John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

ShadowStats Flash Update No. 12

Mounting Systemic Liquidity Stress Evident in the Velocity of Money

October 21, 2019

**Dangerous Times for the U.S. Dollar;
Intensifying Flight to Precious Metals Likely**

**Domestic Systemic Liquidity Issues Appear Serious:
Third-Quarter 2019 Velocity of Money (M3) Is on Track for
Its Sharpest Quarterly Drop Since the Depths of the Great Recession**

**Liquidity Crisis Intensifies,
Reflecting Deepening Financial-System Instabilities**

**Used by Some at the Fed to Minimize FOMC Accommodation,
Overly Optimistic Economic Assumptions Are Falling Apart**

**Latest Headline Reporting, Revisions and Corrective Benchmarkings
Increasingly Put the Lie to Current Federal Reserve Presumptions of
Stable and Positive Economic Growth**

**A Deepening Economic Downturn and Flummoxed Fed Suggest
Intensified FOMC Accommodation at the October 29/30 Meeting, Reflected
Partially in the October 11th Inter-Meeting Liquidity-Infusion Program**

Contents – Flash Update No. 12

The ShadowStats Broad Outlook Remains Unchanged. Other than as exacerbated by fast-moving and potentially extreme domestic liquidity disruptions discussed in today's ***Flash Update No. 12,*** and by global and political instabilities and systemic stresses as highlighted in ***Flash Update No. 9***, ***Flash Update No. 10*** and ***Flash Update No. 11***, and reviewed regularly in the ***Daily Update*** section of the ***ShadowStats*** home page, the ShadowStats broad outlook in the weeks and months ahead remains for:

- A rapidly intensifying U.S. economic downturn and growing recognition of same.
- Mounting selling pressure on the U.S. dollar (particularly against the stronger, more stable currencies such as the Swiss Franc).
- Mounting flight to safety in precious metals, with upside pressures on gold and silver prices.
- Increasingly high risk of extraordinarily heavy U.S. stock-market selling.

Today's ***Flash Update*** previews key points pending in ***Commentaries No. 985-A* and *B*.**

Your comments and suggestions are invited. Always happy to discuss what is happening.

Best Wishes — John Williams (707) 763-5786, johnwilliams@shadowstats.com

Overview – Systemic Liquidity Risks Have Taken a Turn for the Worse

Headline Economic Conditions Continue to Deteriorate

Key Data and FOMC Actions of the Next Week and a Half Should Continue to Show Faltering Systemic and Economic Stability, Roiling the Markets. On October 30th, the Bureau of Economic Analysis (BEA) will publish its "Advance" estimate of Third-Quarter 2019 U.S. Gross Domestic Product (GDP), and the Federal Reserve's Federal Open Market Committee (FOMC) will announce any policy actions taken at its October 2019 meeting. With a mounting systemic-liquidity crisis, and a deepening slowdown in domestic economic activity, neither event is likely to be bullish for the U.S. dollar.

Weakening Third-Quarter 2019 GDP and a Deepening Recession. ShadowStats expects the headline "Advance" estimate of inflation-adjusted real, annualized quarterly growth in Third-Quarter 2019 GDP to have slowed to around 1.5%, from the current headline 2.0% annualized real growth in Second-Quarter 2019 GDP. In line with that, initial Third-Quarter 2019 GDP year-to-year real growth should drop to 1.9% from the present 2.3% Second-Quarter 2019 estimate. ShadowStats also expects that meaningful downside revisions will follow to the "Advance" Third-Quarter GDP growth, both in the monthly November and December 2019 revisions, as well in a major, negative overhaul of current headline GDP reporting in the July 2020 GDP Benchmark Revisions.

ShadowStats' expectations are below the current Market or Consensus Outlook estimate for initial Third-Quarter 2019 quarterly real growth of around 1.9% and annual year-to-year real growth of 2.0%, both also slowing from headline Second-Quarter 2019 quarterly growth of 2.0% and annual growth of 2.3%.

