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

COMMENTARY NUMBER 557
August CPI, Real Retail Sales and Earnings

September 17, 2013

Liquidity Constraints Impair Consumption, Prevent Recovery

Poverty Report Confirmed Falling Household Income

Year-to-Year "Core" CPI Inflation in Upswing

August Annual Inflation: 1.5% (CPI-U), 1.5% (CPI-W), 9.2% (ShadowStats)

PLEASE NOTE: The next regular Commentary *is scheduled for tomorrow, Wednesday, September 18th covering August housing starts and detail from the* Income, Poverty and Health Insurance Coverage: 2012 (The Poverty Report). *A further* Commentary *will follow on Thursday, September 19th, with an assessment of any changes in FOMC policy, plus an updated summary of the* Hyperinflation Outlook *(not the revised* Hyperinflation Report*, which will be published in the near future)*.

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

In this week of unusually heavy reporting of economic activity and potential financial-system changes, the staggered developments are being distributed among five *Commentaries.* August nominal retail sales and the PPI were covered in Friday's *Commentary No. 555*; August industrial production and the pending

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FOMC meeting were discussed in Monday's *Commentary No. 556*; and the CPI and related constant-dollar series such as real retail sales and earnings are covered in today's (September 17th) missive, *No. 557*. Ahead are:

September 18th, No. 558: Income, Poverty and Health Insurance Coverage, 2012 (The Poverty Report)/ Housing Starts. A cursory look at the meaningful data in today's release of the 2012 *Poverty Report* found no surprises. The median household income reporting was consistent with the monthly data published by www.SentierResearch.com, and showed a small real (inflation-adjusted) decline in median annual household income for 2012, albeit not statistically significant. The Commerce Department also confirmed the collapse of household income that took place not only coming into the formal 2007 recession, but also continuing throughout the period of purported economic recovery, up to the present.

Income variance or dispersion, measures of the concentration or distribution of income away from the middle, held at or hit record highs in 2012. Those readings remain severely-negative, longer-term leading indicators of economic activity. Details will follow in the tomorrow's September 18th *Commentary*, along with the previously scheduled, regular coverage on the August housing starts report.

September 19th, No. 559: Discussion of Any FOMC Actions and Update to the Summary Hyperinflation Outlook. Yesterday's *Commentary No. 556* discussed possible Federal Open Market Committee actions on Federal Reserve policy, which would be announced tomorrow (September 18th) afternoon. Assessment of any actions taken will follow in the September 19th *Commentary*. The *Hyperinflation Summary Outlook* also will be revised, at that time, in the *Hyperinflation Watch* section. That update should not be confused with the pending revision to the massive *Hyperinflation Report*, which will be discussed soon and published in the near future. Fiscal and liquidity conditions also will be updated.

Latest Inflation and Economic Reporting. Reflecting the continuing irregular movement in energy-related prices, particularly in gasoline, year-to-year change in the CPI-U remains unstable, while seasonal-factor distortions tend to translate that instability into irregular monthly inflation shifts. Year-to-year, CPI-U inflation has varied from a recent low of 1.1% in April 2013, to 2.0% in July to 1.5% in August.

Net of the volatile food- and energy-sector prices, annual "core" inflation has been more stable, but that stability has turned into upside inflation, most recently rising to 1.8% in August, from 1.7% in July, as the impact of higher oil prices continue their slow permeation of broad economic activity.

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. Dollar-related pressures will be discussed in pending *Commentary No. 559.*

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.

CPI-U. Headline, seasonally-adjusted CPI-U for August 2013 rose by 0.1% (0.08% at the second decimal point) month-to-month, and was up by 0.12% unadjusted. That followed a headline monthly gain of 0.2% (0.16% at the second decimal point) in July, which was up by 0.04%, unadjusted. Not seasonally adjusted, August 2013 year-to-year inflation for the CPI-U was 1.52%, down from 1.96% in July.

The CPI-U August monthly gain of 0.1% (rounded, adjusted and unadjusted) reflected an adjusted 0.3% contraction in energy inflation (an unadjusted 0.5% contraction). In the other major CPI sectors, adjusted food inflation was up by 0.1% for the month (up by 0.2% unadjusted), and "core" inflation (net of food and energy) was up by an adjusted 0.1% (unadjusted 0.2%).

CPI-W. The August 2013 headline CPI-W rose month-to-month by 0.09% (up by 0.12% unadjusted), following an adjusted 0.19% gain (up by 0.04% unadjusted) in July. Unadjusted, August 2013 year-to-year CPI-W inflation was 1.45%, versus 2.00% in July.

Chained-CPI-U. The initial reporting of year-to-year inflation for the August 2013 C-CPI-U was 1.42%, versus 1.77% in July.

In the area of "What could the BLS be up to?" the Bureau announced that after the current calendar year it will cease publishing the average annual C-CPI-U, but will continue publishing the monthly data.

Alternate Consumer Inflation Measures. The ShadowStats-Alternate Consumer Inflation Measure (1990-Base) showed annual CPI inflation was roughly 5.0% in August, versus 5.4% in July 2013. The ShadowStats-Alternate Consumer Inflation Measure (1980-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, eased to about 9.2% in August 2013, versus an annual inflation rate of 9.6% in July 2013.

Structural Liquidity Issues Continue to Impair Retail Sales and Personal Consumption. Discussed in *Commentary No. 552*, *Commentary No. 553*, *Commentary No. 555*, and as suggested by real earnings, as graphed in the next section, the lack of sustainable growth in retail sales and personal consumption can be explained by the lack of growth in consumer income and liquidity. Inflation-adjusted median household income has been down and/or stagnant. Without the availability of normal consumer debt expansion and with an ongoing lack of willingness by the consumer to spend or to take on new debt, there simply is no economic recovery in place or pending.

Real Average Weekly Earnings—August 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) rose by 0.1% in August, following a revised decline in July of 0.4% (previously 0.5%).

Unadjusted and year-to-year, August earnings rose by 0.7%, following a revised annual decline in July earnings of 1.6% (previously 1.7%). Both the monthly and annual fluctuations in this series are irregular, but current reporting remains well within the normal bounds of volatility.

