

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

**COMMENTARY NUMBER 600**  
**January Industrial Production**

**February 14, 2014**

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**Downside Restatement of Recent Economic Activity Continues**  
**January Production Drop Was More than Bad-Weather Effects**  
**First-Quarter 2014 GDP Contraction and Downside Revision to**  
**Third-Quarter GDP Growth Increasingly Are Likely**

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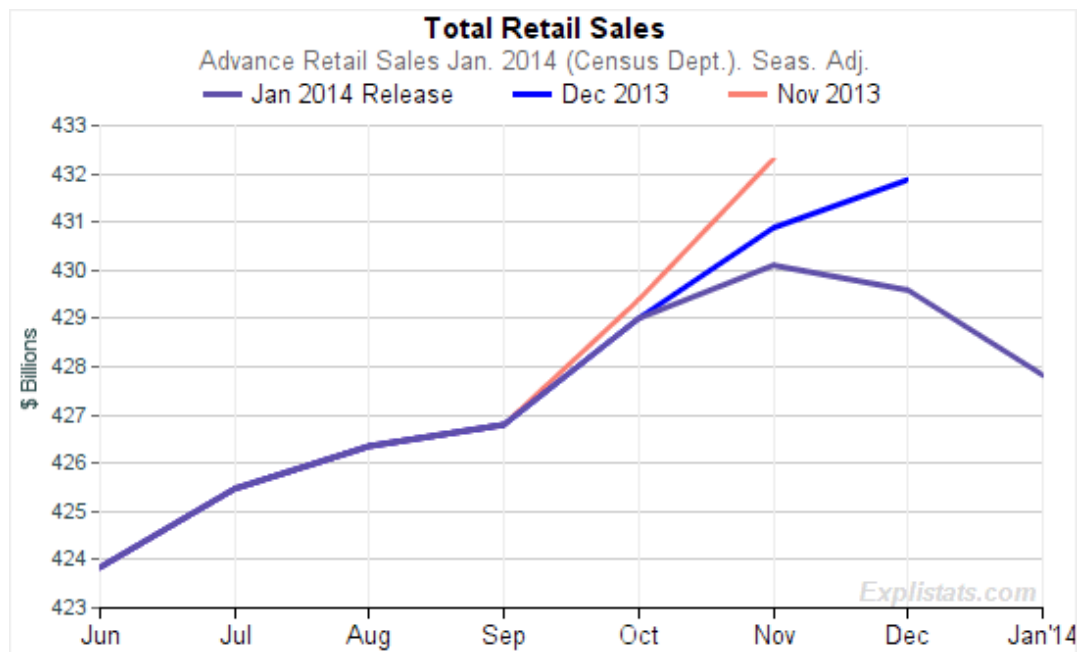
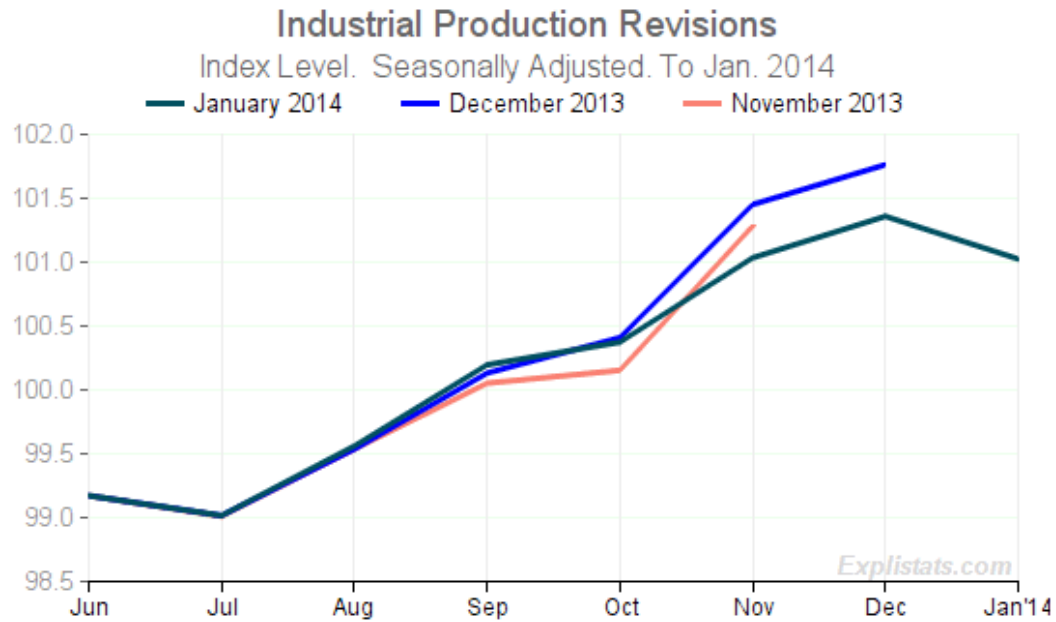
*PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, February 19th, covering the January producer price index (PPI, new series) and housing starts, followed by one on the 20th, covering the January consumer price index (CPI) and real retail sales and earnings.*

