

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

COMMENTARY NUMBER 395
September CPI, PPI, Real Retail Sales, Housing Starts, Industrial Production

October 19, 2011

Consumer and Wholesale Inflation Jumped in September

September's Annual Inflation: 3.9% (CPI-U), 4.4% (CPI-W), 11.5% (SGS)

Annual PPI Inflation Hits 6.9% in September

**Third-Quarter Real Retail Sales, Production and Housing Starts Outpaced
Second-Quarter Activity, but Economy Remains in Severe Downturn**

PLEASE NOTE: The next regular Commentary is scheduled for Thursday, October 27th. It will cover the "advance" estimate of third-quarter 2011 GDP and September new orders for durable goods.

—Best wishes to all, John Williams

Opening Comments and Executive Summary. The pace of annual inflation rose in September at both the consumer and wholesale levels. Also holding up is the pace of annual inflation in the so-called "core" measure, net of food and energy prices. Rising prices continue to be boosted by the effects of the Federal Reserve's efforts at dollar-debasement, not by strong economic activity. At the same time, the economy remains in severe contraction, despite some upside monthly reporting in recent economic series.

CPI and PPI. The September producer price index jumped by 0.8% for the month and 6.9% for the year, versus August's unchanged monthly reading and 6.5% annual inflation.

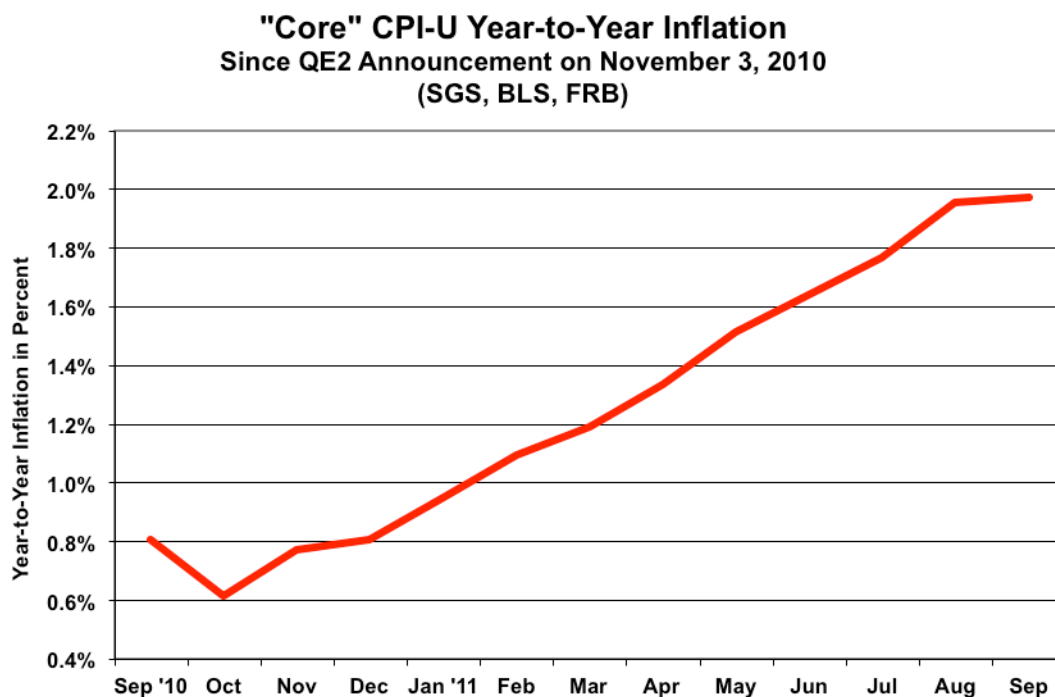
Annual inflation in the September consumer price index again hit the highest level for the CPI-U series since September 2008. The CPI-U gained 0.3% for the month and 3.9% for the year, while the narrower CPI-W gained 0.4% for the month and 4.4% for the year.

The chained-CPI-U (C-CPI) showed annual growth of 3.8%. The miscreants in Washington, D.C., would like to change CPI reporting, once again, so as to cut cost-of-living adjustments artificially. By shifting COLA adjustments from a CPI-W base to the C-CPI base, the politicians can cut the federal deficit without anyone having to vote formally to cut Social Security costs.

If the C-CPI were in place now for such purposes, it would have lowered the coming Social Security COLA adjustment by 0.6 percentage point. It would be better for the general public if the government just came out and said it could not afford to pay a full COLA, rather than put out an understated inflation rate that neither reflects the costs of maintaining a constant standard of living, nor reflects actual out-of-pocket expenses. As a result of the deception, the general public often ends up using understated inflation numbers for purposes such as wage and salary adjustments and for targeting investment returns.

The SGS-Alternate-CPI measures reflected annual inflation for September at 7.2% (1990-based) and at 11.5% (1980-based)

Although at slower pace of increase in September, the CPI-U's annual "core" inflation rate has risen now for 11 straight months, since the Fed introduced QE2. As shown in the following graph, the annual core rate rose to 1.97% in September versus 1.95% in August, and was up from 0.61% in October 2010.



