

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

COMMENTARY NUMBER 559
Hyperinflation Update, FOMC

September 19, 2013

Fed Is Trapped In the End Game for the U.S. Dollar
Panic of 2008 Still Is Playing Out
Hyperinflation Forecast Remains in Place

PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, September 25th, covering August home sales and new orders for durable goods. A subsequent Commentary on the 26th will cover the third estimate, second revision to second-quarter 2013 GDP.

The Hyperinflation Outlook and Week Ahead sections have been revised. The release of August existing-home sales is covered only in the Reporting Detail section.

Best wishes to all — John Williams

THE END GAME NEARS

The United States faces a likely hyperinflationary depression before the end of 2014. That forecast has been in place for years, and still remains. The ultimate, complete debasement of the U.S. dollar became inevitable in recent decades, when those controlling the U.S. government—both sides of the aisle—

deliberately took on federal debt and obligations that never could be satisfied through normal fiscal operations. The timeframe for the eventual full loss of global and domestic confidence in the dollar (all dollar references are to the U.S. dollar, unless otherwise stated) initially was for late in the current decade. That timing was moved to 2014 after the actions taken by the Federal Reserve and the federal government to stabilize the financial system during, and in the wake of, the 2008 financial panic and crisis.

Creating, spending, guaranteeing, loaning and giving away whatever money was needed, the U.S. government and central bank moved to prevent the collapse of the U.S. financial system, which included bailing out major institutions. When systemic collapse was avoided five years ago, effectively by pushing it into the future, none of the underlying issues that fueled the crisis were resolved. The U.S. economy has not recovered and appears to be resuming its contraction. The U.S. banking system remains under severe financial stress, as would appear to have been confirmed, yesterday, by the Federal Reserve's decision not to cut back on its quantitative-easing program.

Where the proximal trigger for the looming sharp increase in inflation and eventual hyperinflation likely will be massive selling of the U.S. dollar in the currency markets, two major illusionary props for the dollar are evaporating. The markets have begun to focus, again, on troubling underlying reality tied to Fed activity and the government's fiscal circumstance, while other major dollar fundamentals—the economy and political stability—have turned increasingly negative. In combination, these factors suggest a rapidly approaching day-of-reckoning for the dollar.

The first big the myth was that the Federal Reserve would extricate itself from its quantitative easing, due to the improving economy. That story appears now to have been confirmed as nothing more than jawboning, aimed at propping the dollar, depressing gold and silver prices and temporarily appeasing critics of Federal Reserve policies.

The Fed has shown itself to be locked in now for the end game. It had the opportunity, yesterday (September 18th), to back off QE3. With markets already expecting reduced bond buying, some less-accommodative action could have been taken without collapsing the stock market. Instead, the U.S. central bank held its policy intact.

As discussed in [Commentary No. 552](#), evidence persists of serious and intensifying financial stress within the banking system. The Fed's quantitative easing always has been about maintaining banking-system liquidity and solvency, not boosting the economy. Fed Chairman Bernanke has admitted that there is little the Fed can do to stimulate business activity. The Fed simply uses the weak economy as political cover for propping the banking system.

The second big myth is that federal deficit is improving and no longer is a problem. While the cash-based deficit for fiscal 2013 will be lower than in 2012, thanks to some one-time factors and accounting gimmicks, that will not be true for the generally accepted accounting principles (GAAP)-based deficit that ran at an uncontrollable annual pace of \$6.6 trillion in 2012.

Long-term U.S. sovereign-solvency and fiscal issues, which the global currency markets have held in abeyance for two years, with waning patience, are about to explode anew. Washington is within weeks of having to deal with all the unresolved fiscal and debt-ceiling issues that have been pushed repeatedly into the future. Whatever actions are taken—even attempts at further delayed action—should have negative impact on the dollar. There is no chance of action that would resolve the fiscal crisis.

Separately, the U.S. economy is turning down anew, noticeably, and the Presidential approval rating already is at low level that usually would be a negative for the dollar. Combined, all these factors suggest difficult times ahead for the dollar. Heavy dollar selling initially would spike oil and gasoline prices, increasing domestic inflation, while hurting already-declining economic activity. It also would put at risk the dollar's global reserve status, which likely will be lost or severely modified.

