

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

COMMENTARY NUMBER 454
May Trade Balance and Consumer Credit, June PPI

July 13, 2012

Trade Data Suggest Negative Contribution to Second-Quarter GDP

Food Prices and Seasonals Offset Declining Oil Prices in PPI

Consumer Credit Bottom-Bounces Net of Government Holdings of Student Loans

PLEASE NOTE: The next regular Commentary is scheduled for Monday, July 16th, covering June retail sales. That will be followed by a Commentary on Tuesday, July 17th, covering June CPI and industrial production, and one on Wednesday, July 18th, covering June housing starts.

Best wishes to all — John Williams

Opening Comments and Executive Summary. This week's light economic reporting included a near-consensus May trade deficit and stronger-than-expected June wholesale inflation. May consumer credit was reported up again, but net of federal government holdings of student loans, consumer credit has been bottom-bouncing for more than a year.

Consistent with the recent pattern of weaker-than-expected reporting seen in major economic releases, next week's estimates of June retail sales, industrial production and housing starts should offer further

downside surprises. A general review of the latest economic indicators will be included in the July 18th *Commentary*, following the housing starts release.

May U.S. Trade Deficit. The headline monthly trade deficit narrowed to \$48.7 billion in June, versus a revised \$50.6 (previously \$50.1) billion in April. Net of inflation effects, however, the first two months of the second-quarter trade deficit were running at an annualized pace of net deterioration against the first-quarter. Where the April and May numbers are used as the basis for the initial guesstimate of the second-quarter 2012 GDP's net-export account, the latest trade reporting indicated a net-negative contribution to the inflation-adjusted "advance" GDP estimate, due for release on July 27th.

June PPI. The regularly volatile headline reporting of the PPI was evident in a stronger inflation report for June than the markets had expected. The June 2012 finished-goods PPI rose by 0.05% (down by 0.57% unadjusted), following a monthly decline of 1.03% (down by 0.56% unadjusted) in May. Seasonal factors—that had been depressing adjusted reporting of energy inflation in recent months—flipped, offsetting much of the impact of declining oil prices in June. With a monthly gain in adjusted food prices and so-called "core" inflation, the headline PPI eked out a small increase.

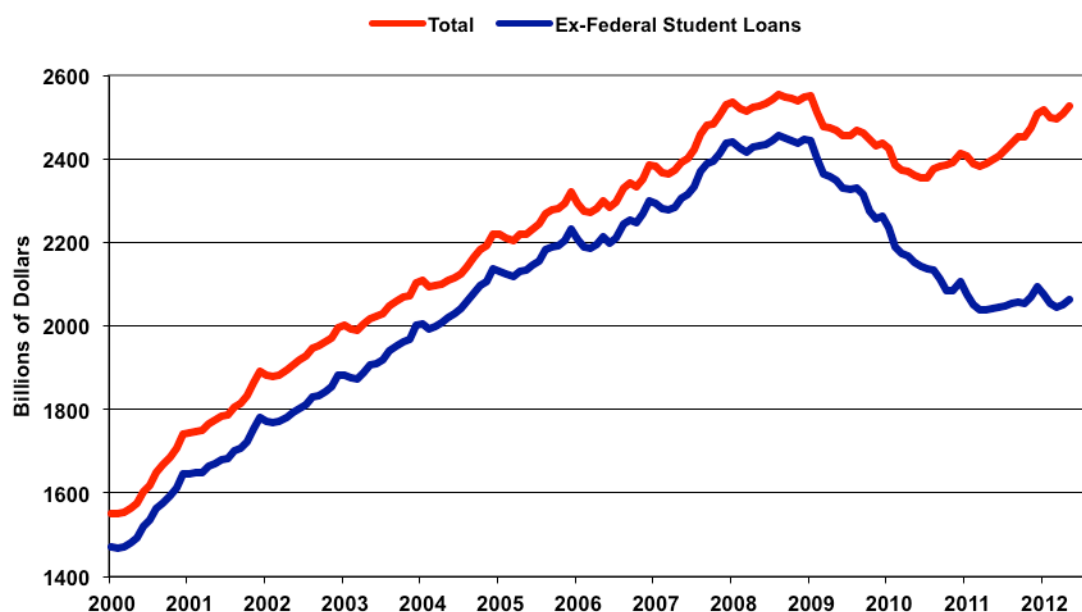
Reflecting the still-spreading broad impact of high oil prices, core inflation (net of direct food and energy prices), gained an adjusted 0.22% for the month and an unadjusted 2.60% year-to-year.