Real Retail Sales, Industrial Production and Housing Starts. Monthly gains reported in September for real retail sales, industrial production and housing starts, which have helped to boost the third-quarter outlook a little, generally appeared to be tied to seasonal-adjustment problems that should reverse out in the month ahead (see the discussion on seasonal-adjustment reporting quality in the [Hyperinflation Special Report \(2011\)](#)). With extraordinarily negative underlying fundamentals still in play, there is no shift in economic outlook and no chance of a near-term economic recovery

Given relatively better current quarterly reporting, versus the second-quarter, for the trade deficit, real retail sales, industrial production and housing starts, however, next week's (October 27th) initial estimate of third-quarter GDP growth likely will be somewhat above that of the 1.3% last estimated for annualized, real (inflation-adjusted) quarterly growth in the second-quarter. Nonetheless, as with the second-quarter, the initial third-quarter headline GDP estimate likely will not be statistically meaningful, encompassing both a potential contraction as well as expansion within its 95% confidence interval of plus-or-minus three percentage points.

Also, where the Bureau of Economic Analysis's (BEA) "advance" estimate tends to target the consensus forecast, weaker than widely recognized underlying fundamentals tend to favor a downside surprise for the initial GDP reporting. As discussed in the prior [Commentary No. 394](#), the underlying structural issues impairing consumer activity are getting worse, not better.

Indeed, the fundamental factors that drive U.S. consumption show the broad economy still to be in decline, with the lack of real consumer income growth and restricted credit availability at the core of U.S. the economic problems.

Hyperinflation Watch—Outlook Remains the Same. The U.S. economic and systemic-solvency crises are ongoing. The systemic-solvency crisis reflects both domestic and global banking-system and sovereign solvency issues, as well as related extreme instability in the domestic and global financial markets and financial and economic systems. The systemic problems are exacerbated by the still-faltering economy, in something of a self-feeding cycle.

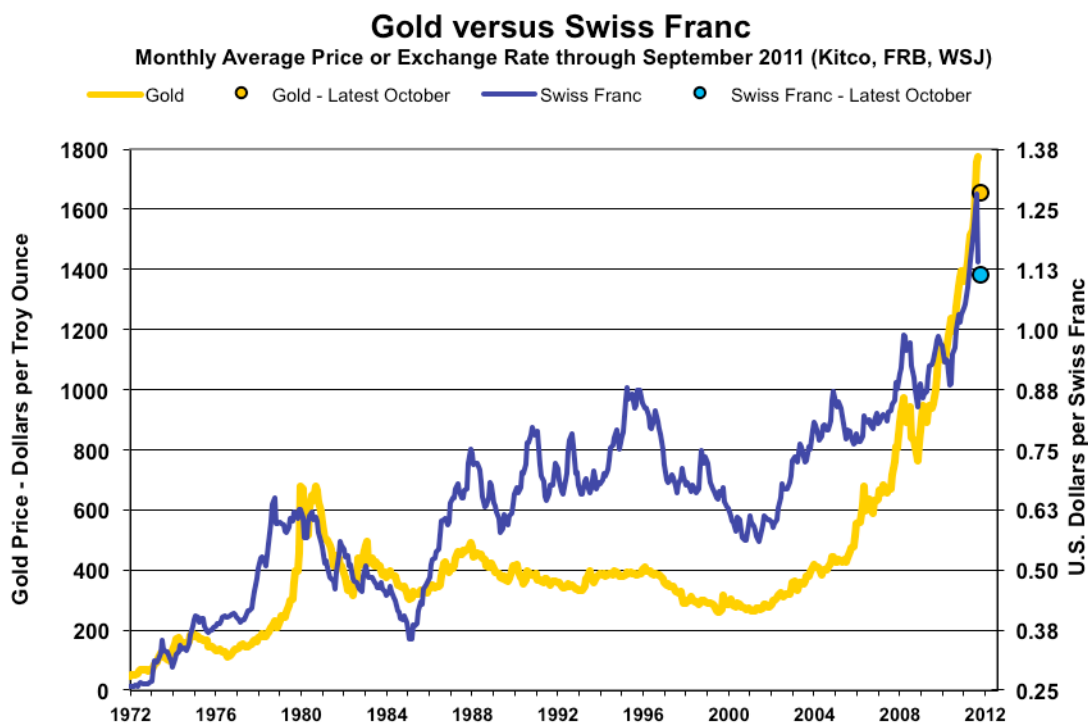
Repeated from the prior *Commentaries*, there are no happy solutions available here to remedy the crises, only tools—devil's choices—for the Fed and the U.S. government to buy a little extra time. From the Fed's standpoint, keeping the banking system afloat remains its primary concern, although needs for economic growth and contained inflation will be given as the rationale behind any overt change in policy. The ultimate cost in propping the system, however, remains inflation. The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the [Hyperinflation Special Report \(2011\)](#) and in recent *Commentaries*, continue to unfold with outlooks that remain unchanged.

