John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

ADVANCE SPECIAL COMMENTARY No. 858
Economic and Financial Review and Preview

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Consumer Expectations Soar Along with
Anticipated Changes from the Incoming Administration

Yet, the Near-Term Domestic Economic Outlook Remains Bleak,
Fueling New Fiscal Stimuli but Frustrating the Fed's Policies

With Resurgent Pressures on the Fed to Expand Quantitative Easing, and with
Global Markets Refocusing on Long-Range U.S. Treasury Solvency Issues,
Massive Selling of the U.S. Dollar and Stocks Is Highly Likely by Mid-2017

Serious Inflation Problems Should Accompany the Dollar Selling;
Precious Metals Remain the Primary Inflation Hedge

Since the Onset of the Millennium,
Gold Still Has Outperformed Stocks, Including Reinvested Dividends,
Despite Recent Heavy Gold Selling and Stocks near All-Time Highs

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PLEASE NOTE: This relatively brief, Advance Summary *covers key elements of the year-ahead outlook, from the full* ShadowStats Special Commentary *now planned for Tuesday, January 3rd. That* Commentary *offers a comprehensive review of the outlook for 2017 and beyond, in the context of historical activity and writings, as well as current, shifting U.S. political and economic conditions. It covers domestic fiscal and inflation circumstances, Federal Reserve behavior and banking crises, and related global impact, including implications for the U.S. dollar, gold, silver and oil.*

The following, summary outlook is not a happy one, but there is potential for a positive shift with the incoming Administration. The full Special Commentary *will provide underlying detail.*

Regular Commentaries *resume with No. 860 on January 6, 2017, covering December 2016 labor conditions and the November 2016 trade-deficit and construction spending.*

Best Wishes to All for a Most Happy, Healthy and Prosperous New Year!
— John Williams

SUMMARY OUTLOOK

Underlying Economic Reality Remains Far Removed from Media Hype and the Consensus Outlook. The euphoria reflected in surging consumer expectations, U.S. stock prices and the U.S. dollar, following the election of Donald J. Trump as the next U.S. President, has been extraordinary. Indeed, positive changes to domestic economic activity appear to be on the horizon, along with some potential for relief from prior-systemic abuses as to fiscal policy and the banking system.

Nonetheless, once the new Administration takes office January 20th, horrendous issues will face the new team. While quick action is likely from the standpoint of economic stimulus, there will be some lag before the economy responds. Those economic woes and other threats to the banking, financial and economic systems were created and exacerbated by decades of operational malfeasance in the policies of, and banking-system oversight and guidance by the Federal Reserve, and from financial-system oversight and fiscal- and regulatory-policy malfeasance by prior Administrations. The resulting problems include:

- A stagnant economy that never recovered meaningfully from its collapse, which began somewhat before 2007, bottomed into 2009 and started to turn down anew at the end of 2014.

- Domestic- and global-banking and financial systems that continue on the brink of insolvency, unable to function normally in circumstances that usually would be helpful to economic activity.

- A federal budget deficit that tops $100 trillion, counting unfunded liabilities—obligations the government has taken on—on a net-present value basis (adjusted for the future value of money, effectively the cash needed in hand today to cover those obligations). If those aggregate obligations remain in place, the United States has zero chance of honoring them. The circumstance promises ultimate insolvency for the U.S. Treasury, or the more-likely full debasement of the U.S. dollar, as the government eventually just prints the money it needs to meet its obligations. Pending banking-system and currency turmoil could trigger that massive-dollar-debasement crisis in the immediate future.

Euphoria from a Public Expecting Positive Change. Voting pocketbook issues, Main Street U.S.A. turned-out the incumbent party holding the White House. Recognizing that trend as he campaigned for the Presidency, Mr. Trump promised action on the economy, including fiscal stimulus, ranging from tax cuts to increased-federal spending, and to revamp trade agreements that have cost American workers jobs and income. Indeed, addressing those matters should boost the economy, but there generally is a lag between such actions and the beginnings of the desired positive economic impact, by nine months to a year or more. The world's largest economy usually does not turn to the upside, rapidly.

