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

COMMENTARY NUMBER 613
Industrial Production Benchmark Revision

March 28, 2014

Incomplete and Inadequate, Minimal Revisions to Industrial Production Left Negative Economic Outlook Intact

Aggregate Net Upside Revision of 0.3% to Series Was in Context of Some Activity Being Shifted from Early-2012 into Late-2012, 2013

Usual New Information for 2012 Was "Unavailable"

PLEASE NOTE: The next regular Commentary *is scheduled for Thursday, April 3rd, covering February construction spending and the trade deficit, followed by one on April 4th, covering March employment and unemployment. On Tuesday, April 1st, the* Hyperinflation 2014 *report will be published, both the* Second Installment *covering the economy and potential protective/preventative actions, and a revised* First Installment, *which will include the United States Government's 2013 GAAP-accounting, as well as an update on systemic developments since the January 7th publication of the original* First Installment.

Today's brief Commentary *covers just the annual revisions to the industrial production series.*

Best wishes to all — John Williams

INDUSTRIAL PRODUCTION BENCHMARK REVISION

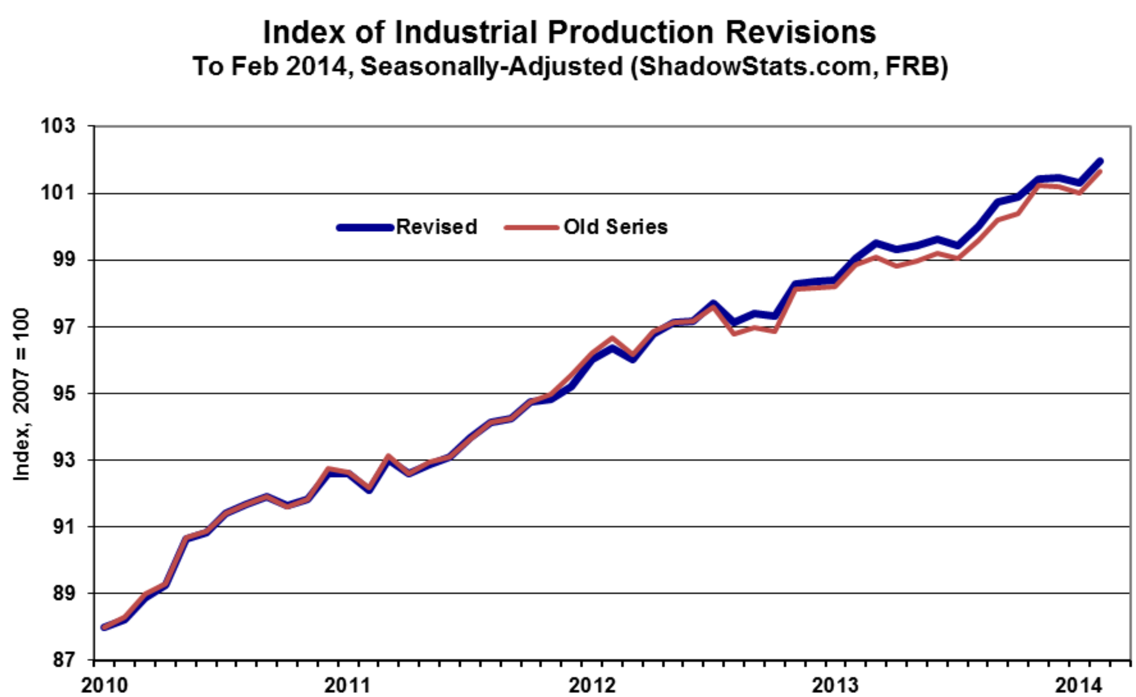
An Incomplete and Inadequate Revision. The Federal Reserve Board (FRB) released its annual benchmark revision to industrial production, today (March 28th), noting in its report that "the annual revision for 2014 was more limited than in recent years." The problem was that "… much of the new data that are typically incorporated in the annual benchmarks for IP were unavailable for this revision. In particular, … the U.S. Census Bureau had not issued detailed results of the 2012 Census of Manufactures."