May Consumer Credit. Other than as an adjunct to consumer liquidity analysis, we do not regularly report on consumer credit outstanding. Reporting quality is poor, as evidenced by the frequent, major revisions to the series. As with many of the other financial-system reports published by the Federal Reserve, including the quarterly flow-of-funds analysis, the data often are worthless. It is hard to understand why the Fed would have such difficulty generating reliable information from the banking system, over which it has significant control.

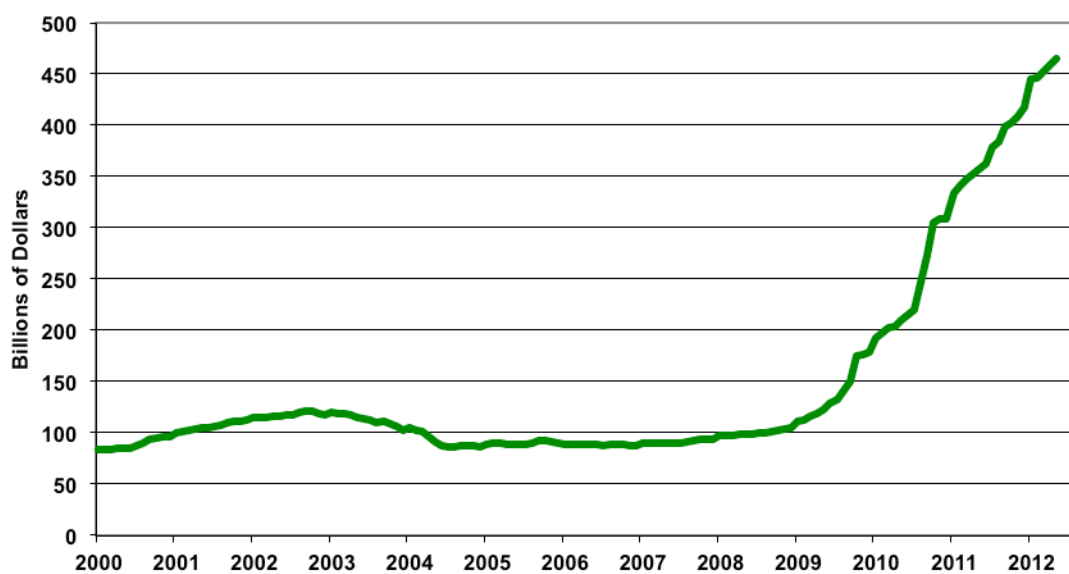
Nonetheless, despite the varying revisions to levels of consumer credit outstanding, the pattern of activity generally has been stable in recent years, and that pattern is useful in terms of assessing consumer liquidity conditions.

As discussed previously (see [Special Report No. 445](#) and [Hyperinflation 2012](#) for example), and as shown in the following graphs, the highly touted surge in consumer credit outstanding since mid-2010 is dominated by the surge in federal government holdings of student loans. Net of that factor, consumer credit outstanding has been stagnant, holding near the low of the current cycle.

**Consumer Credit Outstanding
Total and Total Ex-Federal Student Loans
To May 2012, NSA (ShadowStats.com, FRB)**



**Consumer Credit Outstanding
Federally Owned Student Loans
To May 2012, NSA (ShadowStats.com, FRB)**



Hyperinflation Watch. A general review of inflation and systemic-liquidity conditions will be included in the July 17th *Commentary*, following the release of the June CPI data.