While increased economic growth and resulting higher tax revenues should help some with the deficit, again, there would be a lag, but there would be nothing of adequate substance to address the long-term U.S. sovereign-solvency issues. With any near-term boost to the U.S. fiscal deficit, even if short-lived, the global markets likely would return their focus to those sovereign-solvency problems, as was seen in the dollar crisis of August 2011.

With the current U.S. economy turning down anew, in reality (watch out for headline fourth-quarter 2016 GDP reporting, one week subsequent to Mr. Trump's inauguration, and headline economic data of the months ahead), financial stresses should intensify or mount anew on the U.S. banking system. Discussed in recent *Commentaries*, despite the Federal Reserve's rate hike of December 14th, its Federal Open Market Committee (FOMC) likely will be forced into expanded quantitative easing, before mid-year 2017, and the markets should begin anticipating that, as the headline economy turns decisively lower.

Fed actions remain centered on maintaining banking-system solvency and liquidity, not necessarily in boosting domestic economic activity. Practically, there is little the Fed can do at present to help the economy. The Fed simply has used economic woes of the recent past as political cover for the quantitative easings used in bailing out the banking system.

The Fed's frequent "crying wolf" during 2016, and before, as to imminent rate hikes, and the eventual December action, largely were used to prop the U.S. dollar. A renewed shift in policy towards easing would pummel the U.S. dollar in the global markets, boosting oil prices and domestic inflation, along with increased repatriation of unwanted, foreign-held dollars that the Fed would end up absorbing. In 2008, when the Fed and the U.S. Treasury opted to save the U.S. banking system at any cost, they had to accept willingly that the cost eventually would include a sharp pickup in domestic inflation.

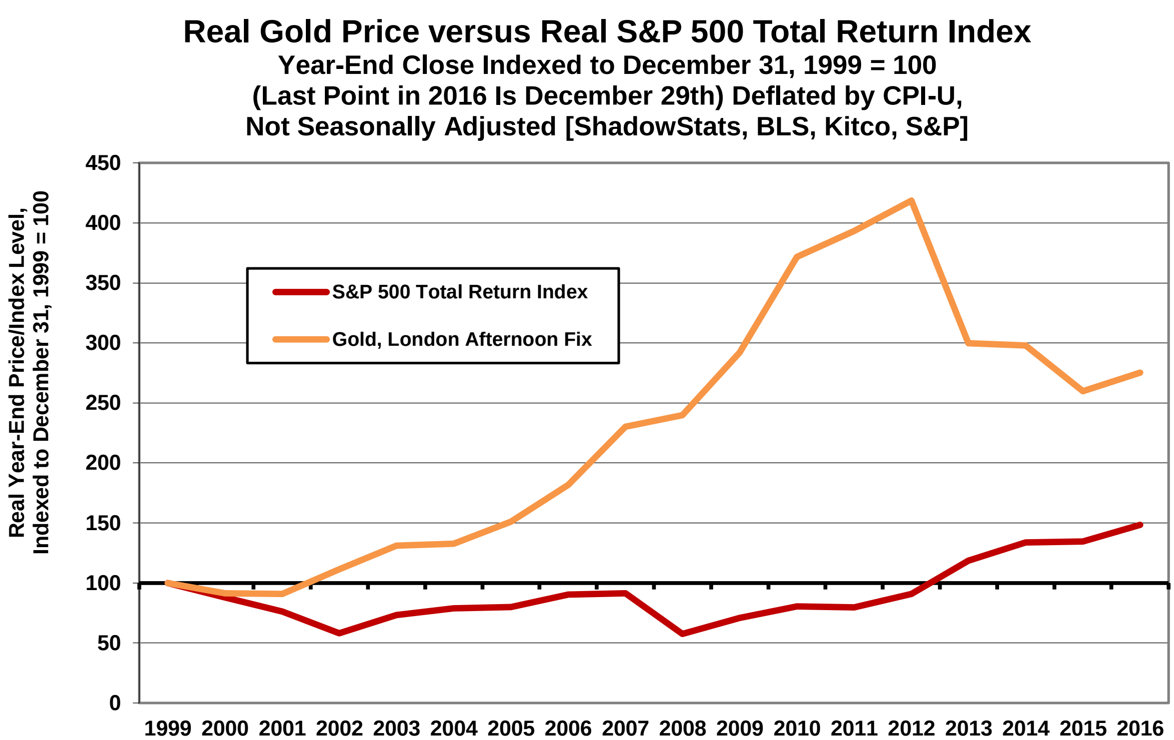
A Potential Positive. The new Administration will have the opportunity not only to address near-term economic issues, but also the long-range U.S. sovereign-solvency and current banking-system solvency problems. Those latter issues are extremely difficult to handle from both a political and practical standpoint, such as bringing programs like Medicare and Social Security into long-term, self-sustaining solvency, and perhaps even dissolving the Fed and nationalizing the banking system. Irrespective of the desires of the new Administration, Congress will have to legislate almost all of the needed changes. Congress has been either unwilling or unable to address the fiscal crisis meaningfully, in recent decades, let alone ignore lobbying pressures from the banking and other industries.