Irrespective of intervening intervention, jawboning or efforts at controlling currency flows, selling of the U.S. dollar eventually should become massive, involving global dumping of dollar-denominated assets such as U.S. Treasury securities. With a collapsing bond market, the Fed would be forced to intervene, in order to absorb the excess debt, rapidly accelerating the monetization of Treasury securities. Money supply growth and velocity (see [Money Supply Special Report](#)) would spike, as inflation moved beyond control. Domestic and foreign holders of dollars would lose confidence in the U.S. currency, holding dollars for as short a time as possible.

The odds for the predicted hyperinflation continue at 90%. Holding physical gold and silver remains the primary hedge and protection for preserving the purchasing power of assets and wealth currently denominated in U.S. dollars. Holding assets outside the U.S. dollar in what will be stronger currencies, such as the Swiss franc, Canadian dollar and the Australian dollar also provides hedging. The fundamentals detailed in [Hyperinflation 2012](#) have not changed. Although that report will be updated in the next month, the background to the crisis, contingencies, hedging concerns and other major areas discussed have not changed.

HYPERINFLATION WATCH

Hyperinflation Outlook—Updated Summary. This updated *Hyperinflation Outlook* revises the summary published in [Commentary No. 550](#) of August 16th. Changes in text have been highlighted with underlining. The summary is intended as background material for new subscribers and for those looking for a brief summary of the broad outlook of the economic, systemic and inflation crises that face the United States in the year or so ahead.

Background Material. [No. 527: Special Commentary](#) (May 2013) supplemented [No. 485: Special Commentary](#) (November 2012), reviewing shifting market sentiment on a variety of issues affecting the U.S. dollar and prices of precious metals. *No. 485*, in turn, updated [Hyperinflation 2012](#) (January 2012)—the base document for the hyperinflation story—and the broad outlook for the economy and inflation, as well as for systemic-stability and the U.S. dollar. Of some use, here, also is the [Public Comment on Inflation](#).

These are the primary articles outlining current conditions and the background to the hyperinflation forecast, and they are suggested reading for subscribers who have not seen them and/or for those who otherwise are trying to understand the basics of the hyperinflation outlook. The fundamentals have not changed in recent years, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, a fully-updated hyperinflation report is planned in the month ahead.

Beginning to Approach the End Game. Nothing is normal: not the economy, not the financial system, not the financial markets and not the political system. The financial system still remains in the throes and aftershocks of the 2008 panic and near-systemic collapse, and from the ongoing responses to same by the Federal Reserve and federal government. Further panic is possible and hyperinflation remains inevitable.

Typical of an approaching, major turning point in the domestic- and global-market perceptions, bouts of extreme volatility and instability have been seen with increasing frequency in the financial markets, including equities, currencies and the monetary precious metals (gold and silver). Consensus market expectations on the economy and Federal Reserve policy also have been in increasing flux. The FOMC and Federal Reserve Chairman Ben Bernanke have put forth a plan for reducing and eventually ending quantitative easing in the form of QE3. The tapering or cessation of QE3 is contingent upon the U.S. economy performing in line with overly-optimistic economic projections provided by the Fed. Initially, market reaction pummeled stocks, bonds and gold. Yet, the early talk of tapering QE3 was little more than jawboning, aimed either at placating a growing chorus of Fed critics or at manipulating variously the gold, currency and domestic-stock markets.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment even could shift from what now is no imminent end to QE3, to an expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and, increasingly, they are beginning to to recognize same. Business activity remains in continued and deepening trouble, and the Federal Reserve is locked into quantitative easing by persistent problems now well beyond its control. Specifically, banking-system solvency and liquidity remain the primary concerns for the Fed, driving the quantitative easing. Economic issues are secondary concerns for the Fed; they are used as political cover for QE3. That cover will continue for as long as the Fed needs it.

