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

COMMENTARY NUMBER 439
April Industrial Production, Housing Starts

May 16, 2012

Unusually Unstable Production Reporting

Housing Starts Stagnation at Slightly Higher Plateau

PLEASE NOTE: The next regular Commentary *is scheduled for Friday, May 18th. It will examine the annual benchmark revision to new orders for durable goods.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Major economic reports of the last several weeks generally have shown patterns of slowing, stagnant or negative economic activity, including the initial estimate of first-quarter GDP and the latest reporting on construction spending, payroll employment, the trade deficit, retail sales and this morning's release (May 16th) of April housing starts. Today's report on April industrial production showed a strong month, in the context of unusual volatility in the reporting and revisions of that Federal Reserve series.

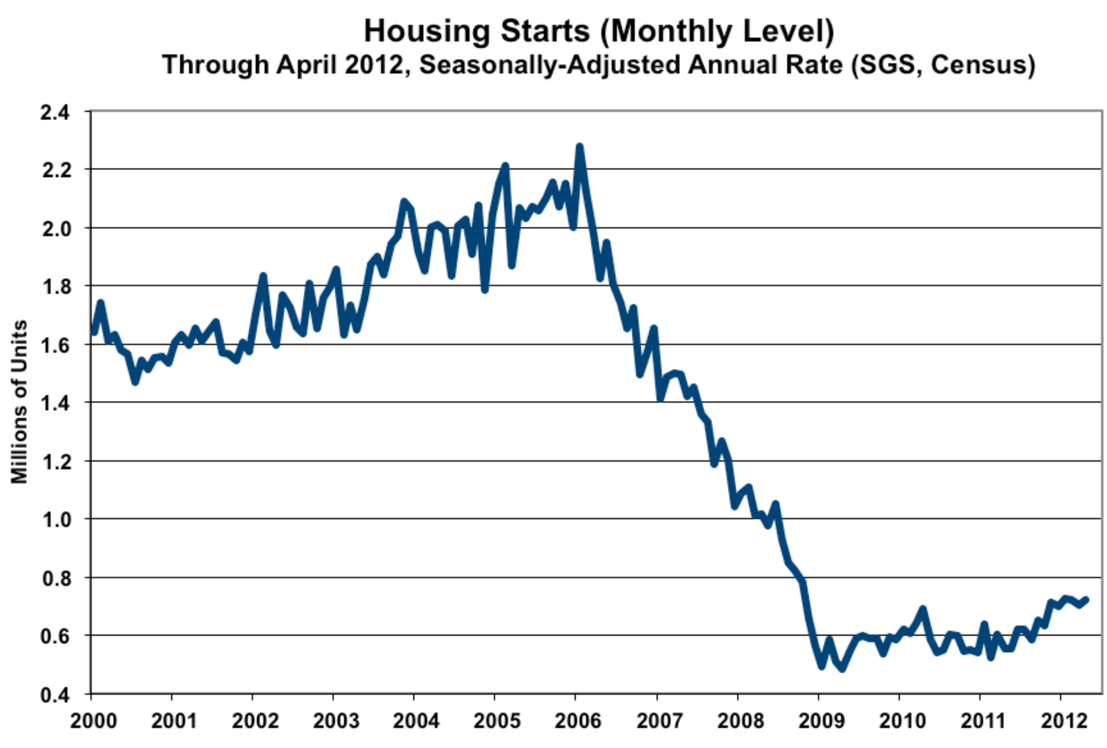
The broad outlook for the economy remains unchanged. U.S. business activity began turning down in 2006 and 2007, plunging from late-2007 into 2009, and bottom-bouncing or stagnating at a low level of activity ever since. As discussed in prior writings such as *Commentary No. 432*, *Special Commentary No. 426* and *Hyperinflation 2012*, the purported economic recovery is an illusion that has resulted from the use of artificially-low inflation rates in deflating the GDP, as well as in deflating series such as retail sales and industrial production. Use of understated inflation in deflating a series results in overstated inflation-adjusted growth.