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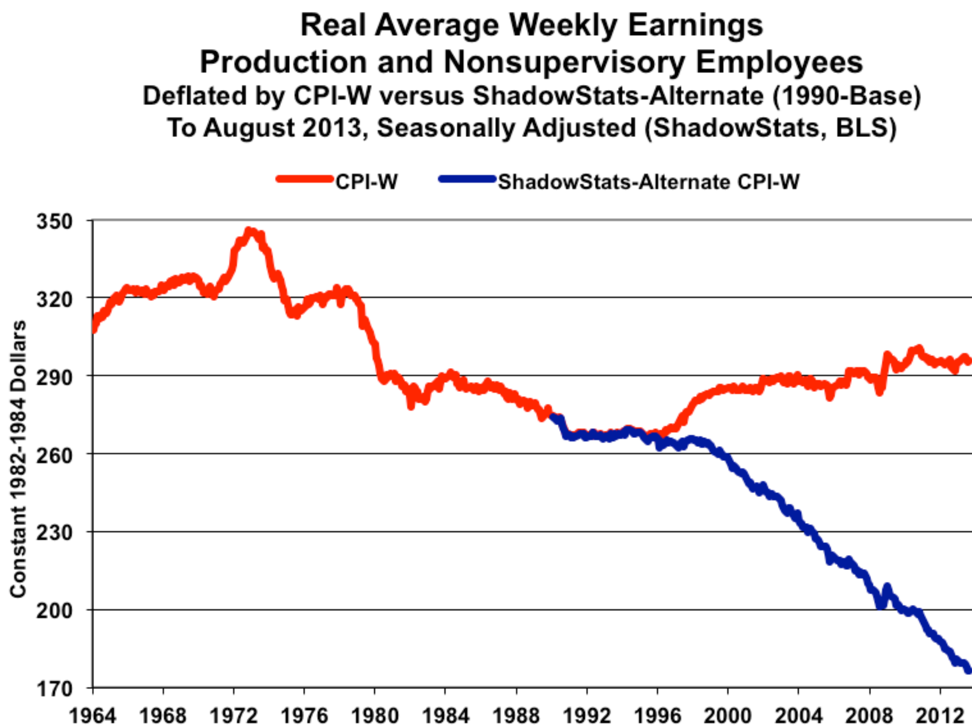
The accompanying graph of real average weekly earnings shows the earnings as officially deflated by the BLS (red-line), and as adjusted for the ShadowStats-Alternate CPI Measure, 1990-Base (blue-line). When inflation-depressing methodologies of the 1990s began to kick-in, the artificially weakened CPI-W (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.



Real Retail Sales (After Adjustnent for Inflation)—August 2013. Discussed in *Commentary No. 555*, the headline nominal (not-adjusted-for inflation) gain in August 2013 retail sales largely was accounted for by rising prices. A similar pattern was seen in the initial reporting of nominal sales in July, but the August upside revision in headline nominal July growth to 0.43%, from 0.20%, pushed the real growth rate above its initial zero reading. Based on the August 2013 CPI-U, real retail sales showed a monthly gain of 0.12% in August, versus the upwardly revised 0.27% of July.

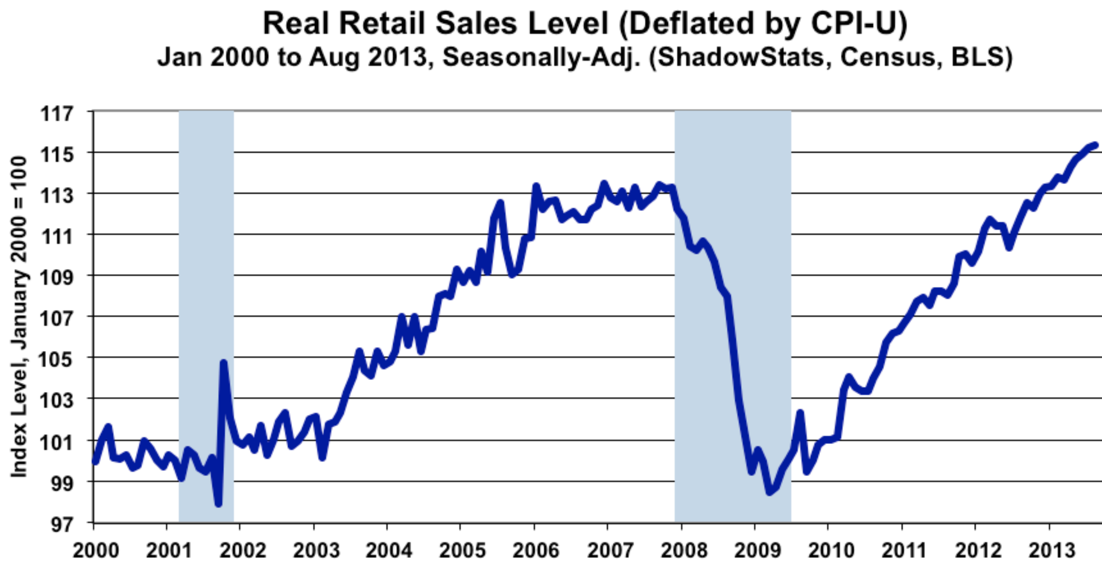
Year-to-year, August 2013 real retail sales rose at an annual pace of 3.10%, versus a revised 3.70% (previously 3.38%) in July, as seen in the graphs of the *Reporting Detail* section. In normal economic

times, the recent levels in annual real retail sales 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 in the first graph following of the indexed real retail sales.

The GDP purportedly expanded beyond pre-recession levels, ten 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, however, that shows 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.



