

John Williams'
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September PPI, August Trade Deficit, Manipulations

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Third-Quarter Wholesale Inflation Jumps to an Annualized 6.2%

August Trade Deficit Suggests Downside Pressure on Third-Quarter GDP Estimate

Political Manipulation of Economic Data: It Has Happened Before

PLEASE NOTE: The next regular Commentary is scheduled for Monday, October 15th, covering September retail sales, with subsequent Commentaries on Tuesday, October 16th, covering September CPI and industrial production, and on Wednesday, October 17th, on September housing starts.

*Publication of the **Special Commentary** reviewing economic, inflation and systemic conditions has been shifted to Monday, October 29th, so as to include the significant September-economic and third-quarter-GDP reporting, as well as detail on fiscal-2012 operations of the federal government. Any updates to timing will be advised in the schedule box on www.shadowstats.com.*

Best wishes to all — John Williams

Opening Comments and Executive Summary. Public speculation as to political manipulation of current labor numbers has hit a level of uproar that—to my knowledge—is unprecedented. Per the discussion in [Commentary No. 473](#) on the unusual reporting of the September 2012 headline unemployment rate, the reporting process there lacks transparency, allowing for potential manipulation of the unemployment number. Yesterday (October 11th), the Department of Labor (DOL) released its latest

weekly estimate of new claims for unemployment, a number that showed a sharp decline and an unusually low level. The DOL made known that the report was understated, based on incomplete reporting by an undisclosed state. There clearly are problems with these data. Manipulated or not, the numbers are being misrepresented as to their accuracy to the voting public, by politicians and major public media who would like the public to believe that the economy is recovering. The economy has not and is not recovering, however, and as discovered by earlier manipulative politicians, Main Street U.S.A. is not fooled easily.

Whether or not manipulations have taken place with current reporting, hard evidence—one way or the other—likely will be forthcoming in the year ahead. In the interim, the initial reporting of third-quarter GDP on October 26th, and the October labor report on November 2nd—in the two weeks before the election—would be likely manipulation targets, if the data indeed were being massaged.

Historical Precedent. Nonetheless, manipulations have happened in the past, as recognized among some economists in the private sector. In an annual survey I conducted in 1990 of how business economists viewed the quality of government statistics, 39% of those surveyed cited political manipulation as a major problem, particularly during election years. Confirmation of manipulations occasionally was provided by employees, or former employees, of the involved government statistical bureaus. The circumstance just has been part of the system—a game played by both sides of the aisle. Many private economists simply have tended to ignore what more than 70% of the survey respondents viewed to be poor-quality data.

Indeed, there were specific manipulations of the first kind (direct political manipulation) to key economic reporting during the Lyndon Johnson administration (GNP), the first-George Bush administration (GNP), and during the Bill Clinton administration (labor and poverty numbers), among other incidents, that became known from individuals involved in the altered reporting, or as otherwise demonstrable from the public record.

The more-common political manipulations of the second kind (long-term alterations of reporting methodologies designed to boost economic and to suppress inflation data) also have been utilized over a number of decades. These issues have been discussed in the *Primer* series on www.shadowstats.com.

Main Street U.S.A. Has A Good Sense of Reality. Facing re-election during a recession, one president claimed that a recovery had begun, based on positive GNP reporting from the Bureau of Economic Analysis (BEA). The numbers were wrong, having been manipulated to the upside by forces external to the BEA. The public viewed the President as being out of touch with reality, and he lost the election.

Irrespective of cause, the recent labor and GDP reporting are so removed from common experience that a similar circumstance “out of touch with reality” could develop here. The average person has a good sense of what is going on in the economy, and the resulting disbelief of the unemployment number is one factor behind the unusual furor over the “manipulation.”

Still, as former Labor Secretary Bob Reich explained in his memoirs, the Clinton administration had found in its public polling that if the government inflated its economic reporting, enough people would believe it to swing a close election.

