

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

**COMMENTARY NUMBER 385**  
**July CPI, PPI, Industrial Production and Housing Starts**

**August 18, 2011**

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**Inflation Spreads Throughout Economy as Annual “Core” Inflation Jumps Again**

**Consumer Inflation at 33-Month High**

**July’s Annual Inflation: 3.6% (CPI-U), 4.1% (CPI-W), 11.2% (SGS)**

**Retail Sales Gain Vanishes, Net of Inflation**

**Unusual Heat and Japanese Auto Assembly Parts Boosted Production**

**Housing Activity Remains Moribund**

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*PLEASE NOTE: The next regular Commentary is scheduled for Friday, August 26th. It will cover the first revision to the second-quarter 2011 GDP estimate, July 2011 new orders for durable goods and new home sales. A Special Commentary would be published, as appropriate, in response to any unusual market or economic developments.*

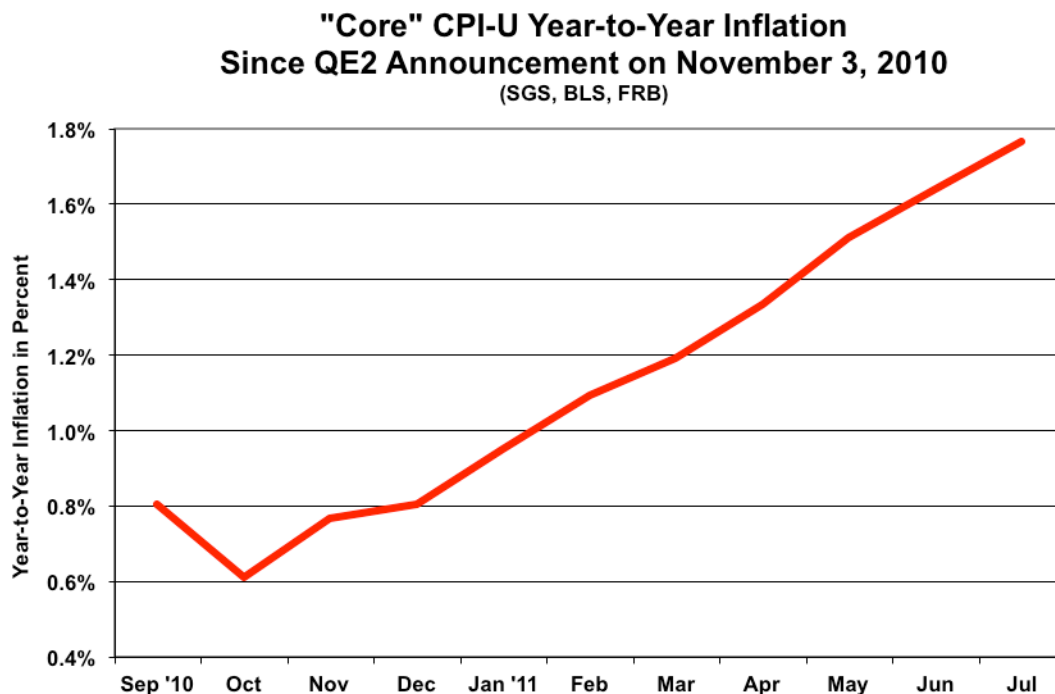
*—Best to all, John Williams*

**Opening Comments and Executive Summary.** The U.S. economy continues to falter as the pace of inflation picks up. With the Fed and the U.S. government twiddling their thumbs as they contemplate devil's choices, the financial markets remain unstable and the U.S. dollar is viewed increasingly as the investment currency of last choice. The U.S. political situation remains untenable. Those currently controlling Washington lack the ability or the political will to address the country's fiscal insolvency and/or ongoing economic depression. Any cosmetic actions taken pre-2012 election likely only will add to the long-term inflation and dollar-debasement problems.

The Federal Reserve, however, still has the ability to act, but it has no happy choices. As the systemic solvency crises comes to another head (both domestically and globally), along with a fall-off in economic activity, financial-market upheaval and an escalating global flight from the U.S. dollar, either the Fed can let the system go once again to the brink of collapse and let the system fail, or the Fed can attempt once again to liquefy the system (both domestically and globally). The latter choice would exacerbate the U.S. dollar crisis and inflationary pressures, but it would be consistent with prior policy that appears to have been aimed at forestalling systemic collapse, for as long as possible, irrespective of the ultimate cost to U.S. credibility or financial stability. The Fed can continue to prop the system over the short-term, by creating as much money as needed, but only until such time as domestic and foreign holders alike abandon the increasingly-worthless U.S. dollar.

Assuming the Fed moves to avoid systemic collapse, some form of QE3 (covert and/or overt) is likely in the near future, under the cover of a weakening economy and/or financial market woes.

**July CPI, PPI.** Both the consumer and producer price indices for July surprised consensus forecasts on the upside, with the inflationary impact of the Fed's dollar-debasement policies spreading beyond oil and gasoline prices, to the general U.S. economy.



As seen in the updated graph, the current rise in annual “core” inflation started following Mr. Bernanke’s efforts, first at jawboning, and then actually moving to debase the U.S. dollar with the announcement of QE2 on November 3, 2010. The annual “core” CPI-U was at 0.61% in October 2010, and it was reported at 1.77% in July 2011, up from 1.64% in June, and up for the ninth consecutive month.

The full CPI and PPI annual inflation rates—including the food and energy components consumed by most everyone—are at or near respective 33-month highs of 3.63% and 7.19%. Other than any short-lived effects from oil-price volatility in the unstable financial markets, annual inflation will be headed higher in the months ahead. In the wake of a possible U.S. dollar panic, that inflation could be much higher.

**July Real Retail Sales, Industrial Production and Housing Activity.** The entire gain in July retail sales was accounted for by rising prices, not by rising physical demand for consumer goods and services. The 0.5% monthly gain in July consumer prices entirely offset the 0.5% sales gain. Such is not a happy indicator for consensus forecasts of an economic recovery surfacing in the second-half of the year.