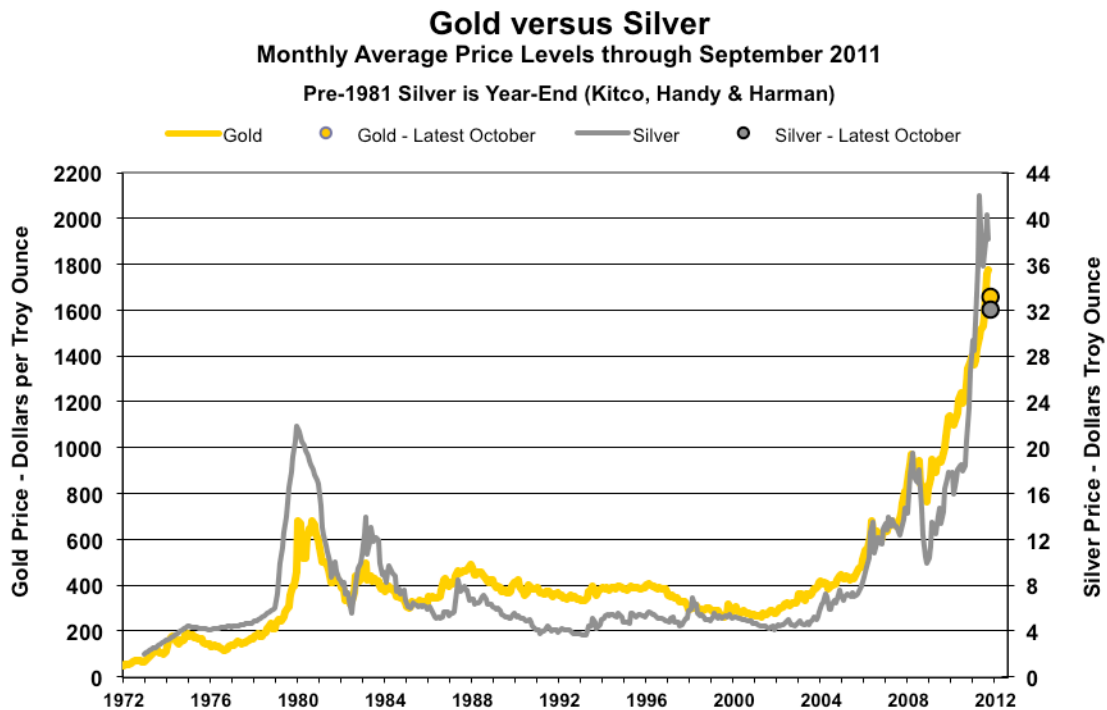
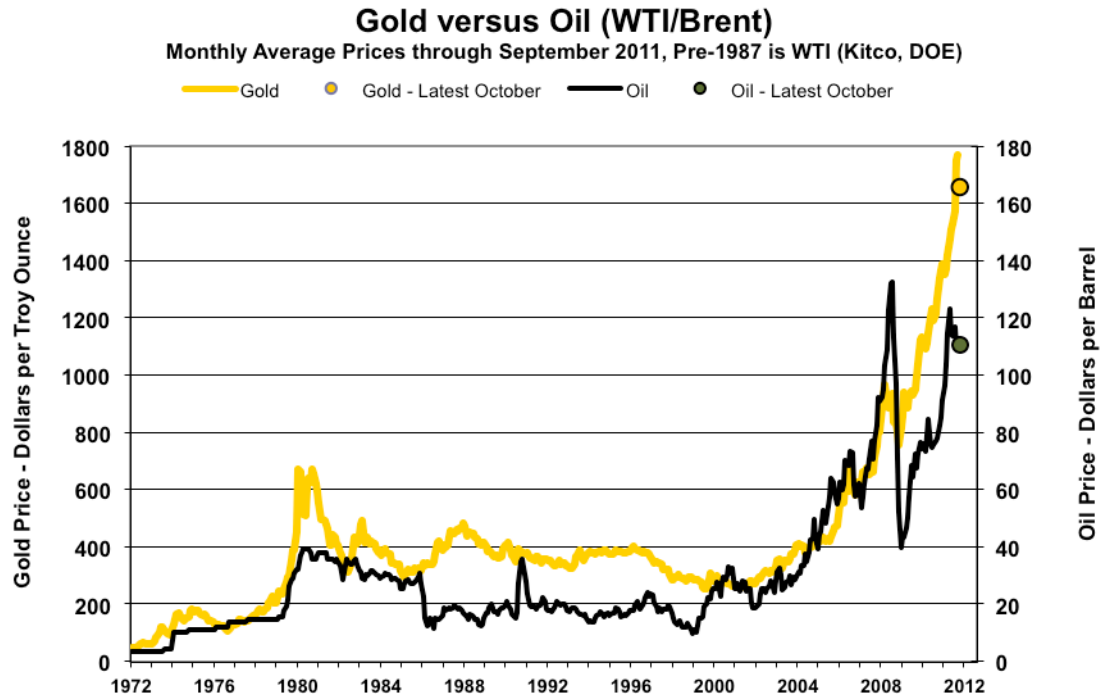
The root source of current global systemic instabilities largely has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent a euro-area crisis from triggering a systemic collapse in the United States. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

The financial markets still are roiled by deepening 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 any further near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold, 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 to address its uncontainable fiscal condition; with the federal government and Federal Reserve standing 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 impact of recent extreme market turmoil and volatility is evident in the usual gold graphs that follow. Again, the precious metals and stronger currencies remain the best long-term hedges against the extreme decline ahead in the purchasing power of the U.S. dollar.





REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (September 2011)

Higher Oil Prices Continue Permeating Broad Economic Activity. Once again, despite a seasonally-adjusted boost to otherwise weak gasoline prices, September CPI reporting showed the continued spread of inflationary pressures well beyond the energy and food sectors, with the annual “core” inflation rate still on the rise. Topping August’s numbers, full September CPI-U reporting showed the highest level of annual consumer inflation since September 2008.