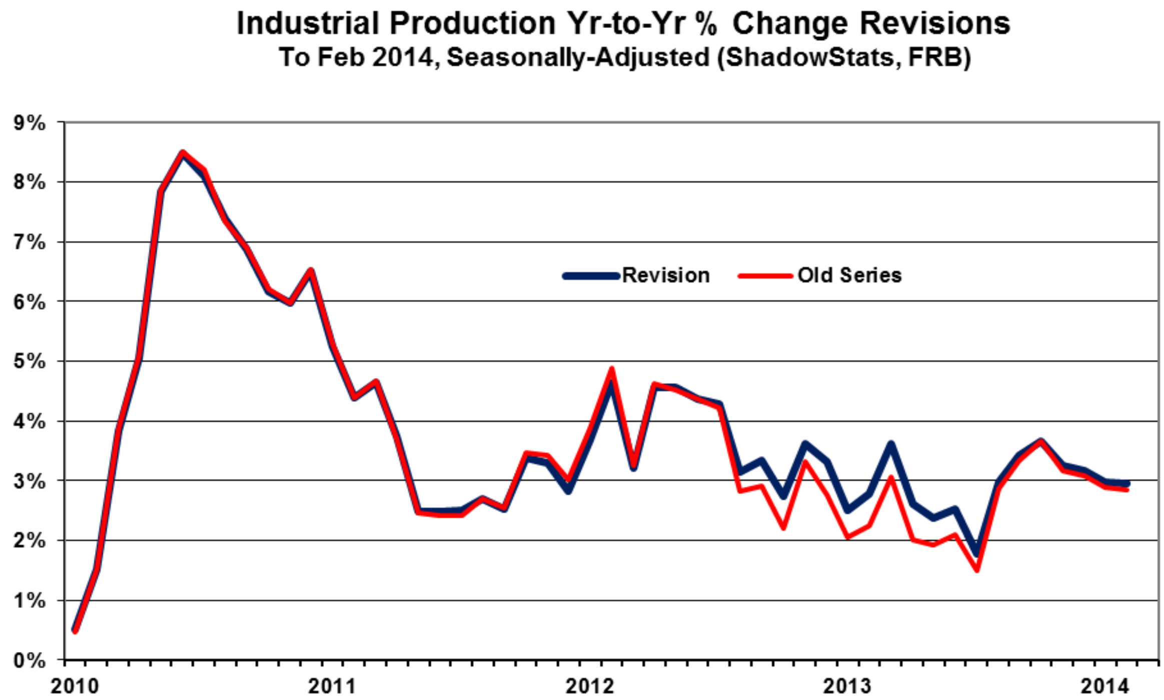
That new detail usually results in downside revisions, as more-realistic hard data are tallied against what usually were overstated and overly-optimistic initial headline estimates. Nonetheless, the current revisions were minimal, with a net upside revision of 0.3% to the level of February 2014 production. That is not outside the scope of regular monthly revisions. The effect here will be to push-off likely negative revisions to recent history (2012) of industrial production and the GDP, until after the mid-term election in November.

The general analysis of February 2014 industrial production published in *Commentary No. 606* would not be altered at all in the context of today's revisions.

Following are three sets of graphs.