Political Disclosure. I do my best to write my *Commentaries* free of political bias, to tell it as it is, irrespective of the political party in power. Long-term subscribers should recognize that. For purposes of full disclosure, though, I describe my political leanings as an old-line conservative Republican with a libertarian bent.

[Note: More Complete Analyses of the Following Series Are Found in the Reporting Detail Section]

September 2012 Producer Price Index (PPI). September's seasonally-adjusted, finished-goods PPI rose by 1.12% (a gain of 0.61% unadjusted) for the month, following a 1.66% (1.24% unadjusted) gain in August. For third-quarter 2012, seasonally-adjusted quarter-to-quarter inflation was 1.51%, an annualized pace of 6.17%, versus a quarter-to-quarter decline in the second-quarter of 0.86% (an annualized decline of 3.39%).

August 2012 Trade Balance. The August trade deficit widened to \$44.2 billion, from a revised \$42.5 (previously \$42.0) billion in July. With two out of three third-quarter months in place, the annualized third-quarter trade deficit—net of inflation and seasonal adjustments—annualizes to a pace that shows net trade deterioration in the third-quarter versus the second-quarter. That implies some deterioration in the GDP's net-export account, with resulting downside pressure to the initial reporting of third-quarter GDP on October 26th.

Hyperinflation Watch—Updated Summary.

General Outlook to Be Revised in Upcoming Special Commentary. The nature and implications of QE3—announced recently by the FOMC of the Federal Reserve Board—were discussed in the *Opening Comments* of [Commentary No. 470](#). Specifically, while general circumstances have continued to advance towards the ultimate demise of the dollar, the general outlook is unchanged. While QE3 is an enabling action for the onset of massive inflation, the outside timing of 2014 for the ShadowStats.com hyperinflation forecast remains in place. The hyperinflation outlook will be reviewed and updated fully in the *Special Commentary* scheduled for October 29th. The following summary of the broad outlook has not been changed since the September 14th *Commentary*.

The detail in [Special Commentary No. 445](#) (June 12th) updated the hyperinflation outlook and the outlook for U.S. economic, U.S. dollar, and systemic-solvency conditions. That Special Commentary supplemented [Hyperinflation 2012](#) (January 25th), which remains the primary missive detailing the hyperinflation story. Those reports are suggested as background reading for new subscribers.

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

In contrast to the GDP reporting—and in line with patterns seen in better-quality economic series—I 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 full recovery shown in the GDP series.

Federal Reserve Chairman Ben Bernanke has observed that broad aggregate measures of the U.S. economy, such as GDP, do not appear to be reflecting the common experience of the general public. Indeed, common experience suggests that the economy has not recovered. The official recovery simply is a statistical illusion created by the government's use of understated inflation in deflating the GDP, which

overstates deflated economic growth, as discussed in [Commentary No. 467](#), [Special Commentary No. 445](#), and [Public Comment on Inflation](#).

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, suggesting a hyperinflation problem by no later than the end of 2014. The continuing economic downturn is intensifying the fiscal- and systemic-solvency problems, and public awareness of this should grow rapidly in the months ahead.

Neither economic nor systemic-solvency issues have been resolved by U.S. government or Federal Reserve actions, and the most recent readings on income variance suggest that the worst is yet to be seen, as discussed in [Commentary No. 469](#).

With the economy weak enough to provide political cover for further Federal Reserve accommodation to the still-struggling banking system, QE3 was introduced on September 13th. That action effectively provided for open-ended monetization of U.S. Treasury debt at the Fed's discretion. The mechanism for eventual full debasement of the dollar now is in place, and it likely will come into full play, as needed to support the banking system and as needed to assure “successful” auctions of Treasury debt.

QE3 likely will lead to a massive dollar-selling crisis, and that will begin the process of a rapid upturn in domestic consumer inflation. A near-term dollar-selling crisis is now of a much greater risk, post-QE3. Separately, though, a dollar-selling crisis could begin at any time, triggered by various economic, sovereign-solvency or political issues. With the guidelines set for QE3, even negative employment reports could trigger massive dollar selling.