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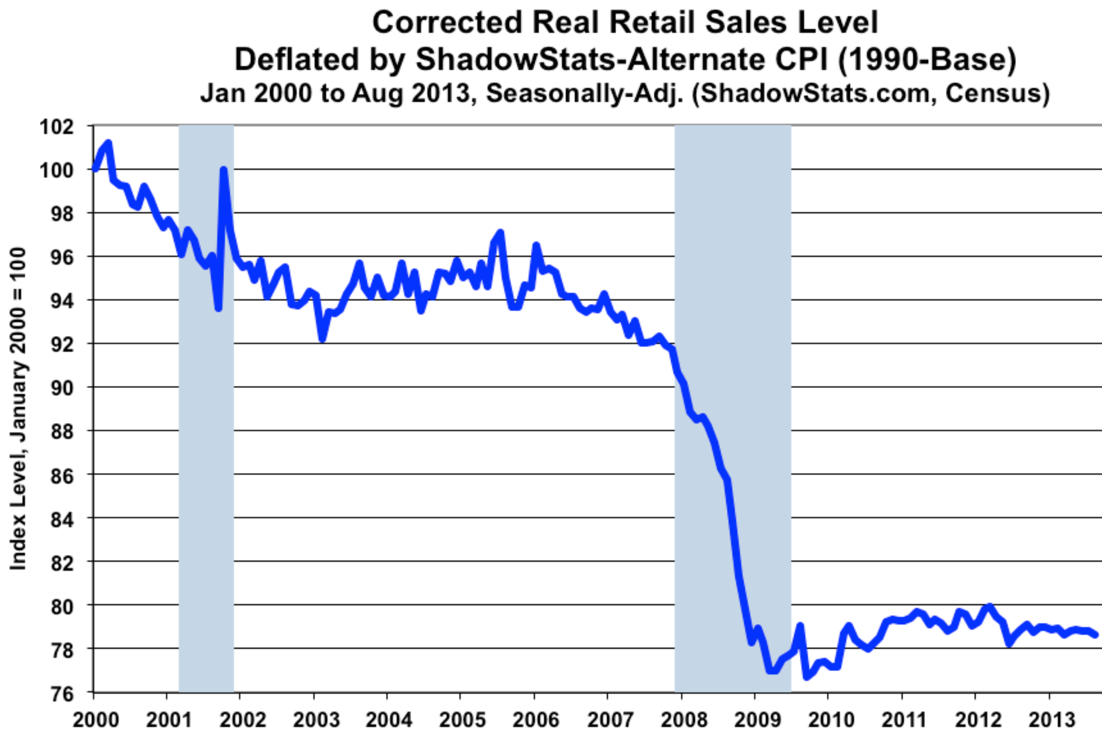

Corrected Retail Sales. The first graph preceding reflects real retail sales as usually reported by the St. Louis Fed, deflated by the CPI-U, but it is indexed to January 2000 = 100. ShadowStats did the deflation using the August 2013 CPI-U and nominal retail sales releases. The CPI-U, however, understates 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, which had been bottom-bouncing along a low-level plateau of economic activity since the economic collapse from 2006 into 2009. Once again, activity is turning lower.

[For further detail on the August CPI, real retail sales and earnings,
see the* Reporting Detail *section.]

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HYPERINFLATION WATCH

Hyperinflation Outlook—Unchanged. An update of the *Hyperinflation Outlook* is planned for a separate *Commentary* on September 19th, accompanying a brief assessment on any changes in Federal Reserve policy that come out of the FOMC meeting on Wednesday afternoon (September 18th). The summary that follows here has not been revised since *Commentary No. 550* of August 16th and is 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 in 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. Yet, the talk of ending (or extending/expanding) QE3 still appears to be little more than jawboning, aimed either at placating a growing chorus of Fed critics or at manipulating variously the gold, currency and domestic-stock markets. Indeed, as part of the ongoing mind-games with the public, various Fed officials regularly offer contradictory stories, when the stock market needs a boost or distraction from other concerns, such as pending discord over U.S. fiscal policy.

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,

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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. These factors, in combination, show the end game to be nearing, and while they may have been in recent summer-holiday hibernation, post-Labor Day political turmoil is imminent.

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, at any time, with little or no warning. 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 precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises, hoping to push the problems even further into the future. Such attempts to save the system, however, all have exceptional inflationary implications.

The global financial markets appear ready to move beyond the forced patience with U.S. policies that had been induced by the financial terror of the 2008 panic. Accordingly, the U.S. dollar faces likely extreme and negative turmoil in the months ahead. A domestic hyperinflationary environment still 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, with current reporting in basic economic series coming into synchronization with a renewed downturn in broad economic activity starting in second- and third-quarter 2013.

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. As of August 15, 2013, the Fed had monetized 110% of the net issuance of U.S. Treasury debt, since the beginning of the calendar year.

The Fed's unconscionable market manipulations and games playing in fueling speculation over the future of quantitative easing clearly have been used to move the U.S. dollar (the purpose of initial quantitative easing was U.S. dollar debasement). QE3 and continuing efforts at dollar-debasement are not about to go away. 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. The loss of some reserve status for the U.S. dollar is likely, as the crises break, and that would intensify both the dollar-selling and domestic U.S. inflationary pressures.

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 remain 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

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No. 500: Special Commentary). Recent reductions reported in the year-to-date cash-based 2013 deficit reflect gimmicks such as the U.S. government declaring itself dividends out of government-backed and controlled Fannie Mae and Freddie Mac. Those dividends also have helped the Treasury operate around the limits of the current debt ceiling. If the government consolidated those entities into its financial statements, as would happen in the corporate world, the deficit position would be much bleaker, as it is otherwise with generally accepted accounting principles or GAAP-based accounting.

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 global markets previously had expressed their extreme discomfort with the unresolved longer-range sovereign solvency issues of the United States, by dumping dollars at the time of the failed July/August 2011 fiscal negotiations. The continuing unwillingness and political inability of the current government to address those issues, only pushes along the regular unfolding of events that eventually will trigger a massive flight from the U.S. dollar and 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 extreme 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 near-term—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. Turmoil in the markets has continued, although gold, silver and oil prices are off bottom, and the U.S. dollar is 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. Oil price volatility partially has reflected shifting political instabilities in the Middle East, but oil prices face significant, further upside pressure when the U.S. dollar comes under heavy selling pressure. Domestic fiscal policy turmoil is likely to spike in the next several weeks, and the U.S. dollar is a good bet to be something of a casualty there. The "latest September" points in the following graphs are London fixes or mid-afternoon (New York) market prices of September 17th.