At the same time, deteriorating expectations for domestic political stability reflect government scandals and conflicting policy actions, in addition to the dominant global-financial-market concern of there being no viable prospect of those controlling the U.S. government addressing the long-range sovereign-solvency issues of the United States government. These factors, in combination, show the end game to be nearing, and while they may have been in recent summer-holiday hibernation, post-Labor Day political turmoil is imminent.

The most visible and vulnerable financial element to suffer early in this crisis likely will be the U.S. dollar in the currency markets (all dollar references here are to the U.S. dollar, unless otherwise stated). Heavy dollar selling should evolve into massive dumping of the dollar and dollar-denominated paper assets, at any time, with little or no warning. Dollar-based commodity prices, such as oil, should soar, accelerating the pace of domestic inflation. In turn, that circumstance likely will trigger some removal of the U.S. dollar from its present global-reserve-currency status, which would further exacerbate the currency and inflation problems tied to the dollar.

This still-forming great financial tempest has cleared the horizon; its impact on the United States and those living in a dollar-based world will dominate and overtake the continuing economic and systemic-solvency crises of the last eight years. The issues that never were resolved in the 2008 panic and its aftermath are about to be exacerbated. Based on precedents established in 2008, likely reactions from the government and the Fed would be to throw increasingly worthless money at the intensifying crises, hoping to push the problems even further into the future. Such attempts to save the system, however, all have exceptional inflationary implications.

The global financial markets appear ready to move beyond the forced patience with U.S. policies that had been induced by the financial terror of the 2008 panic. Accordingly, the U.S. dollar faces likely extreme and negative turmoil in the months ahead. A domestic hyperinflationary environment still should evolve from something akin to these crises before the end of next year (2014). The shifting underlying fundamentals are discussed in [No. 527: Special Commentary](#); some of potential breaking crises will be expanded upon in the next revision to the hyperinflation report.

Still Living with the 2008 Crisis. Despite the happy news from the redefined GDP series that the recession was shallower, and the recovery more rapid, than previously estimated, there still never has been an actual recovery following the economic downturn that began in 2006, and collapsed into 2008 and 2009. No other major economic series has confirmed the pattern of activity now being reported in the GDP. Indeed, 2012 household income data from the Census Bureau show no recovery whatsoever.

Instead, what followed was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012 (see the corrected GDP graph in the *Opening Comments* section of [Commentary No. 552](#)). The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series (see [No. 527: Special Commentary](#) and [Public Comment on Inflation](#)). Nonetheless, given the nature of official reporting, the renewed downturn still should gain eventual recognition as the second-dip in a double- or multiple-dip recession, with current reporting in basic economic series, such as housing, retail sales and production (not the GDP), coming into synchronization with a renewed downturn in broad economic activity starting in second- and third-quarter 2013.

What continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 turmoil. All the extraordinary actions and interventions bought a little time, but they did not resolve the various crises. That the crises continue can be seen in deteriorating economic activity and in the ongoing panicked actions by the Federal Reserve, where it still proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise. As of August 2013, the Fed had monetized in excess of 100% of the net issuance of U.S. Treasury debt, since the beginning of the calendar year.

The Fed's unconscionable market manipulations and games playing in fueling speculation over the future of quantitative easing clearly were used to move the U.S. dollar (the purpose of initial quantitative easing was U.S. dollar debasement). QE3 and continuing efforts at dollar-debasement are not about to go away. Further complicating the circumstance for the U.S. currency is the increasing tendency of major U.S. trading partners to move away from using the dollar in international trade. The loss of some reserve status for the U.S. dollar is likely, as the crises break, and that would intensify both the dollar-selling and domestic U.S. inflationary pressures.

The Fed's recent and ongoing liquidity actions themselves suggest a signal of deepening problems in the financial system. Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Accordingly, the Fed's continuing easing moves appear to have been primarily an effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury, under the political cover of a "weakening economy." Mounting signs of intensifying domestic banking-system stress are seen in soft annual growth in the broad money supply, despite a soaring pace of annual growth in the monetary base, and in global banking-system stress that followed the crisis in Cyprus and continuing, related aftershocks.