Also, due to structural limitations on individual and household income and credit (see *Special Commentary No. 429* and *Hyperinflation 2012*), chances are nil for any sustainable economic recovery in the near future.

Where formal projections for such items as the federal budget deficit, U.S. Treasury funding needs, and banking-system solvency are based on assumptions of positive economic growth going forward in time, ongoing recession means worse-than-expected federal fiscal results, greater than anticipated U.S. Treasury funding needs, and ongoing and deepening systemic solvency issues.

In response to this—beyond any attempted fiscal stimulus by the politicians controlling the White House and Congress—the Fed likely will come forth with significant new "accommodation" to help the banking system. For political reasons, the need for new stimulus will be attributed to the faltering economy instead of to banking system needs. One "benefit" of the stimulus would the Fed's ability to step in openly in support of what should be increasingly difficult Treasury auctions.

At such time as there is a next Fed accommodation, that likely will be a trigger for heavy global selling of the U.S. dollar, which in turn should become highly inflationary, very quickly.



Residential Construction. As shown the preceding graph, April housing starts continued the pattern of broad stagnation that has been in place for 41 months. The 2.6% monthly gain in April starts was, as usual, not statistically significant.

That said, there has been a pattern over the last six months that shows the current level of stagnation to be at a slightly higher plateau than seen previously in the post-housing crash. In the last six months, average housing starts have been down 69% from the pre-recession peak in 2006, somewhat better than the 74% decline seen in the 41-month average of the housing starts series since December 2008. There still remains no recovery or relief in sight.

Industrial Production. Unusual volatility was seen in the today's monthly reporting of and revisions to industrial production. Despite the March 30th annual benchmark revision, which purportedly cleaned up a number of reporting-quality issues for the last several years (see *Special Commentary No. 426*), the April 2012 industrial production release showed wilder revisions than did the benchmark.

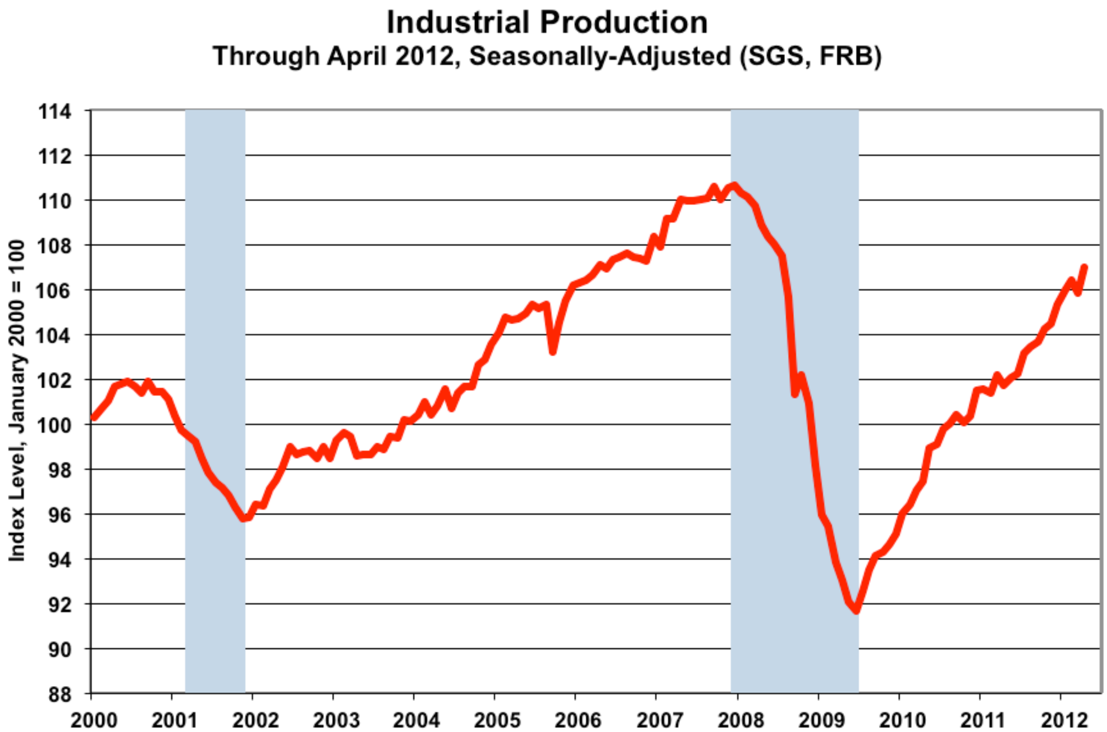
In the initial reporting of the post-benchmark March 2012 release, both February and March production levels were reported as unchanged from the month before. With the April 2012 release, and against a downwardly revised January 2012 base, February 2012 now shows a monthly increase in production of 0.4%, March 2012 now shows a monthly contraction of 0.6%, and April reporting shows an initial monthly production jump of 1.1%. With this type of volatility showing up in near-term monthly revisions to the production data, not too much credibility should be given to the initial reporting of monthly results.