*Best wishes to all — John Williams*

**OPENING COMMENTS AND EXECUTIVE SUMMARY**

**Economic Activity Continues to Take a Hit.** Relatively bloated economic activity was reported in third- and fourth-quarter 2013 GDP, partially as an aftershock from government-shutdown distortions of economic data-gathering and reporting activities. With underlying fundamentals—such as impaired consumer liquidity (see [Commentary No. 599](#))—pummeling basic consumption, and with catch-up downside reporting from recent overstatement of activity in key areas, current headline reporting has been showing monthly contractions, in the context of downside revisions to previously-reported activity.

## Is There A Pattern Developing Here?



The preceding two graphs show the last three months of reporting—through January 2014—for the headline level of the index of industrial production and for the headline level of nominal (not adjusted for inflation) retail sales (the retail sales plot also was seen in yesterday's [Commentary No. 599](#)). These

graphs are courtesy of ShadowStats affiliate [www.ExpliStats.com](http://www.ExpliStats.com), where ShadowStats subscribers may view the official reporting detail of these series, and their various subcomponents, in any number of ways, such as in terms of level and growth.

Both the production and retail sales series showed significant downside revisions to prior reporting in fourth-quarter 2013, and large monthly contractions in January 2014, which were not expected by the markets. In combination with the most recent trade data, the latest economic reporting indicates a likely downside revision in the estimated headline growth for fourth-quarter 2013 (3.2% at present, see [Commentary No. 596](#)), in the upcoming February 28th “first revision” to that series.

Along with underlying negative fundamentals and weakening labor data, the latest production and retail sales estimates also are consistent with a quarterly contraction in first-quarter 2014 GDP and the formal onset of a new or renewed recession.

This *Commentary* details the January 2014 industrial production reporting. A more-extensive review of January 2014 and other recent economic reporting will be seen in *Commentary No. 602*, scheduled for February 20th.

**Industrial Production for January 2014—Offsetting Weather Effects Were a Net-Neutral Element in the January Production Change.** While the cold weather is getting most of the headline blame for the “unexpected” 0.3% monthly drop in January 2014 industrial production, the aggregate decline in the series likely was due primarily to a fundamental economic factor: inventory-balancing cutbacks in production.

Unseasonably-cold weather was a factor in the 0.8% plunge in the manufacturing component of production and likely had some impact on the 0.9% decline in the mining component, but it also was responsible for nearly all the offsetting 4.1% surge in the utility usage component. Accordingly, the bad weather likely was a net-neutral factor in the monthly change of the aggregate industrial production index.

When inventories rise in an environment of slowing or falling consumption, those inventories tend to become excess, an issue that usually is resolved by production cutbacks. That was a factor seen in the January production decline, particularly in cutbacks to automotive production. Further, those trends were in place before the unseasonable weather hit, and were reflected in the sharp downside revisions to November and December 2013 manufacturing activity and production.

Specifically, headline monthly change in the dominant manufacturing component of production, again, was a monthly contraction of 0.8% in January 2014, versus a downwardly revised 0.3% monthly gain in December. Headline manufacturing growth, however, was revised lower on a monthly basis in each month from October through December. Mining output (including oil and gas) fell by 0.9% in January, following a revised 1.8% (previously 0.8%) gain in December. Unstable utility usage exploded by 4.1% in January, following an unrevised 1.4% contraction in December, due to unseasonable weather patterns, instead of to shifting economic activity.

**Industrial Production—January 2014.** In the context of major downside revisions to previously reported November and December 2013 production activity, headline monthly January 2014 production fell by 0.33%, and it was down by 0.73% for the month, net of prior-period revisions. December was

revised to a gain of 0.32% (previously 0.31%), while November was revised to a gain of 0.66% (previously 1.04%, initially 1.13%).

Year-to-year growth in January 2014 production slowed to 2.91%, from a downwardly-revised 3.27% (previously 3.68%) in December 2013, and versus a downwardly revised 2.98% (previously 3.40%, initially 3.23%) in November. Allowing for series volatility and special factors tied to weather-related utility distortions, annual growth still has slowed to levels usually seen at the onset of recessions and at levels seen leading into the 2008 economic collapse.