Still Living with the U.S. Government's Fiscal Crisis. Again, as covered in [No. 527: Special Commentary](#), the U.S. Treasury still is in the process of going through extraordinary accounting gimmicks, at present, in order to avoid exceeding the federal-debt ceiling. Late-September appears to be the deadline for resolving the issues tied to the debt ceiling, including—in theory—significant budget-deficit cuts.

Both Houses of Congress have put forth outlines of ten-year budget proposals that remain shy on detail. The ten-year plan by the Republican-controlled House proposes to balance the cash-based deficit as well as to address issues related to unfunded liabilities. The plan put forth by the Democrat-controlled Senate does not look to balance the cash-based deficit. Given continued political contentiousness and the use of unrealistically positive economic assumptions to help the budget projections along, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of upcoming negotiations. There still appears to be no chance of a forthcoming, substantive agreement on balancing the federal deficit.

Indeed, ongoing and deepening economic woes assure that the usual budget forecasts—based on overly-optimistic economic projections—will fall far short of fiscal balance and propriety. Chances also remain nil for the government fully addressing the GAAP-based deficit that hit \$6.6 trillion in 2012, let alone balancing the popularly-followed, official cash-based accounting deficit that was \$1.1 trillion in 2012 (see [No. 500: Special Commentary](#)). Recent reductions reported in the year-to-date cash-based 2013 deficit reflect gimmicks such as the U.S. government declaring itself dividends out of government-backed and controlled Fannie Mae and Freddie Mac. Those dividends also have helped the Treasury operate around the limits of the current debt ceiling. If the government consolidated those entities into its financial statements, as would happen in the corporate world, the deficit position would be much bleaker, as it is otherwise with generally accepted accounting principles or GAAP-based accounting.

Efforts at delaying meaningful fiscal action, including briefly postponing conflict over the Treasury's debt ceiling, bought the politicians in Washington minimal time in the global financial markets, but the time has run out and patience in the global markets is near exhaustion. The global markets previously had expressed their extreme discomfort with the unresolved longer-range sovereign solvency issues of the United States, by dumping dollars at the time of the failed July/August 2011 fiscal negotiations. The continuing unwillingness and political inability of the current government to address those issues, only pushes along the regular unfolding of events that eventually will trigger a massive flight from the U.S. dollar and a domestic hyperinflation, as discussed in [Commentary No. 491](#).

U.S. Dollar Remains Proximal Hyperinflation Trigger. The unfolding fiscal catastrophe, in combination with the Fed's direct monetization of Treasury debt, eventually (more likely sooner rather than later) will savage the U.S. dollar's exchange rate, boosting oil and gasoline prices, and boosting money supply growth and domestic U.S. inflation. Relative market tranquility has given way to mounting instabilities,

and extreme market turmoil likely looms, despite the tactics of delay by the politicians and ongoing obfuscation by the Federal Reserve.

This should become increasingly evident as the disgruntled global markets begin to move sustainably against the U.S. dollar. As discussed earlier, a dollar-selling panic is likely this year—still of reasonably high risk in the near-term—with its effects and aftershocks setting hyperinflation into action in 2014. Gold remains the primary and long-range hedge against the upcoming debasement of the U.S. dollar, irrespective of any near-term price gyrations in the gold market.

The rise in the price of gold in recent years was fundamental. The intermittent panicked selling of gold has not been. With the underlying fundamentals of ongoing dollar-debasement in place, the upside potential for gold, in dollar terms, is limited only by its inverse relationship to the purchasing power of the U.S. dollar (eventually headed effectively to zero). Again, physical gold—held for the longer term—remains as a store of wealth, the primary hedge against the loss of U.S. dollar purchasing power.

REPORTING DETAIL

EXISTING-HOME SALES (August 2013)

Annual Growth Slowed for August Existing-Home Sales. Despite the positive press surrounding the reported 1.7% monthly gain in August 2013 existing-home sales, the latest activity remained 24.6% below the June 2005 pre-recession high for the series, with annual growth slowing to 13.2% in August, from 17.2% in July.

