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

COMMENTARY NUMBER 549
July CPI, PPI, Nominal and Real Retail Sales, Industrial Production, Real Earnings

August 15, 2013

No Economic Recovery Here

Industrial Production on Brink of Showing Formal New Recession

For Second Month, Rising Retail Sales Reflected Rising Prices, Not Rising Consumer Demand

Real Average Weekly Earnings Fell for Third Month and Year-to-Year

July Year-to-Year Inflation: 2.0% (CPI-U), 2.0% (CPI-W), 9.6% (ShadowStats)

PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Friday, August 16th, covering July housing starts. Due to a paucity of meaningful economic releases in, and a honeymoon during the week of August 19th, the next* Commentary *following the August 16th missive will be published on Monday, August 26th, with July home sales detail.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Weakening Economy Along with Higher Inflation. Economic conditions continue to deteriorate, with no prospects for a near-term economic turnaround or rebound. At the same time, consumer inflation has continued to pick-up. The general outlook remains unchanged.

That said, the economic outlook update planned for today has been shifted to tomorrow's August 16th *Commentary*. This was done in response to the volume of new material in today's missive, with an eye towards a reasonably timely release of the latest reporting. The general economic outlook was reviewed in *Commentaries No. 546* and *No. 547*, and it is unchanged. Yet, for tomorrow's writing, more-recent detail will be available in the context of July's economic reporting, along with a discussion on U.S. fiscal-policy turmoil that likely looms in September. In a related area, the *Hyperinflation Outlook* also will be updated.

The areas covered today include a likely understatement of the July PPI and a near-consensus, rising CPI, where inflation movements continued to be dominated by shifting oil-related prices. With headline July CPI inflation offsetting the retail sales increase, real retail sales activity was unchanged for the month, as was industrial production. Both economic series were suggestive of a new, developing formal recession. Further, continued monthly contractions in real earnings and continued lack of growth in consumer credit outstanding (net of student loans), show no relief in the structural liquidity constraints on consumer activity, which have impaired retail sales and prevented a broad economic rebound or business expansion.

The latest graphs of gold versus the Swiss franc, oil and silver are included at the end of the *Hyperinflation Watch.*

Producer Price Index—July 2013. The highly volatile, headline, seasonally-adjusted finished-goods producer price index (PPI) for July 2013 was unchanged (down by 0.15% unadjusted) month-to-month, against an adjusted gain of 0.77% (0.30% unadjusted) in June.

July's unchanged level in finished goods PPI reflected a seasonally-adjusted 0.21% (0.46% unadjusted) monthly contraction in finished energy costs, offset by a seasonally-adjusted gain of 0.05% (a contraction of 0.25% unadjusted) in July food costs, and an adjusted 0.05% gain (unchanged unadjusted) in month-to-month "core" inflation. The seasonally-adjusted monthly change in each of those three categories appears to be too soft versus anecdotal evidence and previous reporting patterns. Of particular note are the unusually sharp, unadjusted monthly declines indicated for finished energy goods, which do not appear to be consistent with underlying wholesale market activity.

Unadjusted and year-to-year, July 2013 total finished-goods PPI inflation eased to 2.12%, versus 2.49% in June, still remaining well off its near-term July 2011 peak of 7.08%.

In terms of annual change, unusual movement was seen in "core" finished goods. Year-to-year, unadjusted July 2013 core finished-goods inflation slowed sharply to 1.20%, from 1.65% in June. A comparison of core-PPI with core-CPI-U year-to-year growth in July 2013 is graphed in the *Consumer Price Index* section of the *Reporting Detail*. Annual core-CPI-U growth is moving in the other direction.

Consumer Price Index—July 2013. Reflecting the continuing shift in monthly seasonal adjustments, from suppressing, to boosting adjusted energy-related inflation, headline consumer inflation increased by 0.2% in July, matching market expectations. As a result, annual inflation jumped in July, recovering 2.0%, up from 1.8% in June, 1.4% in May and its recent nadir of 1.1% in April.

The recent swings in annual inflation largely have reflected swings in annual gasoline inflation, which, in turn, generally have moved with an inverse relationship to U.S. dollar strength (i.e., a weak U.S. dollar against other currencies puts upside pressure on oil and gasoline prices). Post-2008 bouts of dollar weakness generally have been triggered by the quantitative-easing—dollar-debasement—policies of the Federal Reserve. Oil-related prices are subject to other pressures, of course, such as political developments in the Middle East.

The volatility seen in the month-to-month changes in headline inflation, however, is reflective of a broken, seasonal-adjustment system, where long-term trends in areas such as energy prices have been upended by the recent extreme turmoil in the energy markets, as well as in business activity. There also are other issues in terms of methodological changes—made to the series in recent decades—that were designed to understate the government's reporting of consumer inflation, as discussed in the *Public Comment on Inflation Measurement*.

CPI-U. The headline, seasonally-adjusted CPI-U for July 2013 rose by 0.2% (0.16% at the second decimal point) month-to month, and was up by 0.04%, unadjusted. In June, the adjusted CPI-U rose by 0.5% (0.48% at the second decimal point) month-to month, and was up by 0.24%, unadjusted.

Encompassed by the headline CPI-U monthly gain of 0.2% (a rounded 0.0% unadjusted), aggregate energy inflation in July 2013 was a 0.2% monthly gain (an unadjusted 0.2% contraction). In the other major CPI sectors, adjusted food inflation was up by 0.2% for the month (up by 0.1% unadjusted), and "core" inflation was up by an adjusted 0.2% (unadjusted 0.1%).

Not seasonally adjusted, July 2013 year-to-year inflation for the CPI-U was 1.96%, up from 1.75% in June 2013.

Core-CPI-U. Seasonally-adjusted July 2013 "core"-CPI-U inflation (net of food and energy inflation) rose by 0.15% (0.07% unadjusted) month-to-month, versus an adjusted 0.16% (0.08% unadjusted) gain in June. Year-to-year, the core rate increased to 1.70% in July, from 1.64% in June, counter to the movement of the core-PPI annual inflation rate, which dropped to 1.20% in July, from 1.65% in June (see graph in the *Consumer Price Index* section of the *Reporting Detail*).

CPI-W. The July 2013 headline, seasonally-adjusted CPI-W, which is a narrower series and has greater weighting for gasoline than does the CPI-U, rose month-to-month by 0.19% (up by 0.04% unadjusted), following an adjusted 0.57% gain (up by 0.26% unadjusted) in June. Unadjusted, July 2013 year-to-year CPI-W inflation was 2.00%, up versus 1.75% in June.

Chained-CPI-U. The initial reporting of year-to-year inflation for the July 2013 C-CPI-U was 1.77%, versus 1.60% in June. The Chained-CPI-U is the fully substitution-based series that has been proposed by the White House and Congress as a new cost-of-living adjustment factor for programs such as Social Security.

Alternate Consumer Inflation Measures. The ShadowStats-Alternate Consumer Inflation Measure (1990-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1990, rose by roughly 5.4% in July 2013, up from 5.2% in June. The ShadowStats-Alternate Consumer Inflation Measure (1980-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 9.6% in July 2013, versus an annual inflation rate of 9.4% in June 2013.

[Definitions of these various series are found in the Consumer Price Index *section of* Reporting Detail*.]*

Updated Indicators of Structural Liquidity Issues Facing the Consumer. Supplementing consumer liquidity issues discussed in *Commentary No. 546*, the following two graphs update real (inflation-adjusted) average weekly earnings through July, and consumer credit outstanding through June. There is nothing in the latest detail to suggest an improvement in consumer liquidity conditions or in prospects for the consumer to generate adequate new consumption to fuel an economic recovery. Without real income growth and availability of credit, and lacking the will to expand consumption, the consumer is not in a position to sustain growth in personal consumption, which represents more than 70% of the GDP.

Real Average Weekly Earnings—July 2013. For the production and nonsupervisory employees series—the only series for which there is a meaningful history—headline real average weekly earnings (deflated by the CPI-W) fell by 0.5% in July, versus an unrevised 0.3% decline in June and a 0.1% decline in May.

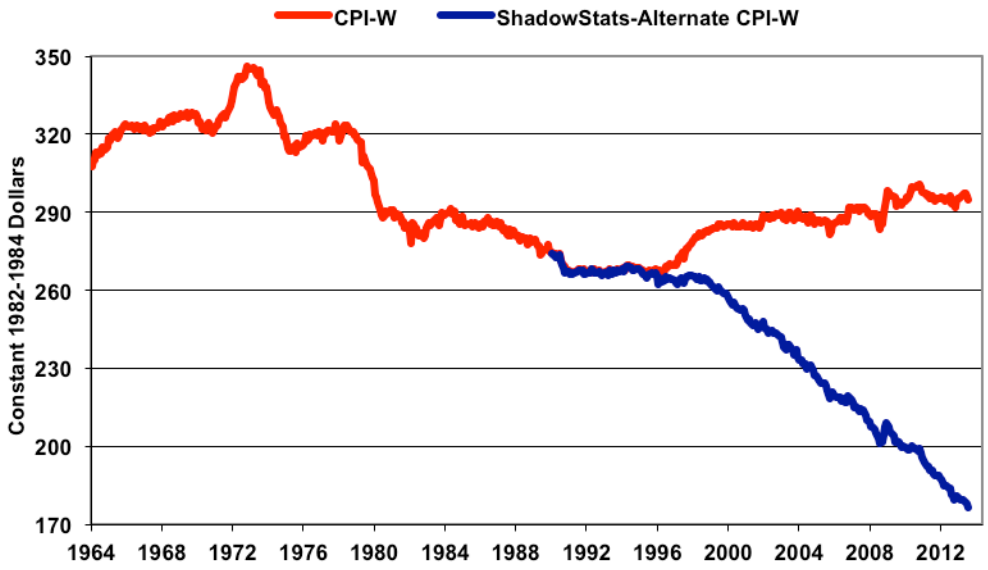
Unadjusted and year-to-year, July real earnings fell by 1.7%, versus a revised 1.6% (previously 1.5%) annual gain in June. Both the monthly and annual fluctuations in this series are irregular, but current reporting remains well within the normal bounds of volatility.

The first graph following of real average weekly earnings shows the earnings as officially deflated by the BLS (red-line), and as adjusted for the ShadowStats-Alternate CPI Measure, 1990-Base (blue-line). When inflation-depressing methodologies of the 1990s began to kick-in, the artificially weakened CPI-W (also used in calculating Social Security cost-of-living adjustments) helped to prop up the reported real earnings.

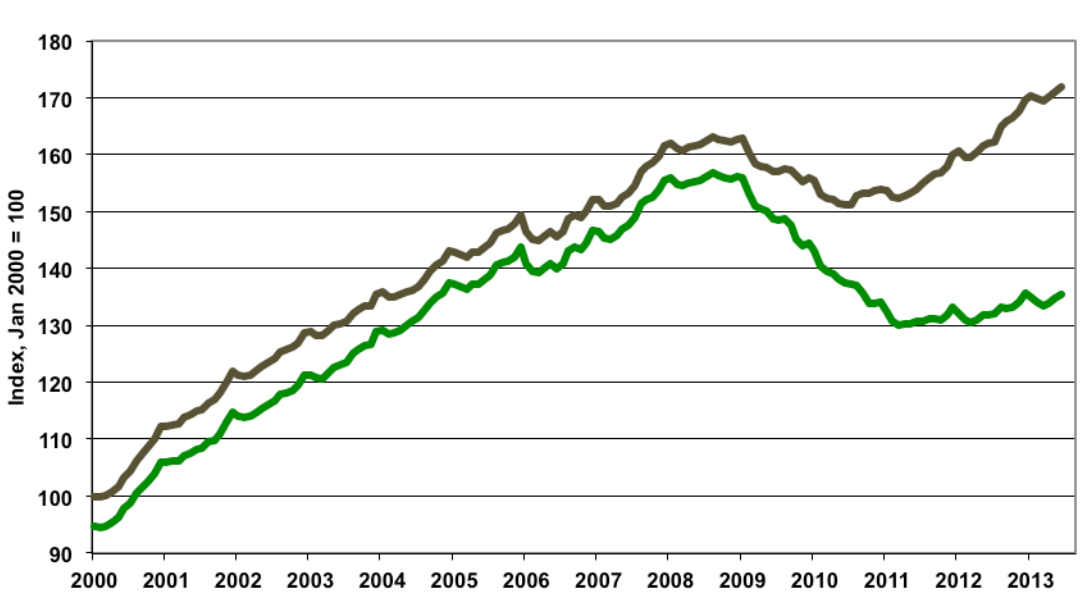
Official real earnings today still have not recovered their inflation-adjusted levels of the early-1970s, and, at best, have been flat for the last decade. Deflated by the ShadowStats measure, real earnings have been in fairly regular decline for the last four decades, which is much closer to common experience than the pattern suggested by the CPI-W. See *Public Commentary on Inflation Measurement* for further detail.

