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

ShadowStats Flash Update No. 2
Financial Market Turmoil

August 6, 2019

China's Devaluation of the Yuan versus the Dollar Began in March 2019

Amidst Likely, Continuing Irregular Financial-Market Volatility and Intensifying Economic Weakness, Flight from U.S. Stocks and the Dollar Into Gold Should Intensify

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Special Note to Subscribers: Covered in today's ***Flash Update*** are several observations on the U.S. Dollar and Gold, out of the yesterday's global political developments and extreme financial-market turmoil. The market turmoil has abated, today, at least temporarily, as we go to press at about 3 p.m. ET. What transpired yesterday (August 5th), and has developed so far this morning, likely triggered or has reflected interventions in several markets, aimed at calming the volatility.

Commentary No. 985 should publish by August 8th, with expanded detail on the current financial-market developments, along with a full review of the Second-Quarter 2019 GDP and related Benchmark Revision details. The July 31st FOMC-meeting actions, updated for circumstances related to the on-again, off-again, sudden collapse of the Sino-U.S. trade relationship, also are covered.

The *ShadowStats* outlook has not changed, specifically including a rapidly deepening U.S. economic downturn, reflected in mounting downside pressures on the U.S. dollar, flight-to-safety and upside pressures on gold and silver prices, and increasingly high risk of heavy stock-market selling in the weeks ahead.

Please feel free to call anytime to discuss what is happening, or with any questions.

– Best regards, John Williams (707) 763-5786, johnwilliams@shadowstats.com

Escalating Sino-U.S. Trade War

Flight from Stocks and the Dollar into Gold

Burgeoning U.S. Trade Deficit Drains U.S. Economic Growth; the Largest and Fastest Growing U.S. Deficit Is With the People's Republic of China. The U.S. trade deficit is the biggest single drain on U.S. economic activity. Far and away the largest U.S. trade deficit with any country is the one with the People's Republic of China, which accounted for 46.4% of the total nominal U.S. trade deficit in first-half 2019. Consider where the headline, inflation-adjusted, second-quarter 2019 U.S. Gross Domestic Product (GDP) was an annualized 2.01%, that growth would have been 2.71% net of the deterioration in the second-quarter U.S. trade deficit. Again, that is the net change in the quarterly level of, not the aggregate level of the deficit. .

A number of issues have accounted for that deficit over the years, ranging from short-sighted U.S. trade policies, and what have evolved into costly, business-killing federal regulations on labor and the environment in the United States, to the lack of same and near slave-labor rates in China and its associated trade areas. The Trump Administration has been negotiating changes in that trade relationship, which at one point hiked tariffs, then relieved them, and then re-imposed meaningful tariffs last week.

Yesterday, China retaliated with a competitive devaluation of the Yuan and announced it would cease buying U.S. agricultural products. In response to these evolving circumstances, the U.S. stock market tanked, capital fled the U.S. Dollar and the price of gold surged, with an influx of flight capital. Similar patterns of market response are expected by ShadowStats as to the slowly unfolding, new recession and a still deeper and longer-range easing by the Federal Reserve's Federal Open Market Committee (FOMC) than the July 31st token quarter-point rate cut. Discussion of what likely is unfolding there—renewed quantitative easing—follows in pending *Commentary No. 985.*

China Began Devaluing the Yuan Back in March, Yet the Trade-Weighted U.S. Dollar Also Has Moved Higher Otherwise. *Graphs 1* and *2* plot first the Federal Reserve Board's (FRB) Major-Market Trade-Weighted Dollar "Goods Only" (TWD), which reflects the U.S. dollar exchange rate weighted versus the Euro, Yen, Pound Sterling, Australian Dollar, Swiss Franc and the Canadian Dollar; and the ShadowStats Financial-Weighted Dollar (FWD). The ShadowStats index reflects the U.S. dollar exchange rate weighted versus the same currencies, based on respective currency trading volume in the markets, instead of merchandise trade. Current relative strength in the U.S. dollar broadly has reflected prospects for a non-easing FOMC and strong economic circumstances, both of which have begun to reverse.