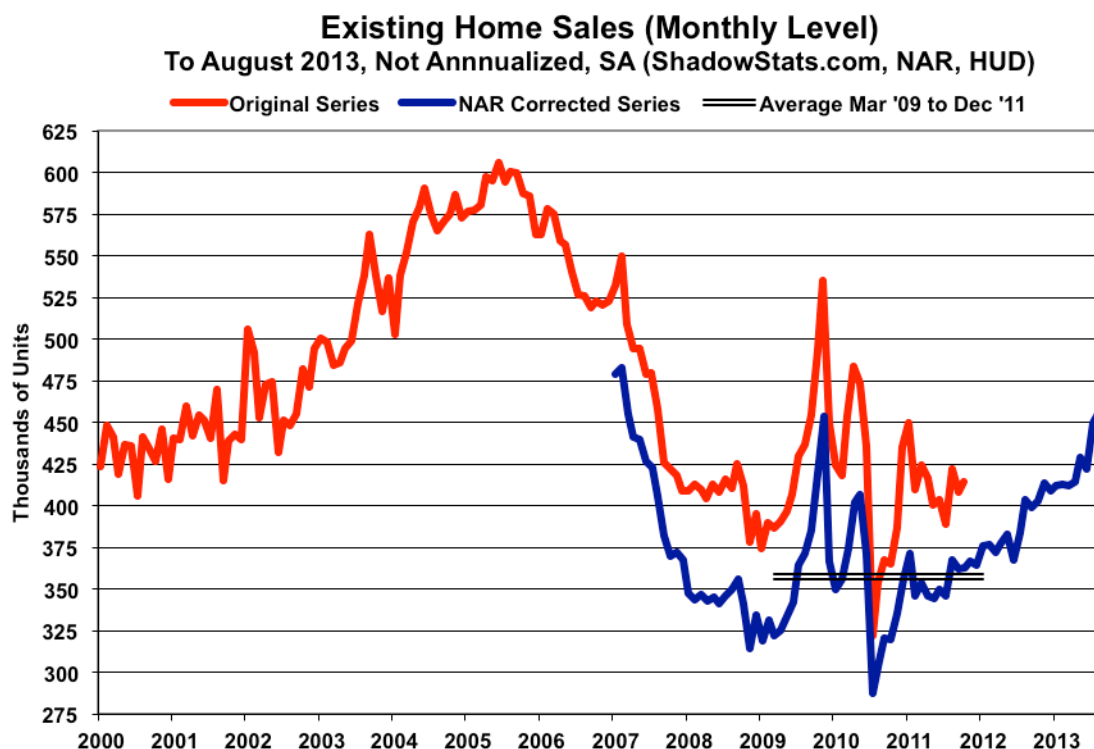
Given questions of the series' reliability, particularly the quality of, and the volatility, instabilities and uncertainties in the reporting of existing-home sales, not too much should be read into the reported trends. These data will be reviewed in the context of new home sales and residential construction in the upcoming September 25th *Commentary*.

August 2013 Existing-Home Sales Reporting. This morning's (September 19th) release of August 2013 existing-home sales (counted based on actual closings, National Association of Realtors [NAR]) showed a seasonally-adjusted monthly gain of 1.7%, against an unrevised 6.5% increase in July.

The August increase to a seasonally-adjusted, monthly-unit sales pace of 456,700 (an annualized pace of 5,480,000), from 449,200 (5,390,000 annualized) in July, was within normal month-to-month volatility

for this otherwise unstable series. On a year-to-year basis, August 2013 annual sales slowed to 13.2%, from 17.2% in July.

Smoothed for irregular distortions, the series remained statistically consistent with a period of broad stagnation that has turned into an uptrend, as suggested by the accompanying graph. Again, the data remain of questionable enough quality to leave the indicated trend highly uncertain.



The portion of total sales in distressed properties declined in the latest reporting to a post-2008 Crisis low. The NAR estimated “distressed” sales in August 2013 were 12% of the total (8% foreclosures, 4% short sales), versus 15% (9% foreclosures, 6% short sales) in July.