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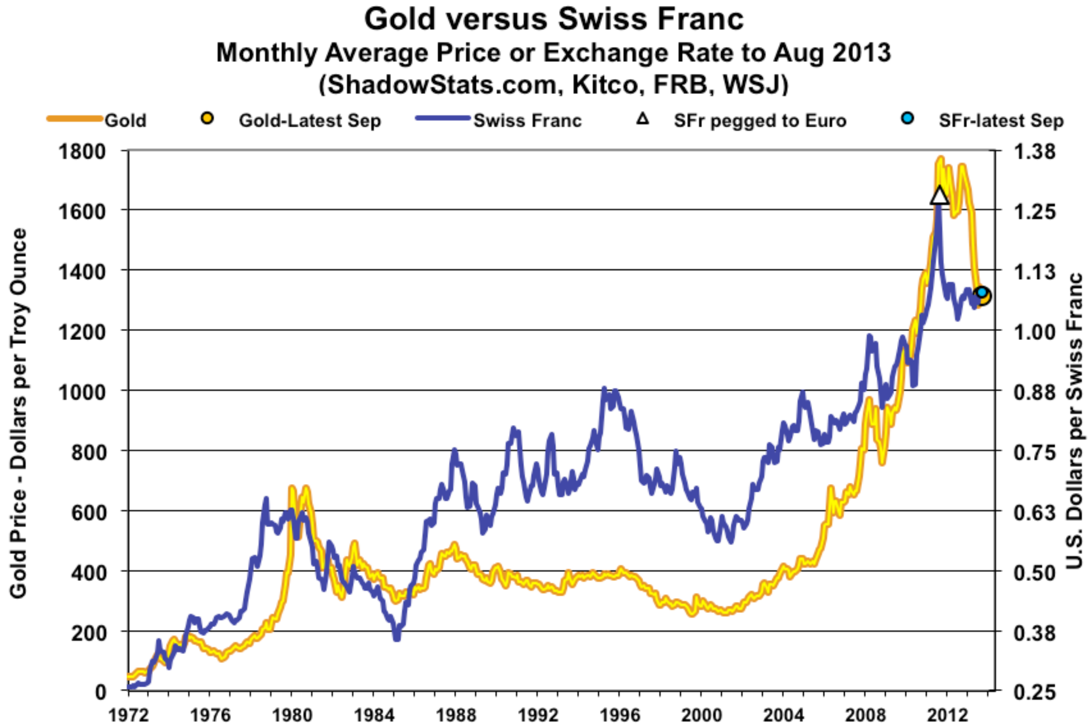

