

**COMMENTARY NUMBER 493**  
**November Trade Deficit**

**January 11, 2013**

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**Official Inflation-Adjusted Merchandise Trade Deficit Hit 4-1/2 Year High**

**Implications for Weaker Advance-Estimate of 4th-Quarter GDP**

**Consumer Structural-Liquidity Issues Continue**

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*PLEASE NOTE: The next regular Commentary is scheduled for Tuesday, January 15th, covering December retail sales and PPI, followed by commentaries on January 16th covering the December CPI and related inflation-adjusted retail sales and earnings, as well as industrial production, and on January 17th covering December housing starts.*

*Best wishes to all — John Williams*

**Opening Comments and Executive Summary.** Although this week's economic calendar has been light, the latest releases still have contributed to dampening the outlook for broad economic activity. A sharp deterioration the November U.S. trade deficit suggested a downgrade of market expectations for upcoming fourth-quarter GDP reporting (due January 30th), while November consumer credit outstanding continued a string of consumer-related releases that showed severe, ongoing structural impairment of U.S. consumer liquidity.

The January 17th *Commentary* will include a review of the current economic and inflation outlooks, following next week's key Decembers releases, including the CPI and PPI, and retail sales, production

and housing starts. Beyond any temporary effects from Hurricane Sandy, there have been no changes in underlying economic fundamentals that would suggest anything other than continued downturn and/or stagnation in business activity. There has been no economic recovery and none is pending.

***Latest Trade Numbers Suggested Weaker Fourth-Quarter GDP.*** The November 2012 trade deficit in goods and services widened sharply, month-to-month, to \$48.7 billion, from a revised \$42.1 billion. Surging import growth, despite declining oil purchases, dominated the much smaller gain in exports. Well beyond consensus expectations, the headline November deficit was the largest since April 2012, and the headline merchandise trade shortfall was the worst since March 2012.

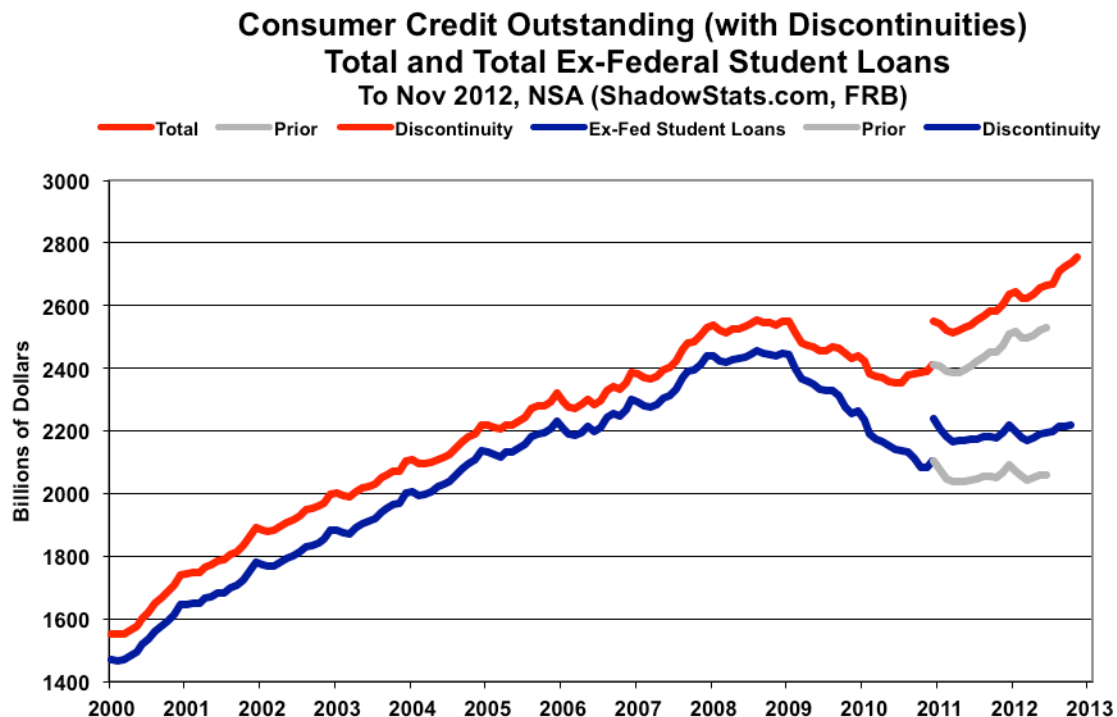
More importantly, net of official inflation adjustment, and consistent with official GDP reporting, the November 2012 merchandise deficit was the worst in 55 months, since April of 2008. Where combined inflation-adjusted October and November 2012 reporting will be the basis for the initial guess at the net-export account in fourth-quarter 2012 GDP, the in fourth-quarter numbers annualize out to a wider deficit than was seen in third-quarter 2012, suggesting negative impact on net exports and, in tandem, on that advance-estimate of fourth-quarter GDP. Accordingly, there should be a reduction in market expectations for the first cut on fourth-quarter GDP growth.

