John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 463
July Retail Sales, PPI

August 14, 2012

July Retail Sales Gain Reflected Ongoing Seasonality Problems and Revisions;
It Did Not Reflect Shifting Consumer Dynamics

Potential Downside Revision Pressure on Second-Quarter GDP

Stronger "Core" PPI Inflation Continues to Show Long-Range Impact of Higher Oil Prices

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PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Wednesday, August 15th, covering July 2012 CPI and industrial production, followed by a Commentary on August 16th, covering housing starts.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Today's (August 14th) reporting of July retail sales and producer prices did not alter meaningfully the general outlook for the economy or inflation. A summary of the July inflation numbers and August inflation outlook will be covered in tomorrow's (August 15th) CPI and industrial production *Commentary*, and a review of the July economic numbers and outlook for August reporting will be included in the August 16th *Commentary* covering housing starts.

July 2012 Retail Sales. The statistically-significant 0.81% headline monthly gain in July retail sales offset the revised 0.73% (previously 0.48%) decline in June sales, but remained below levels seen in April and before. As a result of the net downside prior-period revisions to the series, the annualized quarterly contraction in second-quarter retail sales deepened to 0.99% from the initially-reported 0.78%, before inflation adjustment. Net of inflation adjustment, the annualized quarterly contraction in second-quarter retail sales deepened to 1.73% from the initially-reported 1.52%. The prior-period revisions suggest downside pressure on the pending August 29th revision of second-quarter GDP.

Year-to-year growth picked up in July 2012, but, as with June, the inflation-adjusted growth rate likely remained at what would be a signal for pending recession, at least in normal economic times. This will be discussed further in tomorrow's *Commentary*.

The meaningfulness of the headline monthly growth numbers continues to be impaired by seasonal-factor distortions that have been generated by the severe length and depth of the economic collapse. Those distortions have been compounded by the use of concurrent seasonal factor adjustments. The structural income and credit problems impairing personal consumption remain in place.

July 2012 PPI. The 0.3% (0.26% to the first decimal point) headline gain in the July PPI reflected higher food prices (enhanced by seasonal factors), lower energy prices (counter to reality and depressed by seasonal factors) and higher core inflation (reflecting the spreading impact throughout the general economy of high oil prices). The June headline gain for the full finished goods series was 0.1% (0.05% to the second decimal point). Year-to-year finished goods PPI slowed to 0.52% in July, versus 0.73% in June.

Headline "core" inflation—net of food and energy prices—was a monthly gain of 0.44% in July, double the 0.22% seen in June. Year-to-year core finished goods inflation (unadjusted) was 2.47% in July, versus 2.60% in June.

Hyperinflation Watch. *General circumstances have not changed, but this section will be refreshed with tomorrow's post-CPI* Commentary. *The detail in* Special Report No. 445 *(June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That* Special Report *supplemented* Hyperinflation 2012 *(January 25th), which remains the primary* Commentary *detailing the hyperinflation story. The following text is the same as provided in recent* Commentaries.

Official GDP reporting shows plunging economic activity from fourth-quarter 2007 to second-quarter 2009, with an ensuing upturn in activity that led to a full recovery as of fourth-quarter 2011, and that "recovery" has continued through initial second-quarter 2012 reporting.

In contrast to GDP reporting—and in line with patterns seen in better-quality economic series—I still contend that the economy began turning down in 2006, plunging in 2008 into 2009 and subsequently stagnating—bottom-bouncing—at a low level of activity, ever since. There has been no recovery since mid-2009, and the economic downturn now is intensifying once again. The renewed slowdown is evident in the current reporting of nearly all major economic series. Not one of those series shows a pattern of activity that confirms the recovery evident in the GDP series.

As shown in *Commentary No. 459*, the official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP, which has the result of overstating economic growth (see also *Special Report No. 445*).

The long-term fiscal solvency issues of the United States—where GAAP-based accounting shows annual deficits running in the $5 trillion range—are not being addressed, and the politicians currently running the government lack the political will to address those issues. That circumstance initially suggested a hyperinflation crisis by the end of this decade, but federal government and Federal Reserve actions—in response to the systemic-solvency crisis of 2008—accelerated the process, indicating a hyperinflation problem by no later than the end of 2014. The continuing economic downturn is intensifying the fiscal- and systemic-solvency problems.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions. With the economy weak enough to provide cover for further Fed accommodation to the still-struggling banking system, the next easing by the Fed—and it should follow as needed to support the banking system—likely will lead to a massive dollar-selling crisis and that will begin the process of a rapid upturn in domestic consumer inflation.