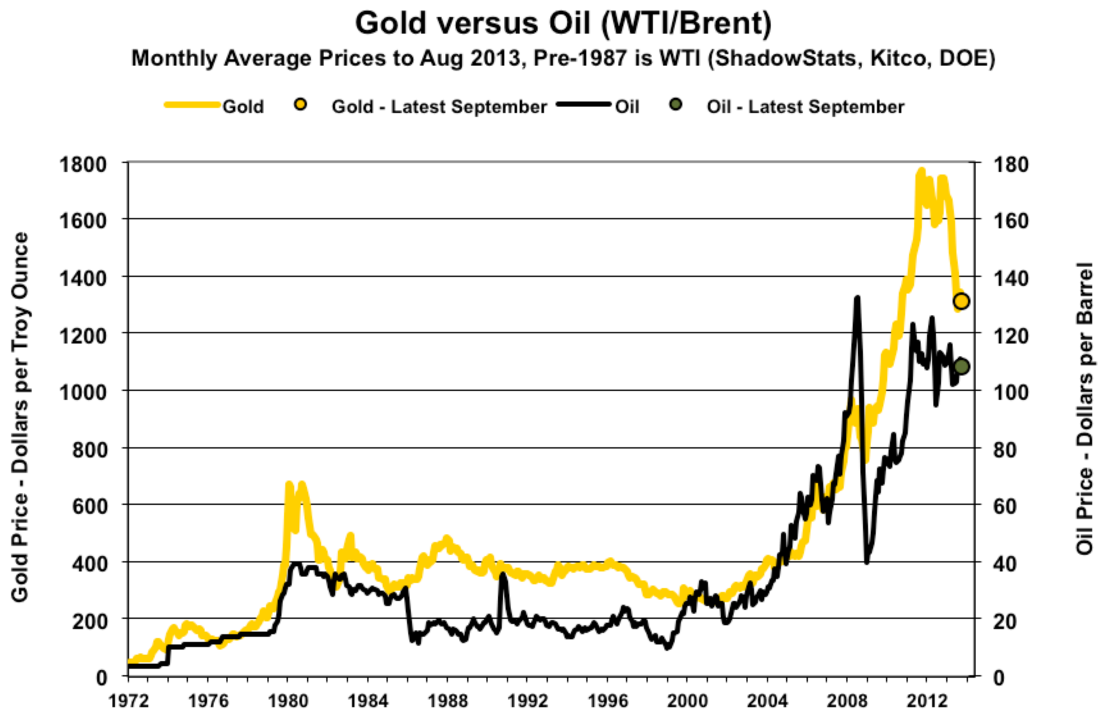

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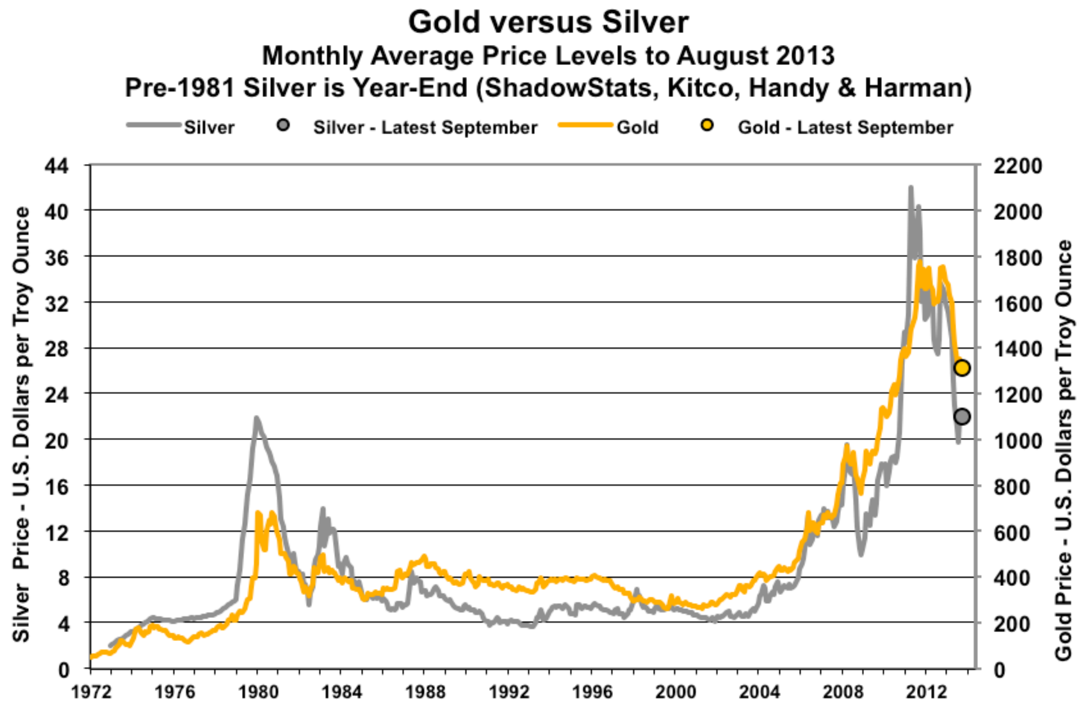

REPORTING DETAIL

CONSUMER PRICE INDEX—CPI (August 2013)

Year-to-Year Consumer Inflation Volatility. Reflecting the continuing irregular movement in energy-related prices, particularly in gasoline, year-to-year change in the CPI-U remains unstable. Year-to-year CPI-U inflation has varied from a recent low of 1.1% in April, to 2.0% in July to 1.5% in August. Even worse, seasonal-factor distortions tend to translate that instability into irregular monthly inflation shifts.

Net of the more-volatile food and energy prices, annual "core" inflation has been relatively stable, but that stability has turned into upside inflation, most recently, as the impact of higher oil prices continue their slow permeation of broad economic activity.

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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*.

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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.*

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CPI-U. The Bureau of Labor Statistics (BLS) reported this morning, September 17th, that the headline, seasonally-adjusted CPI-U for August 2013 rose by 0.1% (0.08% at the second decimal point) month-to-month, and was up by 0.12% unadjusted. That followed a headline monthly gain of 0.2% (0.16% at the second decimal point) in July, which was up by 0.04%, unadjusted.

The headline reporting was a notch below the consensus outlook, which can be explained partially by the BLS using a more-severe estimate of falling gasoline-prices in August—a not-seasonally-adjusted drop of 0.5%—instead of the 0.4% decline indicated by the more-comprehensive surveying of the Department of Energy, combined with the use of less-positive seasonal adjustments to gasoline prices than were used in 2012 revisions. As a result, adjusted gasoline prices were down 0.14% for August 2013, instead of "unchanged." Seasonal adjustments also depressed the headline reporting of food and "core" inflation.

Encompassed by the headline CPI-U monthly gain of 0.1% (rounded, adjusted and unadjusted), aggregate energy inflation in August 2013 was a 0.3% monthly contraction (an unadjusted 0.5% contraction). In the other major CPI sectors, adjusted food inflation was up by 0.1% for the month (up by 0.2% unadjusted), and "core" inflation was up by an adjusted 0.1% (unadjusted 0.2%).

Not seasonally adjusted, August 2013 year-to-year inflation for the CPI-U was 1.52%, down from 1.96% in July.

Year-to-year, CPI-U inflation would increase or decrease in next month's September 2013 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted 0.52% increase in monthly inflation reported for September 2012. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for September 2013, the difference in September's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the August 2013 annual inflation rate of 1.52%.

Core CPI-U. Seasonally-adjusted August 2013 "core" CPI-U inflation (net of food and energy inflation) rose by 0.13% (by 0.20% unadjusted) month-to-month, versus a 0.15% (0.07% unadjusted) gain in July.

Twenty-three of the last thirty-three months have shown rising year-to-year, or annual, core CPI-U inflation, with the year-to-year core rate increasing to 1.76% in August, up from 1.70% in July. The CPI core annual inflation number again ran counter to the core-PPI annual inflation rate, which dropped to 1.15% in August, versus 1.20% in July.

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 August 2013—for both the CPI-U and PPI—continue to reflect ongoing impact of higher energy prices in the broad economy, as reflected in the accompanying graph.

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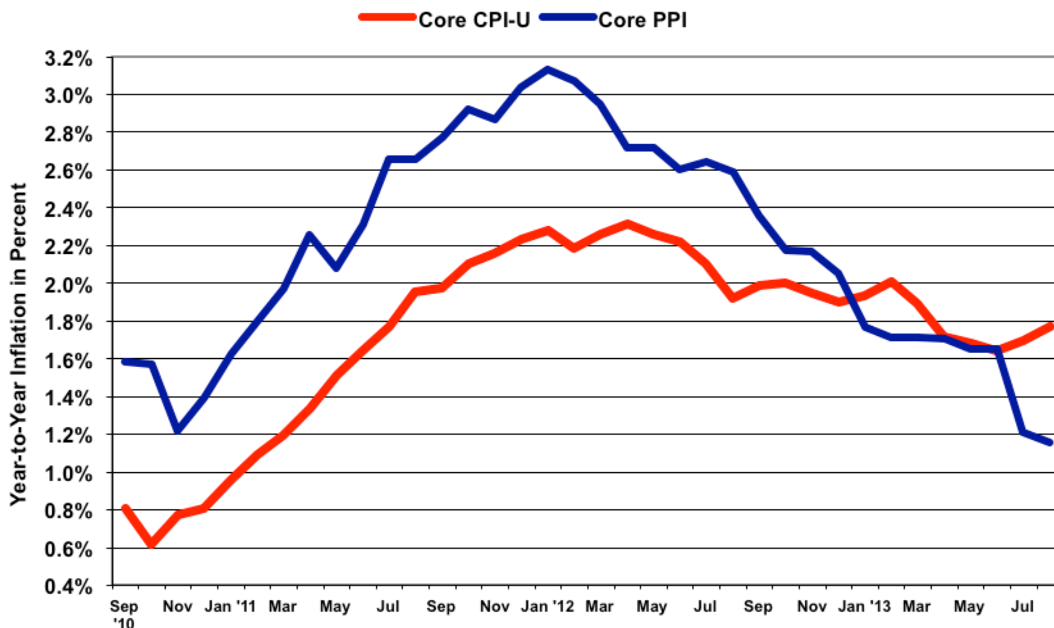

CPI-W. The August 2013 headline, seasonally-adjusted CPI-W, which is a narrower series and has greater weighting for gasoline than does the CPI-U, rose month-to-month by 0.09% (up by 0.12% unadjusted), following an adjusted 0.19% gain (up by 0.04% unadjusted) in July.