Consumer Credit Outstanding—July 2013. The second graph following shows the estimate of June 2013 consumer credit outstanding from the Federal Reserve. As has been the case for the full post-2008 financial-panic period, nearly all the growth seen in this series has been due to the expansion of federally-owned student loans, not in bank lending to consumers that otherwise could help to fuel broad consumer activity.

Real Average Weekly Earnings
Production and Nonsupervisory Employees
Deflated by CPI-W versus ShadowStats-Alternate (1990-Base)
To July 2013, Seasonally Adjusted (ShadowStats, BLS)



ShadowStats Consumer Credit Outstanding Index
Total and Total Ex-Federal Student Loans
2010-2011 Discontinuities Removed
Total Indexed to Jan 2000=100
Through June 2013, NSA (ShadowStats.com, FRB)



Retail Sales, Nominal and Real (Before and After Adjustnent for Inflation)—July 2013. The monthly gain in July 2013 retail sales reflected little more than higher prices. The headline gain of 0.2% was in nominal terms, before adjustment for the effects of consumer inflation. With July 2013 headline CPI-U also at 0.2%, inflation was the primary factor behind the sales increase, not rising consumer demand. With the monthly inflation and growth rates taken to a second decimal point, 0.16% inflation versus 0.20% retail sales left a residual of 0.04% real growth for the month.

Activity in consumer buying of goods and services remains constrained by the intense, structural-liquidity woes besetting the consumer, as discussed in *Commentary No. 546* and in the preceding detail on June consumer credit outstanding and July real earnings. Without real growth in income, and without the ability or willingness to take on meaningful new debt, the consumer simply cannot sustain real growth in retail sales, let alone in the broader personal consumption measure in GDP. In like manner, the consumer has lacked the ability to fuel the purported post-June 2009 recovery in broad economic activity.

As official consumer inflation continues its upturn in the months ahead, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze, the retail sales data should trend meaningfully lower, in what eventually will gain recognition as a formal, double-dip recession.

Nominal (Not-Adjusted-for-Inflation) Retail Sales—July 2013. Not adjusted for inflation, headline July retail sales reporting showed a statistically-insignificant monthly gain of 0.20%, following a revised, statistically-significant June month-to-month gain of 0.62%.

Year-to-year, July 2013 retail sales rose by a statistically-significant 5.40% versus a revised 5.90% in June. Keep in mind that the pattern of growth here remains distorted by the resulting lack of fully-consistent, seasonally-adjusted numbers being published by the Census Bureau, as discussed in the *Reporting Detail*.

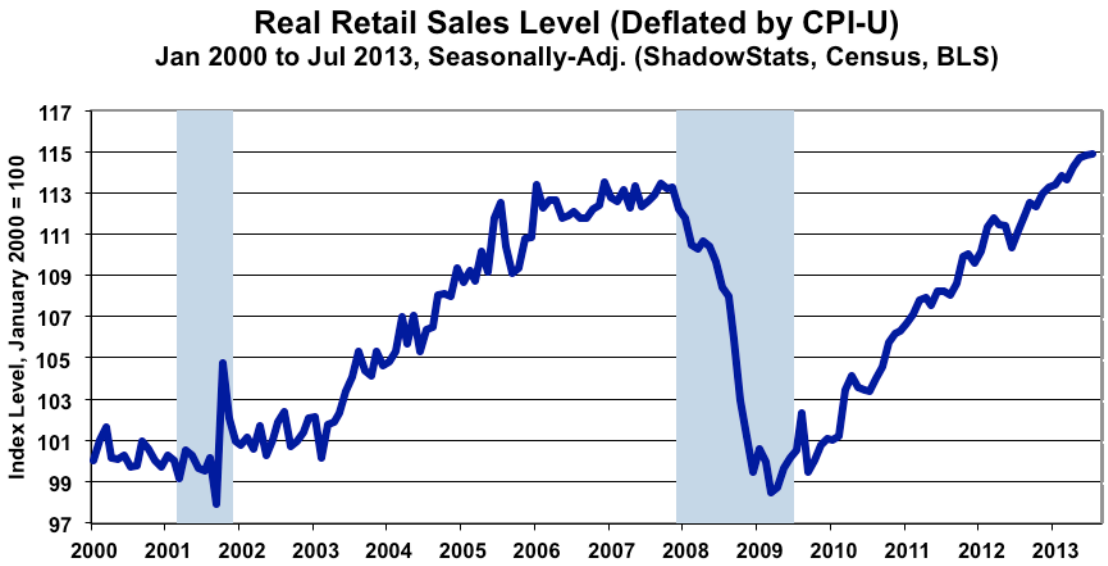
Real (Inflation-Adjusted) Retail Sales—July 2013. July 2013 real retail sales were "unchanged," but rose by 0.04% month-to-month, at the second decimal point, versus a revised 0.14% gain (previously a 0.11% contraction) in June. As discussed above, nominal sales were reported up by 0.20% in July, largely offset by the 0.16% month-to-month increase in the July CPI-U. Nominal June retail sales gained a revised 0.62% month-to-month, which largely was offset by 0.48% headline CPI-U inflation in June.

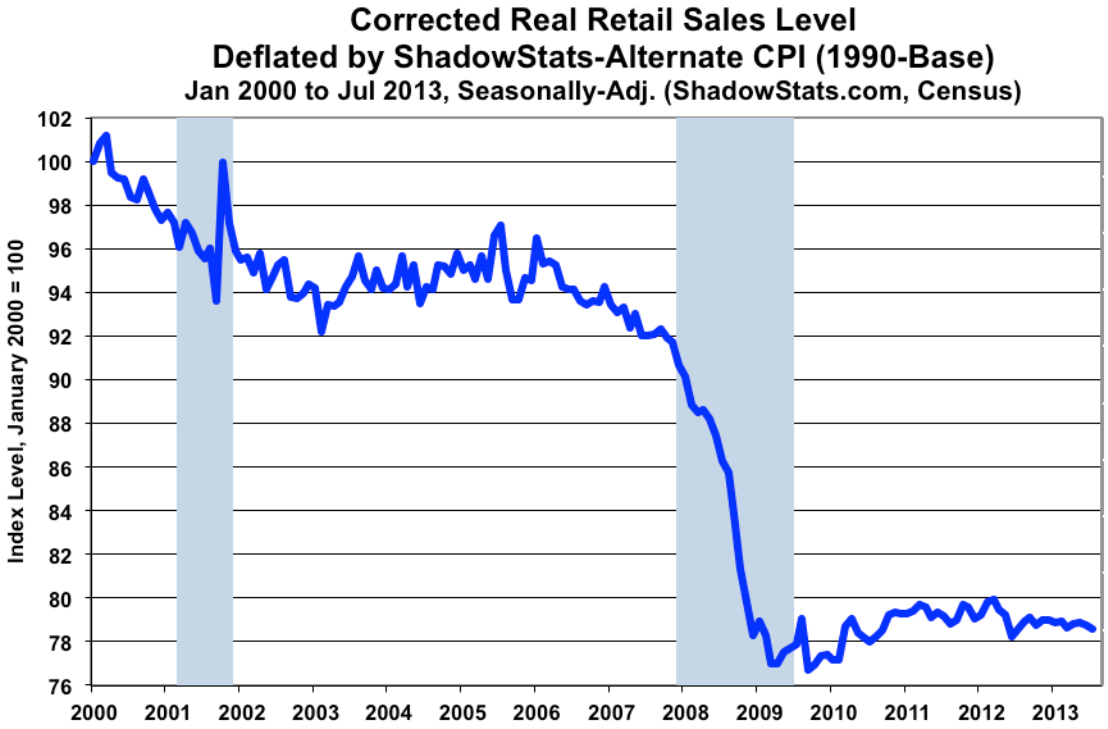
Year-to-year, July 2013 real retail sales rose at an annual pace of 3.38%, versus a revised 4.07% in June, as graphed in the *Reporting Detail*. In normal economic times, the recent levels in annual real growth would be signaling a pending recession. In the current circumstance, this signal likely will serve as an indicator of a renewed downturn in broad economic activity.

Above Pre-Recession Levels. With the July 2013 reporting, the nascent expansion of headline real retail sales above pre-recession levels, which began in February 2013, has flattened out, as reflected the first graph following of the indexed real retail sales.

The GDP expanded beyond pre-recession levels, more than nine quarters ago, starting in second-quarter 2011, and it has kept rising, well beyond the reported activity of any other series, including real retail sales. There is no other major economic series showing the GDP's pattern of official, full recovery and extensive new growth. While real retail sales tend to lead GDP activity, the "recovery" in retail sales reporting has lagged the purported GDP recovery by two years.

The apparent "recovery" in the real retail sales series (as well as in the GDP) is due to the understatement of the rate of inflation used in deflating the respective series. As discussed more fully in *Hyperinflation 2012* and *Special Commentary (No. 485)*, deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating inflation-adjusted economic growth. The recovery patterns does not hold, however, if the series is corrected for understated inflation.





Corrected Retail Sales. The first graph preceding reflects real retail sales as usually reported by the St. Louis Fed, deflated by the CPI-U, but it is indexed to January 2000 = 100. ShadowStats did the deflation using the July 2013 CPI-U release. The CPI-U, however, understates inflation (see the *Public Comment on Inflation*), with the effect of overstating inflation-adjusted growth. Instead of being deflated by the CPI-U, the "corrected" real retail numbers in the second graph use the ShadowStats-Alternate Inflation Measure (1990-Base) for deflation.

With the higher inflation of the ShadowStats measure, the revamped numbers show a pattern of plunge and stagnation, consistent with patterns seen in real median household income, consumer confidence measures and housing statistics. The recent topping-out reverted to renewed decline in second-quarter 2012, in this series that had been bottom-bouncing along a low-level plateau of economic activity since the economic collapse from 2006 into 2009, and once again is turning lower

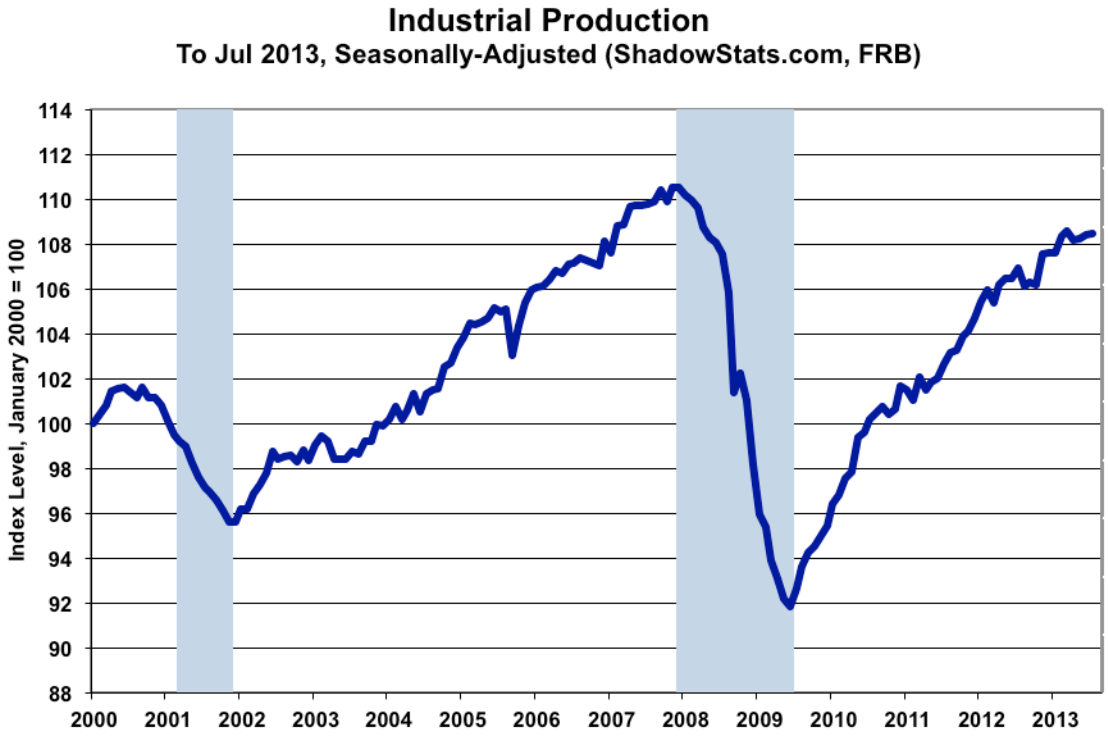
Industrial Production—July 2013. Industrial production reporting in July 2013 was suggestive of the onset of a new recession. In the context of downside revisions to recent reporting, headline July 2013 industrial production was "unchanged" versus June. Disappointing market expectations of a modest monthly gain, July would have shown an outright monthly contraction but for the downward revision to the level of activity in June. Year-to-year growth slowed to 1.4% in July, a level last seen in the slowing annual activity of mid-2008, well into the early stages of the formal 2007 recession. In normal economic times, this pattern of activity would be consistent with a new recession that already was underway.