REPORTING DETAIL

PRODUCER PRICE INDEX—PPI (September 2012)

Wholesale Inflation Continues to Soar. As reported today, October 12th, by the Bureau of Labor Statistics (BLS), the regularly-volatile, seasonally-adjusted finished-goods producer price index (PPI) for September 2012 rose by 1.12% (a gain of 0.61% unadjusted), following a monthly gain of 1.66% (a gain of 1.24% unadjusted) in August. For third-quarter 2012, seasonally-adjusted quarter-to-quarter inflation

was 1.51%, an annualized pace of 6.17%, versus a quarter-to-quarter decline in the second-quarter of 0.86% (an annualized decline of 3.39%).

The rounded 1.1% seasonally-adjusted gain in reported monthly inflation for September was accounted for by an adjusted 4.7% (unadjusted 2.8%) month-to-month jump in finished energy goods, plus an adjusted 0.2% (unadjusted 0.4%) gain in food prices, and by an adjusted unchanged (unadjusted 0.1% decline) 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 at present, 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. For September, the seasonally-adjusted monthly core PPI was unchanged from August (down 0.11% unadjusted), versus an increase of 0.22% (0.16% unadjusted) in August, despite indications from the ISM purchasing managers surveys of sharp jumps in non-energy prices in September. Year-to-year, unadjusted core finished goods inflation eased to 2.30% from 2.53% in August. A comparison of core PPI with core CPI-U will be graphed in the *Opening Comments and Executive Summary* of the October 16th *Commentary* covering the September CPI release.

Unadjusted and year-to-year, September’s total finished goods PPI continued to rise, with an annual inflation gain of 2.13%, versus 1.98% in August and 0.52% in July. Nonetheless, 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, meeting with early success in debasing the U.S. Dollar and generating an increase in oil prices. QE3’s impact, so far, has been from jawboning, not from specific monetary action, with oil prices seeing recent upside pressure, which has been due as well to mounting Middle East political tensions.

Intermediate and Crude Goods. On a monthly basis, seasonally-adjusted September intermediate goods prices rose by 1.5%, following a 1.1% gain in August, with September crude goods prices up by 2.8%, following an August increase of 5.8%.

Year-to-year inflation in unadjusted September intermediate goods notched lower by 0.1%, following a 1.1% decline in August. Year-to-year inflation in September crude goods was down 2.6%, following a decline of 3.5% in August. The recent rebound in oil prices slowly is working its way into the PPI reporting, on top of rising food prices.

U.S. TRADE BALANCE (August 2012)

Deterioration in the Headline August and Revised July Trade Deficits Suggests Downside Pressure on GDP Reporting. The headline August trade deficit widened sharply, while the July deficit deteriorated in revision. Net of inflation, the contribution to the third-quarter net-export account, and related impact on the initial headline estimate of third-quarter 2012 GDP, appears to be slightly negative.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The Bureau of Economic Analysis (BEA) and the Census Bureau reported yesterday (October 11th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for August 2012, on a balance of payments basis, widened to \$44.2 billion from a revised \$42.5 (previously \$42.0) billion in July. The August 2012 deficit narrowed somewhat from the \$44.8 billion deficit in August 2011.

Against the revised July detail, the seasonally-adjusted August 2012 trade balance reflected a drop in exports in conjunction with a much smaller decline in imports.

Crude Oil and Energy-Related Petroleum Products. For the month of August 2012, the not-seasonally-adjusted average price of imported oil notched higher to \$94.36 per barrel, from \$93.83 in July, but it was down from an average \$102.65 in August 2011. Oil prices since have turned higher.

In terms of not-seasonally-adjusted physical oil imports, August 2012 volume averaged 8.835 million barrels per day, versus 8.875 in July, and it was down from 9.707 million barrels per day in August 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 August 2012 merchandise trade deficit (no services) came in at \$48.4 billion, versus a revised \$47.0 (previously \$46.5) billion in July. August 2012 also showed net deterioration versus the August 2011 estimate of \$46.6 billion.