Unadjusted, August 2013 year-to-year CPI-W inflation was 1.45%, versus 2.00% in July.

Chained-CPI-U. The initial reporting of year-to-year inflation for the August 2013 C-CPI-U was 1.42%, versus 1.77% in July. The BLS has announced that after the current calendar year, it will cease publishing the average annual C-CPI-U, but will continue publishing the monthly data.

Where the Chained-CPI-U currently is not designed as a benchmark cost-of-living indicator, with the series subject to revisions for two years, there likely is movement afoot to restructure the indicator. So as to be useful for purposes of improperly cutting Social Security benefits, the series will have to be modified, which, by necessity means a degradation of reporting quality. The BLS always can model an adequate amount of inflation that needs to be cut from official reporting. These areas will be discussed further as more detail on pending changes becomes available.

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*).

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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.*] The BLS also has posted C-CPI material on its site, apparently in anticipation the 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 5.0% in August, versus 5.4% in July 2013.

The ShadowStats-Alternate Consumer Inflation Measure (1980-Base), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, eased to about 9.2% (9.17% for those using the second decimal point) in August 2013, versus an annual inflation rate of 9.6% in July 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 $2,555 per troy ounce, based on August 2013 CPI-U-adjusted dollars, and $10,311 per troy ounce, based on August 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 August 2013 CPI-U inflation, the 1980 silver-price peak would be $149 per troy ounce and would be $600 per troy ounce in terms of August 2013 ShadowStats-Alternate-CPI (1980-Base) adjusted dollars (again, all series not seasonally adjusted).

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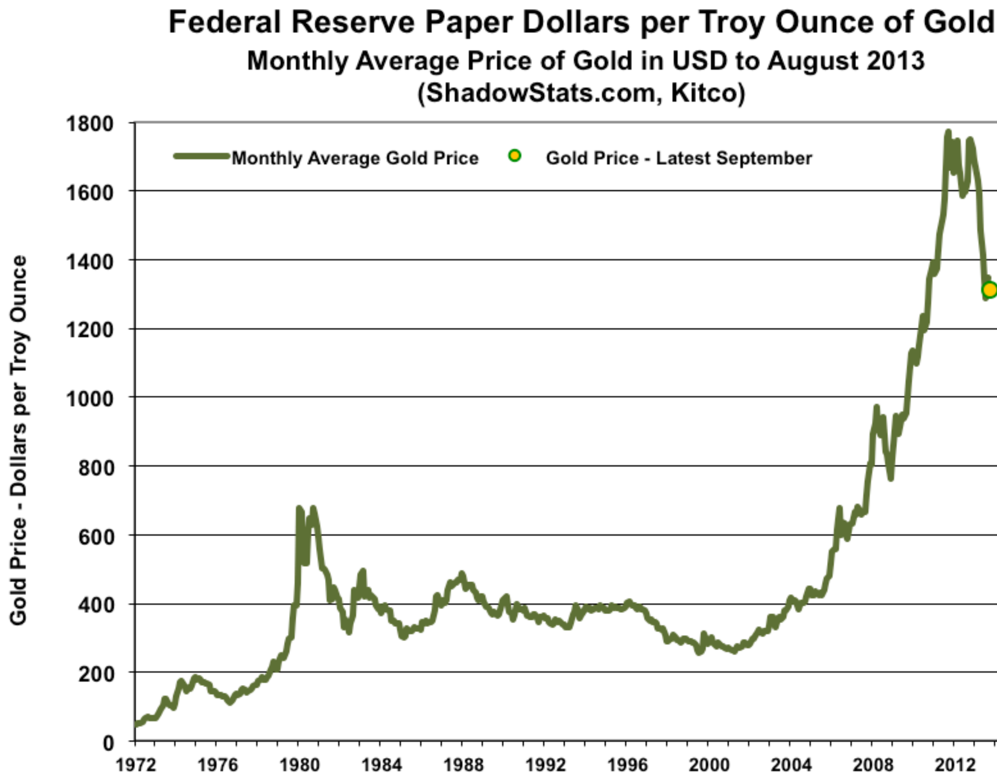
As shown in Table 1 on page 50 of *Hyperinflation 2012*, and as updated in Table III on page 40 of *Special Commentary (No. 485)*, over the decades, the increases in gold and silver prices have compensated for more than the loss of the purchasing power of the U.S. dollar as reflected by CPI inflation, 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) Retail Sales—August 2013. Discussed in *Commentary No. 555*, the headline nominal (not-adjusted-for inflation) gain in August 2013 retail sales largely was accounted for by rising prices. A similar pattern was seen in the initial reporting of nominal sales in July, but the upside revision in headline nominal July growth to 0.43%, from 0.20%, pushed the real growth rate up from its initial zero reading. Based on today's (September 17th) reporting of the August 2013 CPI-U, real retail sales showed a monthly gain of 0.12% in August, versus the upwardly revised 0.27% of July.