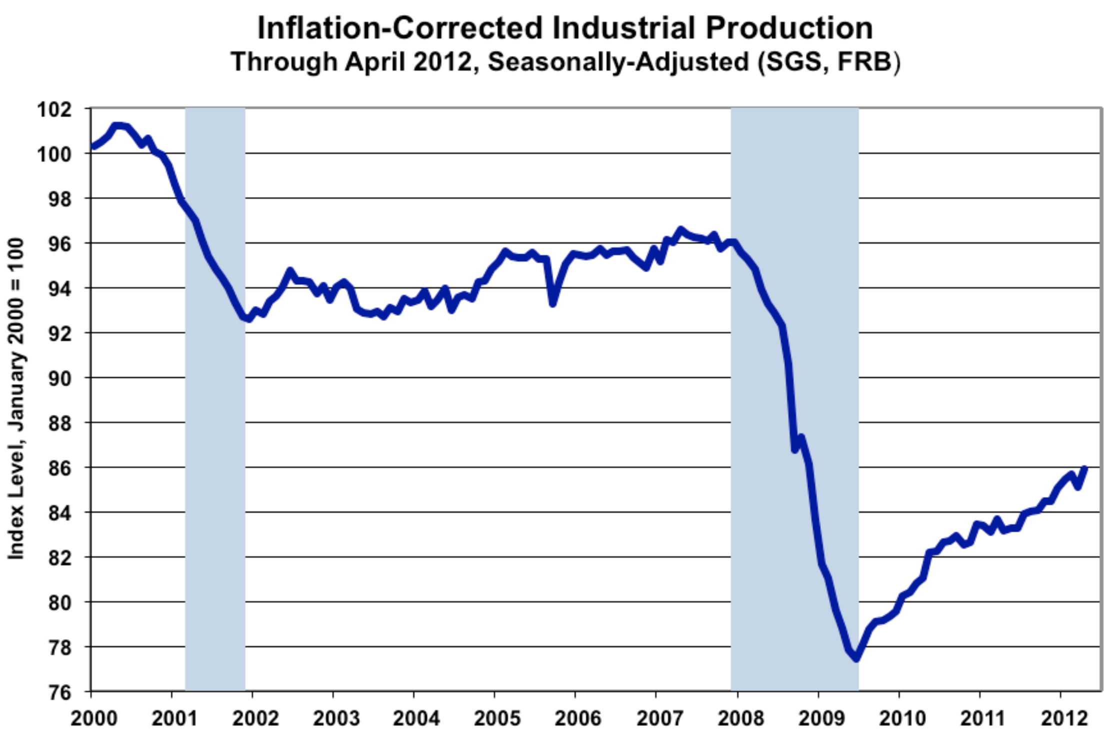
About half of April's aggregate gain was due to a 4.5% jump in utility usage, following a 0.7% gain in March. The utility gain was reported as a seasonal catch-up from the effects of an unseasonably mild winter that otherwise had suppressed reported utility usage. Manufacturing production was up by 0.6% for the month, following a 0.5% contraction in March.