With the revised July and new August estimates in place, the real third-quarter deficit now annualizes out at \$572.6 billion (versus an initial estimate of \$558.6 billion based on the original July report). This is all the information the Bureau of Economic Analysis will have when it prepares its “advance” or initial estimate of third-quarter GDP for release on October 26th. With the annualized pace of the second-quarter 2012 trade deficit at \$562.4 billion, the August data suggest that the trade numbers should have a small negative impact on the net-export account in that GDP estimate. Based on initial July 2012 reporting, the indication had been for a neutral to slightly positive impact on third-quarter GDP.

Week Ahead. As noted in the *Opening Comments*, public speculation as to political manipulation of labor-related data, produced by the Department of Labor, has hit a level of activity that is unprecedented. Whether or not manipulations have taken place with current reporting, supporting evidence either way likely will be forthcoming in the year ahead. Upcoming, initial reporting of third-quarter GDP on October 26th and the October labor report on November 2nd—in the two weeks before the election—would be likely manipulation targets, if the data indeed were being massaged,

Nonetheless, market recognition of an intensifying double-dip recession has taken stronger hold, while recognition of a mounting inflation threat has been rekindled a bit by recent Fed monetary policy announcements and rising headline inflation numbers. 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, otherwise, it puts a happy spin on the numbers; and the financial markets 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, as discussed in the *Hyperinflation Watch* section.

Until such time as financial-market expectations catch up fully with underlying reality, or underlying reality catches up with the markets—shy of manipulated data—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 continue to show up in prior-period revisions.

Retail Sales (September 2012). Scheduled for release on Monday, October 15th, by the Census Bureau, headline September 2012 retail sales likely will surprise market expectations on the downside. Although headline growth could be positive, any gains should be more than accounted for by higher inflation. Structural liquidity problems besetting the consumer continue to cap consumption growth at a level below the pace of inflation. With the September CPI-U likely to show a solid increase, real (adjusted-for-inflation) retail sales, again, should contract for the month.

Consumer Price Index—CPI (September 2012). The release by the Bureau of Labor Statistics (BLS) of the September 2012 CPI numbers is scheduled for Tuesday, October 16th. The headline CPI inflation rate is due for another sharp jump on both a monthly and annual basis, reflecting rising energy, food and “core” inflation, with headline inflation reporting likely stronger than market expectations.

Of particular import, unadjusted monthly average gasoline prices rose by 3.4% in September 2012 (Department of Energy). Consider that September seasonal-adjustment factors tend to boost energy price inflation, where an unadjusted 0.7% monthly decline in September 2011 gasoline prices was turned into a 2.9% increase by the seasonal adjustments of that month. The contribution of gasoline prices to the September headline CPI inflation should be significant and also could pick up some of August’s inflation understatement.

Year-to-year total CPI-U inflation would increase or decrease in September 2012 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.27% gain in the adjusted monthly level reported for September 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2012, the difference in September’s headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from the August 2012 annual inflation rate of 1.69%. A headline gain of 0.6%, for example, would push annual inflation up to roughly 2.0%.

Industrial Production (September 2012). Also due for release on Tuesday, October 16th, by the Federal Reserve, the headline September 2012 industrial production number is likely to show a headline decline and to come in below market expectations. These numbers, however, are subject to massive and irregular revisions that can distort the latest month’s reporting. That said, the ISM’s purchasing managers survey has shown an outright contraction in both August and September production, and continued contraction is likely, as excess inventories are worked off.

Residential Construction (September 2012). Detail on September housing starts is due for release on Wednesday, October 16th, by the Census Bureau. In the wake of a 75% collapse in activity from 2006

through 2008, the ensuing four-year pattern of housing starts stagnation an historically low level of activity continues, with no fundamental shift likely in the near future, including the just-passed September. As has become the standard circumstance, any reported monthly gain likely would not be statistically significant.