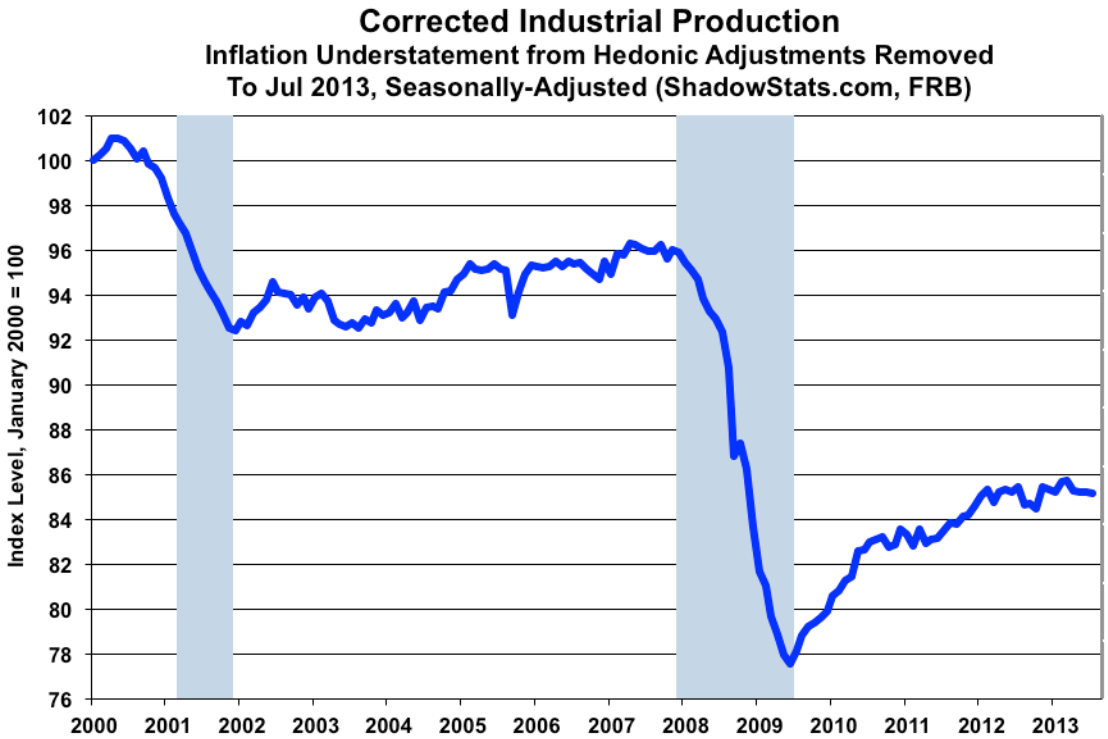
Formal Detail, Industrial Production—July 2013. In the context of downside revisions to the prior six months (the period open to revision), headline monthly production activity was "unchanged" for July, at the first decimal point. At the second decimal point, monthly production was up by 0.04% (down by 0.11% before prior-period revisions). That was against a revised 0.20% (previously 0.31%) monthly gain in June. The headline "unchanged" activity in aggregate production reflected a 0.1% contraction in manufacturing, a 2.1% gain in mining activity (including oil and gas activity), and a 2.1% decline in utility usage.

Suggestive of a renewed downturn in broad economic activity, year-to-year growth in July slowed sharply to 1.42%, a level last seen in a pattern of slowing growth, during the mid-2008 economic collapse, consistent with the annual growth patterns going into recession. The July growth was against revised year-to-year growth of 1.83% (previously 1.98%) in June. Further, annualized second-quarter 2013 growth revised to 0.34% (previously 0.59%), while first-quarter annualized growth revised to 4.07% (previously 4.23%), details that missed inclusion in the comprehensive GDP revision.

Graphs showing the headline index level and year-to-year changes in production are found in the *Reporting Detail*. The following graphs, however, show production activity net of inflation distortions.

Corrected Industrial Production. Hedonic quality adjustments understate the inflation used in calculating some components of industrial production, with the effect of overstating the inflation-adjusted growth reported in the headline industrial production series (see *Special Commentary (No. 485)* and *Public Comment on Inflation*). The two graphs following address that issue. The first reflects official industrial production reporting, indexed to January 2000 = 100, instead of the Fed's index that is set at 2007 = 100. The 2000 indexing is used simply to provide for some consistency in this series of revamped graphics. The second graph is a corrected version of the first, with estimated hedonic-inflation adjustments backed-out of the official deflator.





The "corrected" graph does show some growth in the period following the official June 2009 near-term trough in production activity. Yet, that upturn has been far shy of the full recovery and the renewed expansion reported in official GDP estimation. Production levels have not regained pre-recession highs (even uncorrected) but, instead, entered a period of protracted low-level stagnation in 2012, with quarterly contractions in third-quarter 2012, second-quarter 2013, and with continued, renewed downturn in July.

[For further detail and graphs on the July CPI, PPI, nominal and real retail sales, real earnings and industrial production, see the* Reporting Detail *section.]

HYPERINFLATION WATCH

Hyperinflation Outlook—Unchanged. *[This* Outlook *summary is unchanged from* Commentary No. 546 *of August 1st. It will updated in tomorrow's August 16th* Commentary.*]* The comments here are intended as background material for new subscribers and for those looking for a brief summary of the broad outlook of the economic, systemic and inflation crises that face the United States in the year or so ahead.

Background Material. *No. 527: Special Commentary* (May 2013) supplemented *No. 485: Special Commentary* (November 2012), reviewing shifting market sentiment on a variety of issues affecting the U.S. dollar and prices of precious metals. *No. 485*, in turn, updated *Hyperinflation 2012* (January 2012)—the base document for the hyperinflation story—and the broad outlook for the economy and inflation, as well as for systemic-stability and the U.S. dollar. Of some use, here, also is the *Public Comment on Inflation*.

These are the primary articles outlining current conditions and the background to the hyperinflation forecast, and they are suggested reading for subscribers who have not seen them and/or for those who otherwise are trying to understand the basics of the hyperinflation outlook. The fundamentals have not changed in recent years, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, a fully-updated hyperinflation report is planned for the near future.

Beginning to Approach the End Game. Nothing is normal: not the economy, not the financial system, not the financial markets and not the political system. The financial system still remains in the throes and aftershocks of the 2008 panic and near-systemic collapse, and from the ongoing responses to same by the Federal Reserve and federal government. Further panic is possible and hyperinflation remains inevitable.

Typical of an approaching, major turning point in the domestic- and global-market perceptions, bouts of extreme volatility and instability have been seen with increasing frequency in the financial markets, including equities, currencies and the monetary precious metals (gold and silver). Consensus market expectations on the economy and Federal Reserve policy also have been in increasing flux. The FOMC and Federal Reserve Chairman Ben Bernanke have put forth a plan for reducing and eventually ending quantitative easing in the form of QE3. The tapering or cessation of QE3 is contingent upon the U.S. economy performing in line with overly-optimistic economic projections provided by the Fed. Initially, market reaction pummeled stocks, bonds and gold. The talk of ending QE3 still appears to be little more than jawboning, aimed a placating Fed critics. As part of the mind-game with the public, various Fed officials regularly offer contradictory stories, when the stock market needs a boost or distraction.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment should shift increasingly towards no imminent end to QE3, and then to expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and, eventually, they will have to recognize same. Business activity remains in continued and deepening trouble, and the Federal Reserve—despite currency-market platitudes to the contrary—is locked into quantitative easing by persistent problems now well beyond its control. Specifically, banking-system solvency and liquidity remain the primary concerns for the Fed, driving the quantitative easing. Economic issues are secondary concerns for the Fed; they are used as political cover for QE3. That cover will continue for as long as the Fed needs it.

At the same time, deteriorating expectations for domestic political stability reflect widening government scandals, in addition to the dominant global-financial-market concern of there being no viable prospect of those controlling the U.S. government addressing the long-range sovereign-solvency issues of the United States government. All these factors, in combination, show the end game to be nearing.

The most visible and vulnerable financial element to suffer early in this crisis likely will be the U.S. dollar in the currency markets (all dollar references here are to the U.S. dollar, unless otherwise stated). Heavy dollar selling should evolve into massive dumping of the dollar and dollar-denominated paper assets. Dollar-based commodity prices, such as oil, should soar, accelerating the pace of domestic inflation. In turn, that circumstance likely will trigger some removal of the U.S. dollar from its present global-reserve-currency status, which would further exacerbate the currency and inflation problems tied to the dollar.

This still-forming great financial tempest has cleared the horizon; its impact on the United States and those living in a dollar-based world will dominate and overtake the continuing economic and systemic-solvency crises of the last eight years. The issues that never were resolved in the 2008 panic and its aftermath are about to be exacerbated. Based on the precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises. Attempts to save the system all have inflationary implications. A domestic hyperinflationary environment should evolve from something akin to these crises before the end of next year (2014). The shifting underlying fundamentals are discussed in *No. 527: Special Commentary*; some of potential breaking crises will be expanded upon in the next revision to the hyperinflation report.

Still Living with the 2008 Crisis. Despite the happy news from the redefined GDP series that the recession was shallower, and the recovery more rapid, than previously estimated, there still never has been an actual recovery following the economic downturn that began in 2006, and collapsed into 2008 and 2009. No other major economic series has confirmed the pattern of activity now being reported in the GDP.

Instead, what followed was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012 (see the corrected GDP graph in the *Opening Comments* section of *Commentary No. 546*). The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series (see *No. 527: Special Commentary*, *Commentary No. 528* and *Public Comment on Inflation*). Nonetheless, given the nature of official reporting, the renewed downturn still should gain eventual recognition as the second-dip in a double- or multiple-dip recession.

What continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 turmoil. All the extraordinary actions and interventions bought a little time, but they did not resolve the various crises. That the crises continue can be seen in deteriorating economic activity and in the ongoing panicked actions by the Federal Reserve, where it still proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise.

Before and since the mid-April rout in gold prices, there had and has been mounting hype about the Fed potentially pulling back on its "easing" and a coincident Wall Street push to talk-down gold prices. Again, as discussed in *No. 527: Special Commentary*, those factors appeared to be little more than platitudes to the Fed's critics and intensified jawboning to support the U.S. dollar and to soften gold, in advance of the still-festering crises in the federal-budget and debt-ceiling negotiations. Despite orchestrated public calls for "prudence" by the Fed, and Mr. Bernanke's press conference following the June 19th FOMC meeting, the underlying and deteriorating financial-system and economic instabilities have self-trapped the Fed into an expanding-liquidity or easing role that likely will not be escaped until the ultimate demise of the U.S. dollar.

Further complicating the circumstance for the U.S. currency is the increasing tendency of major U.S. trading partners to move away from using the dollar in international trade, such as seen most recently in the developing relationship between France and China (see *No. 527: Special Commentary*).

The Fed's recent and ongoing liquidity actions themselves suggest a signal of deepening problems in the financial system. Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Accordingly, the Fed's continuing easing moves appear to have been primarily an effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury, under the political cover of a "weakening economy." Mounting signs of intensifying domestic banking-system stress are seen in soft annual growth in the broad money supply, despite a soaring pace of annual growth in the monetary base, and in global banking-system stress that followed the crisis in Cyprus and continuing, related aftershocks.

Still Living with the U.S. Government's Fiscal Crisis. Again, as covered in *No. 527: Special Commentary*, the U.S. Treasury still is in the process of going through extraordinary accounting gimmicks, at present, in order to avoid exceeding the federal-debt ceiling. Early-September appears to be

the deadline for resolving the issues tied to the debt ceiling, including—in theory—significant budget-deficit cuts.

Both Houses of Congress have put forth outlines of ten-year budget proposals that still are shy on detail. The ten-year plan by the Republican-controlled House proposes to balance the cash-based deficit as well as to address issues related to unfunded liabilities. The plan put forth by the Democrat-controlled Senate does not look to balance the cash-based deficit. Given continued political contentiousness and the use of unrealistically positive economic assumptions to help the budget projections along, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of upcoming negotiations. There still appears to be no chance of a forthcoming, substantive agreement on balancing the federal deficit.