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.*

CPI-U. The BLS reported today (October 19th) that the seasonally-adjusted September 2011 CPI-U rose by 0.30% (up by 0.15%, unadjusted) for the month. That followed a gain of 0.37% (up by 0.28%, unadjusted) in August. The September reporting reflected an unadjusted 0.7% drop in monthly average gasoline prices (the Department of Energy reported an unadjusted 0.8% decline), but the unadjusted BLS estimate was turned into a seasonally-adjusted monthly gain of 2.9%. Gasoline-price seasonal-adjustments still are in a price-boosting mode, catching up on depressed adjusted gasoline inflation as reported in the first half of the year.

September’s unadjusted year-to-year CPI-U inflation rose to 3.87%, from August’s 3.77%, the strongest pace of annual inflation since September 2008.

The annualized quarterly gain in seasonally-adjusted CPI-U inflation was 3.07% for third-quarter 2011, versus 4.09% in the second quarter. Unadjusted year-to-year inflation rose to 3.76% in the third-quarter versus from 3.43% in the second-quarter.

The September report also showed still-greater inflationary pressures from the spread of higher energy prices into the broad economy (see the graph and comments in *Opening Comments and Executive Summary*). On an annual basis, “core” CPI-U inflation moved higher, albeit marginally, for the 11th straight month, up to 1.97% in September, versus 1.95% in August. When Fed Chairman Bernanke used his jawboning in an effort to debase the U.S. dollar in the global 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 October 2011 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.25% gain in the adjusted monthly level reported for October 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for October 2011, the difference in October’s headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from September 2011’s reported annual inflation rate of 3.87%.

CPI-W. The narrower, seasonally-adjusted CPI-W, which has greater weighting for gasoline than does the CPI-U, rose by 0.37% (up by 0.16% unadjusted) in September, following August’s gain of 0.42% (up by 0.29% unadjusted).

Unadjusted, September 2011’s year-to-year CPI-W inflation was 4.38%, against a 4.26% annual increase in August.

The annualized quarterly gain in seasonally-adjusted CPI-W inflation was 3.31% for third-quarter 2011, versus 4.55% in the second quarter. Unadjusted year-to-year inflation rose to 4.25% in the third-quarter from 3.94 % in the second-quarter.

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 3.71% in September, up from 3.61% in August.

Unadjusted C-CPI-U year-to-year inflation for the third-quarter was 3.86%. If this gimmicked measure were utilized for this year’s Social Security cost of living adjustment (COLA), instead of the CPI-W, the adjustment would be lowered by 0.39%. Therein is the political motivation for changing the COLA-adjustment mechanism to the C-CPI-U, as a deficit-reduction tool.

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton (1990) methodology, annual CPI inflation was roughly 7.2% in September 2011, up from 7.1% in August, while the SGS-Alternate Consumer Inflation Measure, which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 11.5% (11.45% for those using the extra digit) in September, up from about 11.4% in August.

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 September 5th historic-high gold price of \$1,895.00 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 \$2,479 per troy ounce, based on September 2011 CPI-U-adjusted dollars, \$8,677 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 earlier this year, still has not been hit since 1980, including in terms of inflation-adjusted dollars. Based on September 2011 CPI-U inflation, the 1980 silver price peak would be \$144 per troy ounce and would be \$505 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars (again, all series not seasonally adjusted).

