

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

**COMMENTARY NUMBER 483**  
**October Industrial Production**

**November 16, 2012**

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**Industrial Production Already Was in Contraction  
Before Hurricane Sandy Pummeled the East Coast**

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*PLEASE NOTE: The next regular Commentary is scheduled for Tuesday, November 20th, covering October housing starts and existing home sales.*

*The long-promised Special Commentary is near completion. When the publication date is certain, that will be indicated in the schedule box in the top left-hand column of [www.ShadowStats.com](http://www.ShadowStats.com). This Commentary will update the broad economic, systemic and inflation outlooks, in the context of the 2012 election and the latest detail on the economy, federal government fiscal operations, and Federal Reserve monetary activities.*

*Best wishes to all — John Williams*

**Opening Comments and Executive Summary.** With some output lost to Hurricane Sandy, October industrial production fell by 0.43% month-to-month, following a downwardly-revised 0.18% (previously 0.41%) gain in September. On an annual basis, October 2012 production growth slowed to 1.74%, a 32-month low, even after allowing for official hurricane impact. That was against September annual growth of 2.79%. The October numbers were reported today (November 16th), by the Federal Reserve, in the context of what has become a pattern of regular downside revisions to earlier reporting. Irrespective of production interruptions from the East Coast's super storm, activity remains consistent with a renewed

downturn in the economy, a double-dip contraction that is becoming recognizable in the official numbers, as shown in the first graph following, and in the graphs published in the *Reporting Detail* section.

Using the nature of emergency declarations issued by the Federal Emergency Management Agency (FEMA) for individual counties, in conjunction with four-year-old county-employment demographics prepared by Bureau of the Census, the Fed estimated that the super storm reduced October production growth by “nearly 1 percentage point.” Underlying that detailed assessment were the Fed’s usually overly-optimistic assumptions of production activity, in this case, before the disaster struck. Damage to an already-idled facility has no meaningful impact on current production.

While there is no question that Sandy dampened October activity, and that it also weakened the yet-to-be-published November numbers, I expect that later reporting—based on actual data—will reduce the estimated storm-related impact in October. November could be much worse. At that same time, the production series should continue in its long-range pattern of being revised lower, as better-quality information becomes available. Meaningful downside revisions to the May 2012 to September 2012 period—unaffected by the hurricane—also were published today, as part of that regular reporting process.