Indeed, ongoing and deepening economic woes assure that the usual budget forecasts—based on overly-optimistic economic projections—will fall far short of fiscal balance and propriety. Chances also remain nil for the government fully addressing the GAAP-based deficit that hit $6.6 trillion in 2012, let alone balancing the popularly-followed, official cash-based accounting deficit that was $1.1 trillion in 2012 (see *No. 500: Special Commentary*).

Efforts at delaying meaningful fiscal action, including briefly postponing conflict over the Treasury's debt ceiling, bought the politicians in Washington minimal time in the global financial markets, but the time has run out and patience in the global markets is near exhaustion. The continuing unwillingness and political inability of the current government to address seriously the longer-range U.S. sovereign-solvency issues, only pushes along the regular unfolding of events that eventually will trigger a domestic hyperinflation, as discussed in *Commentary No. 491*.

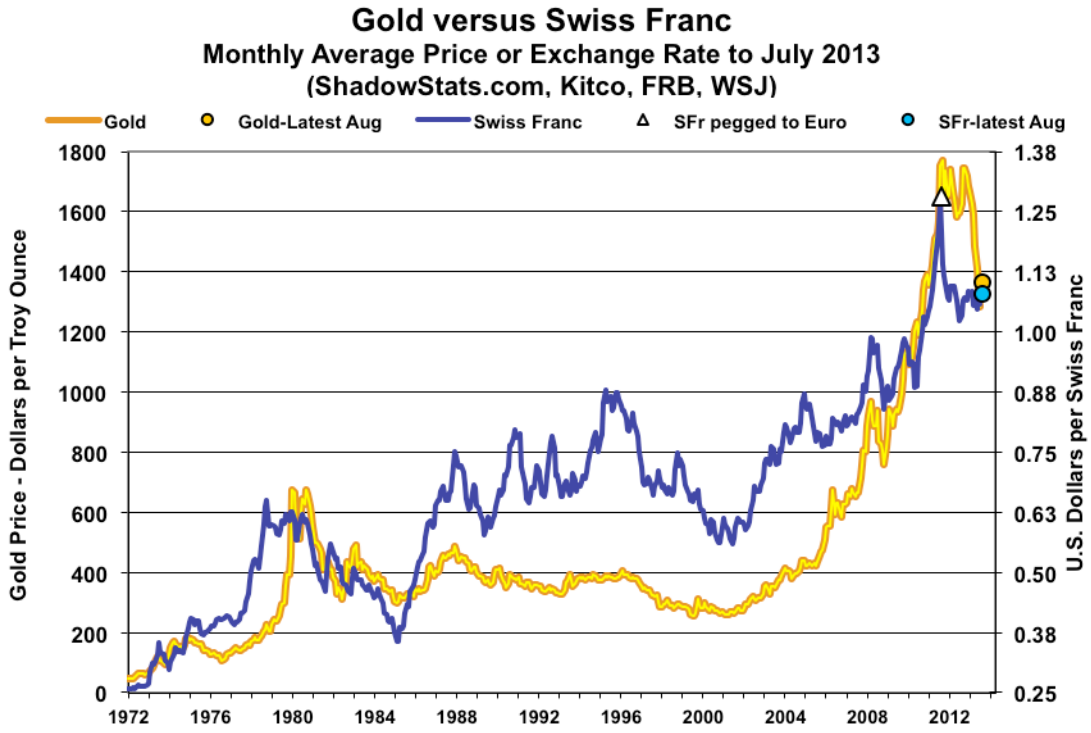
U.S. Dollar Remains Proximal Hyperinflation Trigger. The unfolding fiscal catastrophe, in combination with the Fed's direct monetization of Treasury debt, eventually (more likely sooner rather than later) will savage the U.S. dollar's exchange rate, boosting oil and gasoline prices, and boosting money supply growth and domestic U.S. inflation. Relative market tranquility has given way to mounting instabilities, and severe market turmoil likely looms, despite the tactics of delay by the politicians and ongoing obfuscation by the Federal Reserve.

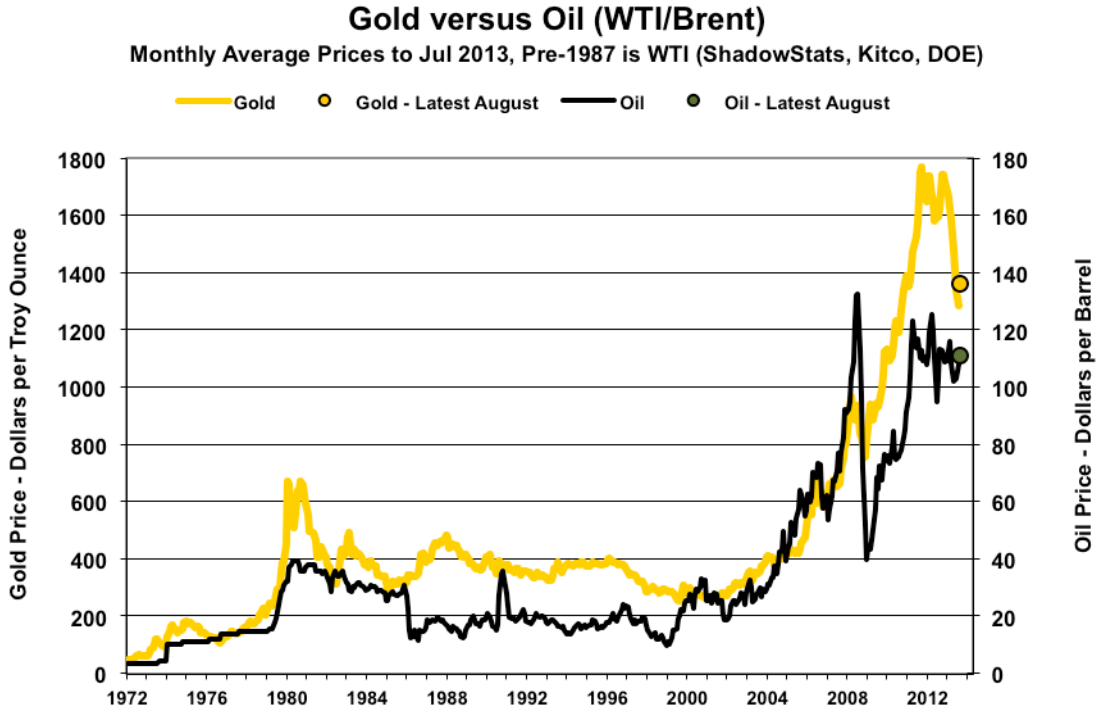
This should become increasingly evident as the disgruntled global markets begin to move sustainably against the U.S. dollar. As discussed earlier, a dollar-selling panic is likely this year—still of reasonably high risk in the next month or so—with its effects and aftershocks setting hyperinflation into action in 2014. Gold remains the primary and long-range hedge against the upcoming debasement of the U.S. dollar, irrespective of any near-term price gyrations in the gold market.

The rise in the price of gold in recent years was fundamental. The intermittent panicked selling of gold has not been. With the underlying fundamentals of ongoing dollar-debasement in place, the upside potential for gold, in dollar terms, is limited only by its inverse relationship to the purchasing power of the U.S. dollar (eventually headed effectively to zero). Again, physical gold—held for the longer term—remains as a store of wealth, the primary hedge against the loss of U.S. dollar purchasing power.

Monthly Gold Graphs. Following are the regular graphs of gold prices versus the Swiss franc, oil prices and silver prices that usually accompany the *Commentary* on the monthly CPI release. The recent turmoil in the markets has abated some, with gold, silver and oil prices off bottom, and the U.S. dollar somewhat

weaker. Still, the underlying fundamentals could not be much weaker for the U.S. dollar, and they could not be stronger for gold and silver. Higher oil prices partially have reflected political instabilities in the Middle East but face significant, further upside pressure when the U.S. dollar comes under heavy selling pressure. Domestic fiscal policy turmoil is likely to spike in early September, and the U.S. dollar is a good bet to be something of a casualty there. The "latest August" points in the following graphs are late-afternoon (New York) market prices, as of August 15th.




Gold versus Oil (WTI/Brent)
Monthly Average Prices to Jul 2013, Pre-1987 is WTI (ShadowStats, Kitco, DOE)
Gold
Gold - Latest August
Oil
Oil - Latest August
Gold Price - Dollars per Troy Ounce
Oil Price - Dollars per Barrel
1800
1600
1400
1200
1000
800
600
400
200
0
180
160
140
120
100
80
60
40
20
0
1972
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012


Gold versus Silver
Monthly Average Price Levels to July 2013
Pre-1981 Silver is Year-End (ShadowStats, Kitco, Handy & Harman)
Silver
Silver - Latest August
Gold
Gold - Latest August
Silver Price - U.S. Dollars per Troy Ounce
Gold Price - U.S. Dollars per Troy Ounce
44
40
36
32
28
24
20
16
12
8
4
0
2200
2000
1800
1600
1400
1200
1000
800
600
400
200
0
1972
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012

REPORTING DETAIL

PRODUCER PRICE INDEX—PPI (July 2013)

Questionably-Deep Contraction in Energy Prices Contained July PPI Inflation. As reported August 14th by the Bureau of Labor Statistics (BLS), the regularly-volatile, headline, seasonally-adjusted finished-goods producer price index (PPI) for July 2013 was unchanged (down by 0.15% unadjusted) month-to-month, against an adjusted gain of 0.77% (0.30% unadjusted) in June.

July's unchanged level in finished goods reflected a seasonally-adjusted 0.21% (0.46% unadjusted) monthly contraction in finished energy costs, offset by a seasonally-adjusted gain of 0.05% (a contraction of 0.25% unadjusted) in July food costs, and an adjusted 0.05% gain (unchanged unadjusted) in month-to-month "core" inflation. The seasonally-adjusted monthly change in each of those three categories appears to be too soft versus anecdotal evidence and previous reporting patterns.

Unadjusted and year-to-year, July 2013 total finished-goods PPI inflation eased to 2.12%, versus 2.49% in June, still remaining well off its near-term July 2011 peak of 7.08%.

Core Finished Goods. "Core" inflation is net of food and energy inflation. The concept of core inflation as a realistic measure of full inflation remains nonsensical, where food and energy account for 41.4% of the weighting of finished goods PPI (24.6% of the CPI-U, 27.6% of the CPI-W).

That said, the core measure still is useful as an indication of how energy prices, in particular, are impacting the broad economy. For July 2013, again, the seasonally-adjusted, month-to-month core PPI rose by 0.05% (unchanged unadjusted), versus an adjusted gain of 0.16% (up by 0.30% unadjusted) in June. Year-to-year, unadjusted July 2013 core finished-goods inflation slowed sharply to 1.20%, from 1.65% in June. A comparison of core-PPI with core-CPI-U year-to-year growth in July 2013 is graphed in the *Consumer Price Index* section, following.

Intermediate and Crude Goods. Reflecting generally higher average oil prices and mixed seasonal-factor impact, seasonally-adjusted July 2013 intermediate-goods inflation was flat, month-to-month, following a 0.5% increase in June, while July crude-goods prices rose by 1.2% for the month, against an unchanged monthly reading in June.

Year-to-year inflation in unadjusted July 2013 intermediate goods gained by 1.3%, versus a 1.1% increase in June. Year-to-year inflation in July 2013 crude goods rose by 9.3%, following an annual gain of 11.0% in June.

CONSUMER PRICE INDEX—CPI (July 2013)

Year-to-Year Consumer Inflation Regained 2.0% in July. Reflecting the continuing shifts in monthly seasonal adjustments from suppressing, to boosting adjusted energy-related inflation, headline consumer inflation increased by 0.2% in July, matching market expectations. As a result, annual inflation jumped to 2.0% in July, up from 1.8% in June, 1.4% in May and its recent nadir of 1.1% in April.

The recent swings in annual inflation largely have reflected swings in annual gasoline inflation, which, in turn, generally have moved with an inverse relationship to U.S. dollar strength, where, for example, a weak U.S. dollar against other currencies puts upside pressure on oil and gasoline prices. Post-2008 bouts of dollar weakness generally have been triggered by the quantitative-easing (also known as dollar-debasement) policies of the Federal Reserve. Oil-related prices are subject to other pressures, of course, such as political developments in the Middle East.

The volatility seen in the changes to monthly headline inflation, though, is reflective of a broken, seasonal-adjustment system, where long-term trends in areas such as energy prices have been upended by the recent extreme turmoil in the energy markets and the economy. As was discussed in *Commentary No. 541*, both monthly and annual inflation data are most meaningfully viewed on a not-seasonally-adjusted basis. That said, there are other issues in terms of methodological changes—made to the series in recent decades—that were designed to understate the government's reporting of consumer inflation, as discussed in the *Public Comment on Inflation Measurement*.