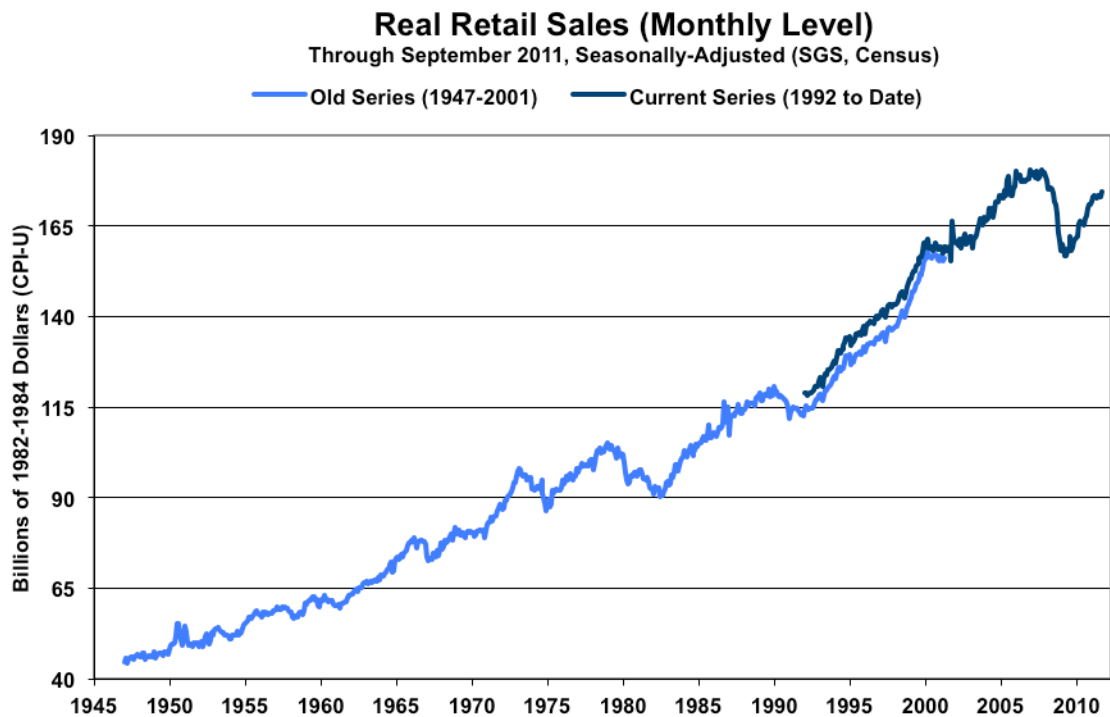
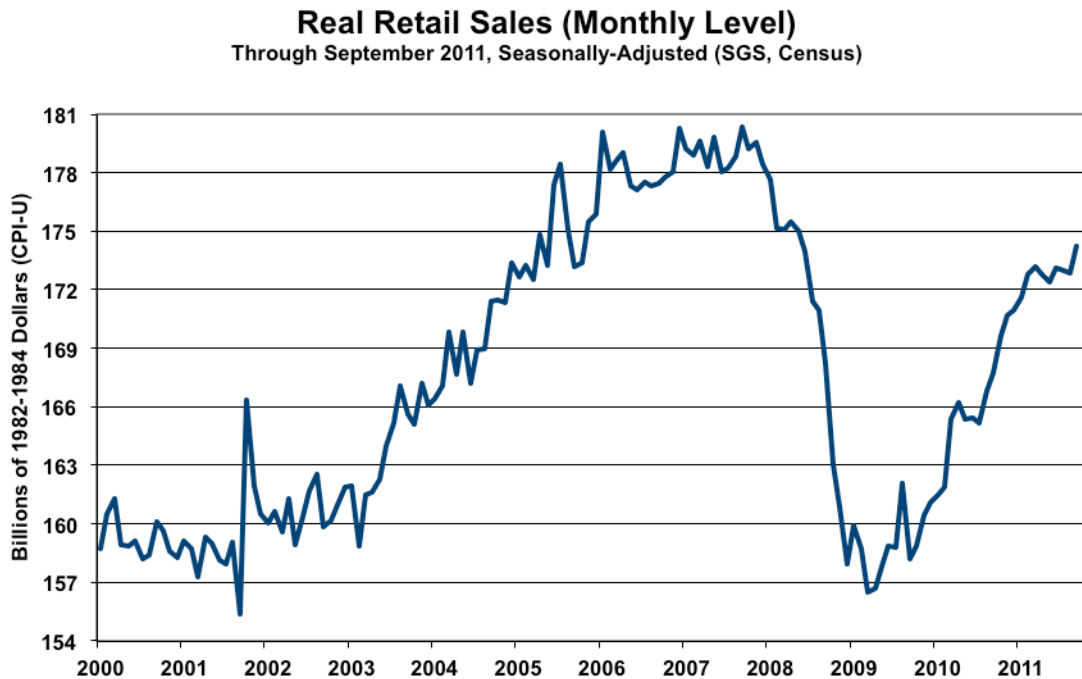
As shown on page 43 of the [Hyperinflation Special Report \(2011\)](#), over the decades, the price of gold has compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, while it has effectively fully compensated for the loss of purchasing power of the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

Real (Inflation-Adjusted) Retail Sales. Based on the September 2011 CPI-U reporting, inflation- and seasonally-adjusted September 2011 retail sales rose by 0.81% for the month, where, before inflation adjustment, the current number was up by 1.13% (see [Commentary No. 394](#) for details of the nominal reporting). Real August retail sales revised to a monthly decline of 0.09% (previously down by 0.33%), where nominal (not-adjusted for inflation) sales in August revised to a gain of 0.28% (previously up by 0.04%).

Real retail sales in third-quarter 2011 were up by a 0.34% from the second-quarter, which, in turn, was up by 0.14% from the first-quarter.

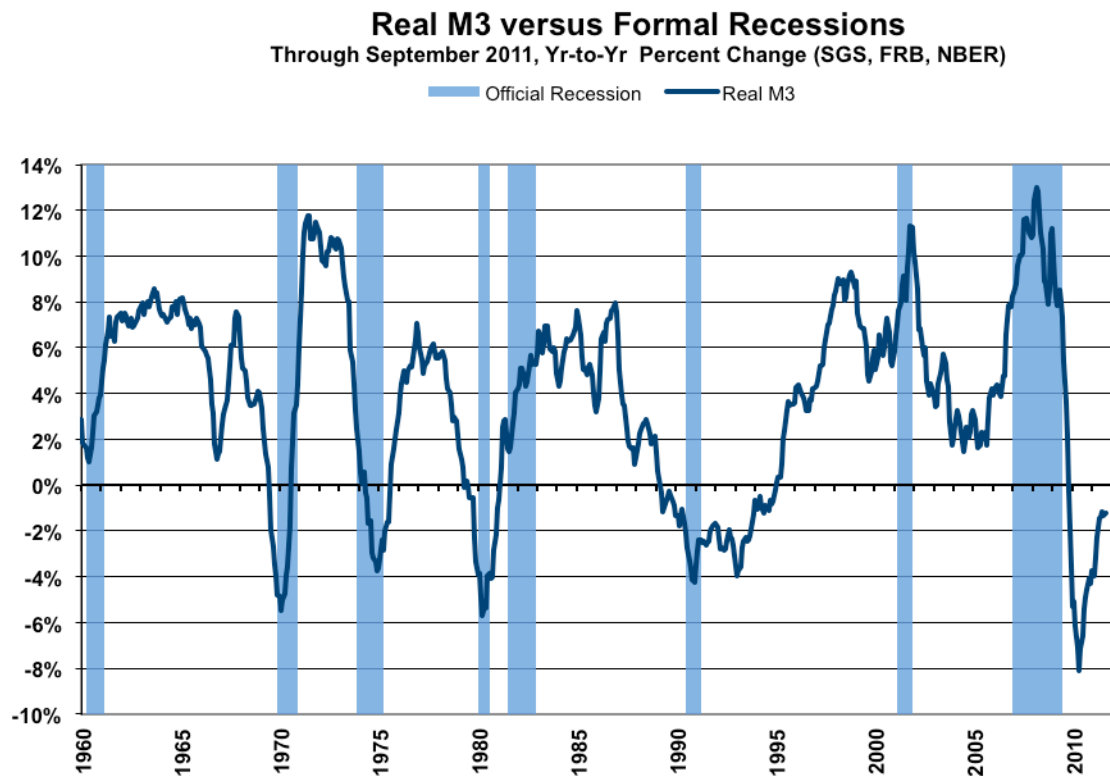
September's real retail sales rose at a year-to-year pace of 3.87%, versus a revised 3.63% (previously 3.28%) annual gain reported for August.