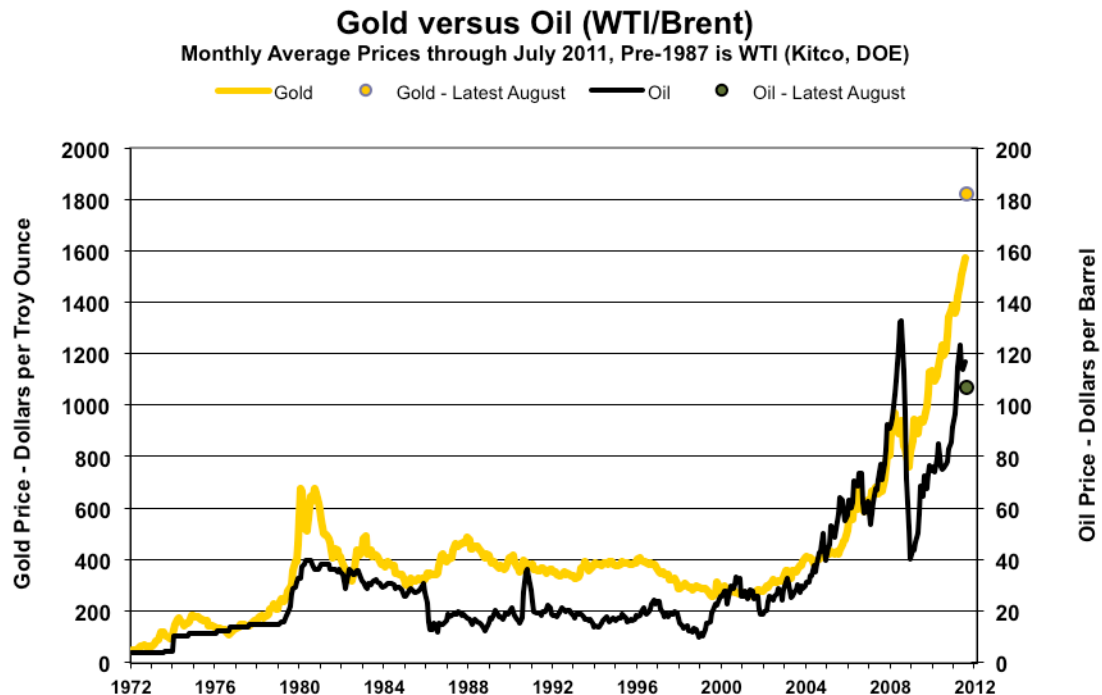
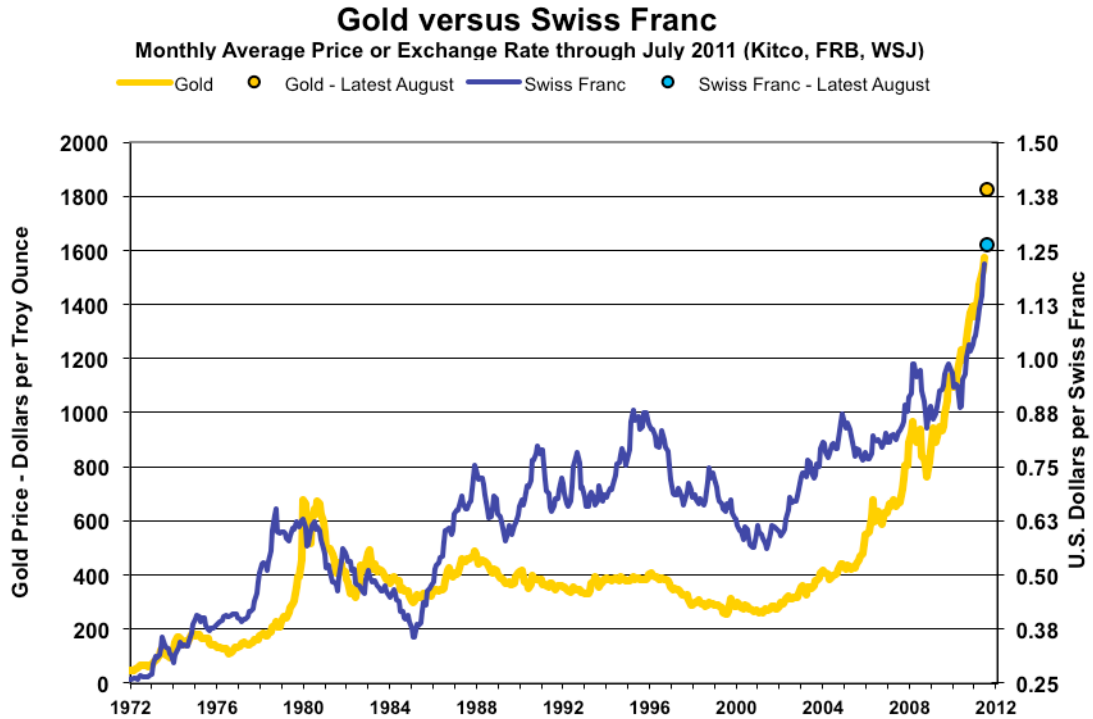
July industrial production, however, did show relatively good monthly growth of 0.9%. The biggest factors behind the gain—a spike to utility usage from an unseasonably severe heat wave, and increased auto assemblies due to a restart of parts supplies from earthquake-damaged Japan—will not be repeated, necessarily.