———————

Notes on Different Measures of the Consumer Price Index

The Consumer Price Index (CPI) is the broadest inflation measure published by the U.S. Government, through the Bureau of Labor Statistics (BLS), Department of Labor:

*The **CPI-U (Consumer Price Index for All Urban Consumers)** is the monthly headline inflation number (seasonally adjusted) and is the broadest in its coverage, representing the buying patterns of all urban consumers. Its standard measure is not seasonally adjusted, and it never is revised on that basis except for outright errors.*

*The **CPI-W (CPI for Urban Wage Earners and Clerical Workers**) covers the more-narrow universe of urban wage earners and clerical workers and is used in determining cost of living adjustments in government programs such as Social Security. Otherwise, its background is the same as the CPI-U.*

*The **C-CPI-U (Chain-Weighted CPI-U)** is an experimental measure, where the weighting of components is fully substitution based. It generally shows lower annual inflation rate than the CPI-U and CPI-W. The latter two measures once had fixed weightings—so as to measure the cost of living of maintaining a constant standard of living—but now are quasi-substitution-based.* Since it is fully substitution based, the series tends to reflect lower inflation than the other CPI measures. Accordingly, the C-CPI-U is the "new inflation" measure being considered by Congress and the White House as a tool for reducing Social Security cost-of-living adjustments by stealth.

*The **ShadowStats Alternative CPI-U Measures** are attempts at adjusting reported CPI-U inflation for the impact of methodological change of recent decades designed to move the concept of the CPI away from being a measure of the cost of living needed to maintain a constant standard of living. There are two measures, where the first is based on reporting methodologies in place as of 1980, and the second is based on reporting methodologies in place as of 1990.*

CPI-U. The Bureau of Labor Statistics (BLS) reported this morning, August 15th that the headline, seasonally-adjusted CPI-U for July 2013 rose by 0.2% (0.16% at the second decimal point) month-to month, and was up by 0.04%, unadjusted. In June, the adjusted CPI-U rose by 0.5% (0.48% at the second decimal point) month-to month, and was up by 0.24%, unadjusted.

As happens at this time of year, seasonal adjustments for energy-related inflation tend to be on the plus-side. Per the BLS, a 0.4% monthly decline (same as the estimate from the more-comprehensive Department of Energy surveying) in not-seasonally-adjusted retail gasoline prices for July 2013 was turned to a 1.0% monthly gain by these irregular and distorting seasonal-adjustment factors. The seasonally-adjusted July inflation numbers reflected some further catch-up from energy-inflation understatement earlier in the year.

Encompassed by the headline CPI-U monthly gain of 0.2% (a rounded 0.0% unadjusted), aggregate energy inflation in July 2013 was a 0.2% monthly gain (an unadjusted 0.2% contraction). In the other major CPI sectors, adjusted food inflation was up by 0.2% for the month (up by 0.1% unadjusted), and "core" inflation was up by an adjusted 0.2% (unadjusted 0.1%).

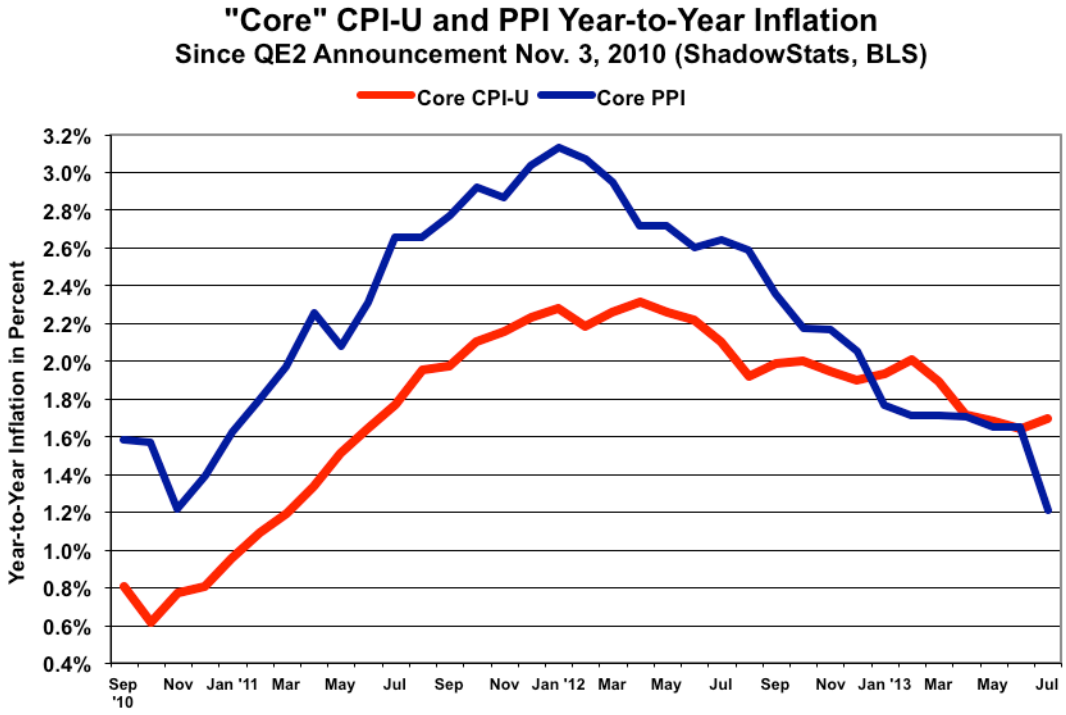
Not seasonally adjusted, July 2013 year-to-year inflation for the CPI-U was 1.96%, up from 1.75% in June 2013.

Year-to-year, CPI-U inflation would increase or decrease in next month's August 2013 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.52% increase in monthly inflation reported for August 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for August 2013, the difference in August's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the July 2013 annual inflation rate of 1.96%.

Core CPI-U. Seasonally-adjusted July 2013 "core" CPI-U inflation (net of food and energy inflation) rose by 0.15% (0.07% unadjusted) month-to-month, versus an adjusted 0.16% (0.08% unadjusted) gain in June.

Twenty-two of the last thirty-two months have shown rising year-to-year, or annual, core CPI-U inflation, with the year-to-year core rate increasing to 1.70% in July, from 1.64% in June. The CPI core annual inflation number ran counter to the core-PPI annual inflation rate, which dropped to 1.20% in July, versus 1.65% in June. Again, there appears to have been some monthly July inflation understatement in the regularly-volatile wholesale inflation index.

The July 2013 CPI-U year-to-year core rate remained well above the core inflation of 0.61%, in November 2010, when Federal Reserve Chairman Bernanke introduced QE2 in a successful bid to debase the U.S. dollar, with the effect of spiking oil prices. The expansion in QE3 into monetization of Treasury debt has created sporadic upside pressures here in recent months. Nonetheless, the core annual inflation numbers in July 2013—for both the CPI-U and PPI—continue to reflect ongoing impact of higher energy prices in the broad economy, as suggested by the accompanying graph.



CPI-W. The July 2013 headline, seasonally-adjusted CPI-W, which is a narrower series and has greater weighting for gasoline than does the CPI-U, rose month-to-month by 0.19% (up by 0.04% unadjusted), following an adjusted 0.57% gain (up by 0.26% unadjusted) in June.

Unadjusted, July 2013 year-to-year CPI-W inflation was 2.00%, up versus 1.75% in June.

Chained-CPI-U. The initial reporting of year-to-year inflation for the July 2013 C-CPI-U was 1.77%, versus 1.60% in June.

[The balance of the text in this Chained-CPI-U *sub-section is unchanged from the prior CPI* Commentary.*]* The Chained-CPI-U is the fully substitution-based series that is included in the President's fiscal-2014 budget as a new cost-of-living adjustment factor. Congress also as been pushing for the C-CPI as a way to reduce cost-of-living payments for Social Security, etc., by stealth. This would be an outright fraud on the public, continuing a pattern of similar, earlier successful efforts at deceptive

inflation reporting, seen in the past several decades (see the discussion in *Public Commentary on Inflation Measurement and Chained-CPI*).

The BLS indicates that the C-CPI-U, "is designed to be a closer approximation to a cost-of-living index than other CPI measures. [That is, a fully-substitution as opposed to a fixed-weight basis cost of living measure, where the fixed-weight measures reflect (and substitution-based measures do not reflect) the cost of maintaining a constant standard of living. Again, see the above-linked *Public Commentary*.]

"That said, BLS publishes thousands of indexes each month; these indexes can vary by which items, geographic areas, and populations are covered. As different users have different needs, BLS cannot say which index is necessarily better than another. As such, BLS takes no position on what the Congress or the Administration should use to make adjustments to Social Security or any other federal program.

"The C-CPI-U to our knowledge currently is not used in any federal legislation as an adjustment mechanism."

The BLS has posted new C-CPI material on its site, apparently beginning to anticipate the pending new political uses for the measure: Chained CPI.

Alternate Consumer Inflation Measures. Adjusted to pre-Clinton methodologies—the ShadowStats-Alternate Consumer Inflation Measure (1990-Base)—annual CPI inflation was roughly 5.4% in July 2013, up from 5.2% in June.

The ShadowStats-Alternate Consumer Inflation Measure (1980-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to about 9.6% (9.62% for those using the second decimal point) in July 2013, versus an annual inflation rate of 9.4% in June 2013.

[The balance of the text in this Alternate Consumer Inflation Measures *sub-section is unchanged from the prior CPI* Commentary.*]*

Note: The ShadowStats-Alternate Consumer Inflation Measure largely has been reverse-engineered from the BLS's CPI-U-RS series, which provides an official estimate of historical inflation, assuming that all current methodologies were in place going back in time. The ShadowStats estimates effectively are adjusted on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made by the BLS (the series is not recalculated).

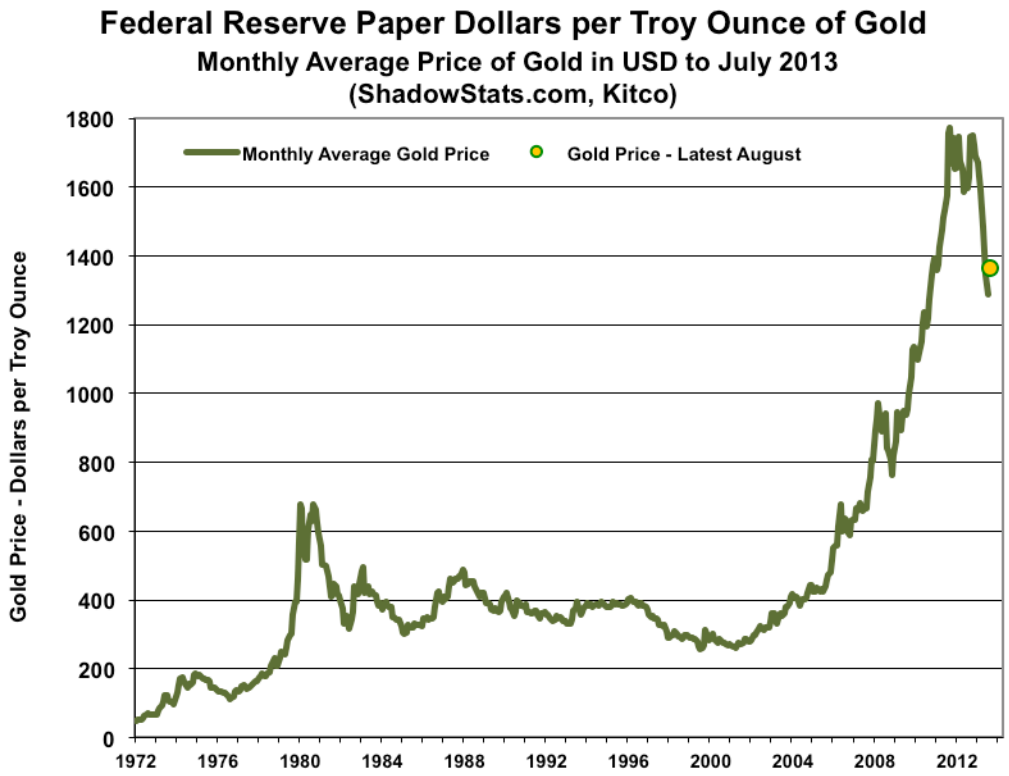
Over the decades, the BLS has altered the meaning of the CPI from being a measure of the cost of living needed to maintain a constant standard of living, to something that neither reflects the constant-standard-of-living concept nor measures adequately what most consumers view as out-of-pocket expenditures. Roughly five percentage points of the additive ShadowStats adjustment reflect the BLS's formal estimate of the annual impact of methodological changes; roughly two percentage points reflect changes by the BLS, where ShadowStats has estimated the impact not otherwise published by the BLS. (See Public Commentary on Inflation Measurement and Chained-CPI *for further details.)*

Gold and Silver Highs Adjusted for CPI-U/ShadowStats Inflation. Despite the September 5, 2011 historic-high gold price of $1,895.00 per troy ounce (London afternoon fix), and despite the multi-decade-high silver price of $48.70 per troy ounce (London fix of April 28, 2011), gold and silver prices have yet

to re-hit their 1980 historic levels, adjusted for inflation. The earlier all-time high of $850.00 (London afternoon fix, per Kitco.com) for gold on January 21, 1980 would be $2,552 per troy ounce, based on July 2013 CPI-U-adjusted dollars, and $10,270 per troy ounce, based on July 2013 ShadowStats-Alternate-CPI (1980-Base) adjusted dollars (all series not seasonally adjusted).