The regular graphs of the headline level of industrial production, and year-to-year change in production, are found in the *Reporting Detail* section. The graphs following in this *Opening Comments* section also show the official level of production activity (first graph), as well as the official data, net of inflation distortions, as corrected by ShadowStats (second graph).

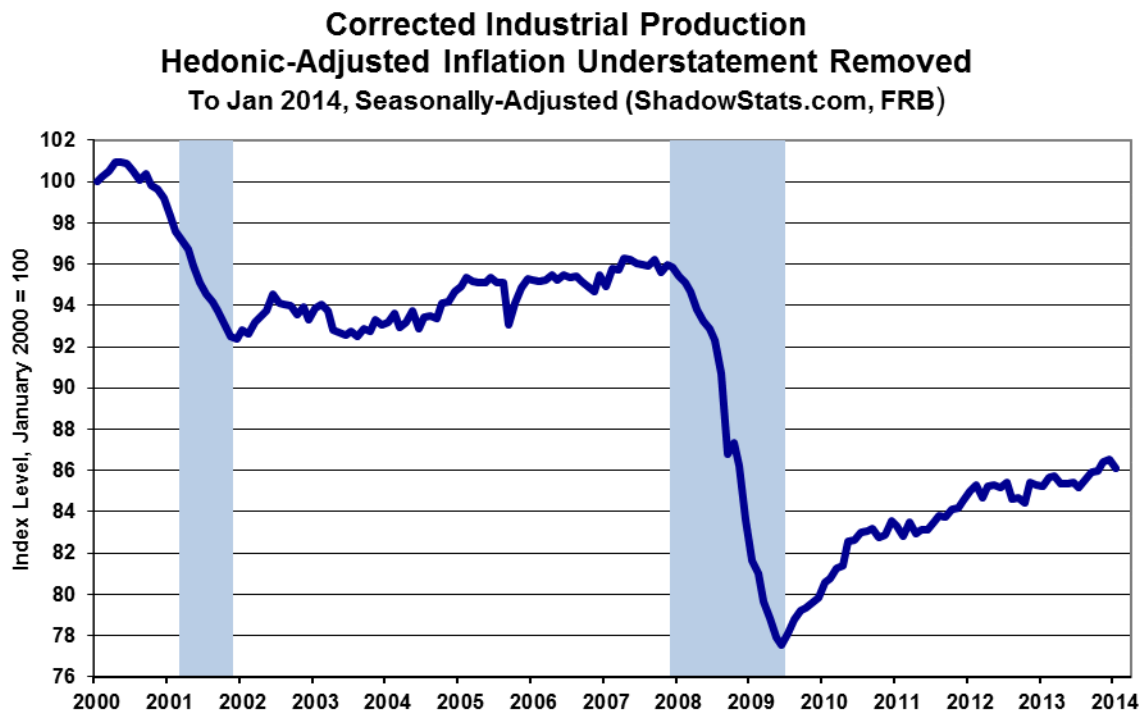
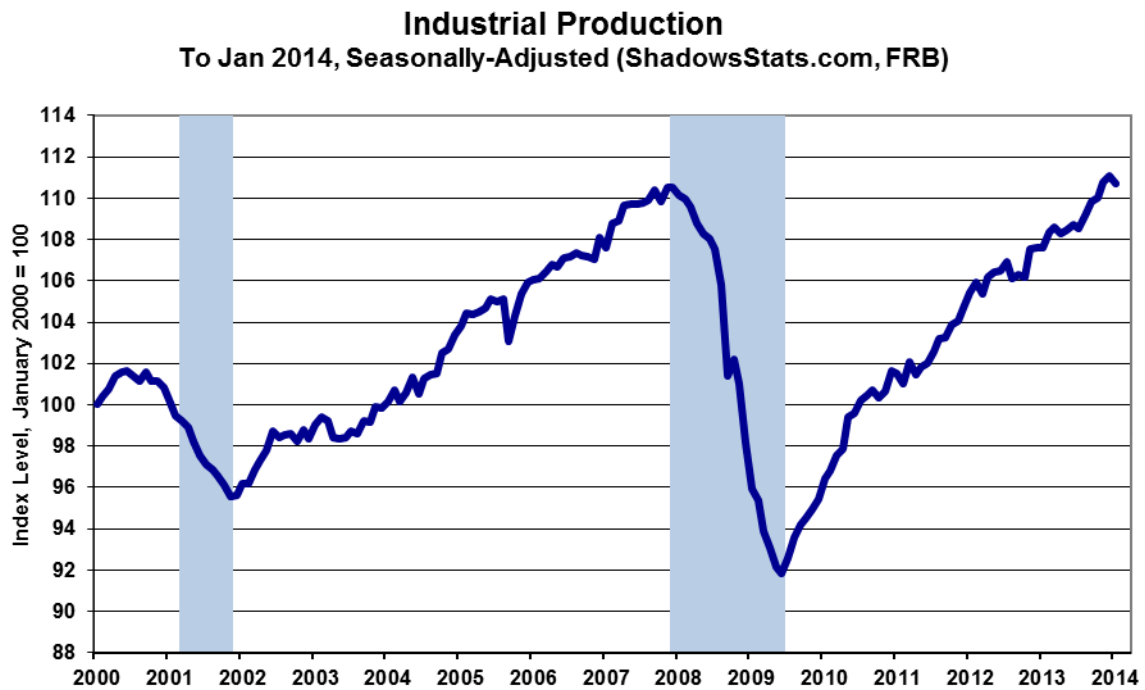
***Production Series Backed Off Recent High, Still Inconsistent With the GDP.*** The headline production series had moved above its pre-recession high, for the first time, in November 2013, with further upside movement in December, but both the November and December levels were revised lower, and January dropped back to November's revised level in the latest reporting. With the headline January 2014 production index level stands at 101.03 (2007 = 100), it remains marginally higher than the December 2007 pre-recession peak of 100.82, but the gain is not of a statistically-significant magnitude.