Separately as highlighted recently in *Commentary No. 552*, *Commentary No. 553*, *Commentary No. 555*, and as suggested by the real earnings shown the next section, sustainable growth in retail sales and personal consumption is not possible without parallel growth in consumer income and liquidity. Inflation-adjusted median household income is not growing, and without the availability of normal debt

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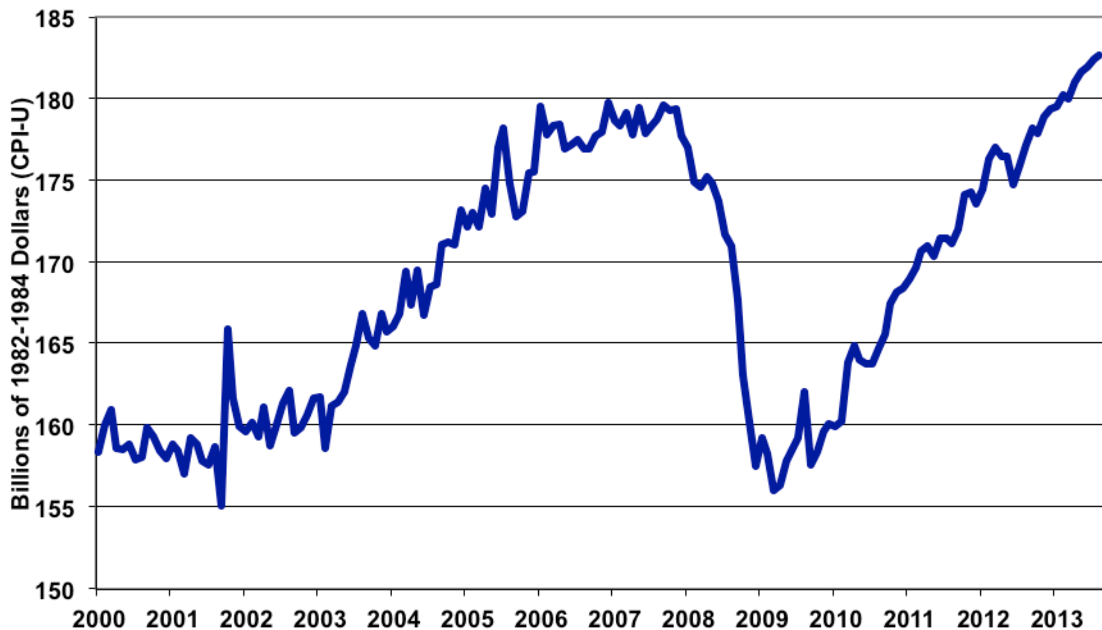
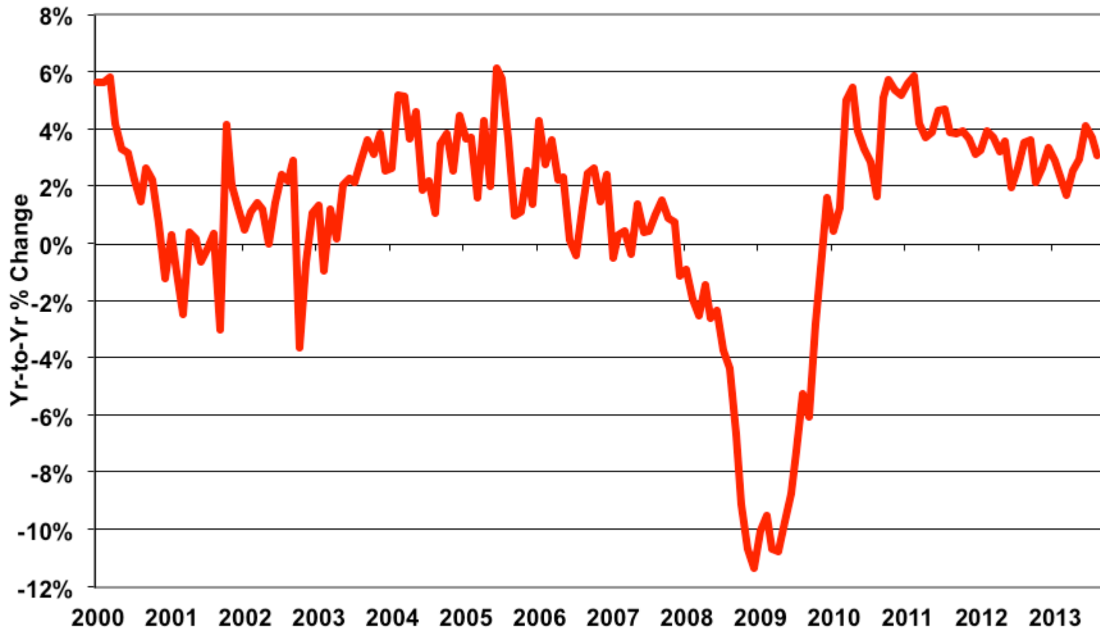
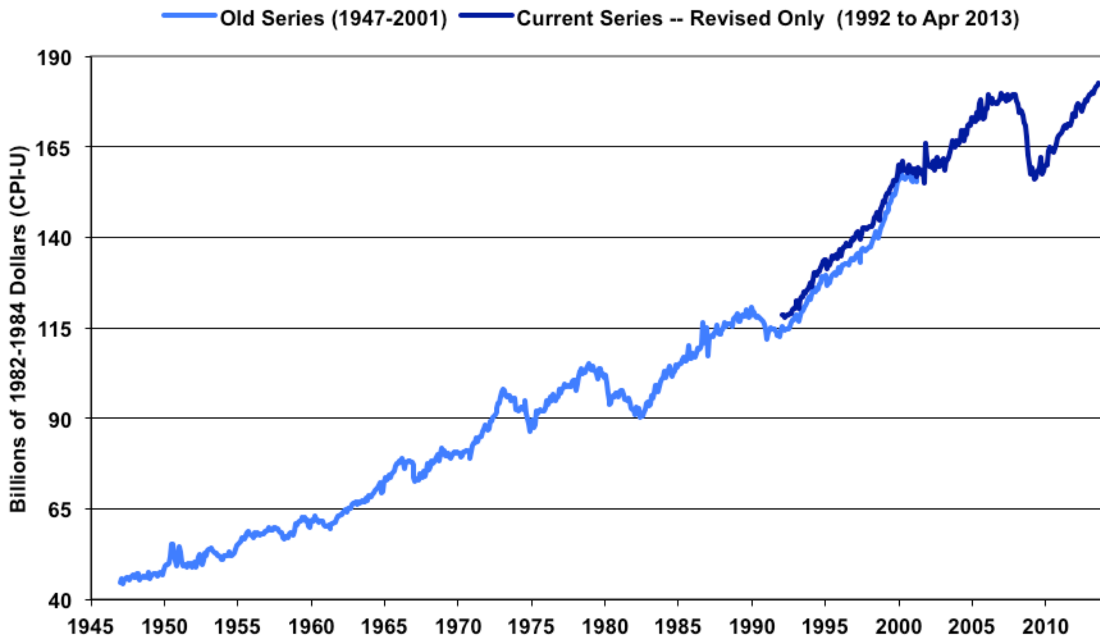
expansion and with an ongoing lack of willingness for the consumer to spend or to take on new debt, there is no economic recovery in place or pending.