The latest data are plotted in the two graphs following. The first graph is with data as published by the Federal Reserve, except the index level is set at 100 as of January 2000, instead of the official indexing of 100 that is set at the average for 2007 (official indexing is used in the graphs in the *Reporting Detail* section).

The January 2000 base also is used in the second graph, which shows the "inflation-corrected" industrial production series. That series reverses the approximated effects of hedonic quality adjustments made to the inflation-adjusted components in the industrial production index (see Chapter 5 in *Hyperinflation 2012* for further discussion). Use of too-low inflation in deflating various economic series results in overstated growth of the inflation-adjusted numbers.

Per subscriber request, the two graphs on industrial production are plotted to the same scale.


Industrial Production
Through April 2012, Seasonally-Adjusted (SGS, FRB)
Index Level, January 2000 = 100
114
112
110
108
106
104
102
100
98
96
94
92
90
88
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012


Inflation-Corrected Industrial Production
Through April 2012, Seasonally-Adjusted (SGS, FRB)
Index Level, January 2000 = 100
102
100
98
96
94
92
90
88
86
84
82
80
78
76
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

Hyperinflation Watch. The broad economic outlook and implications for systemic stability have not changed, but they are discussed in the *Opening Comments and Executive Summary.* The *Hyperinflation Watch* comments from yesterday's CPI and retail sales *Commentary No. 437* are repeated here:

"Again, the currency with the biggest problems remains the U.S. dollar, and that will be reflected in the global markets at some point. Near-term selling pressure against the euro has boosted the dollar, which in turn has hit precious metals and oil... I would expect the euro weakness versus the U.S. currency to be relatively short-lived, eventually reversing as dollar selling kicks in. The timing is anyone's guess, but the underlying fundamentals remain in place against the dollar and strongly favoring the precious metals and the healthier Western currencies.

"As discussed in the prior *Commentary*, potential triggers for the market shift against the dollar include, but are not limited to, new Fed accommodation and/or banking system problems, a particularly nasty presidential campaign, and/or a shock economic statistic that hits the financial markets the wrong way.

"Otherwise, in the context of the updated background published in *Special Commentary No. 426* and *Special Commentary No. 429*, and with full consideration of subsequent economic, inflation and financial-market developments, the broad economic, inflation and hyperinflation outlooks discussed in the January 25th *Hyperinflation 2012* have not changed."

REPORTING DETAIL

INDEX OF INDUSTRIAL PRODUCTION (April 2012)

Reporting Gyrations in Monthly Industrial Production. Despite the March 30th annual benchmark revision purportedly having cleaned up a number of reporting-quality issues for the last several years, the April 2012 industrial production release showed wilder revisions than did the benchmark. In reporting as of the post-benchmark March 2012 release, both February and March month-to-month production changes were reported as unchanged. As of today's April 2012 release, and against a lower January 2012 base than previously reported, February 2012 now shows a monthly increase in production of 0.4%, March 2012 now shows a monthly contraction of 0.6%, and April reporting shows an initial monthly production jump of 1.1%. With this type of volatility showing up in near-term monthly revisions to the production data, not too much credibility should be given to the initial reporting of monthly results.