REPORTING DETAIL

RETAIL SALES (July 2012)

July Headline Gain Received Relative Boost from Downside Revisions to June Data. The headline monthly rebound of 0.81% in July retail sales was in the context of net downside revisions to the June numbers. In nominal terms (not adjusted for inflation), revised second-quarter 2012 retail sales contracted at a quarter-to-quarter rate of 0.25% (an annualized contraction rate of 0.99%), versus initial reporting last month of a 0.20% quarterly contraction (an annualized contraction rate of 0.78%). That remains the first quarterly downturn in nominal retail sales since first-quarter 2009, which was within the formally-recognized 2007/2009 recession. The revisions to the nominal data will flow through proportionately to the real (inflation-adjusted) retail sales numbers, suggesting some downside pressure on the upcoming August 29th revision to second-quarter 2012 GDP. Initial implications for real third-quarter retail sales and GDP will be discussed in the post-CPI *Commentary* tomorrow, August 15th.

Note: The stability of the seasonal-adjustment process (particularly the concurrent seasonal-adjustment process used with retail sales) and sampling methods have been disrupted severely by the unprecedented depth and length of the current economic downturn in the post-World War II era (the period of modern economic reporting).

Under such circumstances, where the markets effectively may be flying blind as to actual economic activity, consideration of broad underlying fundamentals is essential. Consumer income and credit remain structurally impaired, as discussed in Hyperinflation 2012 *and* Special Report No. 445 *and* *related recent* Commentaries*. Those factors continue to signal economic deterioration, not recovery, with the broad economy remaining in serious trouble.*

Nominal (Not-Adjusted-for-Inflation) Retail Sales. Today's (August 14th) report on July 2012 retail sales—issued by the Census Bureau—indicated a statistically-significant, seasonally-adjusted monthly gain of 0.81% (a statistically-insignificant gain of 0.60% before prior-period revisions) +/- 0.6% (all confidence intervals are at the 95% level). July's headline gain followed a revised headline decline of 0.73% (previously a drop of 0.48%). Accordingly, the July reading slightly more than recouped May's revised level, but it remained below each of the monthly levels currently estimated for February through April of 2012.

Year-to-year July 2012 retail sales growth was 4.12% +/- 0.8%, where year-to-year growth for June was revised lower to 3.52% (previously reported as a gain of 3.77%). In normal economic times, the June 2012 real annual growth rate of 1.81% would be signaling a pending recession; the real annual growth rate for July likely will be somewhat higher than June's reading and will be discussed in tomorrow's *Commentary*.

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 preference for ignoring food and energy prices when "core" inflation is lower than full inflation—are estimated using two approaches:

Version I: July 2012 versus June 2012 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—was up by 0.92%, versus the official gain of 0.81%.

Version II: July 2012 versus June 2012 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—was up by 0.71%, versus the official 0.81%.

Real (Inflation-Adjusted) Retail Sales. Real July retail sales will be assessed along with the release of July 2012 CPI-U reporting tomorrow, Wednesday, August 15th. The CPI-U is used in deflating the nominal retail sales series. With the consensus for the headline July CPI-U monthly gain around 0.2%, the nominal headline gain reported in this morning's retail sales report should be mitigated a bit.

As official consumer inflation continues to pick up, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze, downturns in monthly retail sales should accelerate and lead eventually to recognition of a formal double-dip recession.

As discussed in *Special Report No. 445*, there have been no changes in the underlying fundamentals. There have been no shifts in underlying activity that would support a sustainable turnaround in retail sales, personal consumption or in general economic activity. Where in recent years there has been no recovery, just general bottom-bouncing, real retail sales now appear to have entered a period of renewed contraction.

PRODUCER PRICE INDEX—PPI (July 2012)

“Core” PPI Takes a Jump, As Inflation Pressures Push Throughout the Economy. As reported this morning, August 14th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for July 2012 rose by 0.26% (a gain of 0.16% unadjusted), following a monthly gain of 0.05% (a decline of 0.57% unadjusted) in June. Food prices surged again (with some seasonal-factor enhancement), while the impact of a sharp rise in oil and energy-related prices was turned into price declines by questionable reporting and the muting effect of seasonal-factor adjustments.

