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

COMMENTARY NUMBER 681
November Industrial Production, Producer Price Index (PPI)

Scheduled for Second-Quarter 2015, Meaningful Benchmark Revisions to Industrial Production Could Be Unusually Large and to the Downside

November Industrial Production Jump Encompassed Utilities Surge, Widespread Manufacturing Gains, and Declining Oil and Gas Production

Utilities Output Spiked by Unseasonably-Cold Weather

Seasonal Adjustments and Revisions Remain Serious Issues

Significance of Headline Wholesale Inflation Is Muddled In Terms of Real-World Activity

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PLEASE NOTE: The next Commentary *is planned for tomorrow, Tuesday, December 16th, covering housing starts, and one on Wednesday, covering the CPI and real retail sales and earnings.*

A Special Commentary *on Friday, December 19th, will review developments of the Year Past and preview likely developments in the Year Ahead.*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

Varying Reporting-Quality Issues Plague Both Industrial Production and PPI Reporting. November industrial production surged, but reporting issues ranging from survey quality, to seasonal adjustment problems, to large and frequent revisions to the monthly data continue to rattle reporting integrity. The industrial production series never had a normal 2014 benchmarking, thanks to lingering effects of the 2013 government shutdown. A normal benchmarking most likely would have pushed historical production growth much lower, producing also a pattern of ongoing weaker growth into the current period. Discussed in the main text, those issues likely will be resolved, at least partially, in second-quarter 2015, per the announcement today by the Fed of its rough timing for the 2015 benchmark.

Questions linger as to the meaningfulness of the new wholesale inflation series, PPI-Final Demand. The concept of the original PPI series worked. It reflected the underlying costs of the wholesale trade, and was based on changes in the cost of goods to those shy of the end consumer in the supply chain. The new series predominantly is service-sector oriented, based on increases and decreases in margins. As has been seen in this new series, margins reflect changes in cost as well as prices received, with the effect of muting sharp swings in areas such as oil prices. For example, weaker oil prices [deflation] also can mean initially rising margins [offsetting inflation] early on in the Final Demand reporting. It is difficult to find meaningful use for the broad, new and revamped data series.

Today's Missive (December 15th). This *Commentary* concentrates on the headline reporting of the November 2014 PPI and industrial production, both in these *Opening Comments* and in the *Reporting Detail* section.

The *Hyperinflation Summary* is unchanged. The *Week Ahead* section previews reporting for the November CPI and housing starts. An updated review of current economic activity will be included in Friday's (December 19th) *Sepecial Commentary*.

Index of Industrial Production—November 2014—Pending, Massive Downside Benchmark Revisions. The Federal Reserve publishes an annual benchmark revision to the industrial production series, each year, correcting historical detail for more complete information as it becomes available. The March 2014 benchmark revision, however, largely was incomplete, lacking detail from the regular Census of Manufactures (2012), which apparently had been delayed in its release by the government shutdown of October 2013. As a result, what should have been massive downside revisions to 2012 and 2013 industrial production activity (and broader GDP activity) never took place (see *Commentary No. 613*).

This should be corrected in second-quarter 2015. Along with today's press release on November production, the Federal Reserve announced that rough timing for its 2015 annual benchmarking, including "new annual benchmark data for 2012 [previously missing] and 2013 manufacturing ..."

Unstable Headline Reporting and Revisions versus Quarterly Growth. Separately, though, along with today's (December 15th) headline reporting of November 2014 industrial production, the Federal Reserve also revamped patterns of production activity back through June, generally revising growth higher since May. Indicative as to the regular instabilities in the Fed's estimation of production activity, these revisions are about as meaningful as the last set of monthly revisions, which went in the other direction.

As a result of the revised detail, annualized quarterly growth in first-quarter 2014 production held at an unrevised pace of 3.90%. For second-quarter 2014, annualized growth revised to 5.74% from 5.66%, third-quarter growth revised to 4.01% from 3.29%. Where suggested fourth-quarter-growth jumped to 5.12%, based on just the November and upwardly revised October detail, from the 1.45% suggested by just the initial reporting for October, much of that suggested growth was spurious, tied to surging utility usage resulting from the unseasonably cold weather in November. Net of the utility distortion, suggested annualized fourth-quarter growth was 3.80%. There is potential here for some further upside revision to headline third-quarter 2014 GDP growth, scheduled for December 23rd.

Boosted by Utilities, Growth Exceeded Market Expectations. Headline November 2014 industrial production growth of 1.3% topped late-consensus expectations of 0.7% [Bloomberg], where that difference largely was accounted for by a 5.1% headline surge in utility usage, which in turn was driven by heating needs from unseasonably cold weather. Even so, headline production activity was strong, with "widespread" gains in manufacturing, including a 5.1% jump in automobile manufacturing. Those numbers all were on top of upside revisions. Beyond the revisions, seasonal adjustments likely skewed the data some, given the vagaries of the timing of Thanksgiving within the month.

On the downside to the headline reporting was a second month of contracting mining activity, with outright declines in oil and gas well drilling. To the extent those numbers are realistic, whether that is in response to falling oil prices and/or will impact oil prices should become more obvious in the next month or two.

Generally, there remain serious reporting-quality issues with the production series, given distortions in the seasonal adjustment process and the magnitude of regular revisions. Strong automobile production versus ongoing automobile sales issues suggest continued inventory building, but such likely remains in the realm of unstable seasonal-adjustments and reporting, with variability and softness in the resulting inventory numbers providing needed flexibility to the Bureau of Economic Analysis in constructing its initial headline estimate of fourth-quarter 2014 GDP, at the end of January.

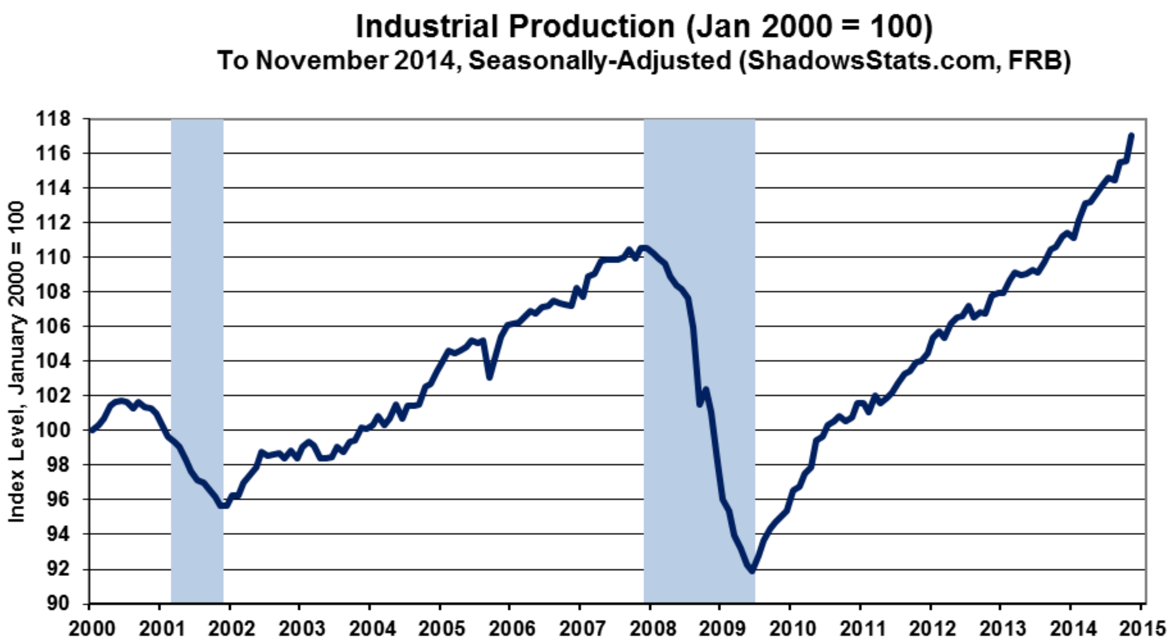
Industrial Production—November—2014. Headline monthly industrial production rose by a seasonally-adjusted 1.26% in November, versus a revised 0.07% headline gain in October. Net of prior-period revisions, the monthly November gain was 1.72%, which encompassed upside revisions to the headline production detail since May 2014. As of last month's reporting, the change from May 2014 to October 2014 in the production index level was an increase of 1.13%, that now is 1.59%, or a net upside revision of 0.46% as of the November reporting detail. In turn, the revised September gain was 0.88%, versus a revised monthly contraction of 0.10% (-0.10%) in August, a revised 0.33% gain in July, and revised 0.41% gain in June.