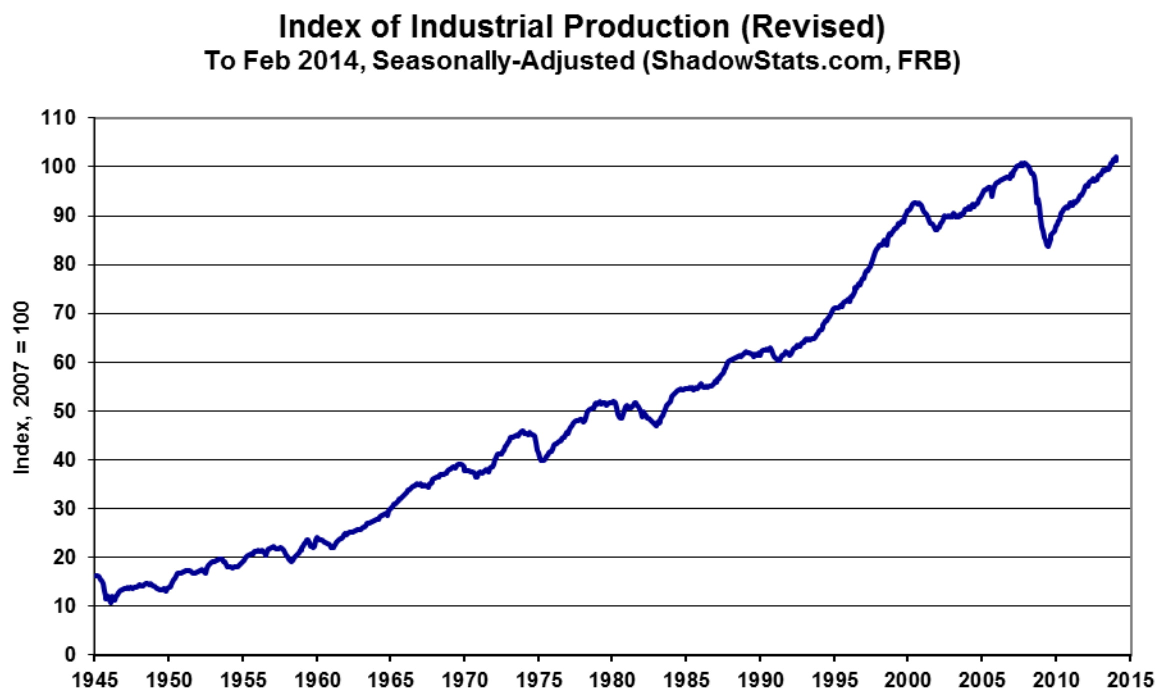
The first two graphs show near-term detail, where the small revisions are visible in the data plots, generally since 2010, although the revisions went back to 1972. The blue line consistently plots the revised numbers, while the red line plots the previous reporting. Both the first graph of index level, and the second graph of year-to-year change, reflect some shifting of activity from late-2011 and early-2012, to late-2012 and 2013, with the differences in level and annual growth largely disappearing by the early-2014 reporting.