The rounded 0.3% seasonally-adjusted gain in reported monthly inflation for July was accounted for by an adjusted 0.4% (unadjusted 0.3%) month-to-month decline in finished energy goods, which was more than offset by an adjusted 0.5% (unadjusted 0.2%) gain in food prices, and by an adjusted 0.4% (unadjusted 0.3%) gain in “core” inflation.

“Core” inflation is net of food and energy inflation. The concept of core inflation as a realistic measure of inflation 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). Even Mr. Bernanke, core-inflation’s primary advocate, purportedly consumes food and energy.

The core measure, however, is useful as an indication of how energy prices (in particular) are impacting the broad economy. Indeed, reflecting the ongoing broad impact of high oil prices throughout the general economy, the seasonally-adjusted monthly core PPI increased by 0.44% (0.28% unadjusted) in July, versus an adjusted gain of 0.22% (0.06% unadjusted) in June. Year-to-year, unadjusted core finished goods inflation was 2.47% in July versus 2.60% in June. A comparison of core PPI with core CPI-U will be graphed in the August 15th *Commentary* covering the July CPI release.

Unadjusted and year-to-year, July’s total finished goods PPI eased to a gain of 0.52%, versus 0.73% in June. Annual change in the PPI has weakened from a 7.08% near-term peak seen in July 2011, after which the annual numbers began going against a year-ago period where Mr. Bernanke was running QE2 and meeting with early success in debasing the U.S. Dollar and generating an increase in oil prices.

<u>Intermediate and Crude Goods.</u> On a monthly basis, seasonally-adjusted July intermediate goods prices fell by 0.9%, following a 0.5% decline in June, with July crude goods prices up by 1.8%, versus a 3.6% decline in June.

Year-to-year inflation in unadjusted July intermediate goods fell by 2.6%, after a 1.3% decline in June. Year-to-year inflation in July crude goods declined by 9.6%, a somewhat slower pace of contraction than the 11.4% reported in June. The recent rebound in oil prices slowly is working its way into the PPI reporting (starting in crude goods), on top of rising food prices.

Week Ahead. *Market recognition of an intensifying double-dip recession is taking a somewhat 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 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.

Consumer Price Index—CPI (July 2012). The release by the Bureau of Labor Statistics of the July 2012 CPI numbers is scheduled for tomorrow, Wednesday, August 15th, and the headline CPI inflation rate is a fair bet to top market expectations that seem to have settled around 0.2%. Despite a near-10% jump in gasoline prices in the last four-to-five weeks, unadjusted average gasoline prices fell by 2.7% in July versus June, per the Department of Energy.

July, however, traditionally has seasonal adjustments that boost adjusted gasoline inflation. Those seasonals turned an unadjusted monthly decline of 1.5% in July 2011 gasoline prices into a seasonally-adjusted monthly gain of 4.7%. Add in rising food inflation and higher "core" inflation (everything but food and energy), the makings are in place for an upside surprise in monthly CPI inflation.

Year-to-year total CPI-U inflation would increase or decrease in the July 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.30% (initially a 0.5%) gain in the adjusted monthly level reported for July 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for July 2012, the difference in July's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from the June 2012 annual inflation rate of 1.66%. A consensus number could leave the annual change around 1.6%.

Industrial Production (July 2012). Also due for release tomorrow, Wednesday, August 15th, by the Federal Reserve, the headline industrial production number could receive some boost from strong utility usage, reflecting the unusual heat extremes seen around the country during July. Continued building of excess automobile inventories also could be a near-term plus. Otherwise, production should have contracted in the month, as suggested by two monthly contractions (June and July) in the purchasing managers survey of manufacturing.

On balance, there is fair risk of a downside surprise to market expectations. Consensus appears to be for a somewhat stronger headline July production growth than was seen in the initial 0.4% gain reported for June. Volatile and unstable prior-period revisions are likely to continue.

Residential Construction (July 2012). Detail on July housing starts is due for release on Thursday, August 16th, 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 July. As has become the standard circumstance, any reported monthly gain likely would not be statistically significant.