As discussed in yesterday’s [Commentary No. 558](#), however, there have been no developments in underlying economic fundamentals that would suggest a pending housing-industry turnaround or broad economic recovery.

Reflecting ongoing lending problems (and likely related solvency issues) within the banking industry, and continuing influx of speculative investment money, the NAR also estimated that all-cash sales in August 2013 were at 32% of the total, up from 31% in July 2013 and 27% in August 2012.

WEEK AHEAD

Weaker-Economic and Stronger-Inflation Reporting Likely in the Months Ahead. Despite continuing downside adjustments to consensus expectations on the domestic economy, the markets still are overly optimistic. That circumstance, and underlying fundamentals that are suggestive of deteriorating business activity, mean that weaker-than-consensus economic reporting should remain the general trend. Inflation likely will be higher than market expectations.

In terms of monthly inflation reporting, energy-inflation-related seasonal-adjustment factors are on the plus-side through the end of the year. That, combined with likely stable or higher oil and gasoline prices, means stronger-than-expected headline CPI and PPI are a good bet for at least the next four months, and beyond. Upside pressure on oil-related prices should reflect intensifying impact from a weakening U.S. dollar in the currency markets, and from ongoing political instabilities in the Middle East. The dollar faces pummeling from continuing QE3, and the soon-to-resurface fiscal-crisis/debt-ceiling debacle (see opening comments and the *Hyperinflation Outlook* section). Particularly in tandem with the likely weakened dollar, inflation reporting in the year ahead generally should reflect much higher-than-expected inflation (see also [No. 527: Special Commentary](#)).

A Note on Reporting Quality Issues and Systemic Reporting Biases. Significant reporting-quality problems remain with most major economic series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-ongoing economic turmoil of the last six-to-seven years, which has been without precedent in the post-World War II era of modern economic reporting. These impaired reporting methodologies provide particularly unstable headline economic results, where concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data), and they have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

Existing- and New-Home Sales (August 2013). August 2013 existing-home sales were released this morning (September 19th) by the National Association of Realtors and are covered in the *Reporting Detail* section. August new-home sales reporting from the Census Bureau is due on Wednesday, September 25th. As is the usual circumstance with these highly volatile and unstable series, whether existing or new sales, an entrenched pattern of stagnation has continued, with the pending report of monthly change in new-home sales activity not likely to be statistically-significant, in either direction, particularly in the context of prior-month revisions. These series should continue to show an ongoing relationship with the weakening trend in single-unit housing starts, as reported and graphed for August 2013 in yesterday's [Commentary No. 558](#).

New Orders for Durable Goods (August 2013). The Census Bureau has scheduled release of August 2013 new orders for durable goods for Wednesday, September 25th. Other than for the continuing sharp and irregular volatility in commercial aircraft orders, new orders generally have been stagnant. Once again, some intensification of recent, sporadic downside movement in orders remains likely during the next several months, coincident with slowing activity evident in other economic indicators. Such reporting generally would tend to surprise market expectations on the downside.

As to the inflation contribution to the monthly and annual change in new orders, the seasonally-adjusted, August 2013 PPI finished goods capital equipment inflation index was down by 0.1%, month-to-month, with year-to-year unadjusted (and adjusted) inflation at 0.6%. These inflation numbers increasingly are nonsensical. Due to hedonic-quality-adjustment distortions to this portion of the PPI series, as with the industrial production and GDP numbers, those inflation data understate inflation reality and, correspondingly, overstate inflation-adjusted growth, by perhaps three-percentage points per year.

GDP (Second-Quarter 2013, Third Estimate, Second Revision). The third estimate of second-quarter 2013 GDP is due for release on Thursday, September 26th, by the Bureau of Economic Analysis (BEA). While the developing consensus may be for a slight upside revision to the third estimate, versus the 2.5% annualized headline growth rate currently in place, any revision should be minimal and no more than ongoing statistical noise. Whatever is reported for this most-worthless of economic series, the new growth estimate will not be statistically significant and will remain useless in terms of providing a meaningful picture of current, broad economic activity.