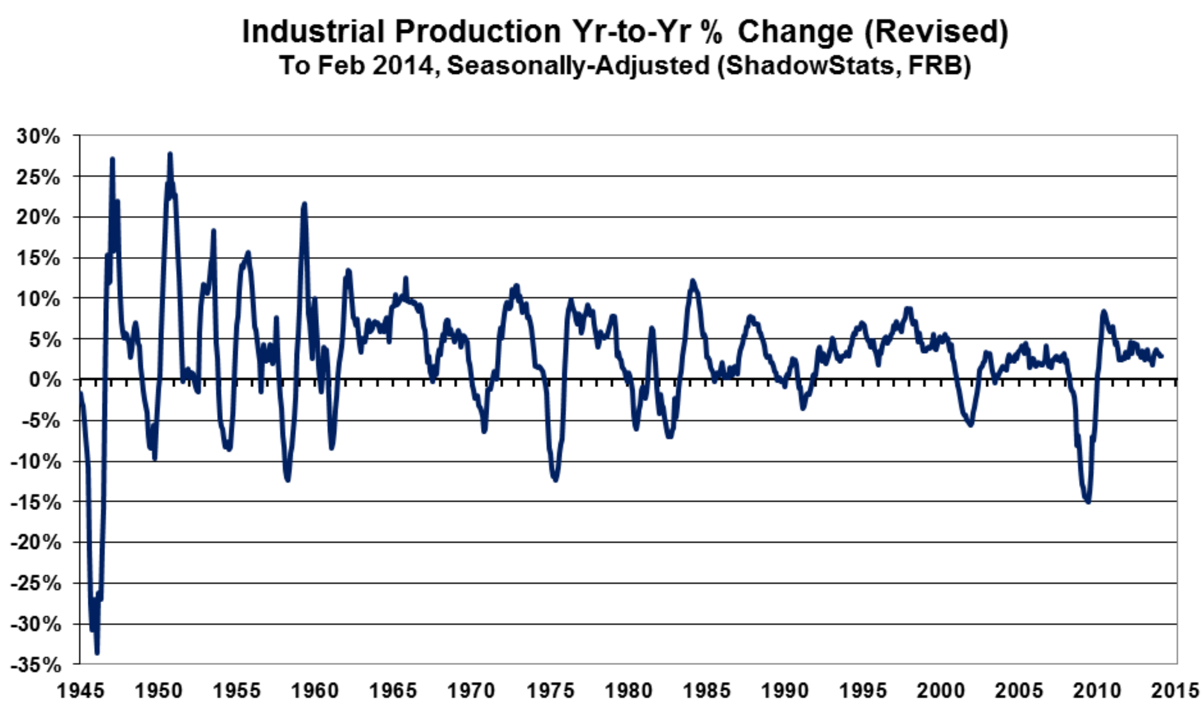




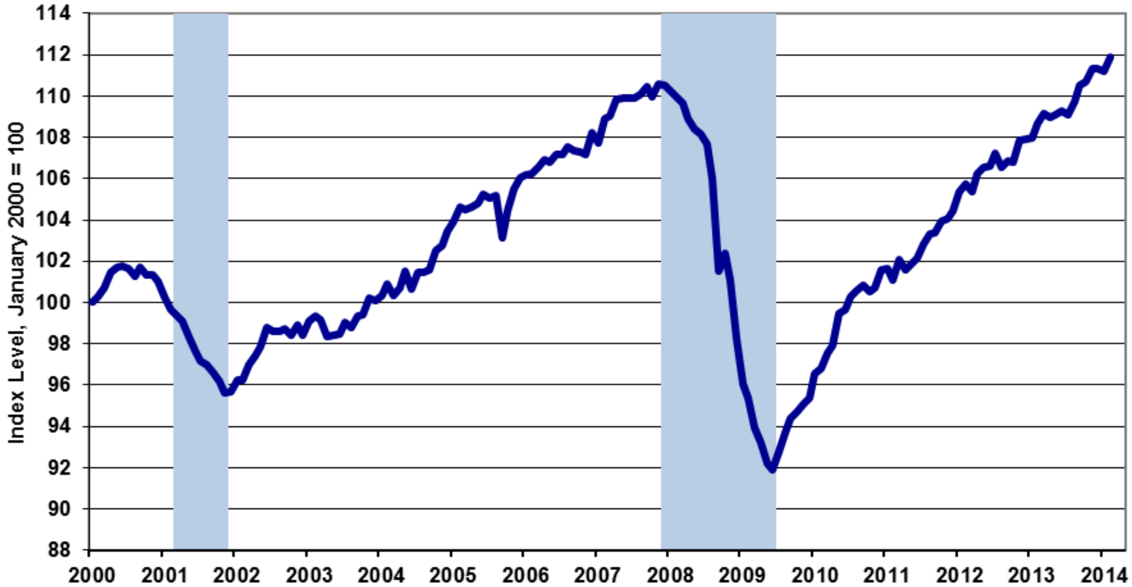
The second and third sets of graphs show only plots of the revised data, since the differences in the comparative revised-versus-prior lines would not be seen easily. The second set shows longer-term historical graphs, covering the post-World War II period to date for both the FRB production index level (2007 = 100) and year-to-year change.

The final set of graphs plots the indexed level (January 2000 = 100) of production since 2000, reflecting the patterns of the index levels of latest data, consistent with official reporting, as well as "corrected" for the understatement of inflation in calculating the index of industrial production. A series, such as industrial production, which is deflated—at least partially—by too-low an inflation estimate, ends up reflecting overstated, inflation-adjusted growth. These issues are more fully discussed in *Commentary No. 606* and the *Public Comment on Inflation*.