In like manner, the all-time high nominal price for silver in January 1980 of $49.45 per troy ounce (London afternoon fix, per silverinstitute.org), although approached in 2011, still has not been hit since 1980, including in terms of inflation-adjusted dollars. Based on July 2013 CPI-U inflation, the 1980 silver-price peak would be $148 per troy ounce and would be $598 per troy ounce in terms of July 2013 ShadowStats-Alternate-CPI (1980-Base) adjusted dollars (again, all series not seasonally adjusted).

As shown in Table 1 on page 50 of *Hyperinflation 2012*, and as updated in Table III on page 40 of *Special Commentary (No. 485)*, over the decades, the increases in gold and silver prices have compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, while they effectively have compensated fully for the loss of purchasing power of the dollar based on the ShadowStats-Alternate Consumer Price Measure (1980-Methodologies Base).

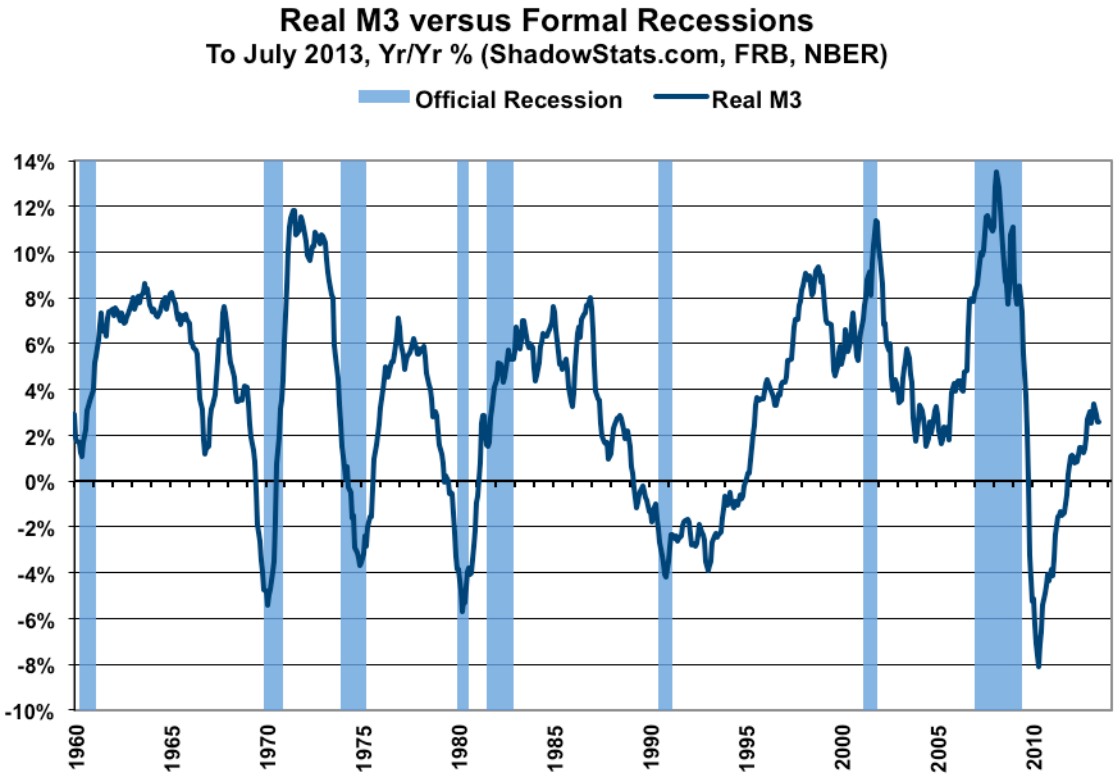


Real (Inflation-Adjusted) Average Weekly Earnings—July 2013. Coincident with the July 2013 CPI release, the BLS published real average weekly earnings for July 2013. For the production and nonsupervisory employees series—the only series for which there is a meaningful history—headline real

average weekly earnings (deflated by the CPI-W) fell by 0.5% in July, versus an unrevised 0.3% decline in June and a 0.1% decline in May.

Unadjusted and year-to-year, July real earnings fell by 1.7%, versus a revised 1.6% (previously 1.5%) annual gain in June. Both the monthly and annual fluctuations in this series are irregular, but current reporting remains well within the normal bounds of volatility.

The usual graph of this series is shown in the *Opening Comments* section. As shown there, the graph plots the earnings as officially deflated by the BLS (red-line), and as adjusted for the ShadowStats-Alternate CPI Measure, 1990-Base (blue-line). When inflation-depressing methodologies of the 1990s began to kick-in, the artificially weakened CPI-W (also used in calculating Social Security cost-of-living adjustments) helped to prop up the reported real earnings. Official real earnings today still have not recovered their inflation-adjusted levels of the early-1970s, and, at best, have been flat for the last decade. Deflated by the ShadowStats measure, real earnings have been in fairly regular decline for the last four decades, which is much closer to common experience than the pattern suggested by the CPI-W. See *Public Commentary on Inflation Measurement* for further detail.



Real Money Supply M3 (July 2013). The signal for a double-dip or ongoing recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), discussed in *Hyperinflation 2012*, remains in place and continues, despite real annual M3 growth having turned to the upside. As shown in

the accompanying graph—based on July 2013 CPI-U reporting and the latest ShadowStats-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for July 2013 held at 2.6% versus a revised 2.6% (previously 2.7%) in June. The July annual growth reflected offsetting gains in nominal M3 annual growth and in year-to-year CPI-U inflation.

[The balance of the text in this Real Money Supply M3 *sub-section is unchanged from the prior CPI* Commentary.*]* The signal for a downturn or an intensified downturn is generated when annual growth in real M3 first turns negative in a given cycle; the signal is not dependent on the depth of the downturn or its duration. Breaking into positive territory does not generate a meaningful signal one way or the other for the broad economy. The current downturn signal was generated in December 2009, even though there had been no upturn since the economy hit bottom in mid-2009. The broad economy tends to follow in downturn or renewed deterioration roughly six-to-nine months after the signal. Weaknesses in a number of series continued into 2011 and 2012, with significant new softness in recent reporting. Actual post-2009 economic activity has remained at low levels—in protracted stagnation—as discussed in *Special Commentary (No. 485)*.

A renewed downturn in official data is becoming more obvious, and that eventually should lead to official recognition of a double-dip recession. Reality remains that the economic collapse into 2009 was followed by a plateau of low-level economic activity—no upturn or recovery, no end to the official 2007 recession—and the unfolding renewed downturn remains nothing more than a continuation and re-intensification of the downturn that began unofficially in 2006.

RETAIL SALES—Nominal and Real (July 2013)

Headline Retail Sales Gain Reflected Little More Than Higher Prices. The statistically-insignificant, headline monthly gain of 0.2% in July 2013 retail sales was in nominal terms, before adjustment for the effects of consumer inflation. With the July 2013 headline CPI-U inflation rate at 0.2%, inflation was the primary factor behind the sales increase, not rising consumer demand. With the monthly inflation and growth rates taken to a second decimal point, 0.16% inflation versus 0.20% retail sales left a residual of 0.04% real growth for the month.

Activity in consumer buying of goods and services remains constrained by the intense, structural-liquidity woes besetting the consumer, as discussed in *Commentary No. 546* (also see the detail on June consumer credit outstanding in the *Opening Comments,* and on real earnings there and in the preceding *Consumer Inflation* section). Without real growth in income, and without the ability or willingness to take on meaningful new debt, the consumer simply cannot sustain real growth in retail sales, let alone in the broader personal consumption measure in GDP. In like manner, the consumer has lacked the ability to fuel the purported post-June 2009 recovery in economic activity.

Otherwise, highly variable and unstable seasonal factors have just continued to cloud activity in the May 2013-to-July 2013 period, and in June 2012-to-July 2012, five months that are published on a non-comparable basis with all the other historical monthly numbers. Although the historical numbers were consistent at the time of the May 31st benchmark revision, three intervening rounds of post-revision concurrent-seasonal adjustments have thrown all the historical data into disorder. The resulting

inconsistencies allow for unreported shifts in the historical data that most likely distort the reporting of current headline numbers.

Note: The stability of the seasonal-adjustment process (particularly the concurrent seasonal-adjustment process used with retail sales) and of sampling methods has 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 are flying blind as to actual economic activity, consideration of broad underlying fundamentals is essential. Consumer income and credit remain structurally impaired, as discussed in Commentary No. 546, Hyperinflation 2012 *and* Special Commentary (No. 485).

Nominal (Not-Adjusted-for-Inflation) Retail Sales—July 2013. Not adjusted for this morning's (August 15th) largely offsetting, headline July CPI-U inflation of 0.16%, the August 13th report on July 2013 retail sales—issued by the Census Bureau—indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.20% (a gain of 0.40% before prior-period revisions) +/- 0.6% (all confidence intervals are at the 95% level). The July increase followed a revised, statistically-significant June month-to-month gain of 0.62% (previously 0.37%) +/- 0.2%.

Year-to-year, July 2013 retail sales rose by a statistically-significant 5.40% +/- 0.8%, versus a revised 5.90% (previously 5.72%) in June. Prior-period revisions, one year ago, reflected little more than the unstable monthly revisions in the concurrent-seasonal-adjustment process, where revised estimates are reported and shown only selectively. Indeed, the pattern of growth here remains distorted by the resulting lack of fully-consistent, seasonally-adjusted numbers being published by the Census Bureau.

Core Retail Sales. Seasonally-adjusted monthly grocery-store sales rose by 0.58% in July, with gasoline-station sales gaining 0.53% for the month. Under normal conditions, 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:

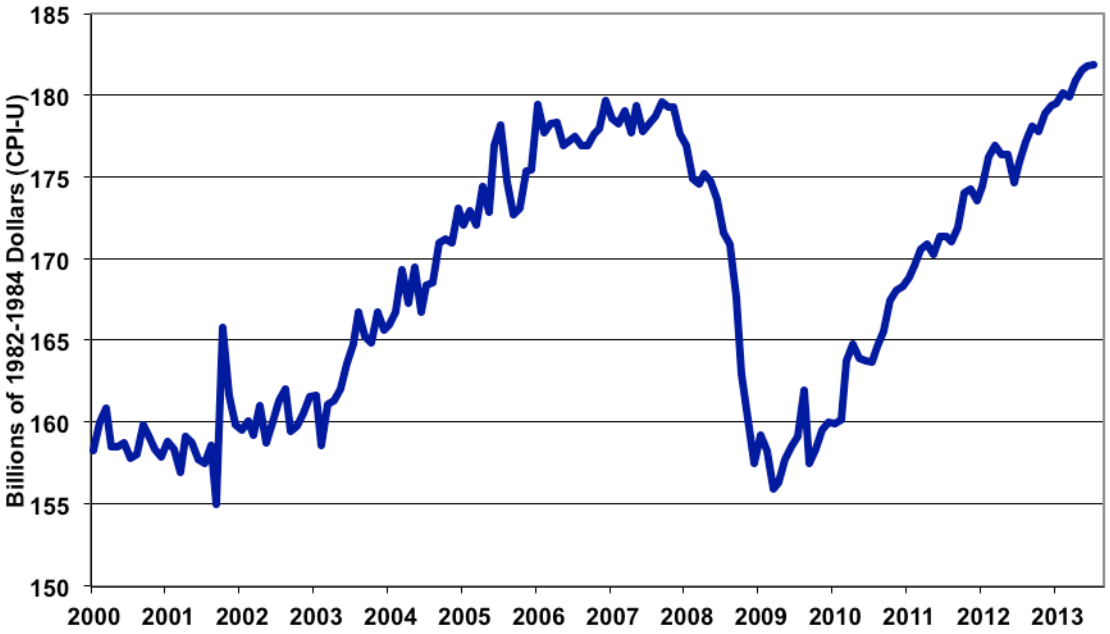
Version I: July 2013 versus June 2013 seasonally-adjusted retail sales series—net of total grocery store and gasoline station revenues—rose by 0.04%, versus the official gain of 0.20%.

