted physical oil imports, May 2011 volume averaged 8.879 million barrels per day, up from 8.408 million in April 2011, but down from 9.082 million in May 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 May 2001 merchandise trade deficit came in at \$47.8 billion, up from a revised \$43.9 (previously \$44.2) billion in April.

Based on the average of the two months' reporting, the real second-quarter 2011 merchandise deficit annualizes out to \$550.2 billion, versus \$604.9 billion in the first-quarter, and against \$557.0 in fourth-quarter 2010. The net export account guesstimate for the "advance" estimate of second-quarter GDP will be based on the two months of reporting, and the latest data suggest a positive contribution to the initial GDP growth estimate.

**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.

***Consumer Price Index—CPI (June 2011).*** Due for release tomorrow, Friday, July 15th, June's CPI headline number is at risk surprising a negative consensus expectation (a 0.1% contraction per Briefing.com) on the upside. Although the monthly average gasoline price in June was down by 5.7% (per the Department of Energy), seasonal factors in June move to neutral there, having depressed adjusted gasoline prices in May. The seasonals will begin to boost adjusted gasoline prices in July. Higher food prices and otherwise spreading inflationary pressures in the broad economy should keep the CPI-U in positive territory, again, stronger than expectations.

Year-to-year inflation would increase or decrease in 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%. For example an adjusted 0.2% monthly gain in the June CPI-U would keep annual CPI-U inflation at about 3.6%, a consensus 0.1% contraction would lower the annual inflation pace to about 3.3%. In any event, that inflation pace should move to top 4% in the next couple of months. The CPI-W broke that barrier, hitting 4.12%, in last month's reporting.

***Industrial Production (June 2011).*** Due for release tomorrow, Friday, July 15th, June's industrial production could show an outright monthly contraction, as the "stall" in recent activity rolls into renewed downturn. In any event, a downside reporting surprise again is a fair bet against moderately positive consensus expectations.

***Residential Construction (June 2011).*** Due for release on Tuesday, July 19th, June's housing starts likely continued a general declining trend, 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.