Year-to-year, August 2013 real retail sales rose at an annual pace of 3.10%, versus a revised 3.70% (previously 3.38%) in July, 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.

Retail Sales "Recovery" Does Not Confirm Broad Economic Rebound. The first of the three following 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 August 2013 reporting, the nascent expansion of headline real retail sales above pre-recession levels, which began in February 2013, has continued a topping out pattern. Monthly real changes have been flat, with initial reporting. Yet, with subsequent upside revisions to the prior monthly numbers, the pattern has become one of a tapering pace of upside growth.







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As revised in the July 31st comprehensive revision of the gross domestic product, the GDP expanded beyond pre-recession levels, ten 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.

Again, 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 resumes 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.

Real (Inflation-Adjusted) Average Weekly Earnings—August 2013. Coincident with the August 2013 CPI release, the BLS published real average weekly earnings for August 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) rose by 0.1% in August, following a revised July decline of 0.4% (previously 0.5%).

Unadjusted and year-to-year, August real earnings rose by 0.7%, following a revised annual decline in July of 1.6% (previously 1.7%). 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.

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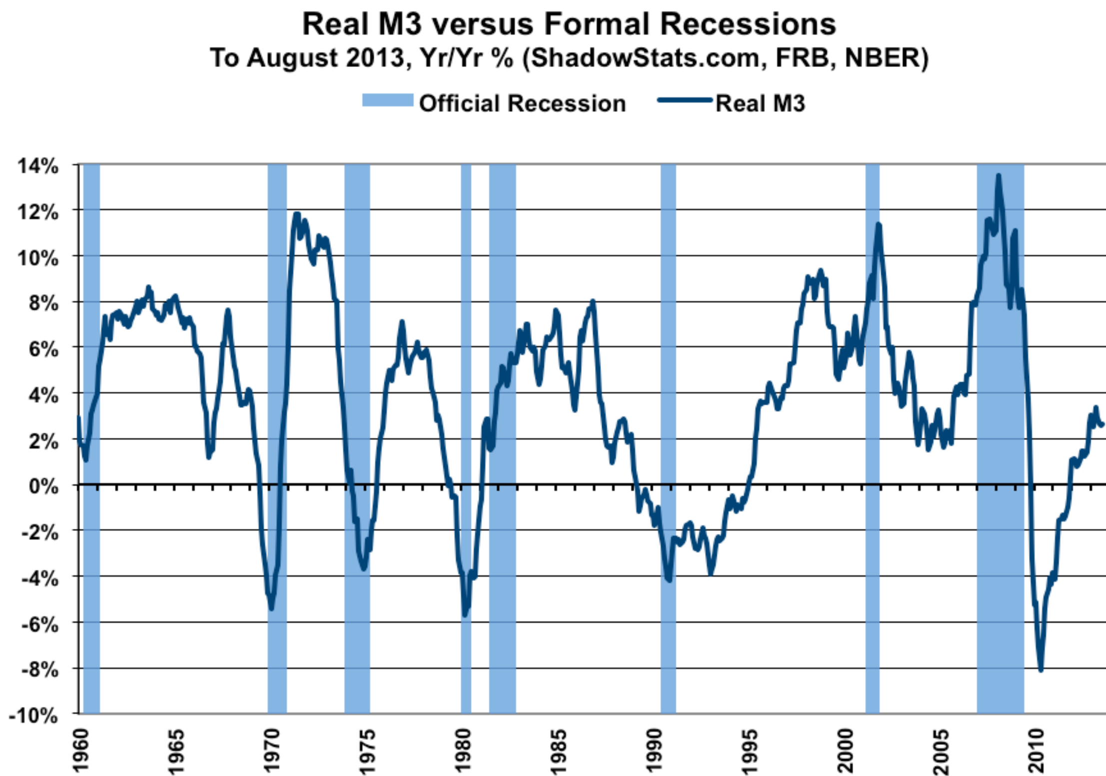
Real Money Supply M3 (August 2013). The signal for a double-dip or ongoing recession, based on annual contraction in the real (inflation-adjusted) broad money supply (M3), discussed in *Hyperinflation 2012*, remains in place and continues, despite real annual M3 growth having turned to the upside. As shown in the accompanying graph—based on August 2013 CPI-U reporting and the latest ShadowStats-Ongoing M3 Estimate—annual inflation-adjusted growth in M3 for August 2013 held at 2.6% for a third month. The August annual growth reflected roughly equivalent, offsetting declines in nominal annual M3 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.

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Continue to Be Likely in the Month and Months Ahead. *[Other than for minor wording adjustments (underlined) to the comment on the pending release, this* Week Ahead *section is unchanged from the prior* Commentary.*]* Although there appears to have been some downside adjustment to consensus expectations on the economy, the markets still are overly optimistic. That circumstance and underlying fundamentals that are suggestive of deteriorating business activity, mean that weaker-than-consensus economic reporting should remain the ongoing trend.

Separately, given that energy-inflation-related seasonal-adjustment factors are on the plus-side for a couple of months, combined with stable or higher oil and gasoline prices—exacerbated at the moment by political tensions in the Middle East—stronger-than-expected headline CPI and PPI also are likely for at least the next month or two.

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 continue to soften, still-weaker-than-expected economic results remain likely, given the intensifying structural liquidity constraints on the consumer, as discussed in the *Opening Comments*.

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.

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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 (August 2013). Tomorrow, Wednesday, September 18th, the Census Bureau will publish its estimate of August 2013 housing starts activity. Despite near-perpetual 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.

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.

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