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 should turn down meaningfully in what eventually will become a 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 (see the household income comments in [Commentary No. 394](#)).



Real Money Supply M3. The signal of the unfolding double-dip recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), discussed in the [Hyperinflation Special Report \(2011\)](#), continues and is graphed above. Based on the September CPI-U report and the latest September SGS-Ongoing M3 Estimate, the annual contraction in real M3 for September 2011 was 1.2%, somewhat shallower than the revised 1.3% (1.5%) annual contraction in August. The August revision was in the context of benchmark revisions to underlying data published by the Fed.

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 have surfaced in recent months, and the downturn likely will accelerate in the months ahead, eventually leading to recognition of a double-dip recession.

PRODUCER PRICE INDEX—PPI (September 2011)

Monthly Wholesale Inflation Jumped to 0.8% for September, Up 6.9% Year-to-Year. As reported yesterday, October 18th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for September up by 0.8% (up by 0.5% unadjusted) month-to-month, following an unchanged month-to-month reading (down by 0.4% before seasonal adjustment) in August.

Unadjusted and year-to-year, September 2011's PPI inflation rose to 6.9% from 6.5% in August. 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 September 2011 intermediate goods prices rose by 0.6%, versus a decline of 0.5% in August, with September crude goods prices up by 2.8%, following a 0.2% gain in August. Year-to-year inflation in September intermediate goods was 10.5%, versus a 10.3% level in August, with September's annual inflation in crude goods at 20.9%, versus August's 18.4% pace.

RESIDENTIAL CONSTRUCTION—HOUSING STARTS (September 2011)

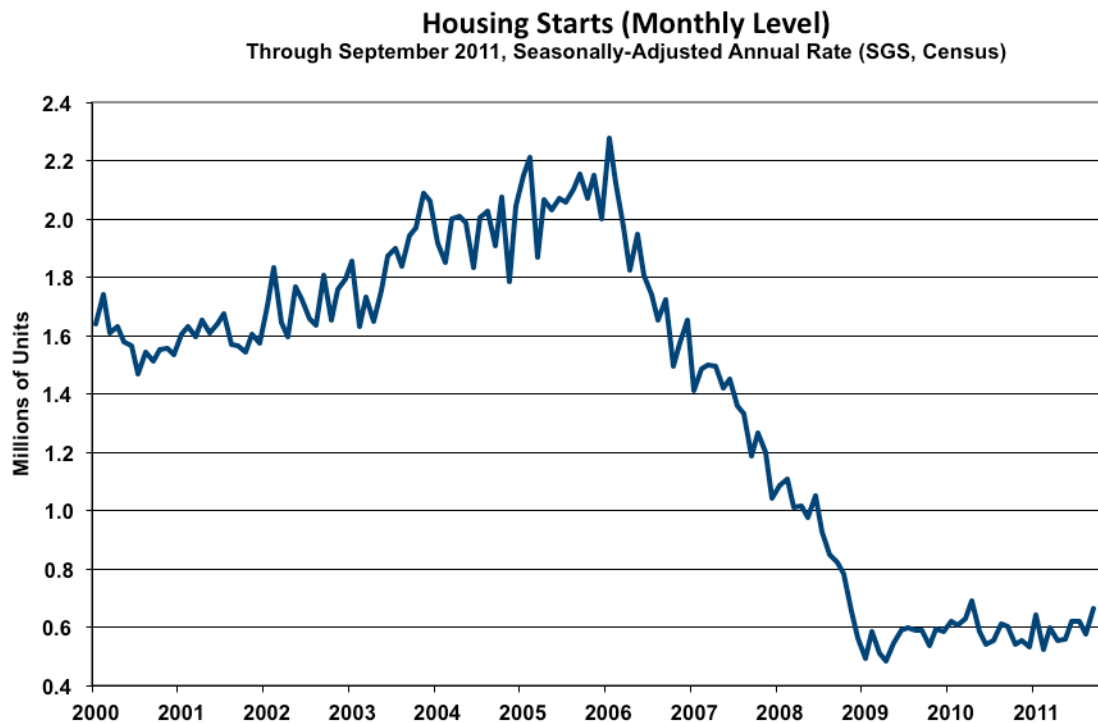
Housing Starts Bottom-Bounced in September. The regularly volatile housing starts series continued its bottom-bouncing in September, having seen nearly three years of activity at 75% below 2006's record construction level, and no relief in sight. The Census Bureau reported this morning (October 19th) a marginally-statistically-significant monthly gain in seasonally-adjusted September 2011 housing starts of 15.0% (a gain of 15.2% before prior-period revisions) +/- 14.9% (all confidence intervals are at the 95% level). August starts were revised to a 7.0% (previously a 5.0%) monthly decline. The bulk of September's monthly gain was due to a 52.4% jump in the highly volatile apartment units component, with single unit starts up by 1.7% for the month.

