

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

**COMMENTARY NUMBER 648**  
**June 2014 Trade Balance, Monetary Conditions**  
**August 6, 2014**

---

**Despite Narrowing in June Trade Deficit  
GDP Growth Remains Subject to Trade-Related Downside Revision**

**Monetary Base at All-Time High**

**Pace of Fed Monetization at 91% Year-to-Date 2014**

**July M3 Annual Growth at Five-Year High of 4.7%**

---

*PLEASE NOTE: The next regular Commentary is scheduled for Wednesday, August 13th, covering July retail sales. That will be followed on Monday, August 18th, with a Commentary covering July industrial production and the producer price index (PPI).*

*Best wishes to all — John Williams*

**OPENING COMMENTS AND EXECUTIVE SUMMARY**

**Continued Economic Weakness Should Surface in Second-Quarter Revisions and Early-Third-Quarter Reporting.** Today's (August 6th) report on the June trade deficit was one of the missing, final indicators for solidifying estimates of second-quarter GDP growth. Although the June trade deficit in goods and services narrowed versus May's reading, the second-quarter merchandise trade deficit—net of inflation—still widened enough versus the first-quarter number to indicate some trade-related, downside revision pending to the recent headline 3.95% GDP growth estimate (see [Commentary No. 646](#)). Significant other downside revisions to GDP growth should become more evident in the weeks ahead.

Headline reporting of key July economic series—initial indicators of third-quarter 2014 economic activity—begin with retail sales on August 13th (see *Week Ahead* section). Headline reporting for the most-widely-followed series generally should disappoint market expectations, confirming a continuing decline in broad economic activity. In turn, the market outlook should move increasingly towards renewed economic contraction. A summary of initial July economic reporting is planned for *Commentary No. 651* on August 19th.

Today's *Hyperinflation Watch* section includes the latest detail on monetary conditions, as well as an updated *Hyperinflation Outlook Summary*. Despite formal reductions in asset purchases by the Fed, money supply, the monetary base and the pace of Treasury-debt monetization all are on the upswing.

Also, ShadowStats-affiliate [www.ExpliStats.com](http://www.ExpliStats.com) has just published its extended analysis of the [trends and biases](#) built into the concurrent seasonal factor modeling of the July payroll employment (by the Bureau of Labor Statistics), with implications that already are in place for reporting of August payrolls, as well as for the developing consensus outlook.

The balance of today's missive concentrates on the June trade data and the latest indicators of the Federal Reserve Board's monetary activity.

**U.S. Trade Deficit—June 2014—Minimal Reduction to Downside-Revision Pressures on GDP Growth.** Skewed by poor-quality seasonal adjustments to oil imports, the headline June 2014 trade deficit narrowed by \$3.1 billion for the month. The trade improvement reflected a \$2.9 decline in imports and a \$0.3 billion increase in exports (with a rounding difference). Although revisions to the headline nominal data only affected May reporting, revisions to the real data went back to January 2014, influencing patterns of relative quarterly change.

With initial, full reporting now in place for second-quarter 2014, the second-quarter trade deficit widened versus the first-quarter 2014 by a somewhat smaller amount than had been imputed previously, based on just two months of reporting available for the advance GDP estimate.

Nonetheless, the real second-quarter deficit widened, subtracting growth from the GDP. Even at the current level of trade reporting, some downside, trade-deficit-related revision to second-quarter GDP growth is due. Today's trade reporting reduced that downside pressure only minimally.

**Nominal (Not-Adjusted-for-Inflation) June 2014 Trade Deficit.** The nominal, seasonally-adjusted monthly trade deficit in goods and services for June 2014, on a balance-of-payments basis, narrowed to \$41.538 billion from a revised \$44.663 billion in May 2014, but widened sharply versus \$36.552 billion in June 2013.

The reported monthly swings in imports and exports remained erratic across a broad spectrum of goods, with the seasonally-adjusted narrowing of the monthly deficit by \$3.125 billion reflecting a \$0.265 increase in exports and a \$2.860 billion decline in imports. Nonetheless, where a seasonally-adjusted decline in dollar-denominated oil imports accounted for a third of the reduction in total imports, unadjusted oil imports actually rose for the month, reflecting both higher prices and increased physical volume.

***Real (Inflation-Adjusted) June 2014 Trade Deficit.*** Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, used for GDP deflation), the June 2014 merchandise trade deficit (no services) narrowed to \$48.757 billion, from a revised \$52.007 billion in May, but widened versus \$44.458 billion in June 2013. The headline monthly revision to May was in the context of monthly revisions since January 2014, which altered the relative real (inflation-adjusted) quarterly deficits as they affect the net-export account in the GDP.