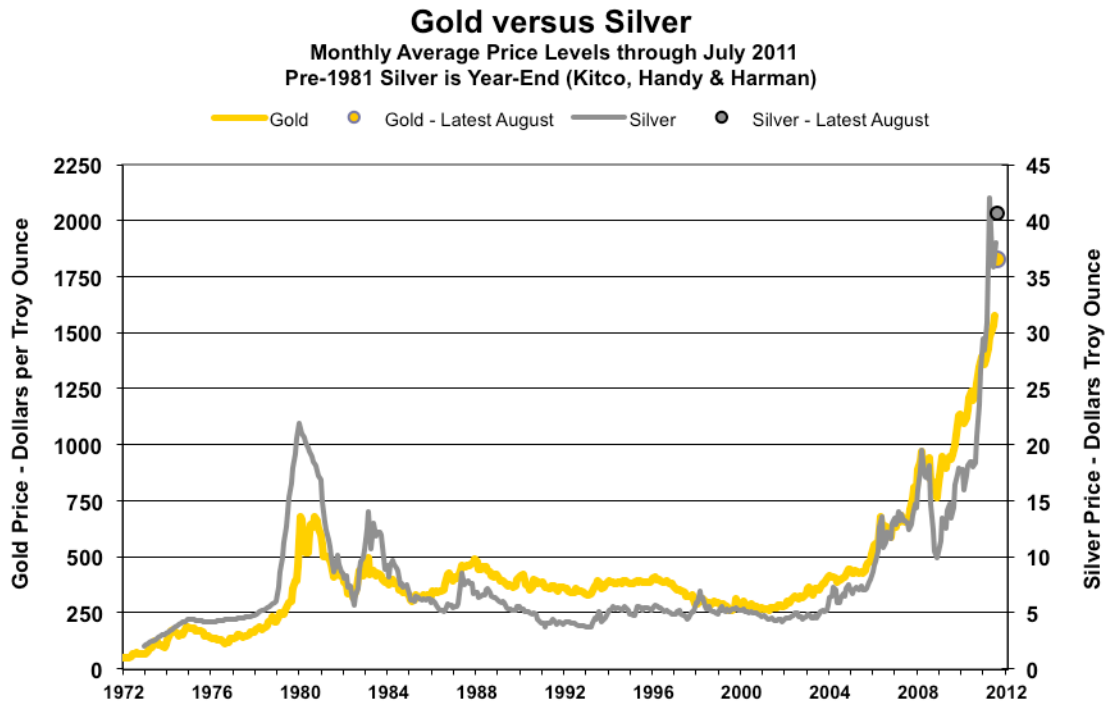
Housing starts and existing home sales both saw small monthly contractions in July. The industry kept bottom-bouncing in a slow, downward trend, with starts still down 75% from peak business seen in 2006.

**Hyperinflation Watch—Gold Signals Instability and Inflation.** As we go to press with today’s (August 18th) *Commentary*, gold continues to soar, hitting a record London afternoon fix of \$1,824.00 per troy ounce. For those in the U.S. dollar, soaring gold prices can signal—and likely are signaling—looming inflation, as well as domestic and global political instabilities. Irrespective of official efforts to contain the price of gold, or of any short-lived heavy selling/profit taking, the signal is sound. Gold prices should head much higher over the longer-term as the U.S. dollar faces ongoing and severe debasement.

The broad inflation and economic outlooks discussed in the [Hyperinflation Special Report \(2011\)](#) continue to unfold and are unchanged. As noted in recent *Commentaries*, the financial markets remain unstable and extremely volatile, roiled by crises of confidence in the U.S. dollar and in the long-term outlook for U.S. financial, economic, systemic and political stability. For those living in a U.S. dollar-denominated world, regardless of further near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold (as noted above), the stronger currencies and precious metals remain the fundamental hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets could start at anytime, with little or no further warning. With a U.S. government unwilling to balance or even address its uncontrollable fiscal condition; with the federal government and Federal Reserve ready to prevent a systemic collapse, so long as it is possible to print and spend whatever money is needed; and with the U.S. dollar at risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.





The preceding, usual graphs of gold, versus the Swiss franc, oil and silver, are updated for today's early market activity. Efforts by the Swiss National Bank to contain the Swiss franc's rally have met with some success, albeit likely short-lived. The markets remain extremely unstable, with unusual crosscurrents and likely manipulations in some areas.

## REPORTING DETAIL

### CONSUMER PRICE INDEX—CPI (JULY 2011)

**Persistent Annual Inflation Increases Seen in “Core” Inflation.** Despite a seasonally-adjusted boost to otherwise weak gasoline prices, July CPI reporting showed a continued spread of inflationary pressures well beyond the energy and food sectors. Such has to be distressing to those, such as Fed Chairman Ben Bernanke, who take refuge in the “core” inflation concept, ignoring food and energy inflation. Keep in mind that rising “core” inflation reflects upside pricing pressures from the spreading of the effects of higher oil prices (driven by the Fed's dollar-debasement policies), not from economic demand. It is graphed in the *Opening Comments and Executive Summary* section.

### ***Notes on Different Measures of the Consumer Price Index***

*The Consumer Price Index (CPI) is the broadest inflation measure published by the 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 (August 18th) that the seasonally-adjusted July 2011 CPI-U jumped by 0.50% (up by 0.09%, unadjusted) for the month. That followed a decline of 0.22% (down by 0.09%, unadjusted) in June. The July reporting reflected an unadjusted 1.5% drop in monthly average gasoline prices, which was turned into a seasonally-adjusted monthly gain of 4.7% by the shifting of gasoline-price seasonal-adjustment factors to a price-boosting mode.

July's unadjusted year-to-year CPI-U inflation rose to 3.63%, from June's 3.56%, the strongest pace of annual inflation since October 2008.

The July report also showed inflationary pressures from higher energy prices spreading further into the broad economy (see the graph and comments in *Opening Comments and Executive Summary*). On an annual basis, “core” CPI-U inflation notched higher for the ninth straight month, up to 1.77% in July from 1.64% in June. When Fed Chairman Bernanke used his jawboning in an effort to debase the U.S. dollar in the markets, in advance of announcing QE2 in November 2010, annual “core” inflation was at 0.61%.

Year-to-year total CPI-U inflation would increase or decrease in next month's August 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.21% gain in the adjusted monthly level reported for August 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for August 2011, the difference in August's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from July 2011's reported annual inflation rate of 3.63%. Annual CPI-U inflation

should move to top 4% in the next couple of months. The CPI-W broke that barrier in May, hitting 4.1% (4.12%), where it held at 4.1% (4.06%) in June, and again at 4.1% (4.11%) in today's reporting.

**CPI-W.** The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose by 0.59% (up by 0.07% unadjusted), following June's decline of 0.34% (down by 0.19% unadjusted).

Unadjusted, July 2011's year-to-year CPI-W inflation was 4.11%%, against a 4.06% annual increase in June. The July annual CPI-W is the first of three months to be averaged into the next Social Security cost of living adjustment (COLA), net of any residual deflation from recent years.

**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 and some members of Congress, as the replacement for the CPI in COLA adjustments—is reported only on an unadjusted basis. Year-to-year inflation increased to 3.47% in July, up from 3.37% in June.

**Alternate Consumer Inflation Measures.** Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 7.0% in July 2011, up from 6.9% in June, while the SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, notched higher to about 11.2% (11.21% for those using the extra digit) in July, from about 11.1% in June.