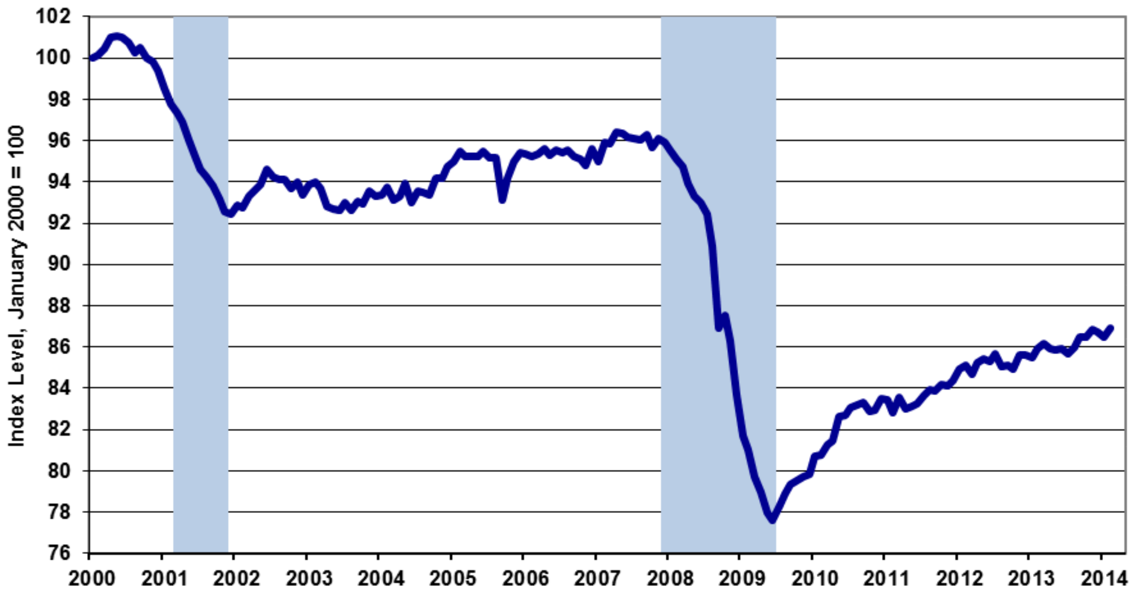

Index of Industrial Production (Revised)
To Feb 2014, Seasonally-Adjusted (ShadowStats.com, FRB)
Index, 2007 = 100
110
100
90
80
70
60
50
40
30
20
10
0
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015


Industrial Production Yr-to-Yr % Change (Revised)
To Feb 2014, Seasonally-Adjusted (ShadowStats, FRB)
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
2015

Industrial Production (Revised)
To Feb 2014, Seasonally-Adjusted (ShadowsStats.com, FRB)



Corrected Industrial Production (Revised)
Hedonic-Adjusted Inflation Understatement Removed
To Feb 2014, Seasonally-Adjusted (ShadowStats.com, FRB)



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WEEK AHEAD

Much 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. Expectations should continue to be hammered, though, by continuing, downside corrective revisions and continued, disappointing headline economic activity. The initial stages of that process have been seen in the recent headline reporting of most major economic series.

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 the 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 global political instabilities. The dollar faces pummeling from continuing QE3, the ongoing U.S. fiscal-crisis debacle, a weakening U.S. economy and deteriorating U.S. and global 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 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:

Construction Spending (February 2014). The Commerce Department is scheduled to release its estimate of February 2014 construction spending on Tuesday, April 1st. The headline monthly changes, as usual, should not be statistically significant, while previous data could be subject to unusually large and unstable revisions.

U.S. Trade Deficit (February 2014). The Commerce Department and Bureau of Economic Analysis (BEA) will release the February 2014 trade-balance data on Thursday, April 3rd. By itself, January's headline deficit was worse enough against fourth-quarter 2013 reporting that a similar February reading would mean a negative contribution to first-quarter GDP growth from the first-quarter estimate of the net export account. The February estimate will be the last trade-deficit accounting before the "advance" estimate of first-quarter GDP on April 30th.

Accordingly, a flat-to-widening headline deficit result in February trade reporting should impair upcoming headline GDP growth by one-percentage point or more. Market expectations appear to be for minimal change in the headline February versus January trade deficit. Any significant narrowing of the February trade deficit would reduce the negative impact on the GDP.

Employment/Unemployment (March 2014). The Bureau of Labor Statistics (BLS) will release its March 2014 labor data on Friday, April 4th. Following February's stronger-than-consensus 175,000 gain in payroll employment, a downside surprise to expectations is a fair bet. The BLS trend model suggests a 178,000 jobs gain for March. While the consensus tends to close in around the trend, early expectations seem to be running about 20,000 above that. Underlying economic reality would suggest a downside surprise versus both the trend and market expectations.

Expectations also appear to be for the headline March U.3 unemployment rate to ease a notch from February's 6.7% reading. Underlying fundamentals would suggest an upturn in U.3, but the BLS's continuing purge of discouraged workers from the unemployment rolls would argue in favor of a lower rate. As discussed regularly in the employment/unemployment-related *Commentaries*, month-to-month comparisons of U.3 are of no meaning, because of the standard, inconsistent reporting calculations that leave the monthly data not comparable.

If U.3 drops, there likely would be some further labor-force loss associated with that. The broader U.6 and ShadowStats unemployment measures would tend to hold, or increase anew, at their broader and higher respective levels.

Again, all these numbers remain unsettled and could come in well outside general expectations.