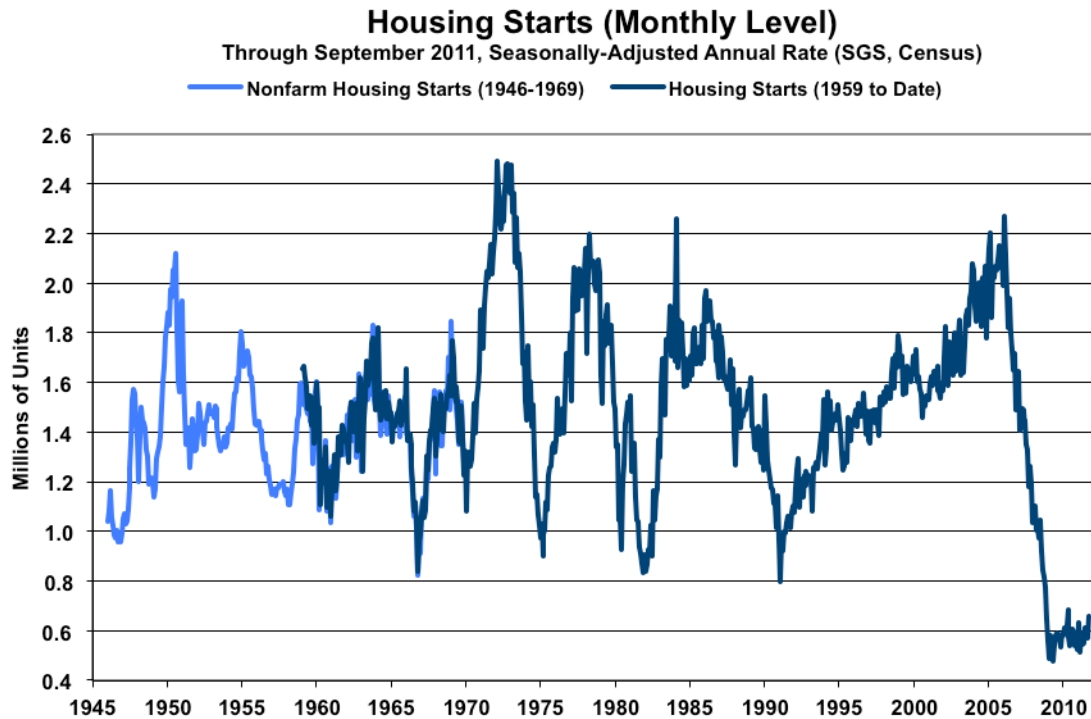
As a result of the September reading, housing starts in the third quarter were 7.5% ahead of the second-quarter, which, in turn was 1.7% below first-quarter activity.

The year-to-year change in September starts was a statistically-insignificant increase of 10.2% +/- 15.5%, following a revised annual 5.6% (previously 5.8%) decline in August. The recent swings in the direction of annual change reflect comparisons with volatile year-ago monthly activity that was exaggerated in both directions by stimulus and post-stimulus effects.

With housing starts well into their third year of post-housing-market-crash bottom-bouncing, there remain no indications of a reprieve for the 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 34 months. Since December 2008, housing starts have averaged a seasonally-adjusted annual rate of 575,000. In that period, all monthly readings have been within the normal range of monthly volatility for the aggregate series around that average, with the 658,000 September 2011 monthly reading at 14.4% above average. Again, such is within the normal reporting range of this extremely volatile 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.





INDEX OF INDUSTRIAL PRODUCTION (September 2011)

Third-Quarter Industrial Production Had a 1.3% Quarterly Gain. Monday's (October 17th) Federal Reserve Board release of seasonally-adjusted September 2011 industrial production showed a monthly gain of 0.19% (0.15% net of prior-period revisions) versus August. In turn, the monthly change in August production was flat (a 0.0045% gain), revised lower from initial reporting of a 0.18% monthly gain.