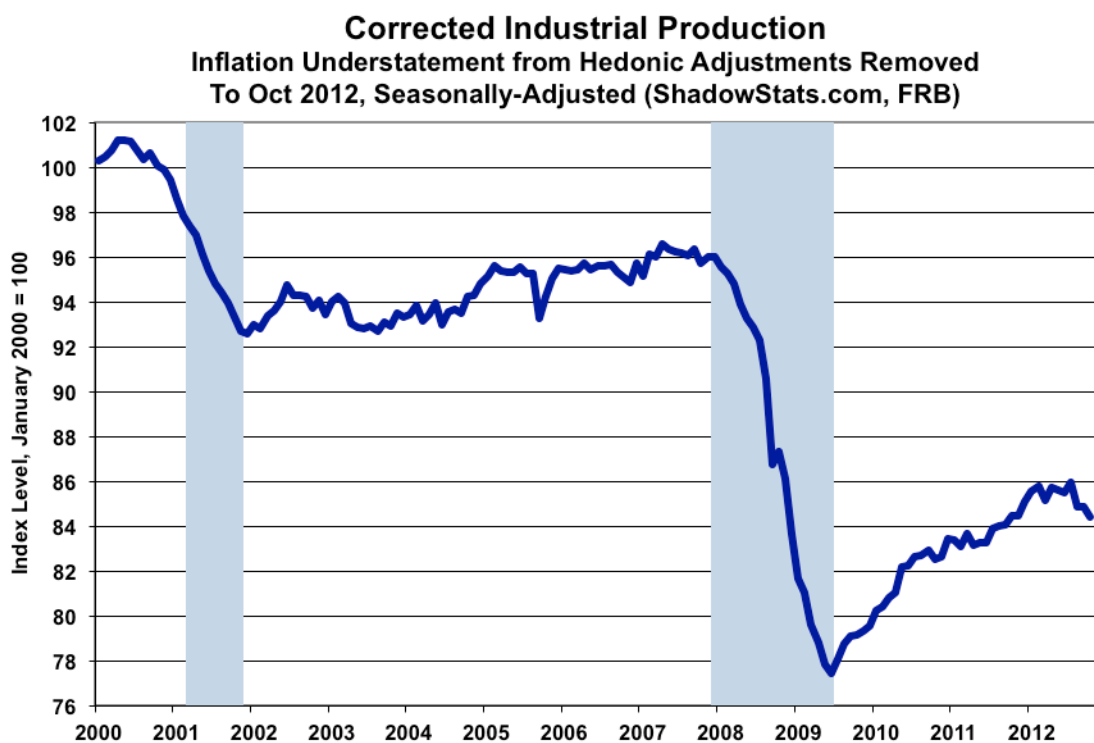
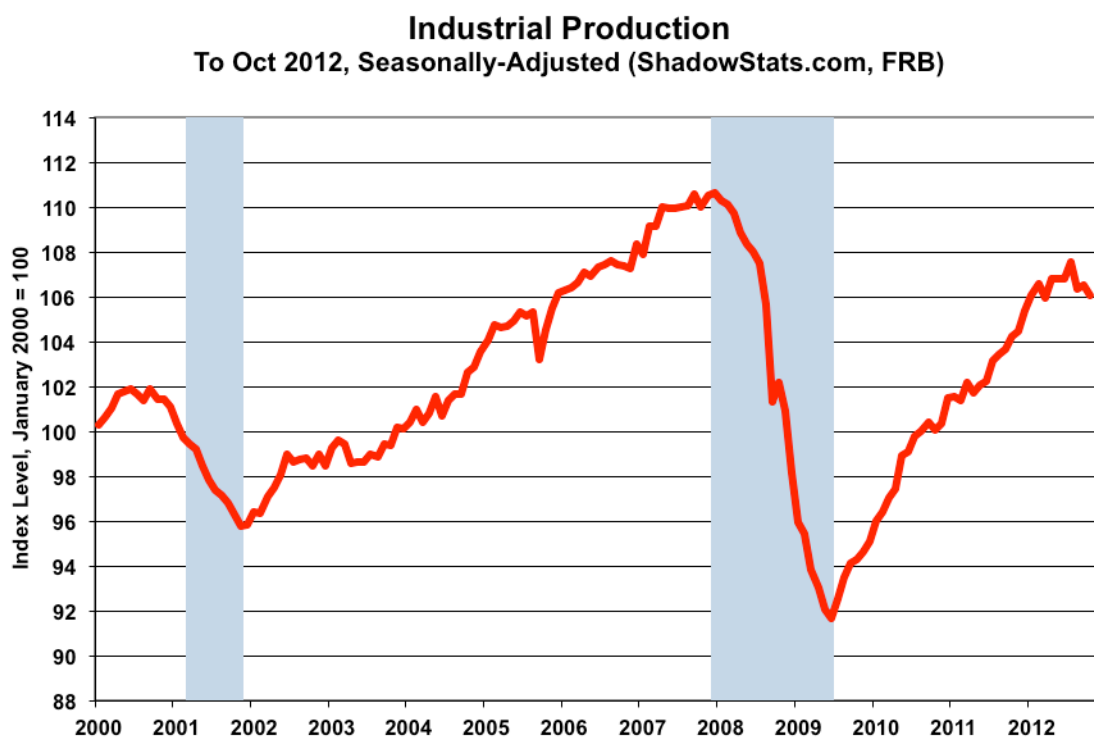
With all the Fed’s efforts to adjust the current data, not too much can be read into the official reporting, but here is the headline story. October manufacturing fell by 0.9% for the month, following a revised 0.1% (previously 0.2%) monthly gain in September. The Fed estimated that manufacturing was “roughly unchanged,” excluding effects from the hurricane. Utility output was down by 0.1% in October, following a revised “unchanged” reading (previously a 1.5% gain) for the month of September (unaffected by the storm). The Fed published no hard estimate of storm damage to October’s utility output. Mining output was reported up by 1.5% in October, following an unrevised monthly gain of 0.9% in September, again, with no estimation of storm impact from the Fed.

***Downside Production and GDP Revisions.*** Based on better-quality reporting, revisions back through May 2012 reduced the annualized growth in second-quarter 2012 production to 2.33% (previously 2.56%). The annualized growth rate is used here, since that is how the GDP growth is reported.

With earlier revisions before May not published, the historical broad series likely will revise lower, further back in time, come the benchmark revisions to the production data in March 2013. In turn, that should mean downside revisions to historical GDP growth, come the annual GDP revisions in July 2013. This is a regular downside-revision cycle that results from the federal government and the Federal Reserve using overly-optimistic economic assumptions in the process that drives economic reporting.

Due to the reduced second-quarter level, the still-preliminary estimate of third-quarter 2012 production now shows a revised, narrower annualized quarterly contraction of 0.04% (previously a 0.40% contraction). The reported level of third-quarter production, however, was virtually unchanged, revising higher by just 0.03% (not annualized). The November 29th GDP revision should not be affected.

***Industrial Production Corrected for Misleading Inflation Measures.*** As discussed in [Hyperinflation 2012, Special Commentary No. 445](#), and as will be updated in the pending *Special Commentary*, the use of understated inflation estimates in generating popular headline data—such as GDP, real retail sales and industrial production—results in the overstatement of headline inflation-adjusted growth rates. Where hedonic quality adjustments are used to understate inflation used in calculating components of industrial production, the following graphs address that issue.