The October and November trade numbers likely included some distorting impact from Hurricane Sandy on the flow of goods and paperwork through the ports in the affected region around New York City. Where those problems might be partially balanced out some in December's reporting, that would be reflected only in the first revision to the fourth-quarter GDP, due for release on February 28th. The initial January 30th GDP estimate will be based on just the October and November numbers.

*[More complete details on the November trade deficit are found in the Reporting Detail section.]*

***Consumer Structural Liquidity Problems Continue.*** Suggestive of the ongoing liquidity crisis besetting the U.S. consumer, the Federal Reserve's January 8th release of November 2012 consumer credit outstanding continued to show negligible credit growth, outside of student loans held by the federal government. The problem there is seen in the accompanying graph, where the "discontinuity" reflects the use of a recent new-survey base by the Federal Reserve, with there having been no attempt to publish revised or consistent earlier reporting.

When the lack of growth in consumer credit is viewed in conjunction with continued bottom-bouncing in real (inflation-adjusted) median household income for November (see graph in [Commentary No. 492](#)), and with continued bottoming-bouncing in December consumer confidence and consumer sentiment (see graphs in [Commentary No. 491](#)), the consumer has been and remains unable to fuel sustainable real growth in retail sales, which will be reported for December on January 15th (see the *Week Ahead* section). There cannot have been a post-2009 economic recovery, and there is no foreseeable recovery in the works, despite wishful thinking in Washington, D.C. and on Wall Street. The so-called "recovery" has been nothing more than a statistical illusion, created by the use of too-low inflation rate in deflating the popular economic series. See [Special Commentary \(No. 485\)](#) for further details.



## HYPERINFLATION WATCH

**Hyperinflation Outlook: Background.** The following text is largely as written for recent, prior *Commentaries*. It is intended for new subscribers, as well as for those who otherwise are not familiar with the hyperinflation report or the recent special commentary, linked below. Those documents are suggested as background reading on the financial turmoil and currency upheaval facing the United States in the next year or two. This section will be revised fully, following the major December economic and inflation releases during the week of January 14th.

The November 27th [Special Commentary \(No. 485\)](#) updated [Hyperinflation 2012](#) and the broad outlooks for the economy and inflation, as well as for systemic stability and the U.S. dollar. These remain the two primary articles outlining current conditions and the background to the hyperinflation forecast.

Subsequent to the *Special Commentary*, neither new economic data nor fiscal developments have altered the outlooks. The expansion of QE3 by the Fed, on December 12th, and the ongoing unwillingness and political inability of the current government to address the longer-range U.S. sovereign-solvency issues only have continued the regular unfolding of events that eventually will trigger a hyperinflation, as discussed in [Commentary No. 491](#).

The Fed's latest actions can be viewed as a signal of deepening problems in the banking system. As discussed by Mr. Bernanke, the Fed can do little to stimulate the economy, but it can create inflation.

Nonetheless, the Fed's move here was to prop-up the banking system and to provide back-up liquidity to the U.S. Treasury in the months ahead. Direct monetization of Treasury debt will tend to savage the U.S. dollar's exchange rate, boost oil and gasoline prices, boost money supply growth and domestic U.S. inflation.