ShadowStats modified the FWD to add the Chinese Yuan (CNY), at such time as it was recognized as a global reserve currency by the Bank for International Settlements in 2015, but there was no resulting visual difference in the ShadowStats plot, until recently, given the relatively low weighting of the CNY at present, and the closely tied movement of the CNY to USD over time. The plots of the FWD versus the TWD and FWD are updated here through the July averages, with the last point reflecting yesterday's

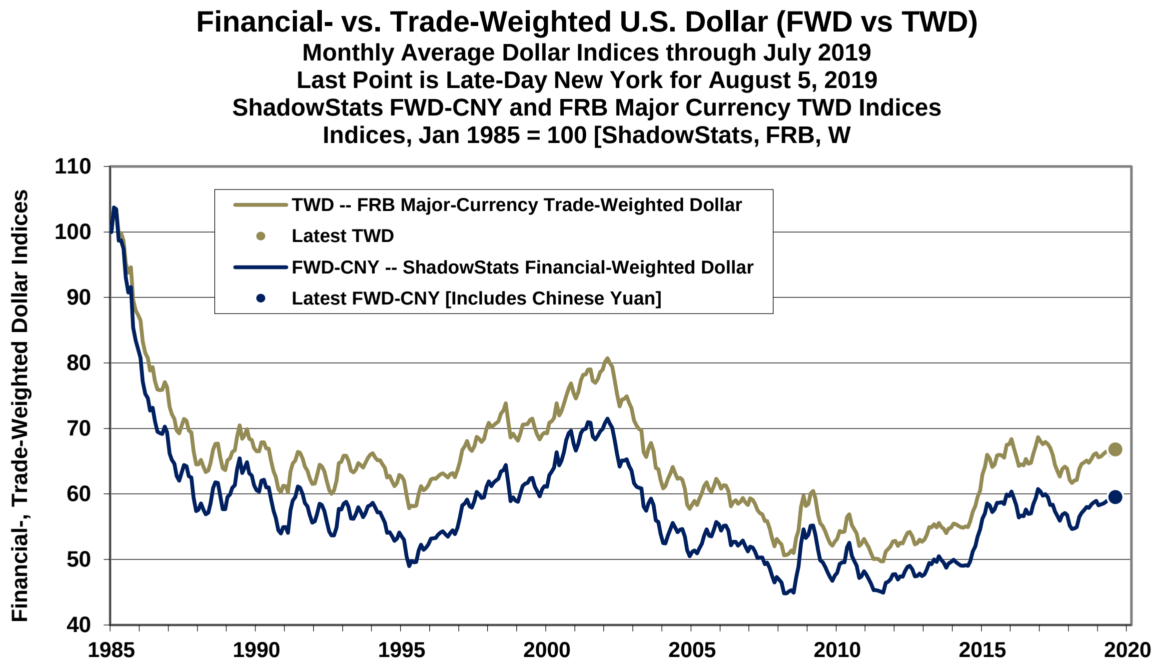
August 5th New York Close. The competitive Yuan devaluation left the Chinese currency down by 2.6% (-2.6%) from its July average, but yesterday's close also was down by an aggregate 4.8% (-4.8%) from the March 2019 average, when the Dollar began its current decline against the Yuan. What is new is that China allowed the Yuan to trade above 7.0 to the dollar in yesterday's move.

The effect of the move in the CNY was that the aggregate Financial-Weighted Dollar strengthened, or became less competitive by 0.1%, or 0.2% against March. Again, those numbers are against the whole world, where, again, the headline disadvantage against the Yuan has been 4.8% since March 2019.