The first graph reflects official industrial production reporting, indexed to January 2000 = 100, instead of the 2007 = 100 used by the Fed. The 2000 indexing is used to provide for some consistency in these revamped graphics. The second graph is a corrected version of the first, with estimated hedonic-inflation adjustments backed-out of the official deflator used in reporting a number of industrial-production components.

While the “corrected” graph does show some growth in period following the official June 2009 near-term trough in production activity. The upturn is far shy of a full recovery, as reported in the GDP. Production levels have not regained pre-recession highs and have entered a period of renewed contraction.

***[More detail on the October industrial production numbers and further graphics are found in the Reporting Detail section.]***

**Hyperinflation Watch—Update Pending.** The broad outlook has not changed from that outlined in [Hyperinflation 2012](#), but it will be updated fully in the pending *Special Commentary*. For new subscribers and for anyone else not familiar with my general outlook, the recent summary in the *Hyperinflation Watch* section of [Commentary No. 479](#), and particularly the hyperinflation report (linked above) are suggested as background material.

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## REPORTING DETAIL

### INDEX OF INDUSTRIAL PRODUCTION (October 2012)

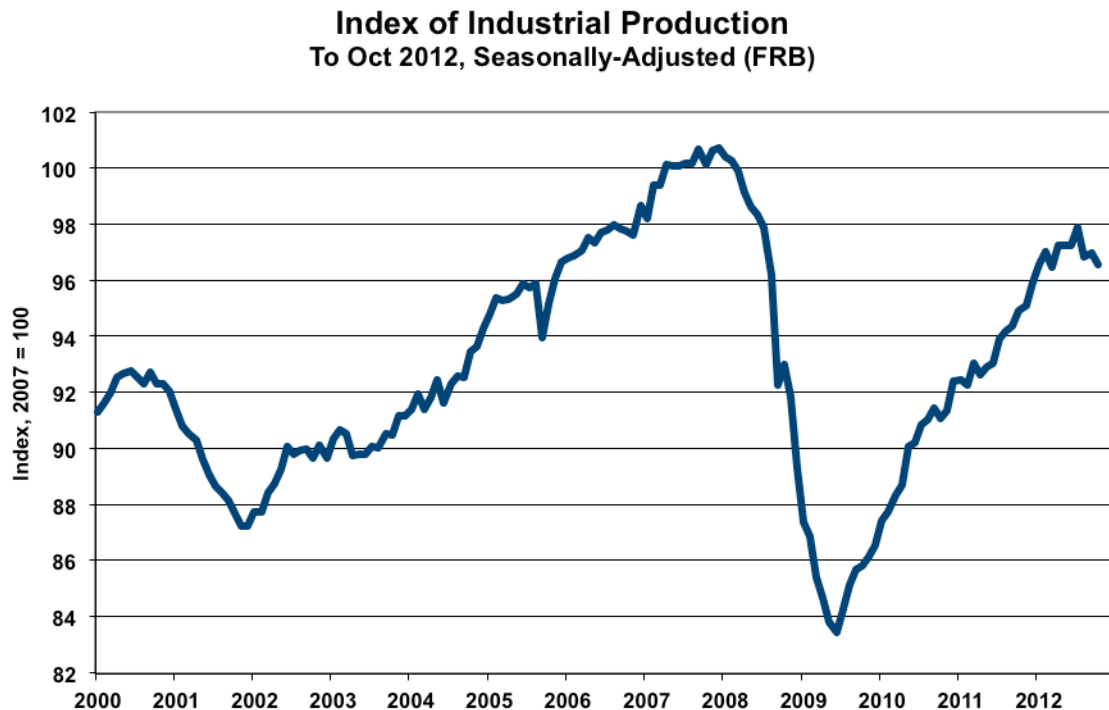
**October Production Weakness Included Some Hurricane Impact; Earlier Production Growth Revised Lower.** This morning’s (November 16th) release by the Federal Reserve Board of seasonally-adjusted October 2012 industrial production showed a headline monthly contraction of 0.43% (down by 0.46% before prior-period revisions), versus a downwardly-revised September monthly gain of 0.18% (previously up by 0.41%). August’s monthly contraction revised to 1.11% (previously down by 1.38%, initially down by 1.16%).

The Fed estimated disruptions from Hurricane Sandy reduced monthly October production by something shy of one-percentage point. The quality of that estimate and implications of prior-period revisions—also published today—are discussed in the *Opening Comments and Executive Summary*.