The “recovery” is not real. The use of understated inflation in deflating certain components compiled in the production index has resulted in overstated headline production growth. As shown in the following “corrected” graph, production remains well shy of an economic recovery.

Additionally, industrial production widely is recognized as a coincident indicator of GDP activity. It is used, for example, by the recession-defining authority—the National Bureau of Economic Research (NBER)—for timing the onsets of recessions. What is unusual here is that the headline GDP purportedly has been fully recovered (again a function of deflation by understated inflation), in economic expansion, since second-quarter 2011. If the GDP data and the production numbers were of consistent good quality, the two series would be moving together, rather than the production numbers lagging GDP reporting by eleven quarters. As discussed frequently, and as covered in [Commentary No. 585](#) and here, there are serious reporting flaws with both series, particularly the GDP.

***Corrected Industrial Production.*** Hedonic quality adjustments to inflation, understate the inflation used in calculating some components of industrial production. That has the effect of overstating the resulting inflation-adjusted growth in the headline industrial production series (see [Special Commentary: No. 485](#), [Public Comment on Inflation](#) and discussion in the forthcoming *Second Installment* to the hyperinflation report).

The two accompanying graphs address that issue. The first reflects official industrial production reporting, indexed to January 2000 = 100, instead of the Fed's formal index that is set at 2007 = 100. The 2000 indexing is used simply to provide for some consistency in this series of revamped graphics; it does not affect the appearance of the graph or reported growth rates. The second graph is a version of the first that has been corrected for the understatement of the inflation rate used in deflating the production index, with estimated hedonic-inflation adjustments backed-out of the official industrial-production 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; corrected production levels have not recovered pre-recession highs. Instead, corrected production entered a period of protracted low-level stagnation in 2012, with quarterly contractions in third-quarter 2012, second-quarter 2013, with stagnation in third-quarter 2013, and minimal upturn in the fourth-quarter 2013 (second graph).

*[For greater detail on January 2014 industrial production, see the **Reporting Detail** section.]*

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## HYPERINFLATION WATCH

**Hyperinflation Outlook.** With the *First Installment* of [Hyperinflation 2014—The End Game Begins](#) published on January 7th, a new *Hyperinflation Summary* for this section will be added in conjunction with the publication of the *Second Installment*. The second and final installment will cover historical and prospective economic activity, as well as possible protective and preventative actions and reactions at both a personal and federal level, versus the unfolding circumstance. It should be published almost immediately following the much-delayed publication of the 2013 GAAP-based financial statements of the United States government, which currently are due for release on February 26th. The new material in the *Second Installment* will supplement and update the basic material already available to ShadowStats readers in Chapters 4, 5 and 9 of [Hyperinflation 2012](#).

## REPORTING DETAIL

### INDEX OF INDUSTRIAL PRODUCTION (January 2014)

**Weather Impact Was a Net-Neutral Element in January's Production Drop.** While the popular press blames the “unexpected” 0.3% monthly drop in January 2014 industrial production on the unusually cold weather, the headline decline in the series generally was due to inventory-balancing cutbacks in production. Indeed, unseasonably-cold weather was a factor in the 0.8% plunge in the manufacturing component of production, and it likely had some impact on the 0.9% decline in the mining component, but it also was responsible for almost all the of the offsetting 4.1% surge in the utility component of the production series. Accordingly, the bad weather likely was a net-neutral factor in the monthly change of the aggregate industrial-production index.