Underlying headline domestic economic activity continues to weaken sharply, deepening along with ongoing, negative headline monthly reporting and revisions, including negative annual benchmark revisions, with further hits to current headline numbers pending from government-shutdown- and budget-delayed negative annual benchmarkings yet to come. ShadowStats contends that the broad U.S. economy remains in deepening recession. A full assessment of current economic activity, and where the happy Wall Street Consensus and the FOMC's economic outlooks have gone astray, follows very shortly in ***Commentary No. 985-A***. While the outlook for an increasing number of economists and for the domestic markets likely will be shifting to a recession by year-end 2019, formal recession recognition likely will follow only after the 2020 election, given the lag times often common to the reporting of same.

Amidst Evidence of an Expanding, Major New Liquidity Crisis, More-Aggressive FOMC Easing Looms, Encompassing the Needs of Collapsing Areas of Systemic Liquidity and Economic Activity. Beyond the FOMC's October 11th inter-meeting Special Action to expand/renew "effective" Quantitative Easing, as discussed in ***Flash Update No. 11***, the pending October 30th FOMC remains a fair bet to expand "formal" Quantitative Easing (QE) to help promote systemic stability and liquidity, along with a rate cut of up to 50 basis points (0.50%). Following ***Commentary No. 985-A***, ***Commentary No. 985-B*** will review and update the likely pending actions by the FOMC, along with an updated *ShadowStats Financial Market ALERT*.

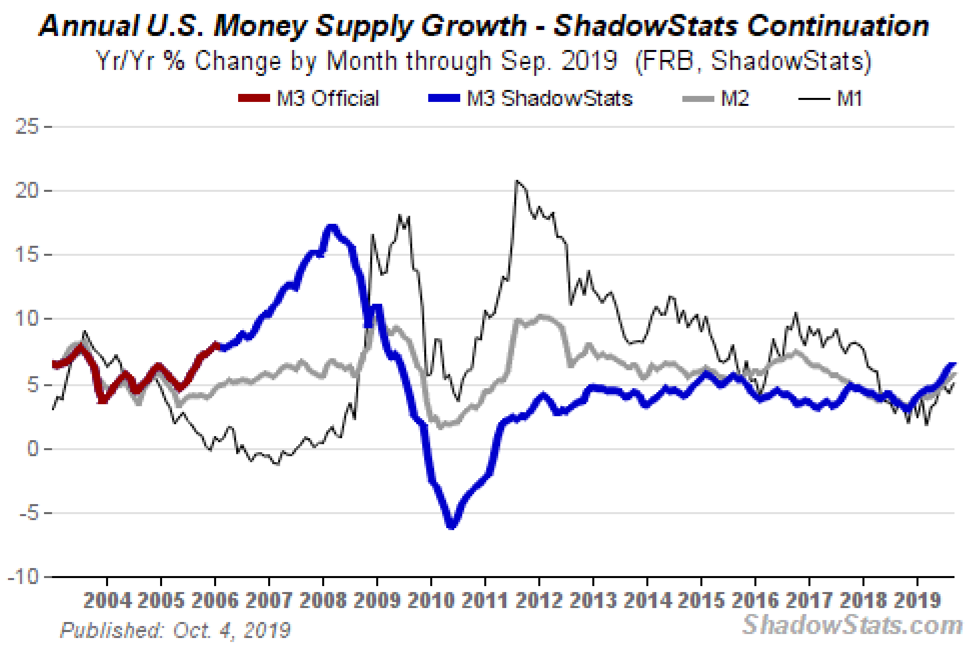
Discussed in the balance of today's ***Flash Update No. 12,*** the recent surge seen in the annual Money Supply growth, in combination with usually over-optimistic market expectations for pending, initial third-quarter GDP growth, imply the sharpest quarterly decline in the Velocity of Money (M3) for Third-Quarter 2019, since the depths of the Great Recession.