Note: The general outlook is unchanged. [Special Report No. 445](#) (June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. The Special Report supplemented [Hyperinflation 2012](#) (January 25th), which remains the primary missive detailing the hyperinflation story. This circumstance will be updated further as new developments unfold.

REPORTING DETAIL

U.S. TRADE BALANCE (May 2012)

April and May Trade Data Suggest Negative Contribution to Second-Quarter GDP Growth. The headline May trade deficit narrowed versus April, which had narrowed versus March. Net of inflation effects, though, the first two months of the second-quarter trade deficit are running at a pace of net deterioration versus the first-quarter. With the April and May numbers used as the basis for the guesstimate of the second-quarter GDP's net-export account, the latest trade numbers indicate a net-negative contribution to the inflation-adjusted "advance" estimate of second-quarter 2012 GDP, due for release on July 27th.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported Wednesday (July 11th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for May 2012, on a balance of payments basis, narrowed to \$48.7 billion from a revised \$50.6 (previously \$50.1) billion in April 2012, and was up from a \$47.7 billion deficit in May 2011.

Against the revised April detail, the seasonally-adjusted May 2012 trade balance reflected a higher level of exports and a lower level of imports. Seasonally-adjusted petroleum-based imports contributed to the import downturn, reflecting unadjusted declines in oil prices and physical oil import volume.

Crude Oil and Energy-Related Petroleum Products. For the month of May 2012, the not-seasonally-adjusted average price of imported oil eased back to \$107.91 per barrel, from \$109.94 in April 2012, and it was down from \$108.74 in May 2011.

In terms of not-seasonally-adjusted physical oil imports, May 2012 volume averaged 8.784 million barrels per day, down from 9.000 million in April 2012, and down from 8.936 million in May 2011.

Caution on Data Quality. The standard caution here for the monthly detail is that heavy distortions likely continue in the seasonal adjustments, much as has been seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. As has been discussed frequently (see [Hyperinflation 2012](#) for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not rely heavily on the accuracy of the monthly headline data.

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil price swings and other inflation (2005 chain-weighted dollars as used in reporting real GDP), the May 2012 merchandise trade deficit (no services) came in at \$48.0, versus a revised \$48.7 (previously \$48.5 billion) in April. Though narrowed slightly versus March, the average of the April and May deficits was bigger than the \$47.7 billion average deficit for first-quarter 2012. Where April and May are the two months on which the “advance” estimate of second-quarter GDP partially will be based, the indication here is for a net deterioration in the GDP’s net export account and a negative contribution to the headline GDP estimate.

Based on the latest reporting and revisions, the annualized pace of April and May 2012’s real deficit (a proxy for second-quarter 2012) was \$579.8 billion, somewhat wider than the annualized estimate of the first-quarter 2012 real trade deficit of \$572.1 billion, which, in turn, was little changed from the \$573.4 billion estimated for fourth-quarter 2011. Again, the real trade deficit detail here is used as a partial base for estimating the GDP’s net-export account.

PRODUCER PRICE INDEX—PPI (June 2012)

Seasonal Factor Swing Mitigated Oil Price Decline; Food Inflation Surged. As reported this morning, July 13th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for June 2012 rose by 0.05% (down by 0.57% unadjusted), following a monthly decline of 1.03% (down by 0.56% unadjusted) in May.

Unadjusted and year-to-year, June’s total finished goods PPI inflation held at 0.73%, the same growth rate as in May. Annual change in the PPI has weakened from a 7.0% near-term peak seen in September 2011, when the annual numbers began going against a year-ago period where Mr. Bernanke was running QE2. He then was meeting with early success in debasing the U.S. Dollar and generating an increase in oil prices.

The rounded 0.1% seasonally-adjusted gain in reported monthly inflation for June was accounted for by an adjusted 0.93% (unadjusted 2.62%) month-to-month decline in finished energy goods, which was offset by an adjusted 0.51% (unadjusted 0.30%) gain in food prices, and by an adjusted 0.22% (unadjusted 0.06%) gain in “core” inflation.