With inventories rising in an environment of slowing or declining consumption, the buildup in inventories tends to become excessive, an issue that usually is resolved with production cutbacks. Indeed, that was seen in the January production decline, particularly in cutbacks to automotive production. Further, those trends were in place before the unseasonable weather hit, as seen in sharp downside revisions to November and December 2013 manufacturing activity and production.

The headline 0.8% monthly decline in the dominant manufacturing component of January production followed a downwardly revised 0.3% (previously 0.4%) monthly gain in December. Headline manufacturing growth also was revised lower on a monthly basis in each month from October through December. Mining output (including oil and gas) fell by 0.9% in January, following a revised 1.8% (previously 0.8%) gain in December. Unstable utility usage exploded by 4.1% in January, following an unrevised 1.4% contraction in December, again, due to unseasonable weather patterns, instead of to shifting economic activity.

**Production Series Backed Off Recent High, Still Inconsistent With the GDP.** The headline production series had moved above its pre-recession high, for the first time, in November 2013, with further upside movement in December, but both the November and December levels were revised lower and January dropped back to November's revised level in the latest reporting. With the headline January 2014 production index level at 101.03 (Index = 100 in 2007), it remains marginally higher than the December 2007 pre-recession peak of 100.82, but that gain is not of statistical significance.

This “recovery” is not real, as discussed in *Corrected Industrial Production* in the *Opening Comments* section. The use of understated inflation in deflating certain components compiled in the production index has resulted in overstated headline production growth. As shown in the “corrected” graph there, production remains well shy of an economic recovery.

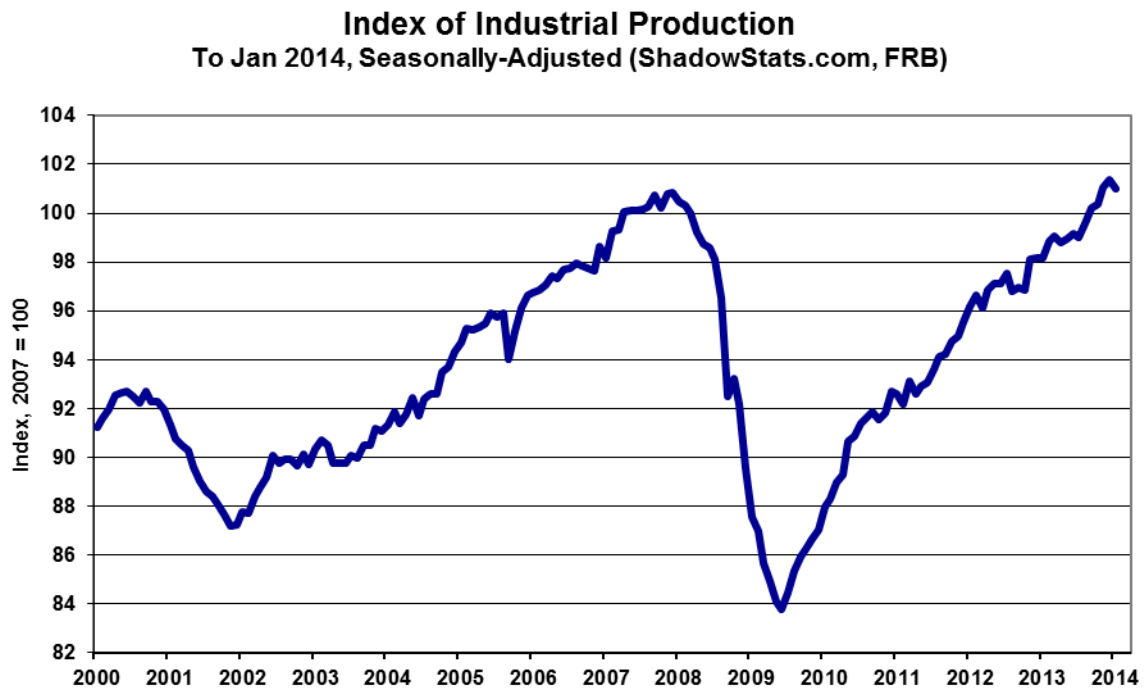
Additionally, industrial production widely is recognized as a coincident indicator of GDP activity. It is used, for example, by the recession-defining authority—the National Bureau of Economic Research (NBER)—for timing the onsets of recessions. What is unusual here is that the headline GDP purportedly

has been fully recovered, in economic expansion, since second-quarter 2011. If the GDP data and the production numbers were of consistent good quality, the two series would be moving together, rather than the production numbers lagging GDP reporting by eleven quarters. As discussed frequently, and as covered in [Commentary No. 585](#) and here, there are serious reporting flaws with both series, particularly the GDP (also with understated-inflation issues).