Contracting Velocity of Money Is a Negative Indicator of Liquidity and Economic Activity

Surging Annual Growth in Third-Quarter 2019 Money Supply M3 Has Set the Stage for the Worst Quarterly Drop in the Velocity of Money Since the Great Recession. The Velocity of Money is the ratio of nominal Gross Domestic Product to nominal Money Supply, or how many times the Money Supply turns over in the economy in one year. The slower the velocity, usually the slower is the growth in domestic liquidity and the economy.

While the Federal Reserve presently uses the ratio of Headline Nominal GDP to Headline Nominal Money Supply M2 for its Velocity of Money measure, ShadowStats uses the ratio of Headline Nominal GDP to the much broader Headline Nominal Money Supply M3, where M3 has the only really meaningful historical relationship to current patterns of domestic economic growth. M2 does not have such a relationship. The problem here is that the Fed ceased publishing its M3 estimate in March 2006. ShadowStats, however, has continued estimating and publishing that series to date, as reflected in ***Graph 1*** and as detailed in ***Money Supply Charts***, updated for September 2019 on October 4th. See the ShadowStats ***Money Supply Special Report*** of August 3, 2008 for a discussion of the reporting transition.

Graph 1: Money Supply M1, M2 and M3 to September 2019



Third-Quarter 2019 Velocity of Money (M3) Likely Is In Its Steepest Decline Since the Great Recession

Numbers in Hand to Estimate Third-Quarter 2019 Velocity of Money. With the headline estimate of Third-Quarter 2019 Nominal Money Supply in hand, all that is needed to estimate Third-Quarter 2019 Velocity of Money is Third-Quarter 2019 Nominal GDP. The Velocity of Money generally is viewed as a precursor to economic activity and inflation.

Discussed Earlier, consensus expectations for the initial Third-Quarter 2019 GDP are running around real annualized quarterly growth of 1.9%, where the consensus outlook usually is an overly optimistic number. With underlying economic reporting largely in place for the third quarter, the GDP consensus should hold close to its current level. Converted to nominal dollar terms, that GDP estimate divided by nominal M3 leaves the Third-Quarter 2019 Velocity of Money (M3) at its lowest level since the 2015 Mini-Recession, but showing its sharpest quarter-to-quarter drop since the depths of the Great Recession. Similar calculations for Money Supply M1 and M2 show the deepest levels of quarterly decline since the 2015 Mini-Recession (see *Graphs 2* to *5*). Again, only the broadest measure here—Money Supply M3—has good predictive quality. The plots of Money Supply M1 and M2 are provided for informational purposes.