Complicating and exacerbating those issues is the failure of the government to make any serious effort at bringing the nation's extreme and dangerous fiscal conditions into balance, or to move to address the Treasury's debt ceiling on a timely basis. Despite a two-month "sequestration" delay, the temporary "fiscal-cliff" avoidance may buy the politicians in Washington only a week or two. Market tranquility likely will not last much longer than that, against what should be increasingly evident as disgruntled global markets beginning to move against the U.S. dollar.

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## REPORTING DETAIL

### U.S. TRADE BALANCE (November 2012)

**Jump in November Trade Deficit Should Hit GDP Reporting, But Could Reflect Hurricane Distortions.** The November 2012 trade deficit widened sharply, month-to-month, beyond market expectations. Where the headline November deficit in goods and services was the largest since April 2012, the headline merchandise trade shortfall was the worst since March 2012. More importantly, net of official inflation adjustment, and consistent with official GDP reporting, the November 2012 merchandise deficit was the largest since April of 2008. Where inflation-adjusted October and November 2012 reporting is the basis for the initial reporting of the net-export account in the fourth-quarter 2012 GDP (January 30th release), the implications here are for negative impact on the advance-GDP estimate. Accordingly there should be a reduction in market expectations for the first cut at fourth-quarter GDP growth.

The October and November trade numbers likely included some distortions from the effects of Hurricane Sandy. Where those distortions might balance out some in December reporting, that will be reflected only in the first-revision to the fourth-quarter GDP on February 28th. The initial January 30th GDP estimate will be based on just the October and November numbers.

**Nominal (Not-Adjusted-for-Inflation) Trade Deficit.** The Bureau of Economic Analysis (BEA) and the Census Bureau reported today, January 11th that the nominal, seasonally-adjusted monthly trade deficit in goods and services for November 2012, on a balance-of-payments basis, widened to \$48.7 billion from a

revised \$42.1 (previously \$42.2) billion in October. The November 2012 deficit narrowed slightly, though, from \$48.8 billion in November 2011. The monthly trade deterioration reflected imports increasing at four times the pace of exports, which might have been affected by hurricane-related disruptions to the flow of goods and trade paperwork in both October and November. December data likely will show activity back at something of a normal pattern. The surge in imports was despite a decline in seasonally-adjusted oil imports.

**Crude Oil and Energy-Related Petroleum Products.** For the month of November 2012, the not-seasonally-adjusted average price of imported oil eased to \$97.45 per barrel, from \$99.75 in October 2012, and it was down from an average of \$102.48 in November 2011.

In terms of not-seasonally-adjusted physical oil imports, November 2012 volume averaged 8.100 million barrels per day, down from 8.376 million in October 2012, and it was down from 8.826 million barrels per day in October 2011.

*Other Cautions on Data Quality.* Beyond possible short-lived disruptions from weather impact, the standard caution here for the monthly detail is that heavy distortions likely also 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 November 2012 merchandise trade deficit (no services) came in at \$51.9 billion, versus a revised \$46.0 (previously \$46.2) in October, and against \$48.5 billion in November 2011. The November 2012 real deficit was the worst monthly reading in 55 months, since April 2008.

With the two months of fourth-quarter reporting in place that are used for the “advance” estimate of fourth-quarter 2012 GDP (due for release on January 30th), the fourth-quarter real merchandise trade deficit annualizes out to \$587.5 billion, widened from an unrevised third-quarter deficit \$567.2 billion. With fourth-quarter initially annualizing out to \$544.0 billion, the new data should be reflected in the “net-export” account, subtracting from the fourth-quarter GDP growth, not adding to it, and in market expectations being lowered a notch or so for the initial reporting of fourth-quarter GDP growth.

Any unusual storm-related catch-up in December trade reporting should be reflected in the first revision to fourth-quarter GDP, due for release on February 28th.