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 today's (August 18th) historic-high gold price of \$1,824.00 per troy ounce (London afternoon fix), and despite the multi-decade high silver price of \$48.70 per troy ounce (London fix of April 28th), gold and silver prices have yet to re-hit 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 \$2,468 per troy ounce, based on July 2011 CPI-U-adjusted dollars, \$8,594 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 July 2011 CPI-U inflation, the 1980 silver price peak would be \$144 per troy ounce and would be \$500 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

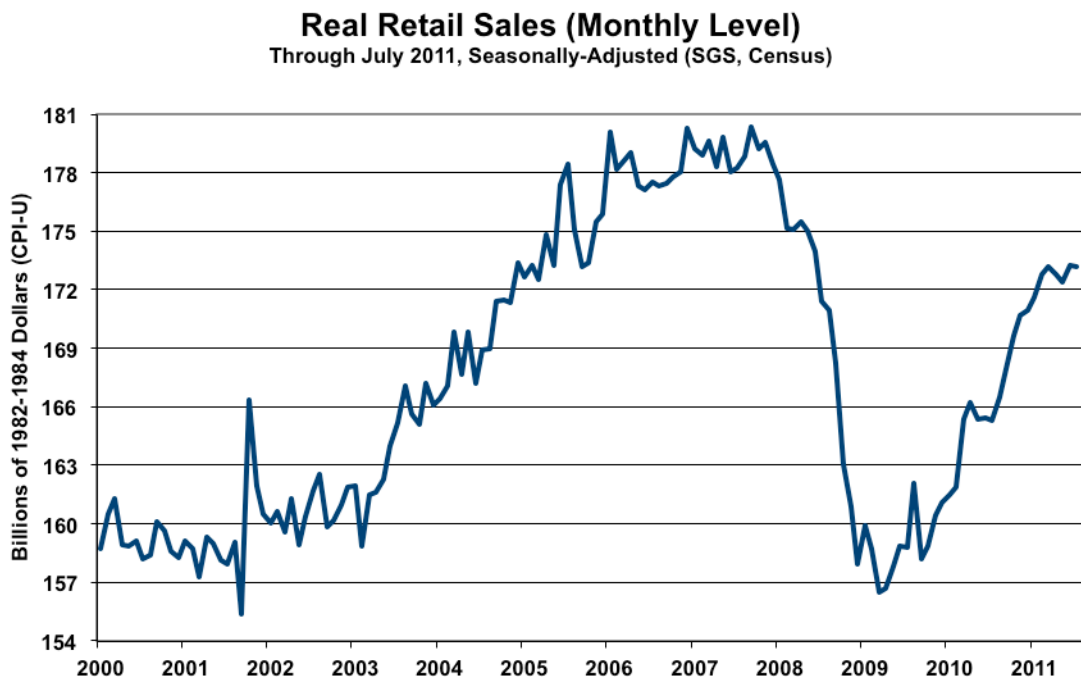


As shown on page 43 of the [Hyperinflation Special Report \(2011\)](#), over the decades, the price of gold has compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, while it has effectively fully compensated for the loss of purchasing power of the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

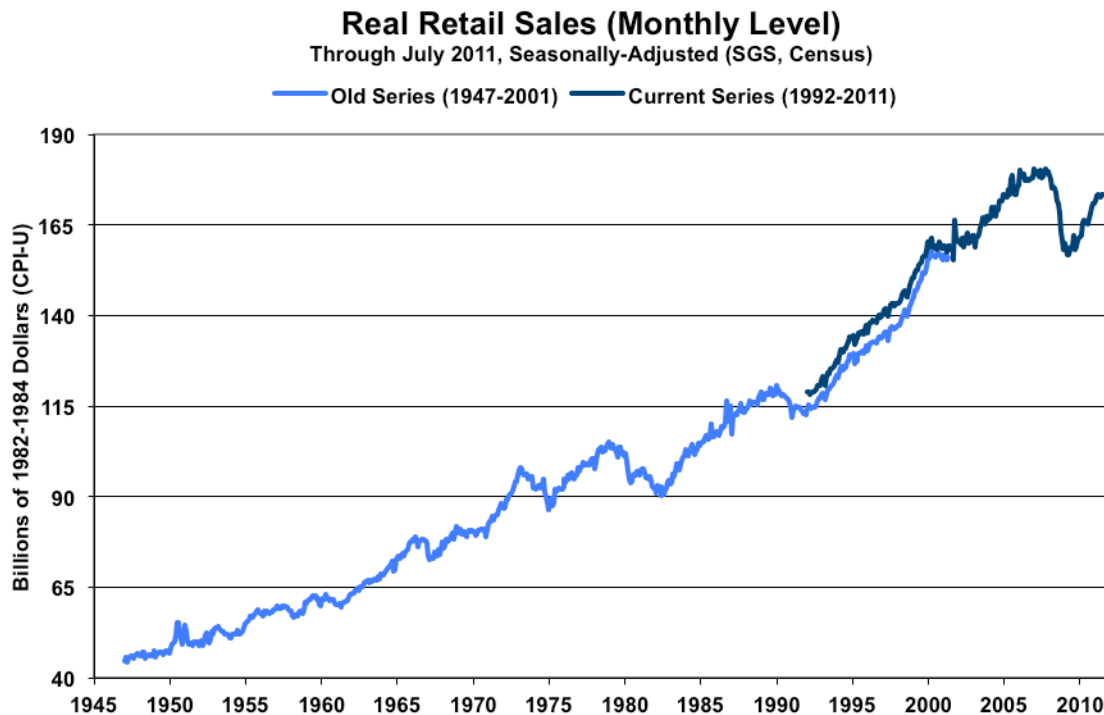
**Real (Inflation-Adjusted) Retail Sales.** Based on the July 2011 CPI-U reporting, inflation- and seasonally-adjusted monthly July 2011 retail sales eased by 0.03%, where, before inflation adjustment, the current number was up by 0.47% (see [Commentary No. 384](#)). Real June retail sales revised to a gain of 0.51% (previously up by 0.36%), where nominal (not-adjusted for inflation) sales in June revised to a gain of 0.28% (previously up by 0.14%). The real retail sales level for July (first month of the third-quarter) was up by 0.13% versus the average level for second-quarter 2011.