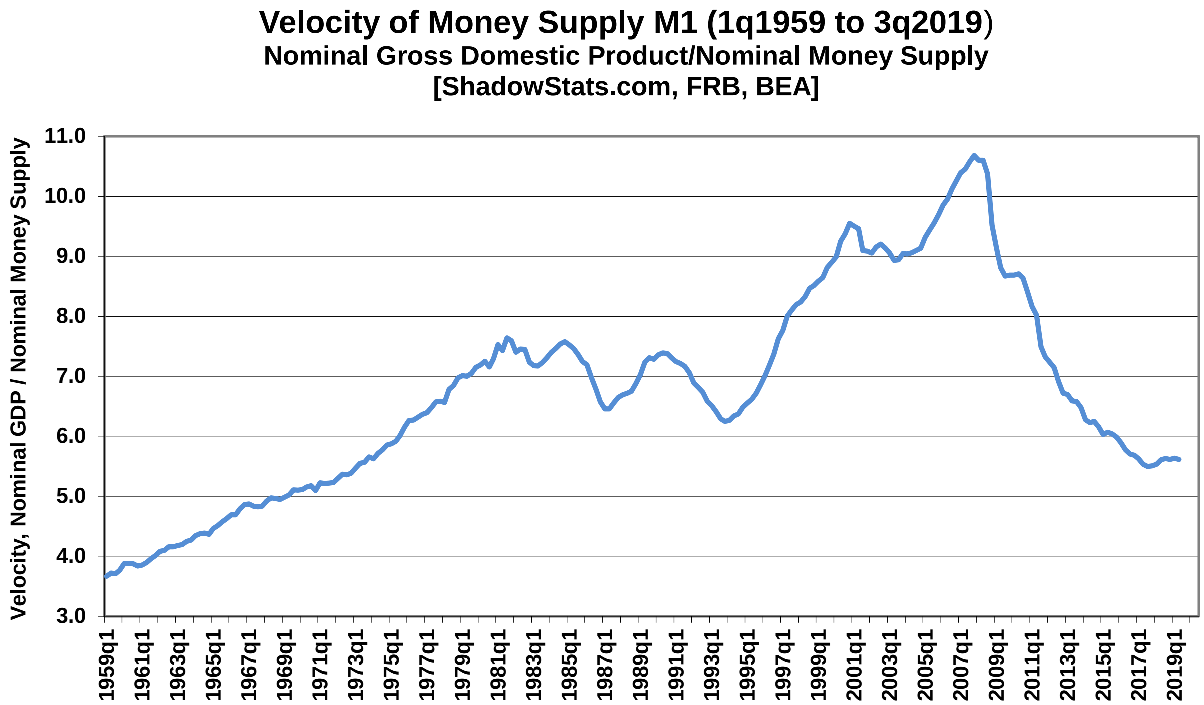
Where the consensus GDP estimate usually is overly optimistic, the declines in the Velocity of Money reflected here likely are conservative, where those declines would be deeper, if the ShadowStats lower quarterly real GDP growth estimate of 1.5% proved more accurate than the consensus 1.9%.

Preliminary Conclusion Is That the Unfolding Systemic Liquidity Fears Are Legitimate. What these numbers show is that despite a sharp pick-up in M3 growth, economic growth is not following. It looks like Third-Quarter 2019 M3 velocity will take its biggest quarter-to-quarter hit since the Great Recession, at the lowest level since the 2015 Mini-Recession, and a hair's breadth from being at the lowest level since the Great Recession.

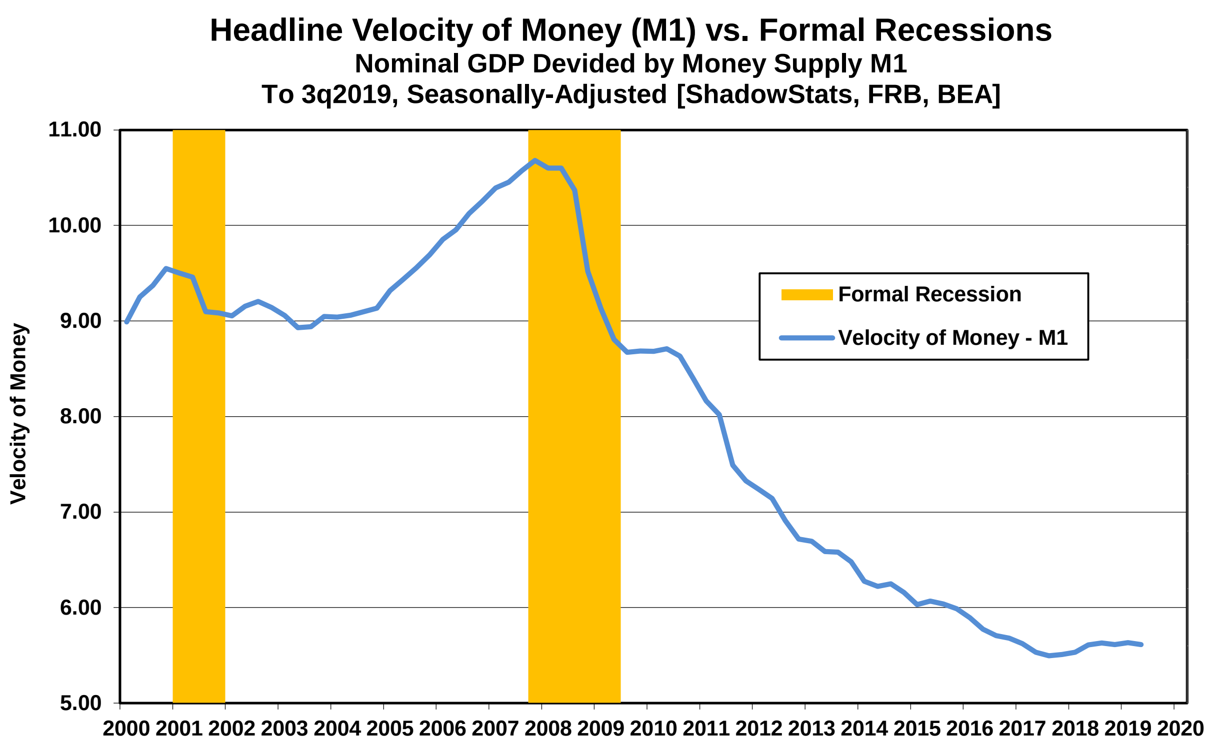
The systemic liquidity squeeze being seen now for the Fed (overnight repos/renewed QE) is real, like it was in 2007/2008. The downturning economy likely is going to get worse.