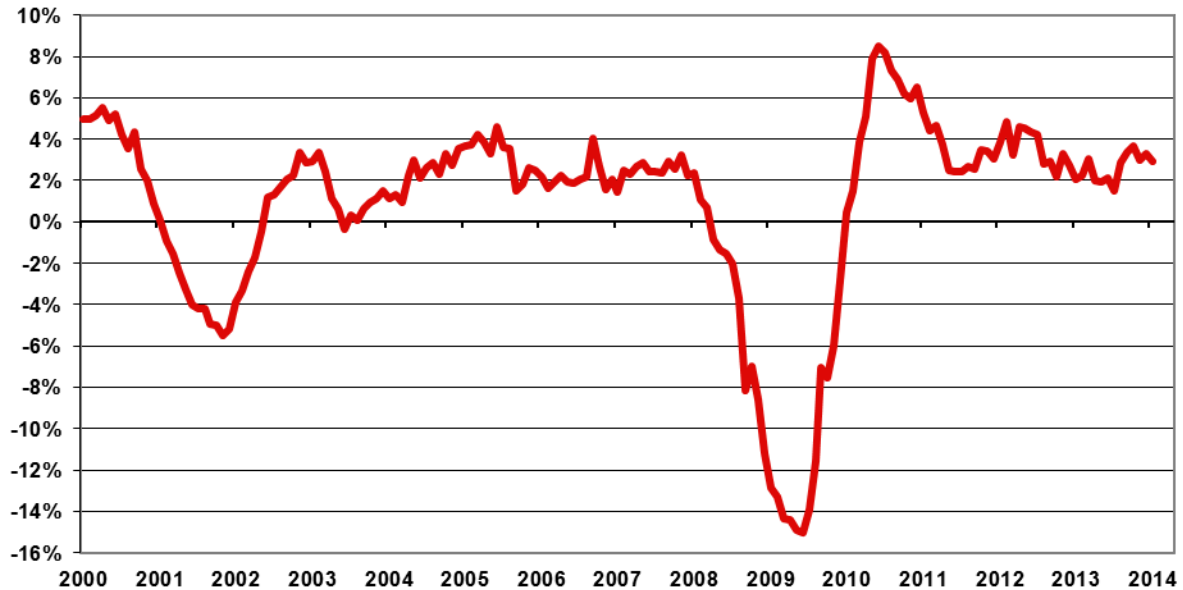
**Industrial Production—January 2014.** The Federal Reserve Board released its estimate of seasonally-adjusted, January 2014 industrial production this morning, February 14th. In the context of major downside revisions to previously reported November and December 2013 production activity, headline monthly January production fell by 0.3% (down by 0.33% at the second decimal point) and was down by 0.73% for the month, net of prior-period revisions. December was revised to a gain of 0.32% (previously 0.31%), while November was revised to a gain of 0.66% (previously 1.04%, initially 1.13%).

Year-to-year growth in January 2014 production slowed to 2.91%, from a downwardly-revised 3.27% (previously 3.68%) in December 2013, and versus a downwardly revised 2.98% (previously 3.40%, initially 3.23%) in November. Allowing for series volatility and special factors tied to weather-related utility spikes, annual growth still has slowed to levels usually seen at the onset of recessions and at levels seen leading into the 2008 economic collapse.