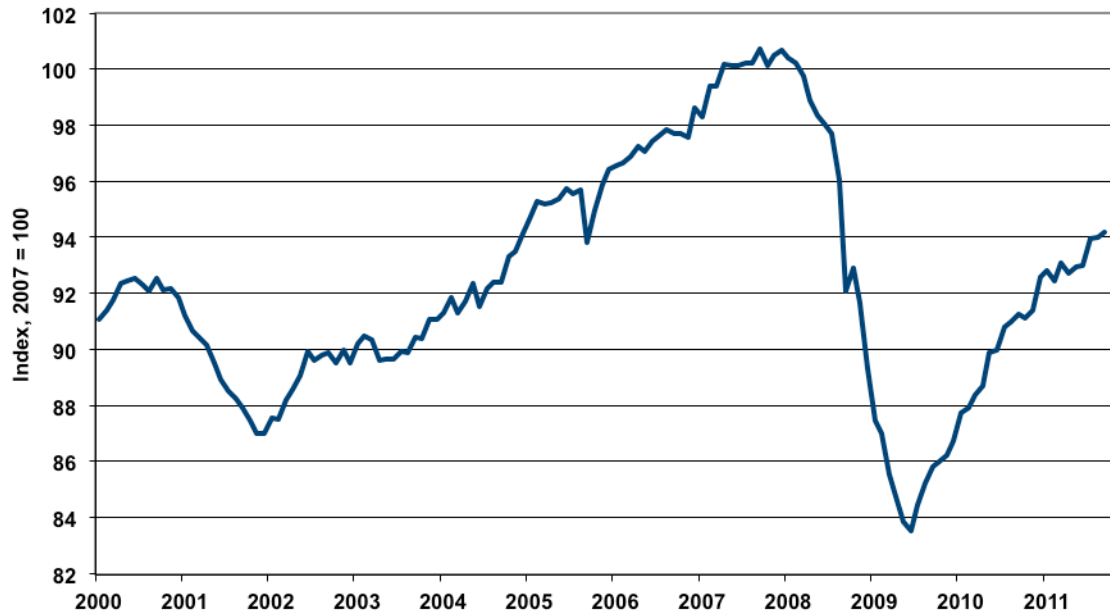
Third-quarter industrial production gained 1.26% versus the second-quarter, which in turn was up by a revised 0.11% (0.13%) from the first-quarter. The relatively stronger third-quarter growth would suggest stronger third-quarter GDP growth in the second-quarter. For some reason, though, where a quarterly gain in industrial production often follows through to GDP reporting, a quarterly decline in production often does not.

Year-to-year growth in September 2011 production was 3.22%, down from a revised 3.32% (previously 3.35%) August increase, and down from the recent relative peak annual growth 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 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.

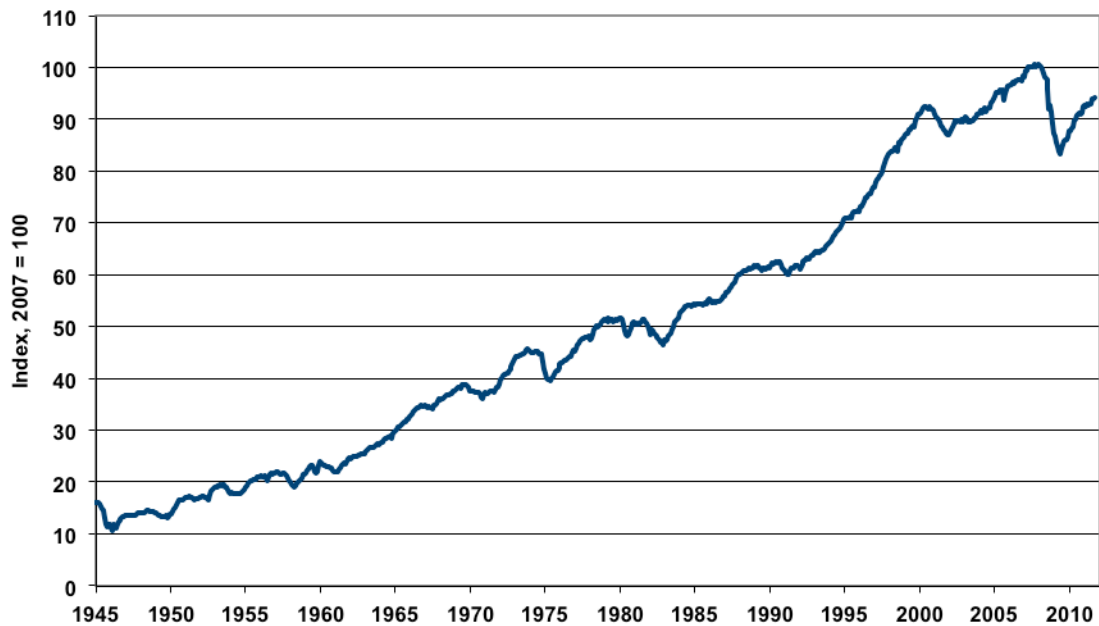
Index of Industrial Production (Monthly Level)

Through September 2011, Seasonally-Adjusted (FRB)



Index of Industrial Production (Monthly Level)

Through September 2011, Seasonally-Adjusted (FRB)



Week Ahead. Although still not fully acknowledged, there is both an intensifying double-dip recession and an 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.

Existing and New Home Sales (September 2011). September existing home sales (National Association of Realtors) are due for release tomorrow, Thursday, October 20th, while September new home sales (Census Bureau) are due for release on Wednesday, October 26th. Once again, as with the ongoing bottom-bouncing seen in today's housing starts release, both home sales series should remain extremely weak, with any positive monthly change lacking statistical significance (especially for the highly volatile new home sales series). 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 reported monthly movements in these numbers (particularly to the upside) generally are meaningless.

New Orders for Durable Goods (September 2011). Due for release on Wednesday, October 26th, the highly volatile new orders for durable goods likely will not show a meaningful monthly change in September, with odds slightly favoring a monthly decline in new orders.

Gross Domestic Product—GDP (Third-Quarter 2011, First Estimate). The “first” or “advance” estimate of third-quarter GDP is due for release from the Bureau of Economic Analysis (BEA) on Thursday, October 27th. With the existing trade, production, retail sales and housing starts data suggestive of a somewhat relatively stronger quarter-to-quarter GDP performance than in the second-quarter, the headline, annualized inflation-adjusted third-quarter GDP growth rate likely will be above the last-estimate of 1.3% for the second-quarter. Yet, given widely weaker-than-recognized underlying economic fundamentals, reporting risk is to the downside of whatever consensus forecasters are likely to estimate.