[Graphs 2 to 5 begin on the next page.]

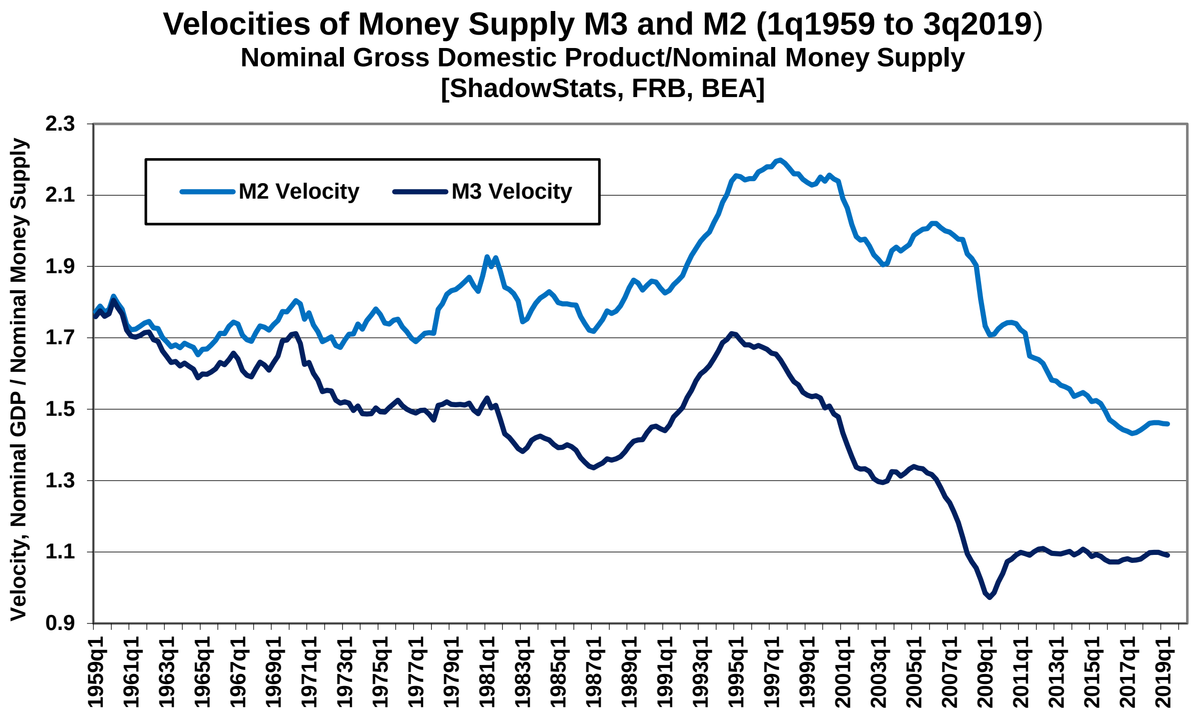
Graph 2: Velocity of Money (M1), Nominal GDP/M1 to Third-Quarter 2019