By major industry group, the headline November 2014 monthly gain of 1.3% [October 2014 revised gain of 0.1%] in aggregate production was composed of a November gain of 1.1% [revised October gain of 0.4%] in manufacturing; a 0.1% (-0.1%) November contraction [revised contraction of 1.0% (-1.0%) in October] in mining; and a 5.1% November gain [unrevised contraction of 0.7% (-0.7%) October] in utilities.

At the highest level since January 2011, year-to-year growth in November 2014 production was 5.22%, up from a revised 4.48% in October, and against a revised 4.51% in September, a revised 4.34% in August, a revised 5.03% in July and a revised 4.51% in June.

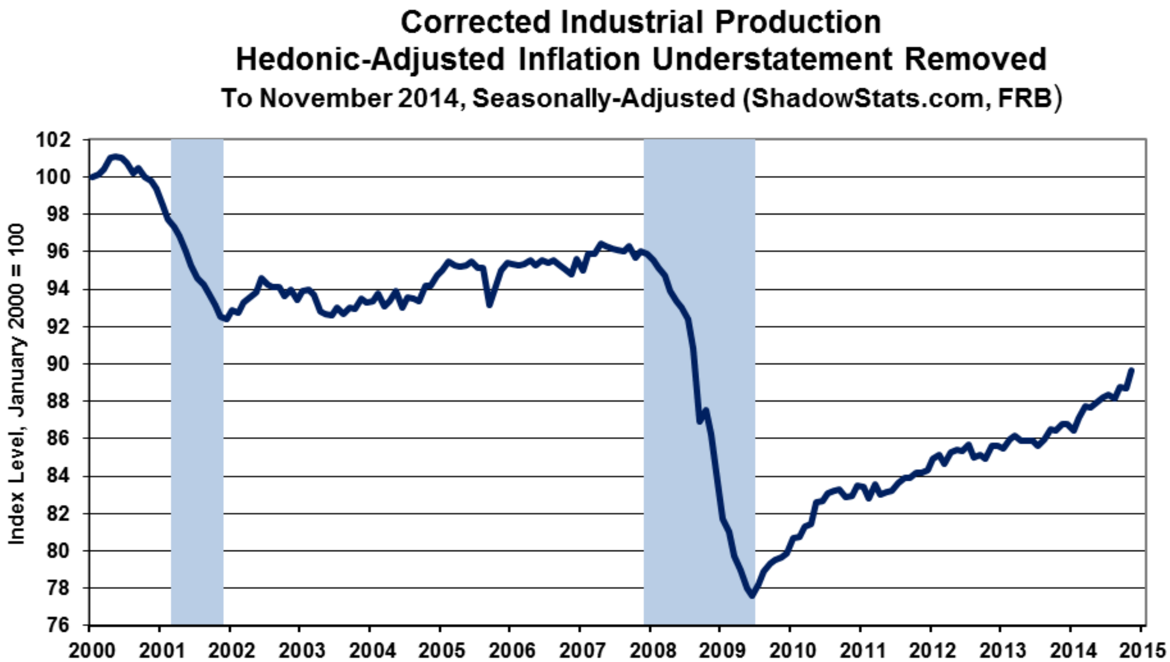
Production Graphs—Corrected and Otherwise. Graphs of the industrial production level and year-to-year change through November are found in the *Reporting Detail* section. The two graphs that follow here address reporting quality issues tied just to the overstatement of headline growth that directly results from using too-low an estimate of inflation in deflating an economic series.

Hedonic quality adjustments to inflation understate the inflation used in deflating some components of the index of industrial production. That has the effect of overstating the resulting inflation-adjusted growth in the headline industrial production series (see *Public Comment on Inflation* and the *Chapter 9* of *2014 Hyperinflation Report—Great Economic Tumble*).



The first graph (preceding) shows official, headline industrial production reporting, but indexed to January 2000 = 100, instead of the Fed's formal index that is set at 2007 = 100. The 2000 indexing simply provides 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, corrected for the understatement of the inflation used in deflating the production index. Estimated hedonic-inflation adjustments have been backed-out of the official industrial-production deflators used for headline reporting.

The "corrected" second graph (following) shows 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 (see *Commentary No. 677*). Unlike the headline industrial production data and the headline GDP numbers, corrected production levels have not recovered pre-recession highs. Instead, corrected production entered a period of protracted low-level stagnation in 2010, with irregular quarterly contractions seen through 2014, and an irregular uptrend in the stagnation into October 2014, with a jump in headline November 2014 reporting. Again, the series remains well shy of a formal recovery.



Producer Price Index (PPI)—November 2014—Large Monthly Revisions, Nontraditional Inflation Accounting. The differences between wholesale inflation measured by what producers reflect as their costs, and as measured by what the Bureau of Labor Statistics (BLS) deems appropriate services-trade area experience with shifting profit margins, remained a dominant factor in headline reporting of the November 2014 PPI.

Further, as will be detailed in the next two months, in conjunction with upcoming annual revisions, headline reporting for the new PPI series has not been particularly stable. Once reported, headline monthly reporting stays in place, pending a one-time revision, four months after the fact, and separate from annual revisions. The just-revised July 2014 headline PPI was shifted 0.3% higher than initially reported, a magnitude of revision that has been reasonably common for the new PPI series. All of the July revision came from the nebulous, but dominant, services sector. Of course, once the one-time revision is in place, the subsequent month's reporting no longer is on a comparable basis with the prior month's reporting.

Unlike Production Costs, Rising Margins Can Reflect Falling Costs as Well as Rising Prices. The headline 0.2% (-0.2%) contraction in November 2014 Final Demand PPI reflected a 0.7% (-0.7%) plunge in Final Demand Goods, largely offset by a 0.1% headline gain in the dominantly-weighted, increasing margins of Final Demand Services.

Discussed in earlier PPI *Commentaries*, margins are not the same thing as the level of prices realized in sales; they are a function of prices received versus cost or prices paid for the product or service. Where rising margins can reflect lower costs paid out as well as higher prices received, it remains likely that the stronger margins, at present, remain at least partially due to a decline in oil-related prices, at cost, not being passed along immediately or fully to the next level of consumption.

Inflation that Is More Theoretical than Real World? Effective with January 2014 reporting, a new Producer Price Index (PPI) replaced what had been the traditional headline monthly measure of wholesale inflation in Finished Goods (see *Commentary No. 591*). In the new headline monthly measure of wholesale Final Demand, Final Demand Goods basically is the old Finished Goods series, albeit expanded.

The new and otherwise dominant Final Demand Services sector largely reflects problematic and questionable surveying of intermediate or quasi-wholesale profit margins in the services area. To the extent that profit margins shrink in the services sector, one could argue that the resulting lowered estimation of inflation actually is a precursor to higher inflation, as firms subsequently would move to raise prices, in an effort to regain more-normal margins. In like manner, in the recent circumstance of "increased" margins—most likely due to the lower cost of petroleum-related products not being passed along immediately to customers—competitive pressures to lower margins would tend to be reflected eventually in reduced retail prices (CPI).

The new PPI series remains an interesting concept, but it appears muted as to its aggregate predictive ability versus general consumer inflation. Further, there is not enough history available on the new series (just six years of post-2008-panic data) to establish any meaningful relationship to general inflation or other economic of financial series.