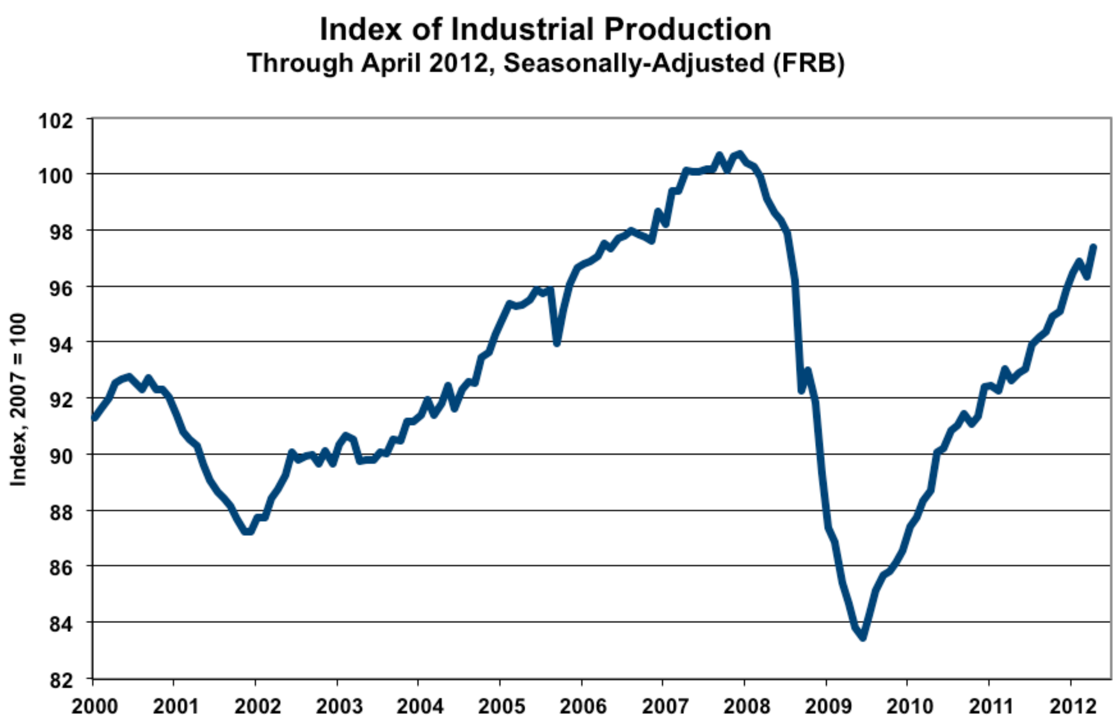
April 2012 Reporting. This morning's (May 16th) release by the Federal Reserve Board of April 2012 industrial production showed seasonally-adjusted April production to have jumped month-to-month by 1.09% (up by 0.87% before prior-period revisions), versus a revised 0.55% contraction (previously "unchanged" at a 0.005% contraction) in March, and against a revised 0.43% gain (previously "unchanged" at a gain of 0.003%) in February.