If the system is not brought under long-term functional control now, it likely never will be, shy of a response to some form of systemic collapse. The long-term solvency issues of the government threaten domestic hyperinflation, sooner rather than later, given current global dollar imbalances and the related, high risk of massive flight out of the U.S. currency. Further, the banking-system problems can accelerate the onset of the hyperinflation issue into the immediate future. Potentially, an extraordinary financial crisis looms for the new Administration by mid-year 2017; one that is not of Mr. Trump's creation, but rather a creation of the Federal Reserve and prior Administrations. Effective and creative use of Teddy Roosevelt's "bully pulpit" or perhaps the "bully twitter" here might help in addressing the otherwise politically un-addressable issues.

If the fiscal and banking-system crises are not resolved, near-term economic boosts could be for naught, as the ensuing dollar, financial and economic turmoil likely would have people yearning for the halcyon days of 2008.

Physical Holdings of Gold and Silver Provide a Practical Inflation Hedge and Store-of-Wealth. Although there is a chance for a reprieve from the pending, massive debasement of the U.S. dollar, ingrained institutional pressures favor not addressing the long-term U.S. fiscal imbalances or fundamental issues within the domestic banking system. Those pressures are strong and will be difficult to overcome before the 2018 congressional election, an event likely much too far into the future to help the dollar.

Real Gold Price versus Real S&P 500 Total Return Index



The current post-election surges in U.S. stocks and the U.S. dollar are not sustainable. In like manner, the related, recent sharp declines in gold and silver prices are not sustainable. When the dollar and stock prices break, the downside adjustment likely will be rapid, along with a corresponding upside reversal in precious metals, with domestic- and foreign-flight capital seeking safety in physical gold and silver.

Given likely heavy U.S. dollar selling or debasement, inflationary pressures should mount rapidly, with the inflation surge beginning with upside spikes to oil and gasoline prices, which, in turn, would tend to fuel a self–feeding cycle. In what would evolve rapidly into a major inflation problem—the early stages of hyperinflation—physical gold (primary) and silver remain the best hedges, stores of wealth that preserve the purchasing power of the invested assets, as well as being highly liquid and portable. They work as solid hedges, only if held through the currency/inflation crisis.

Shown in the preceding graph, despite the most-popular U.S. stock indices having rallied sharply recently, trading now at or near all-time highs, and despite heavy selling of gold this year, particularly, post-election, gold still has outperformed both the S&P 500 (graphed) and the Dow Jones Industrial Average, since the beginning of the new millennium. The plotted points reflect year-end closing prices (December 29th for the current year), with the indexed prices adjusted for CPI-U inflation, and with the stock-index values adjusted to reflect the reinvestment of dividends.