July's real retail sales rose at a year-to-year pace of 4.77%, versus a revised 4.74% (previously 4.48%) annual gain reported for June.

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.







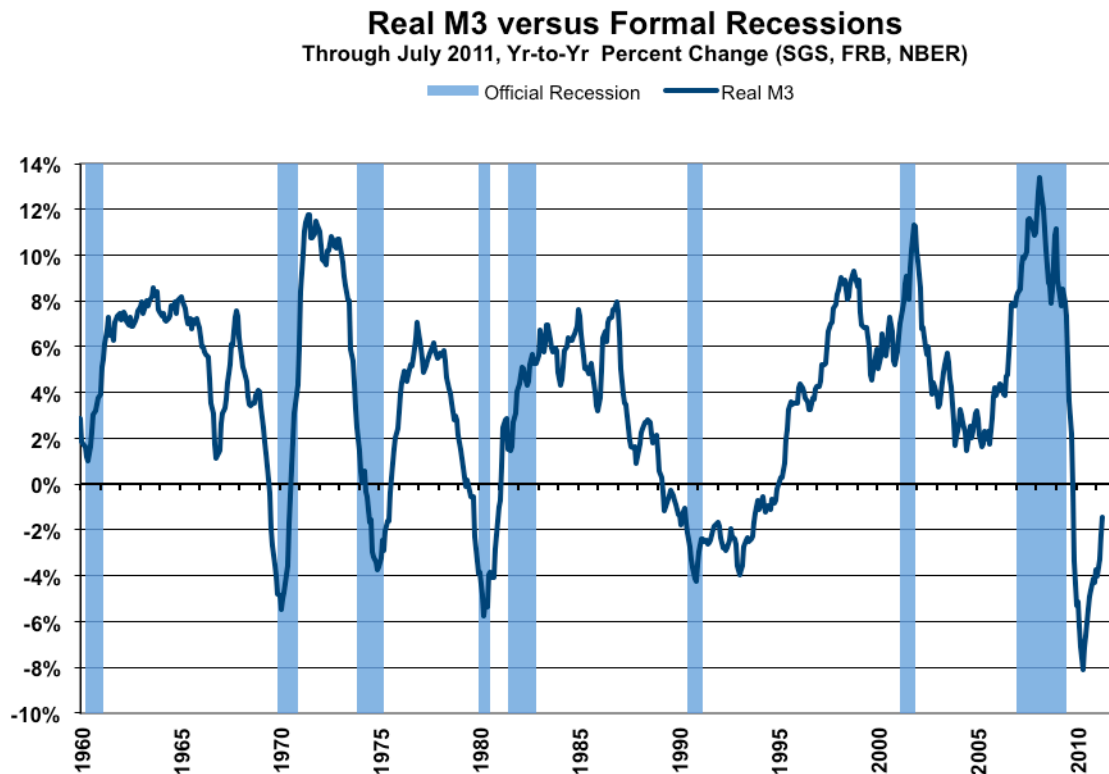
As noted in earlier writings, using the SGS Alternate-CPI Inflation estimates for deflation of the retail series would not have shown an ongoing rise in activity for the last year or so. It is my preference here, and wherever otherwise possible, to use the official estimates (the series here is as calculated 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.

**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 July CPI-U report and the latest July SGS-Ongoing M3 Estimate, the annual contraction in real M3 for July 2011 was 1.2%, a notch narrowed from the 1.3% annual contraction in June.

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. Weakness in a number of series should become increasingly evident in the months ahead, eventually leading to recognition of a double-dip recession.



## PRODUCER PRICE INDEX—PPI (JULY 2011)

**Wholesale Inflation Continues to Reflect Impact of Higher Oil Costs in Broad Economy.** As reported yesterday, August 17th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for July 2011 rose by 0.2% (up by 0.4% before seasonal adjustment) month-to-month, following a monthly decrease of 0.4% (down by 0.7% before seasonal adjustment) in June. The adjusted, monthly July PPI finished goods number was depressed by oil-price seasonal adjustments, which will reverse next month, and it once again reflected above-consensus “core” inflation, up by 0.4%, versus a 0.3% gain in June, with inflationary pressures from higher energy costs spreading further into the broad economy.

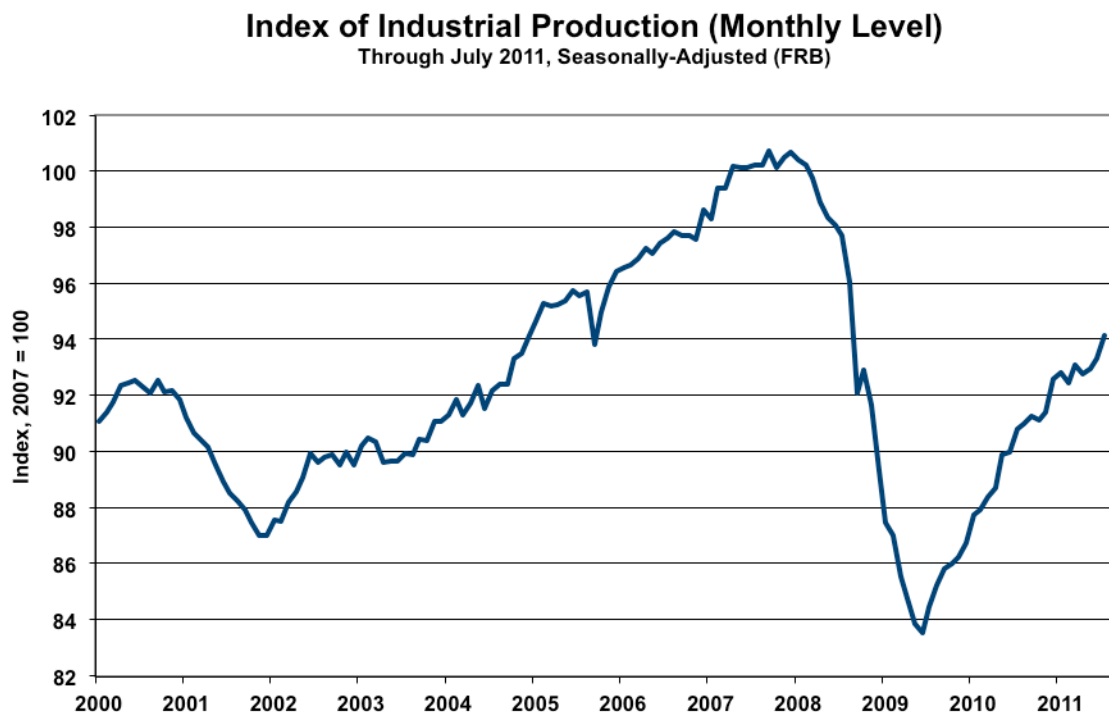
Reflecting a short-lived dip in oil prices, annualized, seasonally-adjusted PPI inflation for the three months ended July 2011 slowed to flat from 2.4% reported in June. Unadjusted and year-to-year, July 2011's PPI inflation rose to 7.2%, from 7.0% in June, and versus 7.3% in May (the highest level since September 2008). The recent run-up in annual PPI inflation generally has reflected ongoing impact of the Fed's dollar-debasement policies, not surging economic demand.