Version II: July 2013 versus June 2013 seasonally-adjusted retail sales series—net of the monthly change in revenues for grocery stores and gas stations—also increased by 0.04%, versus the official gain of 0.20%.

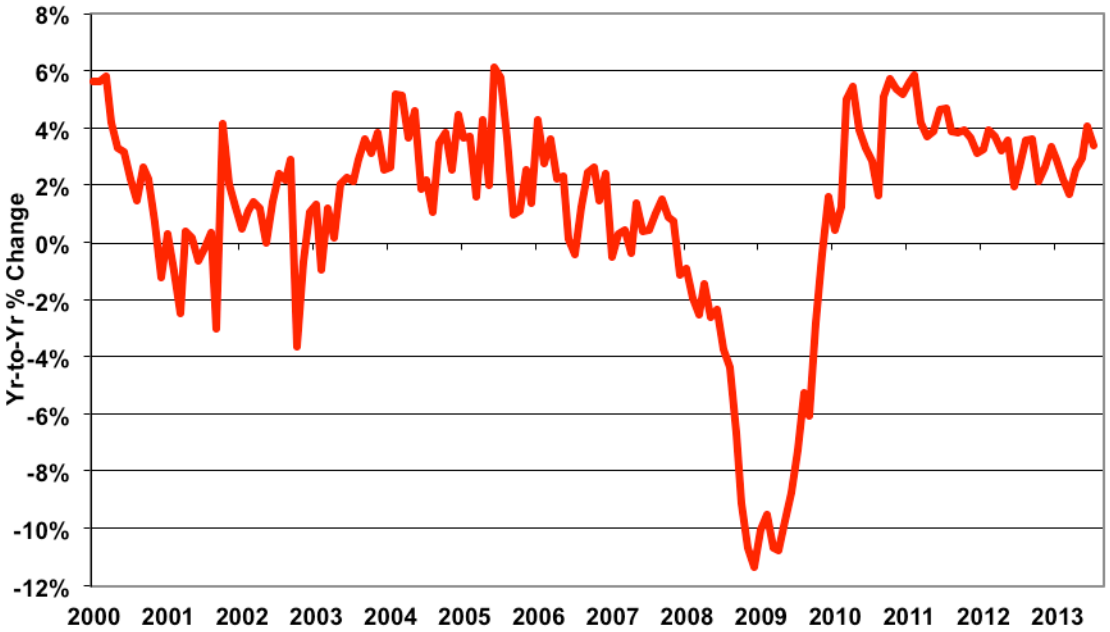
Real (Inflation-Adjusted) Retail Sales—July 2013. July 2013 real retail sales were "unchanged," but rose by 0.04% month-to-month, at the second decimal point, versus a revised 0.14% gain (previously a 0.11% contraction) in June. As discussed above, nominal sales were reported by 0.20% in July, largely offset by the 0.16% month-to-month increase in the July CPI-U. Nominal June retail sales gained a revised 0.62% month-to-month, which largely was offset by 0.48% headline inflation in June.

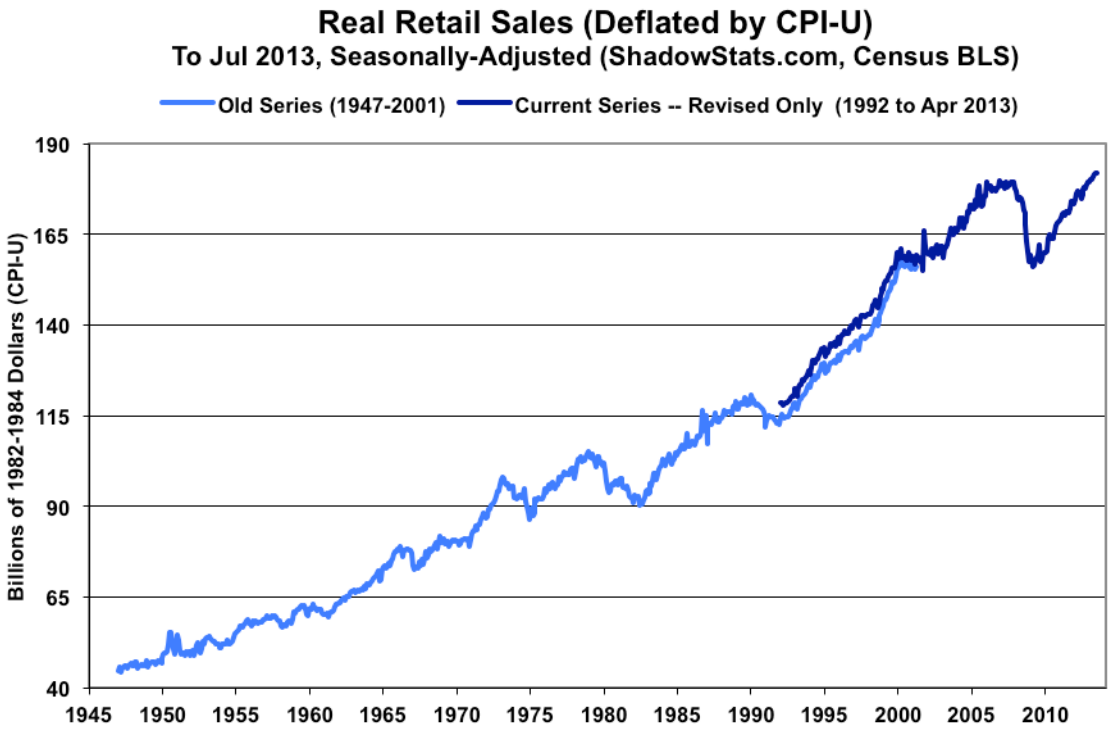
Year-to-year, July 2013 real retail sales rose at an annual pace of 3.38%, versus a revised 4.07% (previously 3.90%) in June, as seen in the second graph following. In normal economic times, the recent levels in annual real growth would be signaling a pending recession. In the current circumstance, this signal likely will serve as an indicator of a renewed downturn in broad economic activity.

Real Retail Sales (Deflated by CPI-U)
Jan 2000 to Jul 2013, Seasonally-Adj. (ShadowStats, Census, BLS)



Real Retail Sales Year-to-Year % Change
Jan 2000 to Jul 2013, Seasonally-Adj. (ShadowStats, Census, BLS)





Above Pre-Recession Levels. The first of the three preceding graphs shows the level of real retail sales activity (deflated by the CPI-U) since 2000, and the second graph shows year-to-year percent change for the same period. The third graph shows the level of the real retail sales series in full post-World War II detail. With July 2013 reporting, the nascent expansion of headline real retail sales above pre-recession levels, which began in February 2013, has flattened out.

As revised in the July 31st comprehensive revision of the gross domestic product, the GDP expanded beyond pre-recession levels, more than nine quarters ago, starting in second-quarter 2011, and it has kept rising, well beyond the reported activity of any other series, including real retail sales. There is no other major economic series showing the GDP's pattern of official, full recovery and extensive new growth. While real retail sales tend to lead the GDP, the "recovery" in retail reporting has lagged the purported GDP recovery by two years.

The apparent "recovery" in the real retail sales series (as well as in the GDP) is due to the understatement of the rate of inflation used in deflating retail sales and other series. As discussed more fully in *Hyperinflation 2012* and *Special Commentary (No. 485)*, deflation by too-low an inflation number (such as the CPI-U) results in the deflated series overstating inflation-adjusted economic growth.

With the deflation rates corrected for understated inflation, the recent pattern of real sales activity turns increasingly flat-to-negative, as shown in the latest "corrected" real retail sales graph in the *Opening Comments*. The corrected graph shows that the post-2009 period of protracted stagnation ended, and a period of renewed contraction began in second-quarter 2012. The corrected real retail sales numbers use the ShadowStats-Alternate Inflation Measure (1990-Base) for deflation instead of the CPI-U.

As discussed in the opening comments of this *Retail Sales* section, there has been no change in the underlying consumer-liquidity fundamentals. There is nothing that would support a sustainable turnaround in retail sales, personal consumption, housing or general economic activity. There never was a broad economic recovery, and there is no recovery underway, just general bottom-bouncing that is turning down anew.

As official consumer inflation continues its upturn in the months ahead, and as overall retail sales continue to suffer from the ongoing consumer liquidity squeeze—reflected partially by recent real earnings difficulties, discussed in the next section—these data should trend meaningfully lower, in what eventually will gain recognition as a formal, double-dip recession.

INDEX OF INDUSTRIAL PRODUCTION (July 2013)

July Industrial Production Was Suggestive of Unfolding Recession. In the context of downside revisions to recent reporting, headline July 2013 industrial production was "unchanged" versus June. Disappointing market expectations of a modest monthly gain, July would have shown an outright monthly contraction, but for the downward revision to the level of activity in June. Further, year-to-year growth slowed to 1.4% in July 2013, a level last seen in slowing annual activity in mid-2008, well into the early stages of the formal 2007 recession. In normal economic times, this pattern of activity would be consistent with a new recession that already was underway.

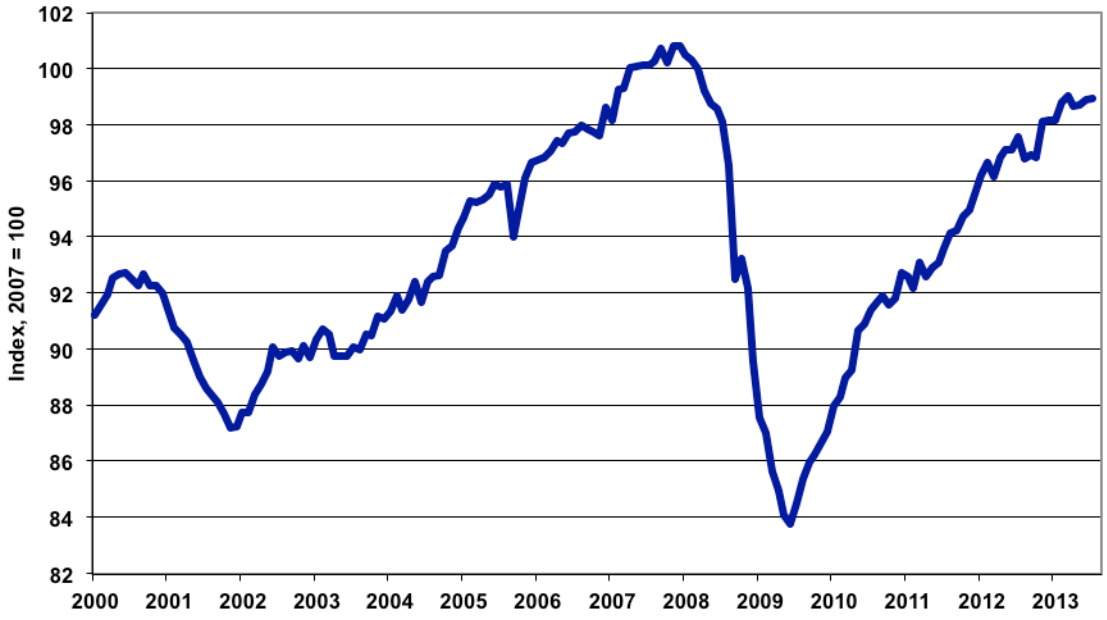
Industrial Production—July 2013. The Federal Reserve Board released its estimate of seasonally-adjusted, July 2013 industrial production this morning, August 15th. In the context of downside revisions to the prior six months (the period open to revision), headline monthly production activity was "unchanged" for July, at the first decimal point. At the second decimal point, monthly production was up by 0.04% (down by 0.11% before prior-period revisions). That was against a revised 0.20% (previously 0.31%) monthly gain in June.

The headline "unchanged" activity in aggregate production reflected a 0.1% contraction in manufacturing, a 2.1% gain in mining activity (including oil and gas activity), and a 2.1% decline in utility usage.