Core inflation is net of food and energy inflation, but the concept from most aspects is nonsensical, where food and energy account for 41.4% of the finished goods PPI (24.6% of the CPI-U, 27.6% of the CPI-W). That said, reflecting the ongoing broad impact of high oil prices on inflation throughout the general economy, the seasonally-adjusted monthly “core” PPI, again, increased by 0.22% (0.06% unadjusted), versus an adjusted gain of 0.17% (unchanged unadjusted) in May. Year-to-year unadjusted core finished

goods inflation was 2.60% in June, versus 2.71% in May. A comparison of core PPI with core CPI-U will be graphed in the July 17th *Commentary* covering the June CPI release.

Unlike the payroll and retail sales numbers, where monthly seasonal factors are revamped every month, the PPI and CPI adjustments get revised but once a year. Accordingly, seasonally-adjusted underreporting of energy-based inflation that took place in the first-half of 2012 will be offset in the second-half of the year, with seasonal adjustments then tending to boost reporting of energy prices.

Intermediate and Crude Goods. On a monthly basis, seasonally-adjusted June intermediate goods prices fell by 0.5%, following a 0.8% decline in May, with June crude goods prices down by 3.6%, versus a 3.2% decline in May.

Year-to-year inflation in unadjusted June intermediate goods fell by 1.3%, after a 0.6% decline in May. Year-to-year inflation in June crude goods declined by 11.4%, against a 7.7% decline in May.

Week Ahead. *Market recognition of an intensifying double-dip recession has started to take a stronger hold, at the moment, while recognition of a mounting inflation threat remains sparse. 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 or to put a happy spin on the numbers; 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.

Retail Sales (June 2012). Scheduled for release on Monday, July 16th, by the Census Bureau, headline June 2012 retail sales could see another small contraction, following the initial reporting of a 0.2% decline in May. Again, market expectations likely will be disappointed, given the continued structural liquidity problems facing the consumer.

With the headline June CPI-U likely to show a small decline, a nominal (not-adjusted-for-inflation) decline in retail sales could swing to unchanged or to a small gain after adjustment for inflation. Nonetheless, the recent pattern of weakening/flattening monthly real (inflation-adjusted) retail sales activity should remain in place.

Consumer Price Index—CPI (June 2012). The release by the Bureau of Labor Statistics of the June 2012 CPI numbers is scheduled for Tuesday, July 17th. With unadjusted gasoline prices down 5.1% for the month (per the Department of Energy), the headline June CPI-U likely will show a small contraction, even with a pending reversal to first-half 2012 seasonal-adjustment pressures that have suppressed gasoline inflation numbers. Any upside surprises likely would come from higher food prices and from relatively strong “core” inflation.

As noted in [Commentary No. 447](#), the regular, artificial depression of adjusted gasoline prices in the first-half of the year is due for a sharp reversal. In June, seasonal adjustments for gasoline prices usually move

towards neutral, turning much less negative in impact. In July, seasonal adjustments flip and turn strongly positive, boosting reported headline gasoline price inflation and often turning actual price declines into adjusted increases. Accordingly, headline monthly CPI inflation should turn to the upside by July 2012 reporting.

Year-to-year total CPI-U inflation would increase or decrease in June 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.09% gain in the adjusted monthly level reported for June 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for June 2012, 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 the May 2012 annual inflation rate of 1.70%. For example, if the headline CPI-U were unchanged in June, year-to-year inflation should come in around 1.6%.

Industrial Production (June 2012). Due for release Tuesday, July 17th, by the Federal Reserve, the headline industrial production number likely will be flat or contract again in June 2012, following the 0.1% monthly decline initially reported for May. Working-off of excess inventories should continue to impair near-term production activity, with results that likely will be weaker than market expectations.

Residential Construction (June 2012). June housing starts detail is due for release on Wednesday, July 18th, by the Census Bureau. Following a 75% plunge in activity from 2006 through 2008, the ensuing four-year pattern of housing starts stagnation—at an historically low level of activity—likely did not change in June. As has become the standard circumstance, any reported monthly gain likely would not be statistically significant.