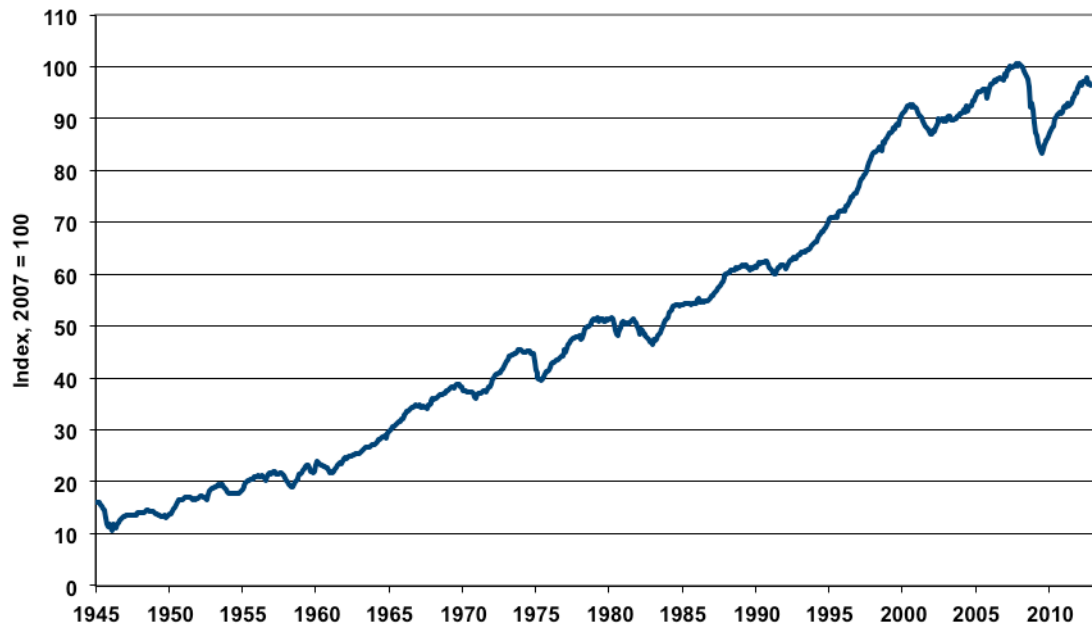
On a seasonally-adjusted basis, revised third-quarter industrial production contracted at an annualized pace of 0.04% (previously down by 0.40%), which still remains the first quarterly contraction in the series since second-quarter 2009, the end of the official recession. Second-quarter 2012 production was revised to a slower annualized growth rate of 2.33% (previously of 2.56%), versus the first-quarter.

Year-to-year growth for October 2012 production slowed to 1.74%, versus a revised 2.79% (previously 2.81%) in September and versus a revised 2.81% (previously 2.60%, initially 2.80%) in August. The October growth was the weakest showing since February 2010, well off the recent relative peak annual growth of the series at 8.13%, in June 2010 (going against the official June 2009 trough of the economic collapse). Indeed, 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.



**Index of Industrial Production**  
**To Oct 2012, Seasonally-Adjusted (FRB)**



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, and it appears have topped out, turning down the more-recent reporting. The corrected production series is graphed in the *Opening Comments and Executive Summary* section. Please note that index base for the corrected graphs is January 2000 = 100, instead of the Federal Reserve's official 2007 = 100 used in the graphs here.

**Week Ahead.** Until such time as financial-market expectations catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally should continue to show higher-than-expected inflation and indicate 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, as seen, for example, in the October retail sales reporting.

Significant reporting-quality problems continue with most widely followed series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments, distortions that have been induced by the still-ongoing economic turmoil of the last five years. The recent economic collapse has been without precedent in the post-World War II era of modern economic reporting. These distortions have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series. In any event, where numbers are too far removed from common experience, they tend to be viewed by the public with extreme skepticism.

Still, recognition of an intensifying double-dip recession continues to gain, while recognition of a mounting inflation threat has been rekindled a bit by recent Fed monetary policies and rising headline inflation numbers. The political system would like to see the issues disappear; 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.

***Existing Home Sales (October 2012).*** October existing home sales are due for release on Monday, November 19th, from the National Association of Realtors, (the new home sales report from the Census Bureau is not due for release until Wednesday, November 28th). Entrenched patterns of stagnation likely have continued in both series, and the pending monthly results are not likely to be statistically-significant.

***Residential Construction (October 2012).*** Detail on October housing starts is due for release on Tuesday, November 20th, by the Census Bureau. In the wake of the 75% collapse in activity from 2006 through 2008, the ensuing four-year pattern of housing starts stagnation at an historically low level of activity continues, with no fundamental shift likely in the just-passed October. Some minimal negative impact from Hurricane Sandy may be evident in the October numbers, but November would have been more severely impacted. Eventually, rebuilding in the storm-devastated areas should provide some temporary boost to activity. As has become the standard circumstance here, any reported monthly gain for October, likely would not be statistically significant.

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