**Production Graphs.** 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.



**Industrial Production Year-to-Year % Change**  
 To Jan 2014, Seasonally-Adjusted (ShadowStats.com, BLS)

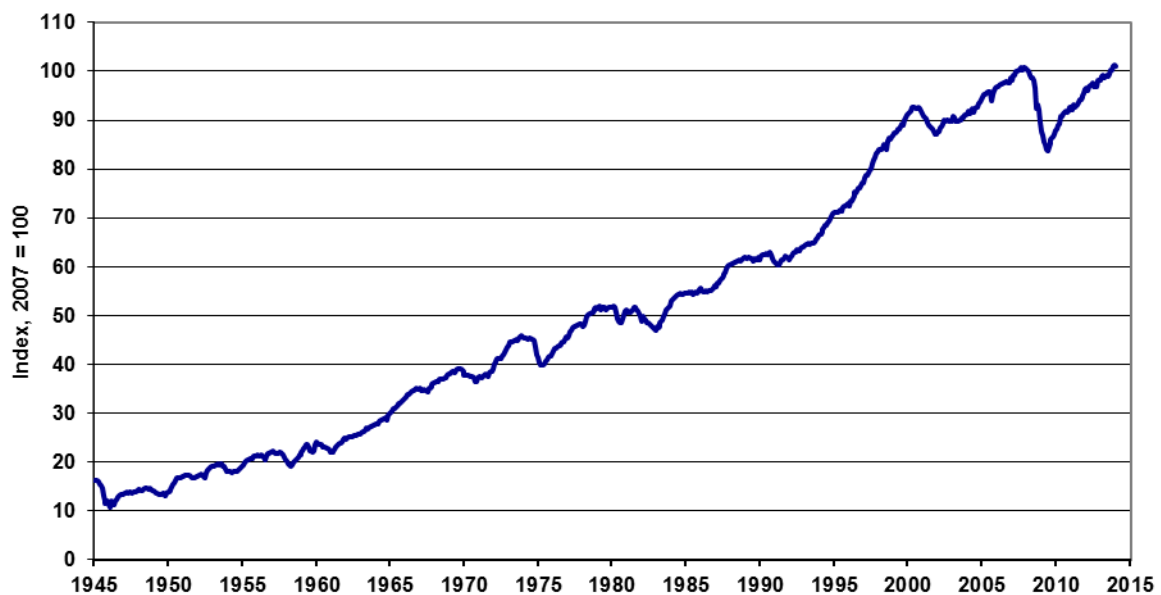


The second set of graphs shows the same data in historical context since World War II.

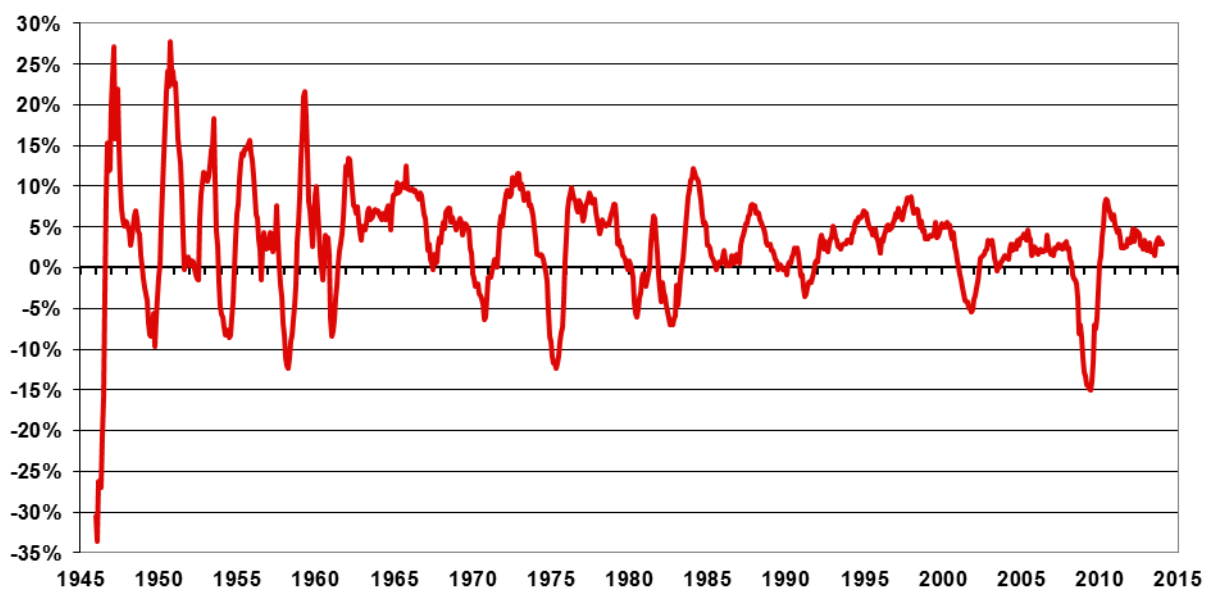
As shown more clearly in the first set of graphs, current year-to-year activity recently dipped lower, with annual growth close to levels last seen in a slowing-growth pattern in the first two quarters of the formal 2007 recession. The higher annual growth initially seen in the last several months have fallen back in revision and should revert back to the earlier patterns as excess inventories are worked off. 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.