November Headline PPI Detail. The seasonally-adjusted, month-to-month, headline producer price index (PPI) for November 2014 "total final demand" declined by 0.18% (-0.18%), basically offsetting the headline monthly increase of 0.18% reported for October. That followed an unrevised monthly decline of 0.09% (-0.09%) in September, but a revised 0.27% (-0.27%) decline in August, versus a previously unchanged reading, thanks to an upside revision of 0.27% in the July index level. July was the only month of revisions released along with the November reporting, with relative downside impact on headline monthly August inflation detail. July and August 2014 price-index levels, however, now are no longer comparable in any form, thanks to the July revision. The revisions predominantly were in the "services" and "construction" details, not on the "goods" side of the numbers.

The aggregate impact of the various seasonal adjustments on the headline monthly November aggregate number was positive, with the unadjusted monthly PPI change a contraction of 0.45% (-0.45%). On a not-seasonally-adjusted basis—all annual growth rates are unadjusted—year-to-year headline PPI inflation eased to 1.37% in November 2014, from 1.55% in October, 1.65% in September, 1.83% in August, and a revised 1.92% (previously 1.74%) in July. Year-to-year inflation was 1.11% in November 2013.

In terms of the three major subcategories for November 2014 "final demand" PPI, headline monthly "final demand goods" inflation contracted by 0.70% (-0.70%), "final demand services" inflation rose by 0.09%, and "final demand construction" inflation was "unchanged."

Final Demand Goods (Weighted at 34.40% of the Aggregate). Running somewhat in parallel with the old "finished goods" PPI series, headline monthly "final demand goods" inflation in November 2014 was down by 0.70% (-0.70%) in November, following a decline of 0.44% (-0.44%) in October, a drop of

0.17% (-0.17%) in September and an unrevised decline of 0.35% (-0.35%) in August. There was an aggregate positive impact on the November 2014 reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, headline November final demand goods inflation contracted by 1.06% for the month.

Also unadjusted, year-to-year goods inflation was up by 0.45% in November 2014, versus 1.07% in October, 1.51% in September and 1.68% in August, and versus a year-to-year annual gain of 0.03% in November 2013.

Headline seasonally-adjusted monthly changes by major components for November 2014 final demand goods:

- "Foods" inflation declined by 0.16% (-0.16%) in November, having soared by 0.99% in October, and having been down by 0.74% (-0.74%) in September, with November's headline monthly decline in inflation unaffected by seasonal adjustments. Unadjusted, November food inflation fell by 0.16% (-0.16%) for the month.
- "Energy" inflation fell by 3.05% (-3.05%) in November, having dropped by 3.04% (-3.04%) in October, and by 0.71% (-0.71%) in September, with the November negative reading narrowed by seasonal adjustments. Unadjusted November energy inflation declined by 4.85% (-4.85%) month-to-month.
- "Less foods and energy" ("core" goods) inflation fell by 0.09% (-0.09%) in November, the same as in October, having increased by 0.18% in September. Seasonal adjustments were neutral on "core" inflation, with an unadjusted November monthly decline of 0.09% (-0.09%).

Final Demand Services (Weighted at 63.52% of the Aggregate). Headline monthly "final demand services" inflation rose by 0.09% in November 2014, following a gain of 0.46% in October 2014, and a decline of 0.09% (-0.09%) in September and a revised decline of 0.09% (-0.09%), which initially had been a gain of 0.27%, in August. The overall impact on the November services inflation reading from underlying seasonal-factor adjustments was positive, with an unadjusted decline of 0.09% (-0.09%) for the current month.

Year-to-year unadjusted inflation was 1.86% in November, up from 1.76% in October, 1.58% in September and versus 1.86% in August. The annual inflation rate for year-ago November 2013 was 2.01%.

The headline monthly changes by major component for November 2014 final demand services inflation:

- "Services less trade, transportation and warehousing" inflation increased by 0.09% in November, the same as in October, having been down by 0.09% (-0.09%) in September, and following a revised gain of 0.37% (previously 0.28%) for the month of August. Seasonal-adjustment impact on the November detail was neutral.
- "Transportation and warehousing" inflation plunged by 0.84% (-0.84%) in November, having declined by 0.08% (-0.08%) in October, and by 0.17% (-0.17%) in September, following a revised monthly gain of 0.42% (previously 0.34%) in August. Seasonal adjustments deepened the monthly November decline from an unadjusted drop of 0.93% (-0.93%).

- "Trade" inflation rose by 0.09% in November, versus a 1.45% monthly surge in October, which followed an unchanged reading in September, and a revised 1.26% (-1.26%) plunge, previously an "unchanged" reading in August. The headline monthly November gain of 0.09% was boosted sharply by seasonal adjustments, from a 0.45% (-0.45%) unadjusted monthly decline.

Final Demand Construction (Weighted at 2.08% of the Aggregate). Although a fully self-contained subsection of the "final demand PPI," "final demand construction" inflation receives no formal headline coverage. Nonetheless, headline numbers are published. Headline monthly construction inflation was "unchanged" in November 2014, having jumped by 0.54% in October. It also was unchanged for the month in September, but August revised to a 0.09% gain, having been unchanged previously. The impact of seasonal factors on the "unchanged" headline November number was negative, with an unadjusted monthly gain of 0.09%.

Also on an unadjusted basis, year-to-year inflation was 2.20% in November 2014, the same as in October, versus 2.97% in September and 3.16% in August. In November 2013, annual inflation here was 3.12%.

Discussed in *Commentary No. 679*, ShadowStats now uses the "final demand construction" index for deflating headline activity in the monthly construction-spending series.

PPI-Inflation Impact on Pending Reporting of Durable Goods Activity. As to the upcoming November 2014 new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods in November 2014 was a negative 0.06% (-0.06%), versus a 0.42% surge in October, with annual inflation of 1.15% in November, versus 1.33% in October. November durable goods orders will be published on December 23rd and reviewed in *Commentary No. 685* of that date.

[For further detail on November Industrial Production and the PPI, see the* Reporting Detail *section. Various drill-down and graphics options on the headline production data also are available to ShadowStats subscribers at our affiliate:* www.ExpliStats.com*].

HYPERINFLATION WATCH

Hyperinflation Outlook Summary. Except for minor language changes tied to updating reference links, this *Summary* has not been changed from the version updated in the November 25th *Commentary No. 677*, which incorporated details from the second estimate of third-quarter 2014 GDP. Nonetheless, the

Summary should be considered in the context the *Opening Comments* on the U.S. dollar found in prior *Commentary No 680*. It will be updated subsequent to the December 19th *Special Commentary*.

The long-standing hyperinflation and economic outlooks were updated with the publication of *2014 Hyperinflation Report—The End Game Begins* – *First Installment Revised*, on April 2nd, and publication of *2014 Hyperinflation Report—Great Economic Tumble* – *Second Installment*, on April 8th. The outlooks also are updated in regular *Commentaries*, such as *Commentary No. 661*, *Commentary No. 664*, and *Commentary No. 672*, and the *Opening Comments* of *Commentary No. 673* should be considered in terms of near-term, proximal triggers for massive dollar selling. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts.

Hyperinflation Timing Shifted to 2015. Discussed in the *Opening Comments* of *Commentary No. 673*, as 2014 draws to a close, the U.S. dollar has strengthened significantly in recent months, instead of being dumped in a panicked sell-off as predicted for 2014. Nonetheless, the outlook for the dollar panic remains in place. It could be triggered or otherwise just start at any time, with little or no warning, and still before year-end.

From a practical standpoint, though, where a dollar-selling panic will be the likely immediate precursor to and trigger of the early stages of a hyperinflation, the outlook for the timing of the hyperinflation as detailed in the *Hyperinflation Reports* has been shifted to 2015, from 2014. I had put 80% odds in favor of the hyperinflation breaking this year, in 2014. Other than for the calendar shift, the general outlook was not changed, with the ultimate currency panic and financial crises still highly likely in the very near-term (80%), virtual certainties (95% in the not-so-distant future, *i.e.*, the year ahead).