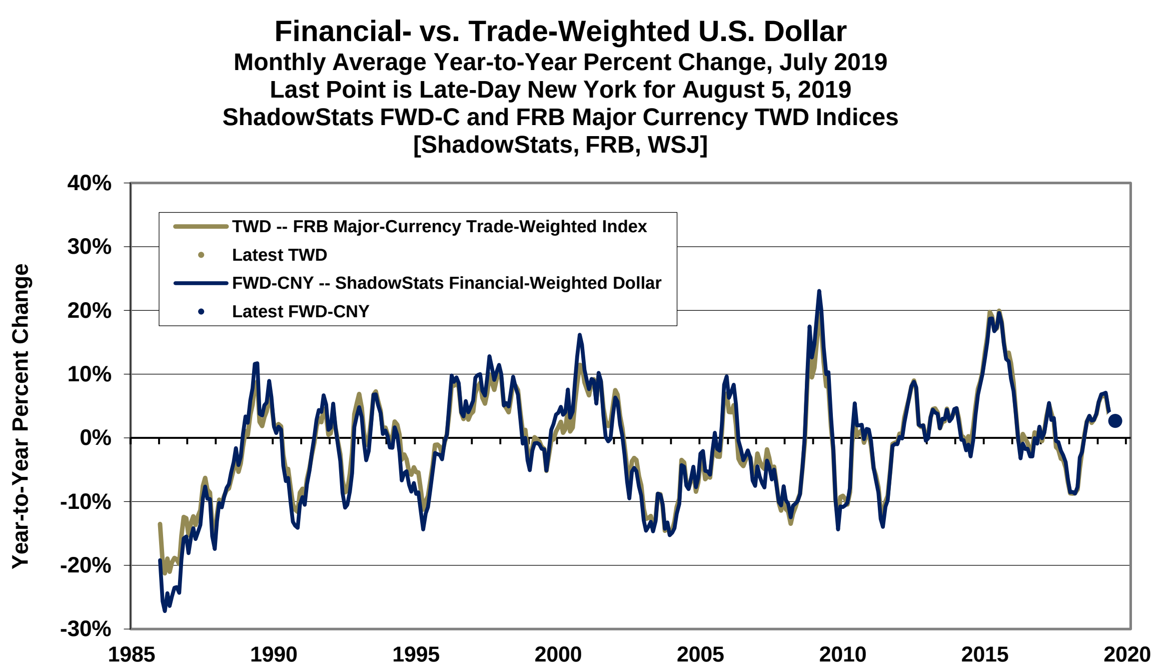
Gold versus the S&P 500® and the Dow Jones Industrial Average. *Graphs 3* and *4* show respective plots of the levels of the S&P 500 Total Return Index (all dividends reinvested) and the Dow Jones Industrial Average (the raw DJIA, no dividend accounting) versus the price of physical gold, with all series indexed to January 2000 =100, in nominal dollar terms (not adjusted for inflation). Where gold had gained with growing gap against the stock indices into 2011, falling back some as gold pulled back in 2014, that upside gap has begun to grow anew in favor of gold in the current circumstance.

[Graphs 1 to 4 begin on the next page.]

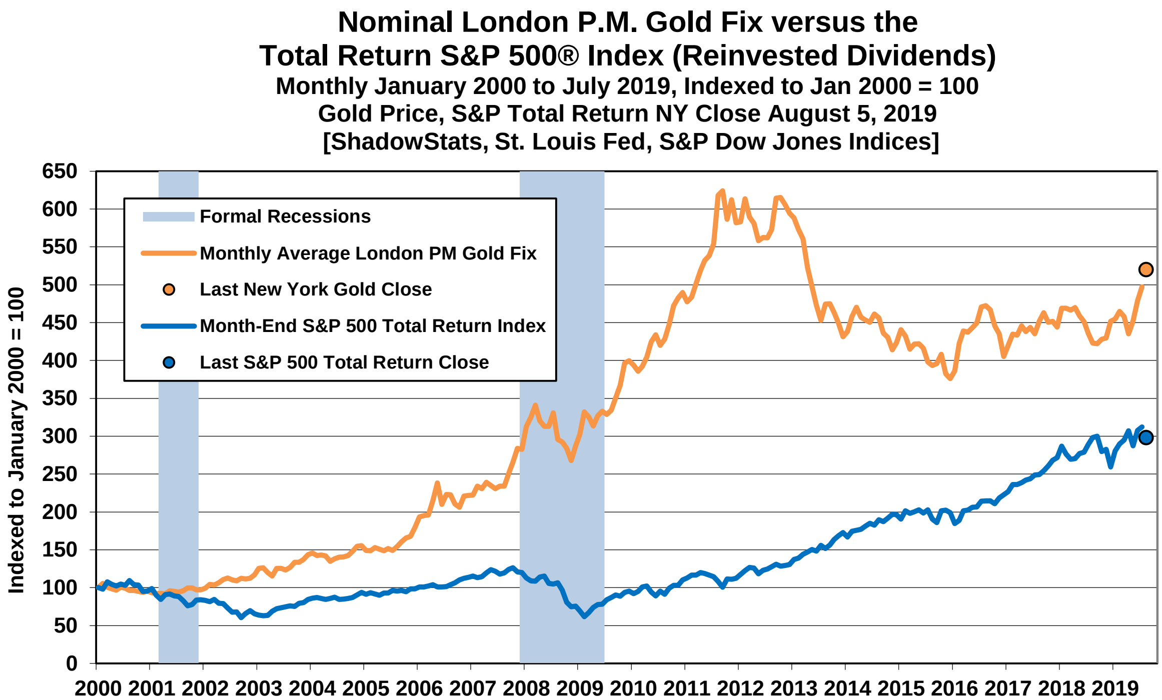
Graph 1: Financial- versus Trade-Weighted U.S. Dollar to Date – Index Level