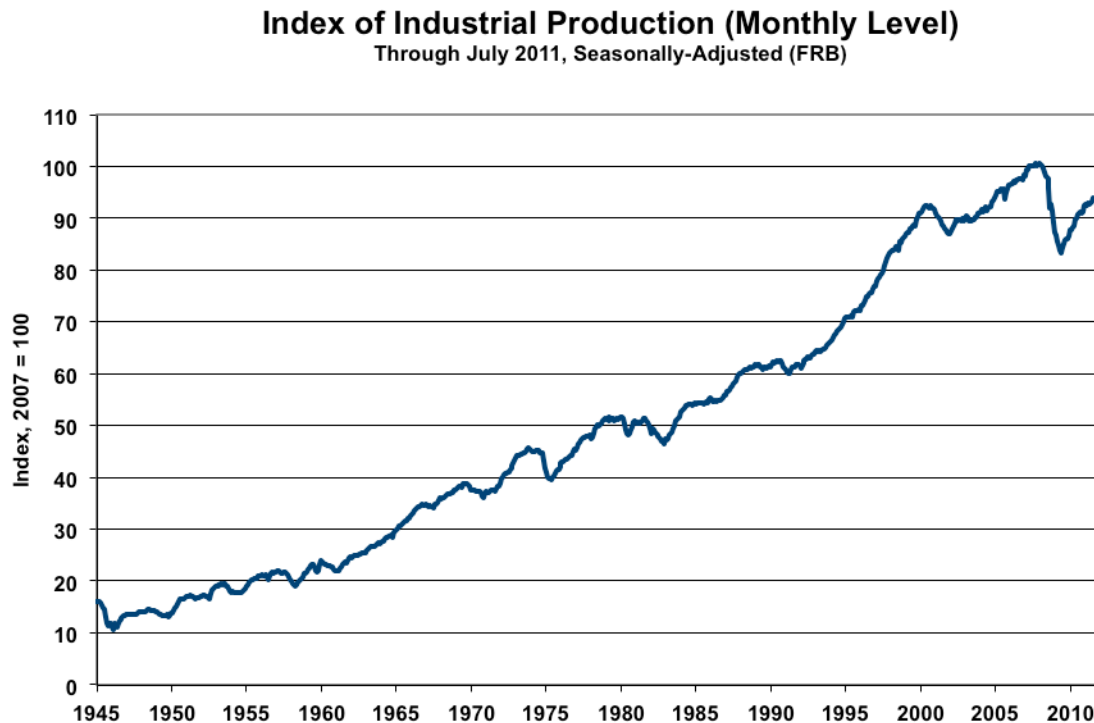
Separately, on a monthly basis, seasonally-adjusted July 2011 intermediate goods rose 0.2%, versus unchanged in June, with July's crude goods prices down by 1.2%, after falling 0.6% in June. Year-to-year inflation in July intermediate goods was 11.6%, up from 11.0% in June, with July's annual inflation in crude goods up by 22.6%, versus June's 26.2% gain.

## INDUSTRIAL PRODUCTION (JULY 2011)

**July Industrial Production Boosted by Extreme Heat.** Tuesday's (August 16th) Federal Reserve Board release of seasonally-adjusted July 2011 industrial production showed a monthly gain of 0.91% (a gain of 1.13% net of prior-period revisions) versus June. In turn, the monthly change in June production was revised to a 0.37% (previously a 0.19%) gain. Such was in the context of major downside revision in April, more than offset by upward revisions to May and June production. The gain reported in July production reflected one- or limited-time events, such a surging utility usage from unusually hot weather, and some catch up in auto assembly, as assembly parts from Japan re-entered the system.

Year-to-year growth in July 2011 production was 3.70%, versus the revised 3.68% (previously 3.41%) in June, 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, at the end of second-quarter 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 preceding 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. The July “surge” likely will prove to be short-lived, with a downside move or revisions to be reported next month.