Primary Summary. Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would be met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation (see *Commentary No. 672*). The 2008 Panic and near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same, pulled the elements of the eventual hyperinflation crisis into the 2014-2015 period. The primary and basic summary of the broad outlook and the story of how and why this fiscal, financial and economic crisis has unfolded and developed over the years—particularly in the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked earlier). The following sections summarize the underlying current circumstance and recent developments.

Consistent with the above *Special Commentaries*, the unfolding economic circumstance, in confluence with other fundamental issues, should place mounting and massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic. Physical gold and silver, and holding assets outside the U.S. dollar, remain the primary hedges against the pending total loss of U.S. dollar purchasing power, despite sharp recent rallies in the U.S. dollar's exchange rate and related heavy selling in the gold and silver markets.

Current relative U.S. economic strength versus major U.S. trading partners is seriously over-estimated, with a crash back to recognition of realistic domestic-economic circumstances likely to be accompanied by a crash in the U.S. dollar versus major currencies, such as the euro, yen, pound, Swiss franc, Canadian dollar and Australian dollar; related rallies in precious metals and oil; and related sell-offs in the domestic stock and bond markets. Further, a sharp deterioration in near-term domestic U.S. political stability appears to be developing and is of meaningful near-term risk for triggering heavy selling of the dollar.

***Current Economic Issues versus Underlying U.S. Dollar Fundamentals*.** U.S. economic activity is turning down anew, despite overstated growth in recent GDP reporting. The headline contraction in first-quarter 2014 GDP was the reality; the headline second-quarter GDP boom and continued strong headline GDP growth in third-quarter 2014 were not. The more-recent data appear to have been spiked, at best, by overly-optimistic assumptions on the part of the Bureau of Economic Analysis (BEA). At worst, the bloated growth estimates reflect heavy political massaging. Where third-quarter GDP still may see some near-term downside revision, both second- and third-quarter 2014 GDP growth patterns should suffer heavy downside revisions in the July 30, 2015 benchmark revision. The weak, underlying economic reality should become increasingly and painfully obvious to the financial markets in the domestic economic reporting and accompanying data revisions of the weeks and months ahead, including early indications for an outright contraction in fourth-quarter 2014 GDP.

As expanded upon in the *Opening Comments* of *Commentary No. 677*, recent reporting of relatively hard annual numbers from 2013 showed ongoing economic contraction, with no trend towards sustainable economic growth (see *Commentary No. 656*). Also, discussed in *Commentary No. 668*, actual business activity—net of all the happy assumptions and modeling used by the Bureau of Economic Analysis in putting together the overstated third-quarter GDP growth estimate—has been flat-to-minus, with real sales of the S&P 500 showing a decline in third-quarter 2014 activity. Further, Main Street U.S.A. remains the ultimate judge of actual economic activity, and the 2014 election results and related exit polling confirmed no post-Panic economic recovery (see *Commentary No. 672*).

Despite short-term pre-election fluff, those basic underlying and increasingly-negative economic conditions should show with mounting frequency in various series, such as the trade deficit, retail sales, industrial production, payroll employment and inventories, providing consensus expectations with downside shocks. In turn, that should shift the popular outlook quite rapidly towards a "new recession," with negative shifts in the economic consensus negatively roiling the extraordinarily unstable financial markets.

As financial-market expectations shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, particularly deteriorating domestic political conditions, should place mounting and massive selling pressures on the U.S. dollar, as well as potentially resurrect elements of the 2008-Panic.

Unexpected economic weakness intensifies the known stresses on an already-impaired banking system, hence a perceived need for expanded, not reduced, quantitative easing. The highly touted "tapering" by the FOMC finally has run its course. Future, constructive Federal Reserve behavior—purportedly moving towards normal monetary conditions in the currently unfolding, perfect economic environment—is pre-conditioned by a continued flow of "happy" economic news. Suggestions that all is right again with world are nonsense. The 2008 Panic never has been resolved, and the Fed soon will find that it has no easy escape from its quantitative easing.

The economy has not recovered; the banking system is far from stable and solvent; and the Federal Reserve and the federal government still have no way out. Significant banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs will be provided, as needed, by the Fed, under the ongoing political cover of a weakening economy—a renewed, deepening contraction in business activity. The Fed has no choice. Systemic collapse is not an option for the Board of Governors. This circumstance simply does not have a happy solution.

Accordingly, some speculation already has begun to circulate as to an added round of Federal Reserve quantitative easing, QE4. That would be a major factor behind crashing the dollar and boosting the price of gold. The Fed has strung out its options for propping up the system as much as it could, with continual, negative impact on the U.S. economy. The easing to date, however, appears to have been only a prop to the increasingly unstable equity markets (see *Commentary No. 663*).

In the event of QE4, any resulting renewed boost to U.S. equities would be a fleeting illusion, at least in terms of real value (purchasing power of the dollar). Such gains would tend to be losses, in real terms, with the stocks valued in terms of Swiss francs, for example, or valued against what would be a rapidly-increasing pace of domestic U.S. inflation.

Unexpected economic weakness also savages projections of headline, cash-based, federal-budget deficits (particularly the 10-year versions) as well as projected funding needs for the U.S. Treasury. Current fiscal "good news" is from cash-based, not GAAP-based and accounting projections, where comparative year-ago, cash numbers recently were distorted against U.S. Treasury and government activity operating *sub rosa*, in order to avoid the limits of a constraining debt ceiling (see *Commentary No. 672*).

All these crises should combine against the U.S. dollar, likely in the very-near future. That said, recent faux market perceptions of domestic economic, financial-system and monetary tranquility have boosted the U.S. dollar's strength significantly in global trading and have contributed to savaging the prices of precious metals. Again, such should not prevail in the context of underlying reality. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed. The key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew.*** The circumstance includes a widening trade deficit (see trade deficit analysis in *Reporting Detail section*), as well as ongoing severe, structural-liquidity constraints on the consumer, which are preventing a normal economic rebound in the traditional, personal-consumption-driven U.S. economy (see the *Opening Comments* of *Commentary No. 678*). Sharply-negative economic reporting shocks, versus unrealistically-positive consensus forecasts, remain a heavily-favored, proximal trigger for the pending dollar debacle.

- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of will to address long-term U.S. solvency issues, but also the current political impossibility of doing so. The impact of the shift in control of Congress will be assessed in the weeks ahead, but the change does not appear likely to alter the systemic willingness to address the underlying fundamental issues, specifically to bring the GAAP-based deficit into balance. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version continues to run in the $6-trillion-plus range for annual shortfall, while those in Washington continue to increase spending and to take on new, unfunded liabilities. The history and issues here are explored in the first installment of the *Hyperinflation Report*, as previously linked; the initial fiscal-2014 details are discussed in *Commentary No. 672*.

- ***Monetary malfeasance by the Federal Reserve, as seen in central bank efforts to provide liquidity to a troubled banking system, and also to the U.S. Treasury.*** Despite the end of the Federal Reserve's formal asset purchases, the U.S. central bank monetized 78% of the U.S. Treasury's fiscal-2014 cash-based deficit, as discussed in *Commentary No. 672*. The quantitative easing QE3 asset purchase program effectively monetized 66% of the total net issuance of federal debt to be held by the public during the productive life of the program (beginning with the January 2013 expansion of QE3). The monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury. With highly tenuous liquidity conditions for the banking system and the Treasury, it would not be surprising in this period of increasing instability to see covert Federal Reserve activities masked in the purchases of Treasury debt by nations or other entities financially friendly to or dependent upon the United States.

- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, usually with a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. The weaker the rating, the weaker tends to be the U.S. dollar. The positive rating for the President is at an historic low, post-election. Early post-election activity continues to show disintegrating chances of a shift towards constructive cooperation between the White House and the new Congress in addressing fundamental issues such as non-recovered, faltering economic activity and the consumer liquidity crisis, and addressing the nation's long-range solvency issues, let alone addressing the contentious immigration circumstance. Conditions here still could devolve rapidly into an extreme political crisis (see *Opening Comments* of *Commentary No. 673*)

- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the ongoing situation in Ukraine versus Russia and the extremely-volatile circumstances in the Middle East.

- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar continue to expand. In particular, anti-dollar rhetoric and actions have been seen with Russia, China, France and India, along with some rumblings in OPEC and elsewhere.

When the selling pressure breaks massively against the U.S. currency, the renewed and intensifying weakness in the dollar will place upside pressure on oil prices and other commodities, boosting domestic inflation and inflation fears. Domestic willingness to hold U.S. dollars will tend to move in parallel with global willingness, or lack of willingness, to do the same. These circumstances will trigger the early stages of a hyperinflation. Both the renewed dollar weakness and the resulting inflation spike should boost the prices of gold and silver, where physical holding of those key precious metals remains the ultimate hedge against the pending inflation and financial crises.

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REPORTING DETAIL

INDEX OF INDUSTRIAL PRODUCTION (November 2014)

Massive Benchmark Revisions Should Show Much-Weaker Production in Recent Years. Discussed in the *Opening Comments*, the Federal Reserve publishes an annual benchmark revision to the industrial production series, each year, correcting historical detail for more complete information as it becomes available. The March 2014 benchmark revision, however, largely was incomplete, lacking detail from the regular Census of Manufactures (2012), which apparently had been delayed in its release by the government shutdown of October 2013. As a result, what should have been massive downside revisions to 2012 and 2013 industrial production activity (and broader GDP activity) never took place (see *Commentary No. 613*).

This should be corrected in second-quarter 2015. Along with today's press release on November production, the Federal Reserve announced that rough timing for its 2015 annual benchmarking, including "new annual benchmark data for 2012 [previously missing] and 2013 manufacturing ..."

Unstable Headline Reporting and Revisions versus Quarterly Growth. Separately, though, along with today's (December 15th) headline reporting of November 2014 industrial production, the Federal Reserve also revamped patterns of production activity back through June, generally revising growth higher since May. Indicative as to the regular instabilities in the Fed's estimation of production activity, these revisions are about as meaningful as the last set of revisions, which went in the other direction.

As a result of the revised detail, annualized quarterly growth in first-quarter 2014 production held at an unrevised pace of 3.90%. For second-quarter 2014, annualized growth revised to 5.74% from 5.66%, third-quarter growth revised to 4.01% from 3.29%. Where suggested fourth-quarter-growth jumped to 5.12%, based on just the November and upwardly revised October detail, from the 1.45% suggested by just the initial reporting for October, much of that suggested growth was spurious, tied to surging utility usage resulting from the unseasonably cold weather in November. Net of the utility distortion, suggested annualized fourth-quarter growth was 3.80%. There is some potential here for some further upside revision to headline third-quarter 2014 GDP growth, scheduled for December 23rd.

Boosted by Utilities, Growth Exceeded Market Expectations. Headline November 2014 industrial production growth of 1.3% topped late-consensus expectations of 0.7% [Bloomberg], where that difference largely was accounted for by a 5.1% headline surge in utility usage, which in turn was driven by heating needs from unseasonably cold weather. Even so, headline production activity was strong, with "widespread" gains in manufacturing, including a 5.1% surge in automobile manufacturing. Those numbers all were on top of upside revisions. Beyond the revisions, seasonal adjustments likely skewed the data some, given the vagaries of the timing of Thanksgiving within the month.

On the downside to the headline reporting was a second month of contracting mining activity, with outright contractions in oil and gas well drilling. To the extent those numbers are realistic, whether that is in response to falling oil prices and/or will impact oil prices should become more obvious in the next month or two.

Generally, there remain serious reporting-quality issues with the production series, given distortions in the seasonal adjustment process and the magnitude of regular revisions. Strong automobile production versus ongoing automobile sales issues suggest continued inventory building, but such likely remains in the realm of unstable seasonal-adjustments and reporting, with variability and softness in the resulting inventory numbers providing needed flexibility to the Bureau of Economic Analysis in constructing its initial headline estimate of fourth-quarter 2014 GDP, at the end of January.

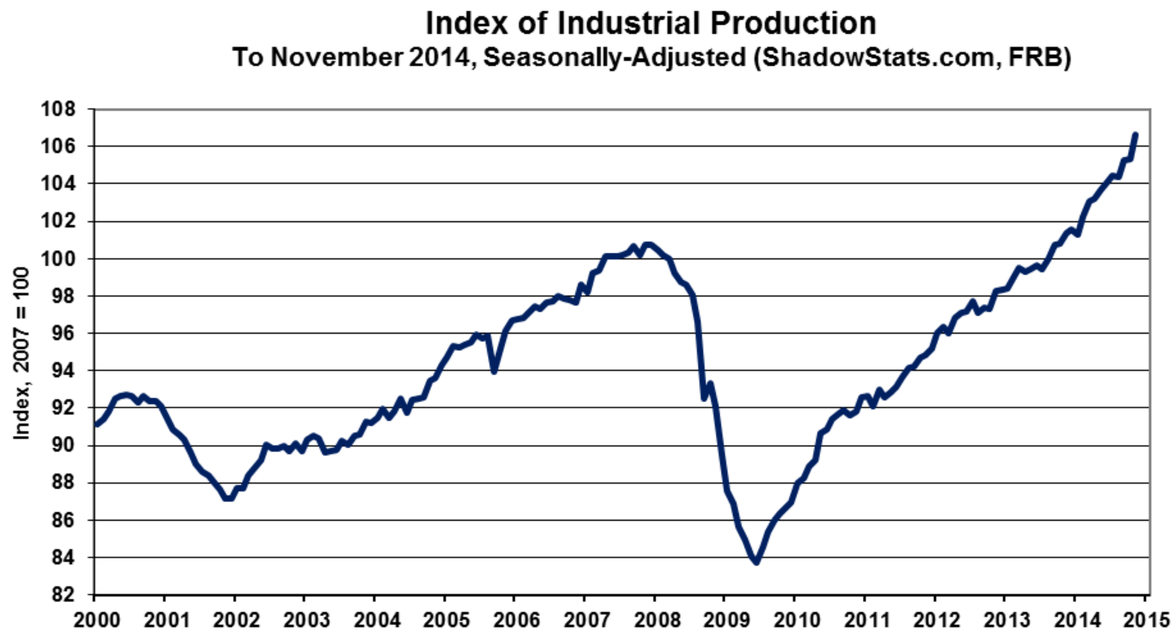
Industrial Production—November—2014. The Federal Reserve Board released its first estimate of seasonally-adjusted, November 2014 industrial production this morning (December 15th). Headline monthly production rose by 1.26% in November, versus a revised 0.07% gain in October, which previously had been a contraction of 0.11% (-0.11%) versus September. Net of prior-period revisions, the monthly November gain was 1.72%, which encompassed upside revisions to the headline production detail since May 2014. As of last month's reporting, the change from May 2014 to October 2014 in the production index level was an increase of 1.13%, that now is 1.59%, or a net upside revision of 0.46% as of the November reporting detail.