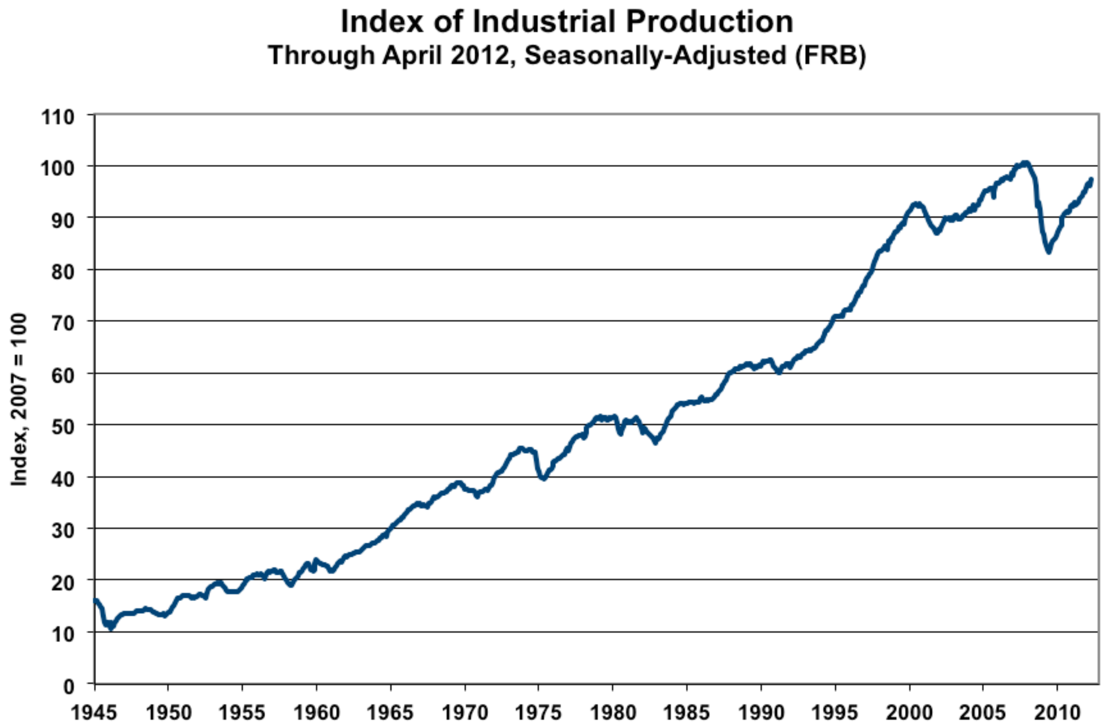
Part of the April production increase was a 4.5% gain in utilities, up from a 0.7% gain in March, where reported activity had been depressed artificially in seasonally-adjusted reporting of recent months due to an unseasonably mild winter. Manufacturing production was up by 0.6% in April, versus a 0.5% contraction March.

Year-to-year growth in April 2012 aggregate production rose to 5.16%, from a revised 3.56% (previously 3.78%) in March, and versus a revised 4.99% (previously 4.64%) in February, still well off the series' recent relative peak annual growth of 8.13% in June 2010. The year-to-year contraction of 15.15% 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 recent historical detail for the period beginning in 2000, the second shows the same data in historical context since World War II.

Corrected for the understatement of inflation used in deflating portions of the industrial production index, the series has shown more of a bottom-bouncing pattern since 2009. The inflation-corrected production series is graphed in the *Opening Comments and Executive Summary* section.





RESIDENTIAL CONSTRUCTION (April 2012)

April Housing Starts Near Post-Crash High, But Remain 69% Below Pre-Recession Peak. Housing starts showed a statistically-insignificant monthly upside bounce in April, as the series went through its annual seasonal-factor revisions with the current release. So adjusted, the regularly volatile aggregate housing starts series continued its protracted bottom-bouncing, with the series well into its fourth year of activity averaging 74% below 2006's record construction level. Although within the normal scope of volatility for the series in the last four years, a slightly higher plateau of activity has settled into place during the last six months that is about 69% below the 2006 high. There still remains no recovery or relief in sight.