## HOUSING STARTS (JULY 2011)

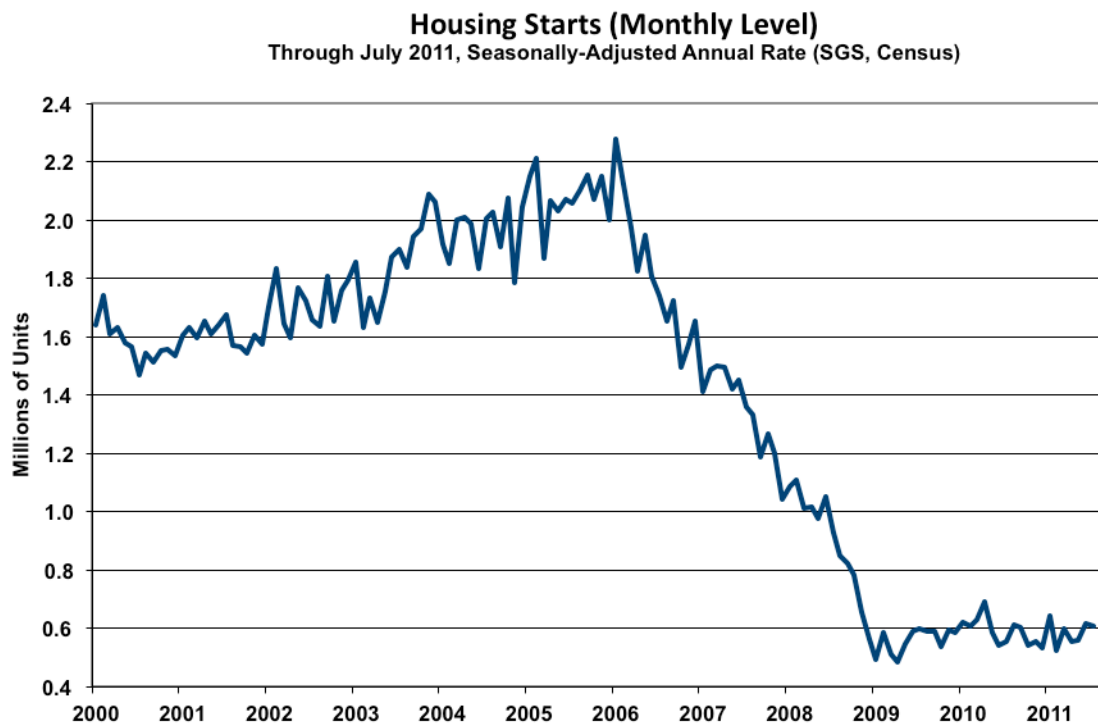
**July Housing-Starts Starts Turn Down Again.** The regularly volatile housing starts series continued bottom-bouncing in July, continuing a slow, general downtrend. The Census Bureau reported on Tuesday, August 16th, a statistically-insignificant monthly decrease in seasonally-adjusted July 2011 housing starts of 1.5% (a decline of 4.0% before prior-period revisions) +/- 12.5% (all confidence intervals are at the 95% level). June starts were revised to a 10.8% (previously a 14.6%) monthly gain.

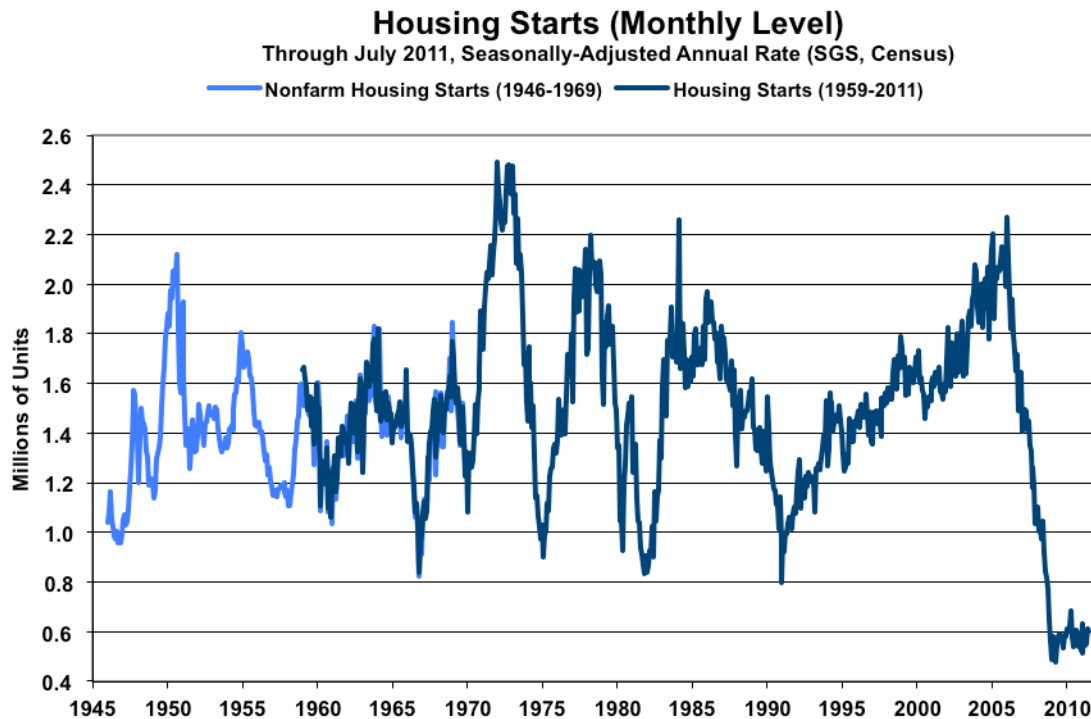
The year-to-year change in July starts was a statistically-insignificant increase of 9.8% +/- 12.6% (95% confidence interval), following a revised annual 13.7% (previously 16.7%) increase in June. The recent swing to annual gain reflects the continued year-ago drop-off in post-stimulus activity.

There still are no indications of a reprieve for the housing industry or the otherwise deteriorating broader economy. Indeed, the pattern of housing starts has remained one of stagnation at an historically low-level plateau of activity, over the last 32 months. The six-month moving-average of seasonally-adjusted housing starts was 572,000 in July, 8.7% above the historic low six-month moving-average seen in May 2009. Significantly weaker monthly numbers remain likely in the months ahead. Since December 2008,

housing starts have averaged a seasonally-adjusted annual rate of 572,000. In that period, all monthly readings have been within the normal range of monthly volatility for the aggregate series around that average, with the 604,000 July 2011 monthly reading at 5.6% above average. Again, such is within the normal volatility of the series.

As shown in the following graphs, current monthly housing starts activity remains near the record monthly low seen for the present series in April 2009. The current number also is well below any level reported in the predecessor nonfarm housing starts series, which was introduced in 1946. The first graph shows recent detail for current housing starts activity, the second graph shows the same data within the historical context of the post-World War II period.