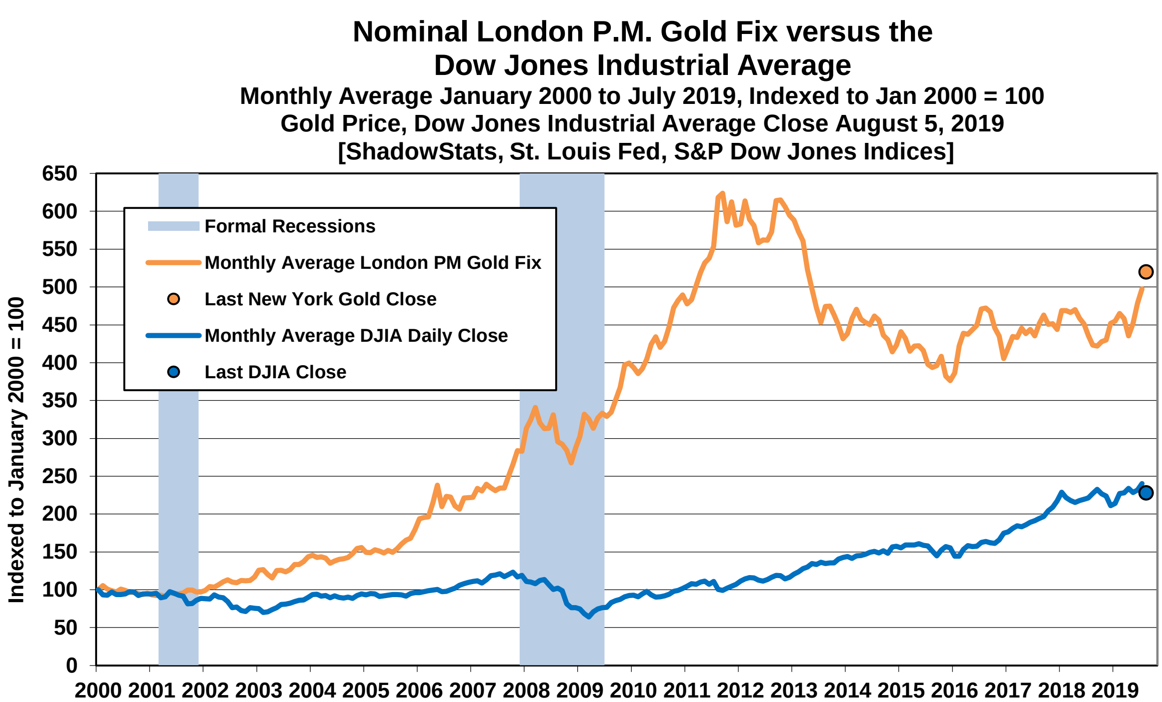
Graph 2: Financial- versus Trade-Weighted U.S. Dollar to Date – Year-to-Year Change



Graph 3: Nominal Gold versus the Total Return S&P 500® (January 2000 to Date)



Graph 4: Nominal Gold versus the Dow Jones Industrial Average (January 2000 to Date)



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