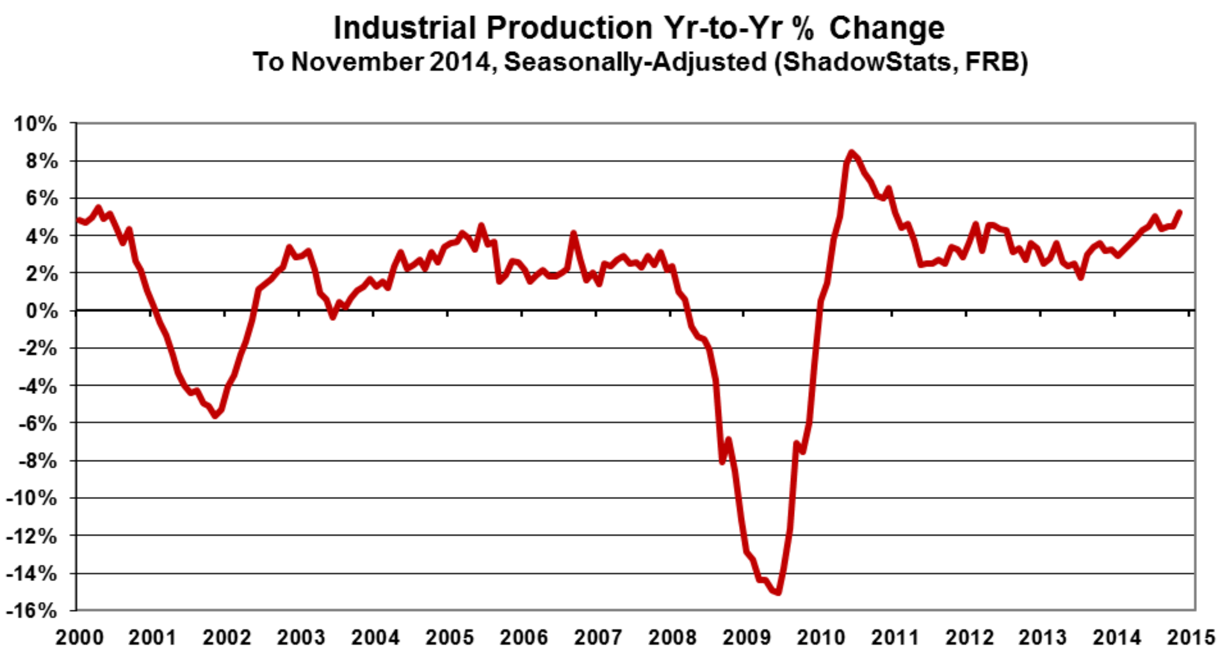
In turn, the revised September gain was 0.88% (previously up by 0.80%, initially up by 1.01%), versus a revised August monthly contraction of 0.10% (-0.10%) [previously down by 0.20% (-0.20%) and by 0.17% (-0.17%) and initially down by 0.10% (-0.10%)]. In turn, July was up by a revised 0.33% (previously up by 0.28%, 0.23%, 0.22% and initially up by 0.44%), versus June, which was up by a revised 0.41% (previously 0.35%, 0.28%, 0.32%, 0.38% and initially up by 0.22%), from May.

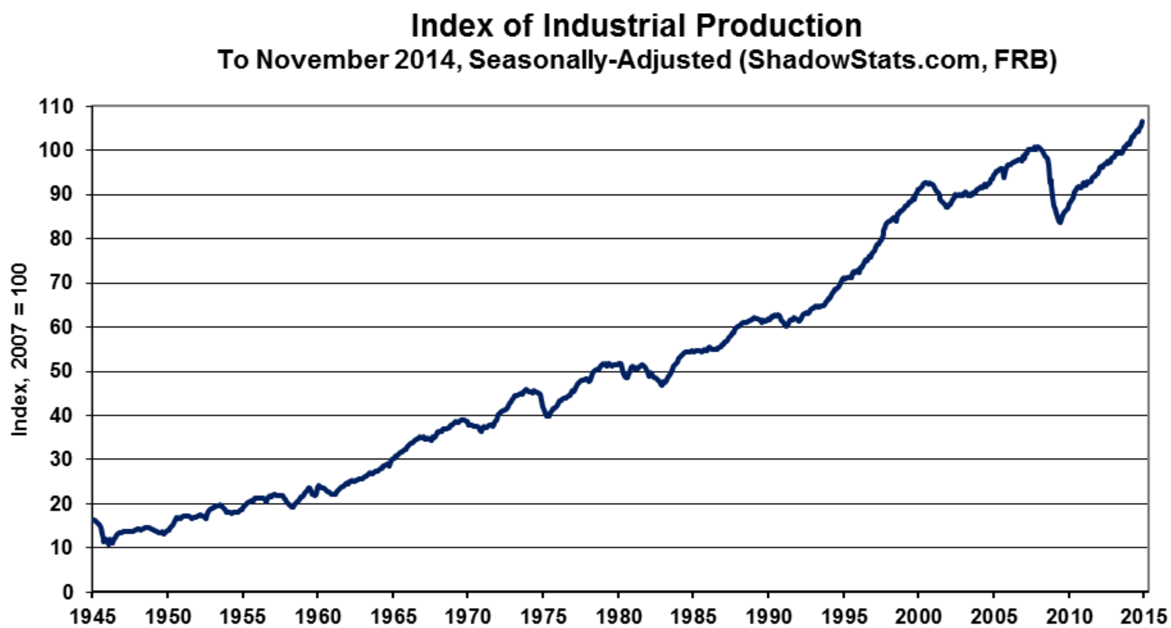
By major industry group, the headline November 2014 monthly gain of 1.3% [October 2014 revised gain of 0.1%, previously down by 0.1% (-0.1%)] in aggregate production was composed of a November gain of 1.1% [revised October gain of 0.4%, previously up by 0.2%] in manufacturing; a 0.1% (-0.1%) November contraction [revised October contraction of 1.0% (-1.0%), previously down by 0.9% (-0.9%)] in mining; and a 5.1% November gain [unrevised 0.7% (-0.7%) October contraction] in utilities.

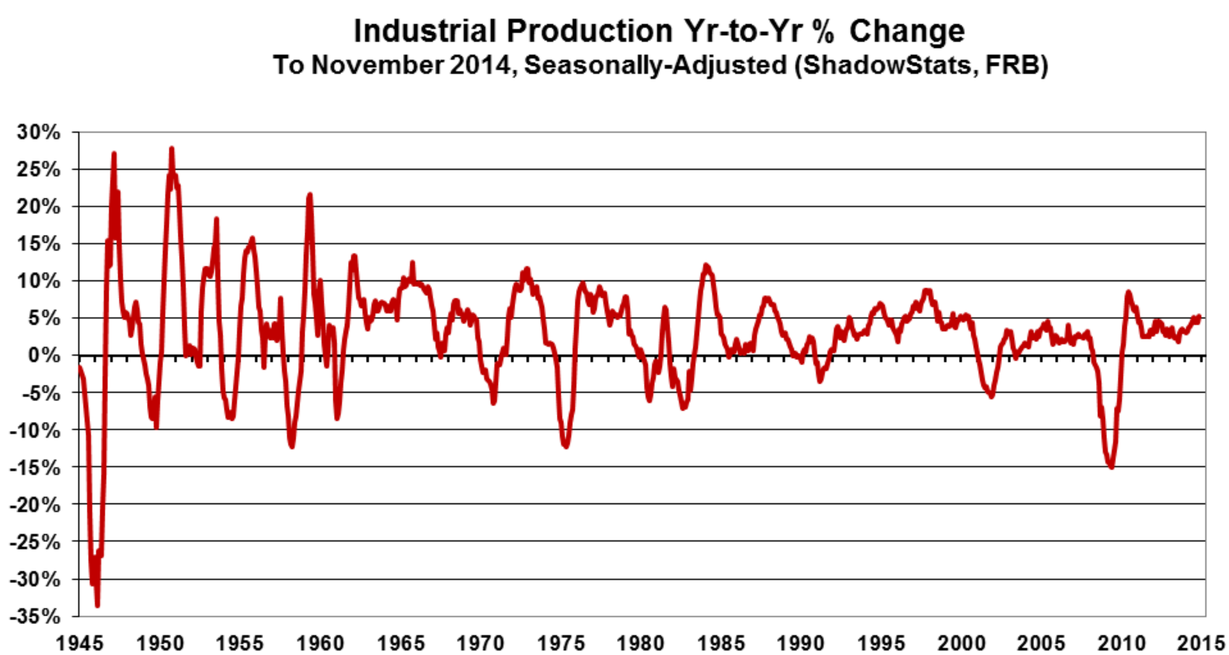
At the highest level since January 2011, year-to-year growth in November 2014 production was 5.22%, up from a revised 4.48% (previously 4.01%) in October, and against a revised 4.51% (previously 4.22%, initially 4.30%) gain in September, a revised 4.34% (previously 4.14%, 4.02%, and initially 4.12%) gain in August, a revised 5.03% (previously 4.92%, 4.78%, 4.80%, and initially 4.97%) in July and a revised 4.51% (previously 4.45%, 4.36%, 4.40%, 4.34%, and initially 4.32%) in June.