## WEEK AHEAD

**Weaker Economic and Stronger Inflation Data Ahead.** Beyond what will be the dissipating effects of the repair, replacement and reconstruction activity generated by Hurricane Sandy, and in anticipation of the likely negative impact of expanded QE3 and the ongoing fiscal crisis/debt-ceiling negotiations on the currency markets, reporting in the months and year ahead generally should reflect higher-than-expected

*inflation and indicate weaker-than-expected economic results. Increasingly, previously unreported economic weakness should continue to show up in prior-period revisions.*

*Significant reporting-quality problems continue with most major economic series. Headline reporting issues remain 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 by the Fed's monetary policies. The political system would like to see the issues disappear, and still appears to be trying to work numerical slight-of-hand with series such as the GDP; 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 [Hyperinflation 2012](#) and [No. 485: Special Commentary](#).*

**Retail Sales (December 2012).** Scheduled for release on Tuesday, January 15th, by the Census Bureau, the headline December 2012 retail sales number likely will disappoint financial markets looking for a monthly gain in December that would be stronger than the 0.3% monthly increase reported initially for November. Beyond any lingering effects from the repair-and-replacement consumption generated by Hurricane Sandy—at least partially funded by insurance payments—the consumer remains in a severe liquidity bind, unable to sustain positive, inflation-adjusted consumption growth, as discussed in the *Opening Comments*.

Weakening consumption already was in play before the “superstorm,” and that pattern should renew shortly, particularly net of inflation’s impact on sales. A fair bet here is that revisions to prior reporting will be unusually volatile and likely to the downside, as details from actual storm impact begin to replace the happy guesstimates that previously had been worked into official reporting.

**Producer Price Index—PPI (December 2012).** The December 2012 PPI is scheduled for release on Tuesday, January 15th, by the Bureau of Labor Statistics (BLS). The headline December PPI has a good chance of showing a small monthly gain, despite what appears to be developing negative market expectations.

Depending on the oil contract followed, oil prices on average were up month-to-month in December by 0.4-to-1.5 percentage points. With supportive seasonal adjustments for oil prices in the month, higher food prices and still relatively strong “core” inflation, the monthly change in wholesales prices should be in positive territory.

**Consumer Price Index—CPI (December 2012).** The release by the Bureau of Labor Statistics (BLS) of the December 2012 CPI numbers is scheduled for Wednesday, January 16th. The headline CPI-U inflation rate should be flat-to-positive on a monthly basis, with some pick-up possible in terms of annual inflation.



Seasonally-unadjusted, monthly-average gasoline prices declined by 4.0% in December 2012, per the Department of Energy, but that monthly decline should be offset somewhat in BLS calculations by upside seasonal adjustments. In December 2011, a similar 4.0% unadjusted monthly decline revised to a 2.0% drop after seasonal adjustment. With continued upside pressures from both food and core inflation, there is some chance of the December 2012 headline number topping market expectations, which appear to be developing around unchanged.

Year-to-year, CPI-U inflation would increase or decrease in December 2012 reporting, dependent on the seasonally-adjusted monthly change, versus an unchanged level in the adjusted monthly reporting for December 2011. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for December 2012, the difference in December's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the November 2012 annual inflation rate of 1.76%. A headline "unchanged" number would leave annual CPI-U inflation at about 1.8% for December 2012 (year-to-year).

***Industrial Production (December 2012).*** Due for release on Thursday, January 16th, by the Federal Reserve, the headline December 2012 industrial production number likely will continue to gyrate, both in hard reporting and in the context of prior-period revisions, as the Fed begins to get hard numbers against its recent guesses and estimations of the effects from Hurricane Sandy. To the extent there is any gain in December reporting, it likely will be tied to meeting demand for temporary repair-and-replacement storm effects, as seen for example in the replacement of damaged automobiles.

Liquidation opportunities—given already excessive inventory levels—could mute expected production gains, with reporting likely to disappoint minimally-positive market expectations. Again, keep in mind that this series is subject to frequent and significant downside revisions.

***Residential Construction (December 2012).*** Detail on December housing starts is due for release on Thursday, January 17th, by the Census Bureau. In tandem with a temporary uptick in December 2012 construction employment and with November's gain in building permits, December reporting on housing starts should begin to see some temporary boost from post-Hurricane Sandy reconstruction efforts. The biggest such effects likely still will be seen in later months.

In the continuing wake of the 75% collapse in activity from 2006 through 2008, and given the ensuing four-year pattern of housing starts stagnation at an historically low level of activity continues, there is no chance of a sustainable turnaround in the housing construction market, unless the circumstance is affected by a fundamental upturn in consumer and banking liquidity conditions. Chances are fair that any reported monthly gain for December still will not be statistically significant.

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