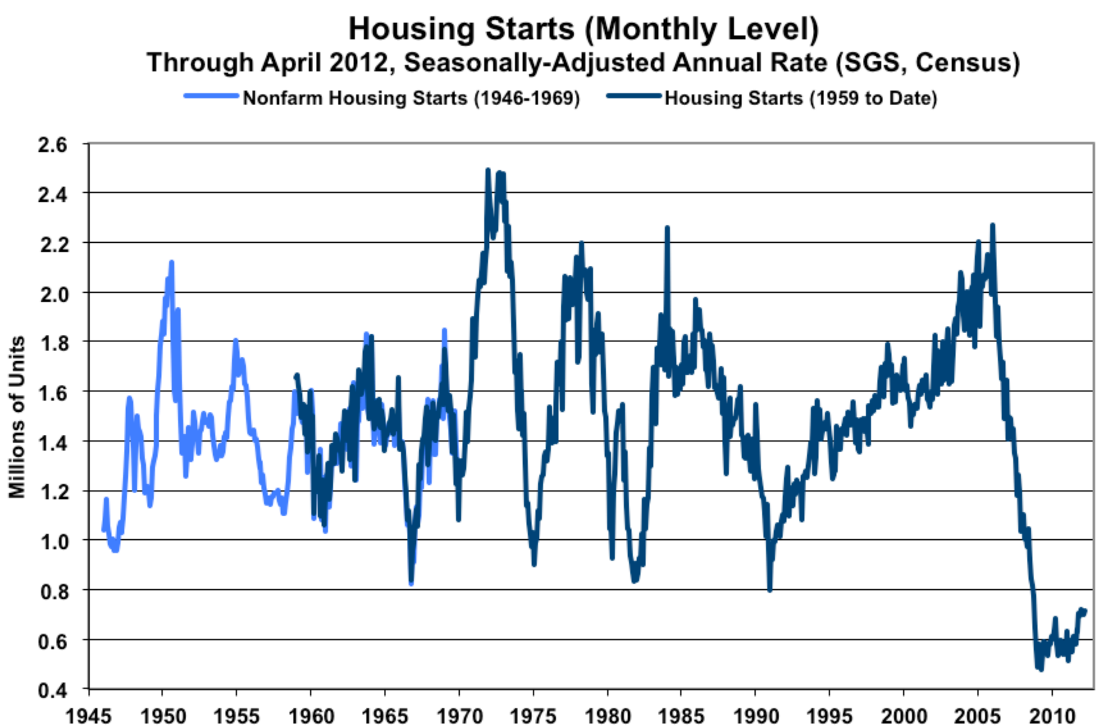
April 2012 Reporting. The Census Bureau reported today (May 16th) a statistically-insignificant month-to-month gain in seasonally-adjusted April 2012 housing starts of 2.6% (a gain of 9.6% before prior-period revisions, which included the annual overhaul of seasonal-adjustment factors) +/- 17.7% (all confidence intervals are at the 95% level). March starts were revised to a monthly decline of 2.6% (previously a decline of 5.8%).

Starts for apartment buildings remained highly irregular, month-to-month, rising by a statistically-insignificant 4.3% +/- 37.2%, after falling by a revised 13.3% (previously 19.8%) in March. The "one-unit" category for April gained 2.3% +/- 13.9%, following a revised 2.3% monthly gain (previously a 0.2% decline) in March.

The year-to-year change in aggregate April 2012 housing starts was a statistically-significant increase of 29.9% +/- 18.0%, following a revised 16.5% (previously 10.3%) annual gain in March.

For the last 41 months, the pattern of housing starts has remained one of stagnation at an historically low-level plateau of activity. Since December 2008, housing starts have averaged a seasonally-adjusted annual rate of 596,000. In that period, all monthly readings have been within the normal range of monthly variability for the aggregate series, around that average, with the 717,000 annual rate for April 2012 near the top of that range.

As shown in the graph in the *Opening Comments and Executive Summary*, current monthly housing starts activity remains off the record monthly low seen for the present series in April 2009. Recent series detail is seen more easily in that graph, which covers reporting since 2000. The following graph shows that current activity is well below any level reported prior to the 2006 peak in the current series or in the predecessor nonfarm housing starts series, which was introduced in 1946.



Week Ahead. Recognition of an intensifying double-dip recession as well as an escalating inflation problem remains sporadic. The political system would like to see the issues disappear until after the election; the media does its best to avoid publicizing unhappy economic news; and the financial markets will do their best to avoid recognition of the problems for as long as possible, problems that have horrendous implications for the markets and for systemic stability.

Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

New Orders for Durable Goods (Benchmark Revision). The annual benchmark revision to new orders for durable goods is due for release on Friday, May 18th. The general pattern there should be one of downside revisions, as seen recently in retail sales and industrial production. Where more complete data are available, the economy in 2010 should be reported as having been weaker than estimated previously. Data subsequent to 2011 likely will be built up with the same overly-optimistic underlying assumptions that currently are in place, but growing off a weaker base.