Production Graphs. The following two sets of graphs reflect headline industrial production activity to date. The first graph in the first set shows the monthly level of the production index, with November 2014 setting an historic high level for the series. The second graph shows the year-to-year percentage change in the same series for recent historical detail, beginning January 2000, with the current level at its highest since January 2011. The second set of graphs shows the same data in historical context since World War II.


Index of Industrial Production
To November 2014, Seasonally-Adjusted (ShadowStats.com, FRB)
Index, 2007 = 100
108
106
104
102
100
98
96
94
92
90
88
86
84
82
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015


Industrial Production Yr-to-Yr % Change
To November 2014, Seasonally-Adjusted (ShadowStats, FRB)
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
-8%
-10%
-12%
-14%
-16%
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015





Shown more clearly in the first set of graphs, the pattern of year-to-year activity dipped anew in late-2013 to levels usually seen only at the onset of recessions, bounced higher into mid-2014, headed lower again through October, and jumped anew in the headline November 2014 reporting. Even so, annual growth remains well off the recent relative peak for the series, which was 8.49% 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 15.06% 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, again, setting a new series high with November 2014 reporting. Corrected for the understatement of inflation used in deflating portions of the industrial production index (see the *Opening Comments* section), however, the series has shown more of a pattern of stagnation with a slow upside trend, since 2009, with irregular quarterly contractions since. The slow uptrend continued into 2014, with a boost from the initial reporting of a headline spike in November 2014 reporting. The "corrected" series remains well shy of a formal recovery.

PRODUCER PRICE INDEX—PPI (November 2014)

Amidst Large Monthly Revisions, Nontraditional Inflation Accounting warps Headline Wholesale Inflation. *[Text here largely is unchanged from that in the* Opening Comments.*]* The differences between wholesale inflation measured by what producers reflect as their costs, and as measured by what the Bureau of Labor Statistics (BLS) deems appropriate services-trade area experience with shifting profit margins, remained a dominant factor in headline reporting of the November 2014 PPI.

Further, as will be detailed in the next two months, in conjunction with upcoming annual revisions, headline reporting for the new PPI series has not been particularly stable. Once reported, headline monthly reporting stays in place, pending a one-time revision, four months after the fact, and separate from annual revisions. The just-revised July 2014 headline PPI was shifted 0.3% higher than initially reported, a magnitude of revision that has been reasonably common for the new PPI series. All of the July revision came from the nebulous, but dominant, services sector. Of course, once the one-time revision is in place, the subsequent month's reporting no longer is on a comparable basis with the prior month's reporting.

Unlike Production Costs, Rising Margins Can Reflect Falling Costs as Well as Rising Prices. The headline 0.2% (-0.2%) contraction in November 2014 Final Demand PPI reflected a 0.7% (-0.7%) plunge in Final Demand Goods, largely offset by a 0.1% headline gain in the dominantly-weighted, increasing margins of Final Demand Services.

Discussed in earlier PPI *Commentaries*, margins are not the same thing as the level of prices realized in sales; they are a function of prices received versus cost or prices paid for the product or service. Where rising margins can reflect lower costs paid out as well as higher prices received, it remains likely that the stronger margins, at present, remain at least partially due to a decline in oil-related prices, at cost, not being passed along immediately or fully to the next level of consumption.

Inflation that Is More Theoretical than Real World? Effective with January 2014 reporting, a new Producer Price Index (PPI) replaced what had been the traditional headline monthly measure of wholesale inflation in Finished Goods (see *Commentary No. 591*). In the new headline monthly measure of wholesale Final Demand, Final Demand Goods basically is the old Finished Goods series, albeit expanded.

The new and otherwise dominant Final Demand Services sector largely reflects problematic and questionable surveying of intermediate or quasi-wholesale profit margins in the services area. To the extent that profit margins shrink in the services sector, one could argue that the resulting lowered estimation of inflation actually is a precursor to higher inflation, as firms subsequently would move to raise prices, in an effort to regain more-normal margins. In like manner, in the recent circumstance of "increased" margins—most likely due to the lower cost of petroleum-related products not being passed along immediately to customers—competitive pressures to lower margins would tend to be reflected eventually in reduced retail prices (CPI).

The new PPI series remains an interesting concept, but it appears muted as to its aggregate predictive ability versus general consumer inflation. Further, there is not enough history available on the new series (just six years of post-2008-panic data) to establish any meaningful relationship to general inflation or other economic of financial series.

November Headline PPI Detail. The Bureau of Labor Statistics (BLS) reported, Friday, December 12th, that the seasonally-adjusted, month-to-month, headline producer price index (PPI) for November 2014 "total final demand" declined by 0.18% (-0.18%), basically offsetting the headline monthly increase of 0.18% reported for October. That followed an unrevised monthly decline of 0.09% (-0.09%) in September, but a revised 0.27% (-0.27%) decline in August, versus a previously unchanged reading, thanks to an upside revision of 0.27% in the July index level. July was the only month of revisions released along with the November reporting, with relative downside impact on headline monthly August inflation detail. July and August 2014 price-index levels, however, now are no longer comparable in any form, thanks to the July revision. The revisions predominantly were in the "services" and "construction" details, not on the "goods" side of the numbers.

The aggregate impact of the various seasonal adjustments on the headline monthly November aggregate number was positive, with the unadjusted monthly PPI change a contraction of 0.45% (-0.45%). On a not-seasonally-adjusted basis—all annual growth rates are unadjusted—year-to-year headline PPI inflation eased to 1.37% in November 2014, from 1.55% in October, 1.65% in September, 1.83% in August, and a revised 1.92% (previously 1.74%) in July. Year-to-year inflation was 1.11% in November 2013.

In terms of the three major subcategories for November 2014 "final demand" PPI, headline monthly "final demand goods" inflation contracted by 0.70% (-0.70%), "final demand services" inflation rose by 0.09%, and "final demand construction" inflation was "unchanged."

Final Demand Goods (Weighted at 34.40% of the Aggregate). Running somewhat in parallel with the old "finished goods" PPI series, headline monthly "final demand goods" inflation in November 2014 was down by 0.70% (-0.70%) in November, following a decline of 0.44% (-0.44%) in October, a drop of 0.17% (-0.17%) in September and an unrevised decline of 0.35% (-0.35%) in August. There was an aggregate positive impact on the November 2014 reading from underlying seasonal-factor adjustments. Not-seasonally-adjusted, headline November final demand goods inflation contracted by 1.06% for the month.

Also unadjusted, year-to-year goods inflation was up by 0.45% in November 2014, versus 1.07% in October, 1.51% in September and 1.68% in August, and versus a year-to-year annual gain of 0.03% in November 2013.

Headline seasonally-adjusted monthly changes by major components for November 2014 final demand goods:

- "Foods" inflation declined by 0.16% (-0.16%) in November, having soared by 0.99% in October, and having been down by 0.74% (-0.74%) in September, with November's headline monthly decline in inflation unaffected by seasonal adjustments. Unadjusted, November food inflation fell by 0.16% (-0.16%) for the month.
- "Energy" inflation fell by 3.05% (-3.05%) in November, having dropped by 3.04% (-3.04%) in October, and by 0.71% (-0.71%) in September, with the November negative reading narrowed by seasonal adjustments. Unadjusted November energy inflation declined by 4.85% (-4.85%) month-to-month.
- "Less foods and energy" ("core" goods) inflation fell by 0.09% (-0.09%) in November, the same as in October, having increased by 0.18% in September. Seasonal adjustments were neutral on "core" inflation, with an unadjusted November monthly decline of 0.09% (-0.09%).