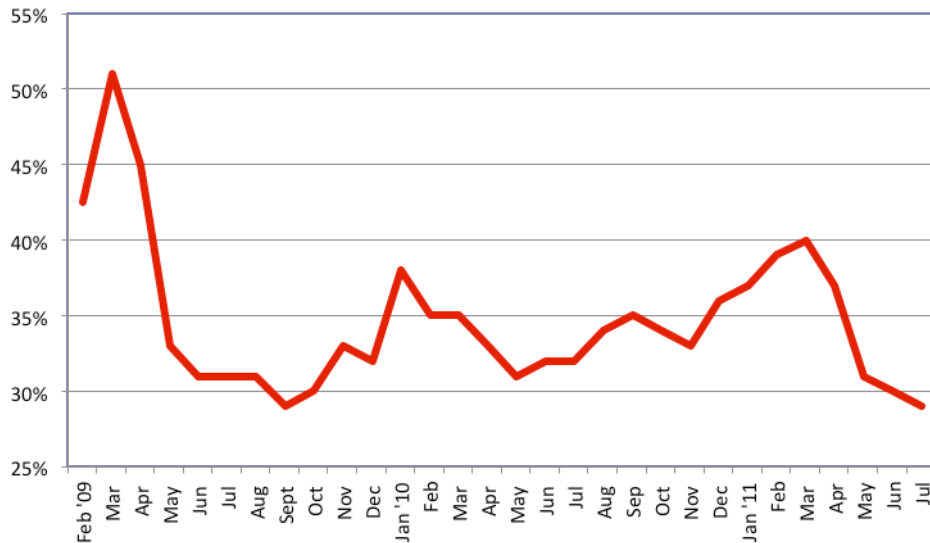


## EXISTING HOME SALES (JULY 2011)

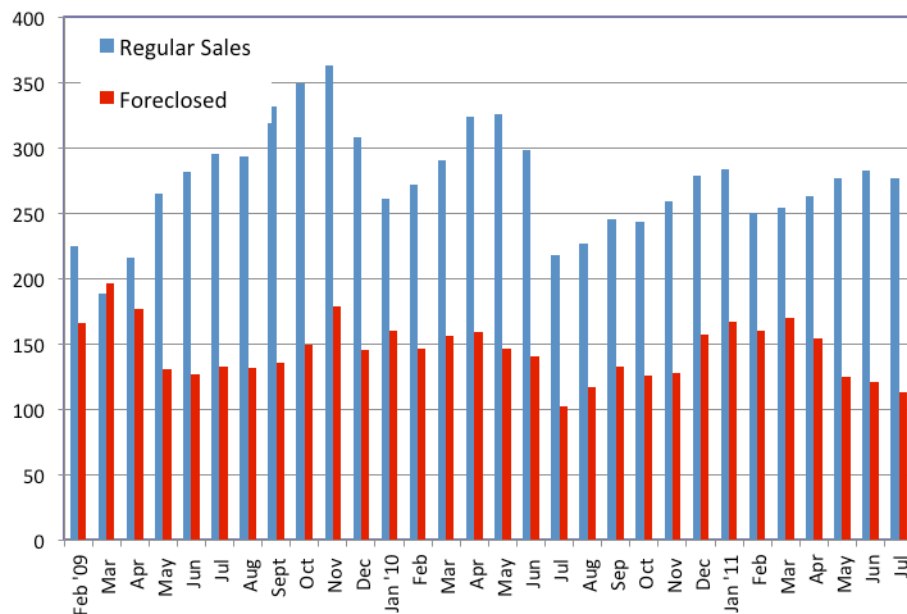
**Existing Home Sales Weaken Anew.** Today's (August 18th) release of July existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly decline of 3.5%, versus June's revised gain of 0.6% (previously a 0.8% contraction). On a year-to-year basis, July sales jumped by 21.0%, versus a revised 7.5% (previously an 8.8% decline) in June. The swing to annual growth from contraction reflects year-ago stimulus effects.

Foreclosure activity remained a major distorting factor for home sales, with "distressed" activity accounting for an estimated 29% of existing sales in the NAR's July reporting, down from the 30% estimated for June.

### Foreclosures as % of Existing Home Sales Sources: SGS, NAR

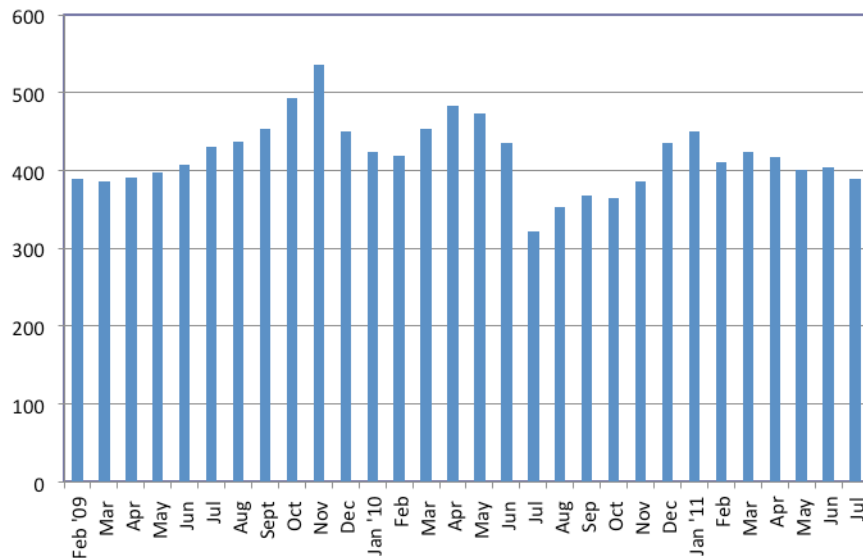


### Existing Home Sales - Foreclosed and Not Monthly Rate ('000's), Seasonally Adjusted. Sources: SGS, NAR





**Existing Home Sales - Total**  
**Monthly Rate (000's), Seasonally Adjusted. Sources: SGS, NAR**



**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. Generally, previously unreported economic weakness should show up in prior-period revisions.

**New Home Sales (July 2011).** July existing home sales (National Association of Realtors) were released today, August 18th, and are covered above. July 2011 new home sales (Census Bureau) are due for release on Tuesday, August 23rd. As with the ongoing historic weakness in housing starts and existing sales, the volatile new home sales series should remain extremely weak, with any positive monthly change again lacking statistical significance. Also, as usual, given the extreme volatility, reporting error and revisions in both these series, given the poor-quality seasonal adjustments, given continuing negative anecdotal evidence, and given ongoing massive distortions from irregularly volatile foreclosure activity, the monthly movements in these numbers (particularly to the upside) remain meaningless.

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

**Gross Domestic Product—GDP (Second-Quarter 2011—"Second" Estimate, First Revision).** The "second" estimate of second-quarter GDP is due for release from the Bureau of Economic Analysis (BEA) on Friday, August 26th. Based on the June trade data (see [Commentary No. 384](#)), a downside revision to the initial 1.3% estimate of real, annualized quarterly GDP growth is a fair possibility.