Official production levels have moved higher since the June 2009 trough, and the headline series is at its pre-recession high as of January 2014 reporting. Corrected for the understatement of inflation used in deflating portions of the industrial production index, however, the series has shown more of a pattern of stagnation with a slow upside trend, since 2009, topping out into 2012, with a renewed slight upturn into a recent, protracted period of inventory build-up, and now downturn with inventory liquidation. The corrected production series is discussed and graphed in the *Opening Comments*.

**Index of Industrial Production**  
To Jan 2014, Seasonally-Adjusted (ShadowStats.com, FRB)



**Industrial Production Year-to-Year % Change**  
To Jan 2014, Seasonally-Adjusted (ShadowStats.com, BLS)



## WEEK AHEAD

### **Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead.**

Although shifting to the downside, market expectations generally still appear to be overly optimistic as to the economic outlook, based on data that likely were puffed-up in the process of going through the data-gathering and reporting distortions of the October shutdown to the federal government. Expectations should continue to soften, though, with an increasing number of corrective revisions and disappointing headline economic activity. The initial stages of that process have been seen in the recent reporting of December and January payroll, retail sales and industrial production data, and in the December trade balance detail.

That corrective circumstance and underlying weak economic fundamentals remain highly suggestive of deteriorating business activity. Accordingly, weaker-than-consensus economic reporting should become the general trend until such time as an unfolding “new” recession receives general recognition.

Stronger inflation reporting remains likely. Upside pressure on oil-related prices should reflect intensifying impact from a weakening U.S. dollar in the currency markets, and from ongoing political instabilities in the Middle East. The dollar faces pummeling from continuing QE3, the ongoing U.S. fiscal-crisis debacle, a weakening U.S. economy and deteriorating U.S. political conditions (see [Hyperinflation 2014—The End Game Begins](#)). Particularly in tandem with a weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected inflation.

***A Note on Reporting-Quality Issues and Systemic Reporting Biases.*** Significant reporting-quality problems remain with most major economic series. Ongoing headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-evolving economic turmoil of the last seven-to-eight 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.

### ***PENDING RELEASES:***

**Residential Construction—Housing Starts (January 2014).** On Wednesday, February 19th, the Census Bureau will publish its estimate of January 2014 housing starts. This series was distorted heavily to the upside by data-gathering and reporting issues that resulted from the government shutdown in October, and it is due for significant catch-up in negative reporting or downside revisions.

Despite near-perpetual market expectations for strengthening activity in housing starts, market expectations appear to be to the downside for January. Reported month-to-month change likely will resume its regular pattern of statistical-insignificance, soon, with ongoing stagnation and renewed downturn 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 five-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.

**Producer Price Index—PPI (January 2014).** The fully-revamped January 2014 PPI is scheduled for introduction and release, in its overhauled and redefined incarnation, on Wednesday, February 19th, by the Bureau of Labor Statistics (BLS). The new series was discussed and compared and plotted versus the old series in [Commentary No. 591](#). The new series is less heavily weighted with energy prices, so with oil prices lower and gasoline prices up in the month, and with seasonal factors on the plus-side for energy, it would be reasonable to expect a small headline increase in PPI. The new monthly numbers, however, likely will be more volatile than before and thus will tend to offer up more-frequent surprises.

That said, depending on the oil contract followed, not-seasonally-adjusted monthly-average oil prices, fell by 2.4%-to-3.1% for the month of January, along with a 1.0% increase in average retail gasoline prices. The PPI seasonal adjustments are mildly positive for January final-demand energy prices.

**Consumer Price Index—CPI (January 2014).** The release by the Bureau of Labor Statistics (BLS) of the January 2014 CPI is scheduled for Thursday, February 20th. The headline CPI-U is a fair bet to be close to unchanged for the month.

Average gasoline prices rose month-to-month in January 2014 by 1.0%, on a not-seasonally-adjusted basis, per the Department of Energy. The BLS seasonal adjustments will depress gasoline prices in the headline January CPI. As last revised, an unadjusted 0.3% monthly decline in January 2013 gasoline prices was enlarged to a 3.0% monthly contraction, with negative seasonal adjustments. Similar effects in the January 2014 number, by themselves, would subtract about 0.1% from the headline CPI-U number. Upside food prices and core inflation, however, should leave the headline CPI-U around unchanged for the month.

Year-to-year, CPI-U inflation would increase or decrease in January 2014 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted and negligible 0.03% increase in the monthly inflation reported for January 2013. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for January 2014, the difference in January's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the December 2013 annual inflation rate of 1.50%. For example, if the January headline CPI-U were unchanged month-to-month, year-to-year change would hold at about 1.5%.