Final Demand Services (Weighted at 63.52% of the Aggregate). Headline monthly "final demand services" inflation rose by 0.09% in November 2014, following a gain of 0.46% in October 2014, and a decline of 0.09% (-0.09%) in September and a revised decline of 0.09% (-0.09%), which initially had been a gain of 0.27%, in August. The overall impact on the November services inflation reading from underlying seasonal-factor adjustments was positive, with an unadjusted decline of 0.09% (-0.09%) for the current month.

Year-to-year unadjusted inflation was 1.86% in November, up from 1.76% in October, 1.58% in September and versus 1.86% in August. The annual inflation rate for year-ago November 2013 was 2.01%.

The headline monthly changes by major component for November 2014 final demand services inflation:

- "Services less trade, transportation and warehousing" inflation increased by 0.09% in November, the same as in October, having been down by 0.09% (-0.09%) in September, and following a revised gain of 0.37% (previously 0.28%) for the month of August. Seasonal-adjustment impact on the November detail was neutral.
- "Transportation and warehousing" inflation plunged by 0.84% (-0.84%) in November, having declined by 0.08% (-0.08%) in October, and by 0.17% (-0.17%) in September, following a revised monthly gain of 0.42% (previously 0.34%) in August. Seasonal adjustments deepened the monthly November decline from an unadjusted drop of 0.93% (-0.93%).
- "Trade" inflation rose by 0.09% in November, versus a 1.45% monthly surge in October, which followed an unchanged reading in September, and a revised 1.26% (-1.26%) plunge, previously an "unchanged" reading in August. The headline monthly November gain of 0.09% was boosted sharply by seasonal adjustments, from a 0.45% (-0.45%) unadjusted monthly decline.

Final Demand Construction (Weighted at 2.08% of the Aggregate). Although a fully self-contained subsection of the "final demand PPI," "final demand construction" inflation receives no formal headline coverage. Nonetheless, headline numbers are published. Headline monthly construction inflation was "unchanged" in November 2014, having jumped by 0.54% in October. It also was unchanged for the month in September, but August revised to a 0.09% gain, having been unchanged previously. The impact of seasonal factors on the "unchanged" headline November number was negative, with an unadjusted monthly gain of 0.09%.

Also on an unadjusted basis, year-to-year inflation was 2.20% in November 2014, the same as in October, versus 2.97% in September and 3.16% in August. In November 2013, annual inflation here was 3.12%.

Discussed in *Commentary No. 679*, ShadowStats now uses the "final demand construction" index for deflating headline activity in the monthly construction-spending series.

PPI-Inflation Impact on Pending Reporting of Durable Goods Activity. As to the upcoming November 2014 new orders for durable goods, unadjusted monthly inflation for new orders for manufactured durable goods in November 2014 was a negative 0.06% (-0.06%), versus a 0.42% surge in October, with annual inflation of 1.15% in November, versus 1.33% in October. November durable goods orders will be published on December 23rd and reviewed in *Commentary No. 685* of that date.

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WEEK AHEAD

Against Overly-Optimistic Expectations, Pending Economic Releases and Revisions Should Trend Much Weaker; Inflation Releases Should Be Increasingly Stronger after Temporary Oil-Price Declines. Shifting some to the downside, again, from the upside, amidst wide fluctuations in the numbers, market expectations for business activity still are overly optimistic in the extreme. They exceed any potential, underlying economic reality. Continuing, downside corrective revisions and an accelerating pace of downturn in broad-based headline economic reporting, however, increasingly should hammer those expectations.

Longer-Range Reporting Trends. While gradual process of downside shifting in economic-growth expectations has been sporadic, underlying fundamental activity has remained extraordinarily negative. Allowing for the nonsense-growth in the headline second-quarter and third-quarter GDP (see *Opening Comments* of *Commentary No. 677*), renewed weakness has been, and increasingly will be seen in the post-election headline reporting of other major economic series (see *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*). Indeed, weaker-than-consensus economic reporting should become the general trend until the unfolding "new" recession receives broad recognition, which minimally would follow the next reporting of a headline contraction in real GDP growth (which most likely will involve reporting of fourth-quarter 2014 GDP).

A generally stronger consumer inflation trend remains likely, as seen before August, although headline inflation is muted at present, for a couple of months, by a temporary decline in oil prices. Beyond the spread of earlier oil-based inflation pressures into the broad economy, upside pressure on oil-related prices should continue and be rekindled from the intensifying impact of global political instabilities and a likely near-term weakening of the U.S. dollar in the currency markets. Such excludes any near-term, covert financial sanctions against Russia that currently are pushing oil prices lower.

The dollar faces eventual pummeling from the weakening economy, continuing perceptions of needed, ongoing quantitative easing, the ongoing U.S. fiscal-crisis debacle, and deteriorating U.S. and global political conditions (see *Hyperinflation 2014—The End Game Begins (Updated)* – *First Installment*). Particularly in tandem with a prospective, significantly-weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected U.S. inflation, across the board.

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, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment, and unemployment data). Combined with recent allegations (see *Commentary No. 669*) of Census Bureau falsification of data in its monthly Current Population Survey (the source for the Bureau of Labor Statistics' Household Survey), these issues 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 (November 2014). The Census Bureau will release November 2014 residential construction detail, including housing starts, tomorrow, Tuesday, December 16th. Monthly results are likely to be unstable, and not statistically meaningful.

As discussed in *Commentary No. 660* on the August version of this most-unstable of monthly economic series, the headline reporting here simply is worthless. Not only is month-to-month reporting volatility extreme, but also those headline monthly growth rates rarely come close to being statistically significant. Late-consensus expectations are for a headline monthly gain of about 2.8% in November, as indicated by Bloomberg. That still is well shy of the usually-expected headline monthly surge. Market expectations increasingly have shifted towards a renewed decline in residential construction activity.

The extreme variability seen regularly in the reporting of month-to-month change in this series likely will continue, although, again, with a pattern of no statistical-significance, and with ongoing stagnation and renewed downturn and/or downside revisions seen in the six-month moving-average of the series. This series also is subject to regular and extremely-large prior-period revisions.

In the wake of a 75% collapse in aggregate activity from 2006 through 2008, and of an ensuing five-year pattern of housing starts stagnation at historically low levels, little has changed. As discussed frequently in these *Commentaries*, there remains no chance of a near-term, sustainable turnaround in the housing market, unless there is a fundamental upturn in consumer and banking-liquidity conditions. That has not happened and does not appear to be in the offing, as updated in the *Opening Comments* section of prior *Commentary No 680*.

Consumer Price Index—CPI (November 2014). The November 2014 CPI is scheduled for release on Wednesday, December 17th, by the Bureau of Labor Statistics (BLS). The headline CPI-U has a fair chance of being flat-to-minus, against market expectations of a 0.1% (-0.1%) month-to-month decline [Bloomberg].

Plunging again, average gasoline prices fell by 7.93% (-7.93%) month-to-month in November 2014, on a not-seasonally-adjusted basis, per the Department of Energy (DOE). While BLS seasonal adjustments to gasoline prices should be positive in November, they still should leave adjusted monthly gasoline prices down by roughly 5.5% (-5.5%) or so for the month. By itself, such an adjusted decline in gasoline prices would leave the headline CPI-U down by roughly 0.3% (-0.3%).

Higher food and “core” (net of food and energy) inflation, however, should offset much of the negative energy number, leading to a headline flat-to-minus headline monthly change in the November CPI.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in November 2014 reporting, dependent on the seasonally-adjusted monthly change, versus an adjusted "unchanged" [down by 0.03% (-0.03%) at the second decimal point] monthly inflation reported for November 2013. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for November 2014, the difference in November’s headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the October 2014 annual inflation rate of 1.66%. If the headline monthly inflation came in at about at unchanged, the resulting annual inflation pace would be around 1.7% (at the first decimal point), holding at that level again for the fourth month.