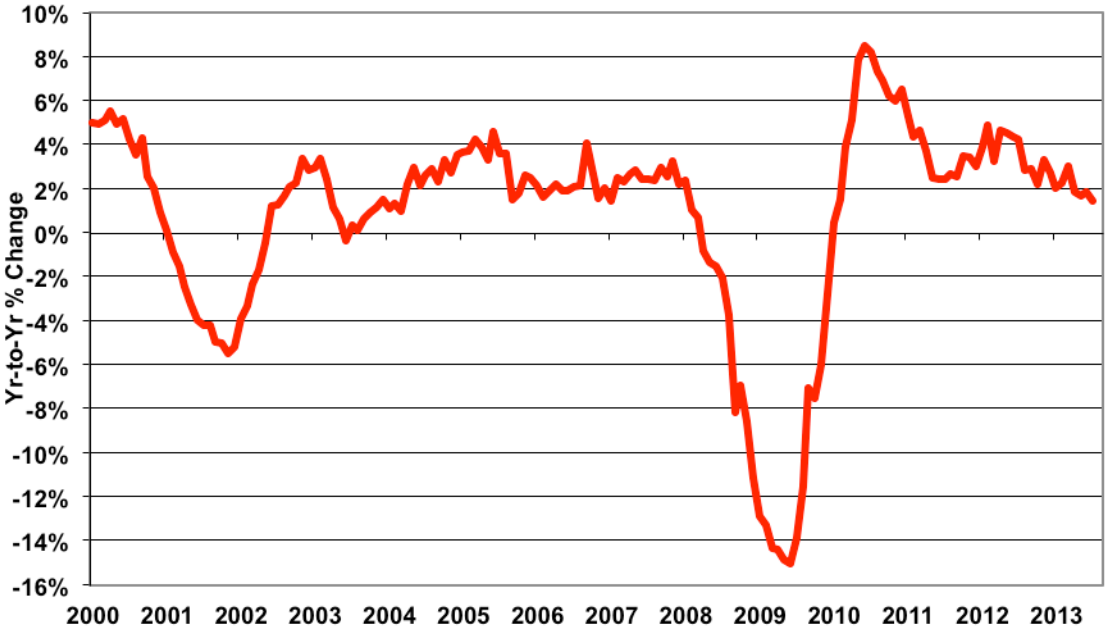
Suggestive of a renewed downturn in broad economic activity, year-to-year growth in July was 1.42%, a level last seen, with growth in a downswing, during the mid-2008 economic collapse, consistent with the annual growth patterns going into recession. The July growth of 1.42% was against revised year-to-year growth of 1.83% (previously 1.98%) in June. With the July reporting revisions, annualized second-quarter 2013 growth revised to 0.34% (previously 0.59%), while first-quarter annualized growth revised to 4.07% (previously 4.23%), details that missed inclusion in the comprehensive GDP revision.

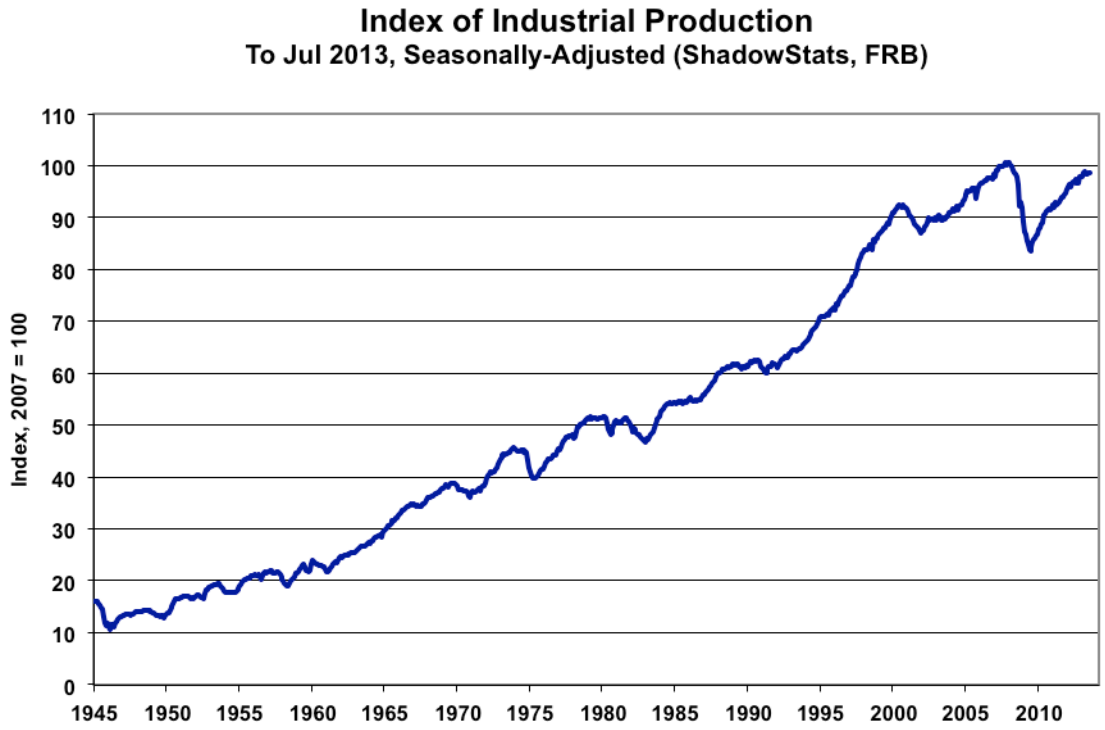
The "recovery" in industrial production is reflected in the following two sets of graphs. The first graph in the first set shows the monthly level of the production index, while the second graph shows the year-to-year or annual percentage change in the same series for recent historical detail, beginning January 2000. The second set of graphs shows the same data in historical context since World War II.

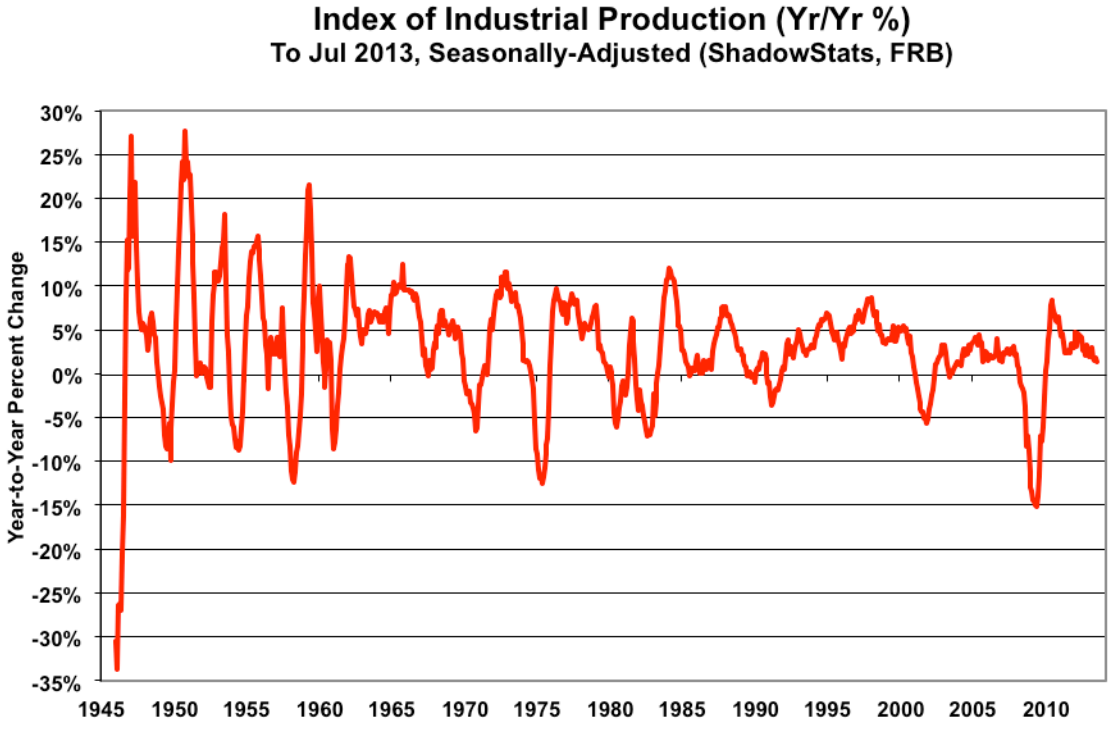
Index of Industrial Production
To Jul 2013, Seasonally-Adjusted (FRB)



Industrial Production Year-to-Year % Change
Jan 2000 to Jul 2013, Seasonally-Adj. (ShadowStats, FRB)




Index of Industrial Production
To Jul 2013, Seasonally-Adjusted (ShadowStats, FRB)
Index, 2007 = 100
110
100
90
80
70
60
50
40
30
20
10
0
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


Index of Industrial Production (Yr/Yr %)
To Jul 2013, Seasonally-Adjusted (ShadowStats, FRB)
Year-to-Year Percent Change
30%
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-30%
-35%
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010

As shown more clearly in the first set of graphs, current activity has dipped lower, and annual growth has slowed to levels last seen in a slowing-growth pattern in the first two quarters of the formal 2007 recession. Annual growth remains well off the recent relative peak for the series, which was 8.50% in June 2010, going against the official June 2009 trough of the economic collapse. Indeed, as shown in the second set of graphs, the year-to-year contraction of 15.02% in June 2009, at the end of second-quarter 2009, was the steepest annual decline in production since the shutdown of war-time production following World War II.

Although official production levels have moved higher since the June 2009 trough, the series still remains shy of a full recovery and appears to be turning down, anew, unlike the dubious data in the GDP, which show full recovery as of second-quarter 2011, with continuous, new expansion ever since.

Corrected for the understatement of inflation used in deflating portions of the industrial production index, the series has shown more of a bottom-bouncing and recent-downturn pattern, since 2009, where it appears to have topped out coming into 2012, with a renewed downturn likely in process. The corrected production series is discussed and graphed in the *Opening Comments*. Please note also that the index base for those graphs showing production levels, both the corrected graph and the accompanying graph based on official reporting, is January 2000 = 100, instead of the Federal Reserve's official 2007 = 100, used in the graphs here.

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Data Are Likely in the Month and Months Ahead. Given underlying economic activity that continues to appear weaker than overly-optimistic market expectations, and given underlying fundamentals that are suggestive of deteriorating business activity, weaker-than-consensus economic reporting should be the continuing trend.

Separately, given that energy-inflation-related seasonal-adjustment factors now are on the plus-side for a couple of months, combined with stable or higher oil and gasoline prices, higher headline CPI and PPI are likely in the next month.

Reflecting the still-likely negative impact on the U.S. dollar in the currency markets, pending from continuing QE3, and the still-festering fiscal crisis/debt-ceiling debacle (see *Hyperinflation Outlook* section), reporting in the ensuing months and year ahead generally should reflect much higher-than-expected inflation (see *No. 527: Special Commentary*).

Where market expectations for economic data in the months and year ahead should begin to soften, weaker-than-expected economic results remain likely, given the still-intensifying structural liquidity constraints on the consumer, as discussed in the *Opening Comments* section.

[Except for the underlined detail in the comment on July housing starts, the balance of this Week Ahead *section is unchanged from the prior* Commentary.*]*

Reporting Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-ongoing economic turmoil of the last six-to-seven years, which has been without precedent in the post-World War II era of modern economic reporting. These impaired reporting methodologies provide particularly unstable headline economic results, where concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data), and they have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

With an increasing trend towards downside surprises in near-term economic reporting, recognition of an intensifying double-dip recession should continue to gain. Nascent concerns of a mounting inflation threat, though muted, increasingly have been rekindled by the Fed's monetary policies. Again, though, significant inflation shocks are looming in response to the fiscal crisis and a likely, severely-negative response in the global currency markets against the U.S. dollar.

The political system and Wall Street would like to see the issues disappear, and the popular media do their best to avoid publicizing unhappy economic news, putting out happy analyses on otherwise negative numbers. Pushing the politicians and media, the financial markets and their related spinmeisters do their best to hype anything that can be given a positive spin, to avoid recognition of serious problems for as long as possible. Those imbedded, structural problems, though, have horrendous implications for the markets and for systemic stability, as discussed in *Hyperinflation 2012*, *No. 485: Special Commentary* and *No. 527: Special Commentary*.

Residential Construction (July 2013). The Census Bureau will publish tomorrow, Friday, August 16th, its estimate of July 2013 housing starts activity. Despite continual market expectations for strengthening activity in housing starts, reported month-to-month change likely will continue to be statistically-insignificant, with ongoing stagnation seen in the aggregate series, as well as particularly for single-unit housing starts. With market expectations settling into the range of 5% to 8% monthly aggregate growth in July, month-to-month change would have to top 13.3% (based on June's 95% confidence interval), to be statistically significant.

In the wake of a 75% collapse in aggregate activity from 2006 through 2008, and an ensuing four-year pattern of housing starts stagnation at historically low levels, little has changed. There remains no chance of a near-term, sustainable turnaround in the housing construction market, unless there is a fundamental upturn in consumer and banking liquidity conditions. That has not happened and still does not appear to be in the offing.