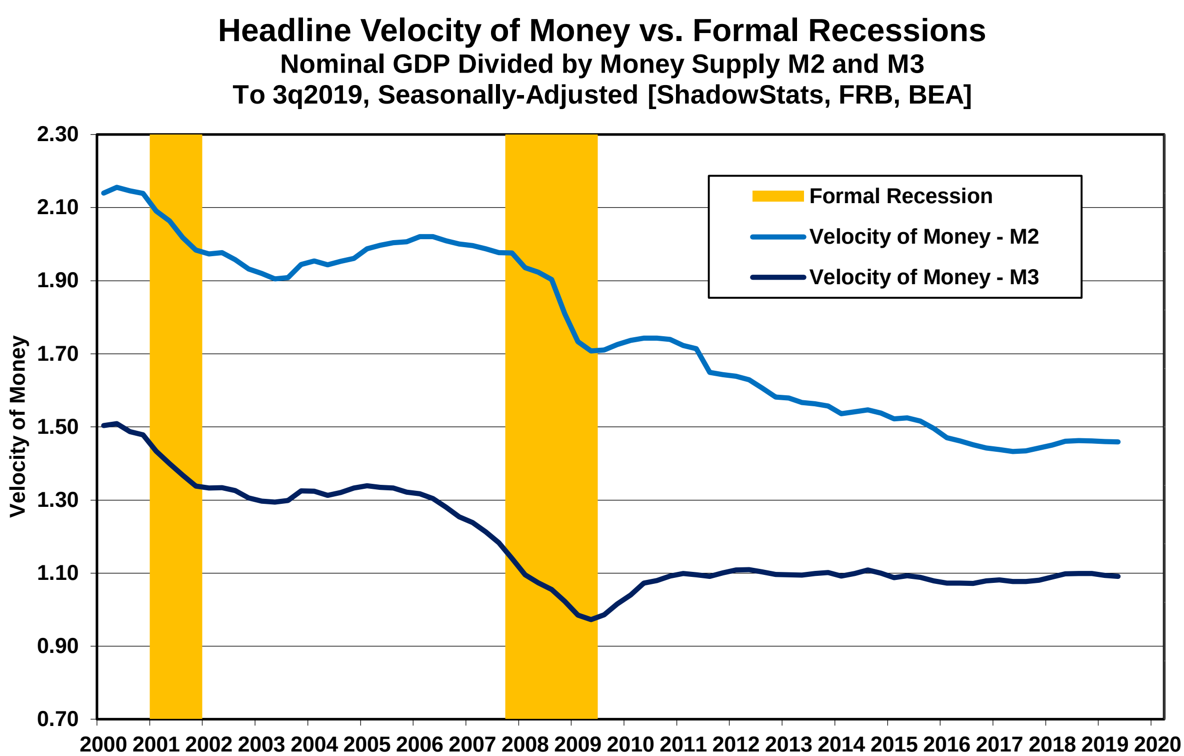
Graph 3: Velocity of Money (M1) vs. Formal Recessions, to Third-Quarter 2019



Graph 4: Velocity of Money (M2 and M3), Nominal GDP/M2 and M3 to Third-Quarter 2019



Graph 5: Velocity of Money (M2 and M3) vs. Formal Recessions, to Third-Quarter 2019



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