Consistent with today's headline June reporting, the annualized quarterly real merchandise trade deficit stood at an unrevised \$554.7 billion as of fourth-quarter 2013, at a revised \$591.0 billion (previously \$591.7) billion as of first-quarter 2014, and at \$618.6 billion for second-quarter 2014 (last imputed at \$635.0 billion, based on reporting for just April and May). The narrowed estimate for the second-quarter trade deficit did not change enough to reverse the likely pending, trade-related downside revision to second-quarter GDP growth, but it minimally reduced the likely magnitude of the revision (see [Commentary No. 646](#)).

***[For further details on the June trade deficit, see the Reporting Detail section.]***

---

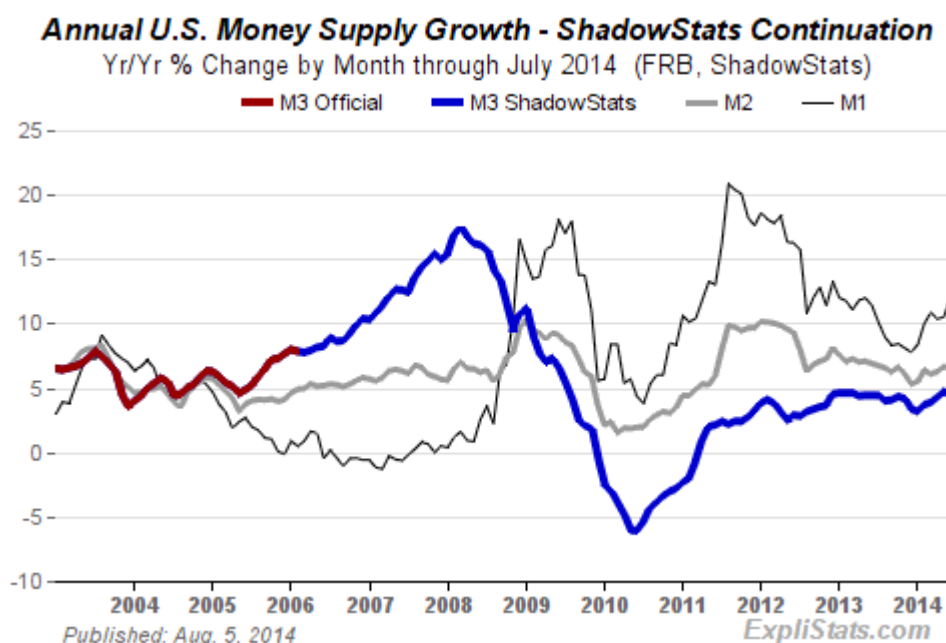
## HYPERINFLATION WATCH

**Monetary Base at All-Time High; M3 Growth at Five-Year-High; Current Fed Monetization at 91% of Net Treasury Issuance of Debt for Public.** Despite increased “tapering,” by the Federal Reserve Board, the U.S. central bank’s reduced pace of purchases of U.S. Treasury securities has not been matched by downturns in various other measures of Federal Reserve monetary activity.

***Money Supply M3 Annual Growth Rose to 4.7%.*** Estimated at 4.7%, annual growth for July 2014 M3 increased from a revised 4.5% (previously 4.4%) estimate for June. Monthly year-to-year growth began to slow after hitting a near-term peak of 4.6% in each of the months of January, February and March 2013, the onset of expanded QE3. Growth then fell to a near-term trough of 3.2% in January 2014, but that period of slowing growth had reversed fully as of May 2014, which now has hit 4.7%, in revision. Annual growth pulled back to 4.5% in June, but jumped anew to an initial estimate of 4.7% annual growth for July. The May and July 4.7% readings were the highest since the “end” of the recession, in July 2009. The M3 estimates and the first readings of annual growth for M2 and M1 in June 2014 are posted on the [Alternate Data](#) tab of [www.shadowstats.com](http://www.shadowstats.com).

Any revisions in the following numbers generally are attributable to recent revisions in underlying data by the Federal Reserve. The seasonally-adjusted, preliminary estimate of month-to-month change for July

2014 money supply M3 was roughly a 0.6% gain, up from a revised 0.2% (previously 0.1%) gain in June. Estimated month-to-month M3 changes, however, remain less reliable than are the estimates of annual growth.



**Growth for July M1 and M2.** For July 2014, year-to-year and month-to-month changes follow for the narrower M1 and M2 measures (M2 includes M1; M3 includes M2). See the [Money Supply Special Report](#) for full definitions of those measures. M2 for July 2014 showed year-to-year growth of 6.6%, versus a revised 6.7% (previously 6.5%) in June, with a month-to-month gain of 0.6% in July, versus an unrevised 0.4% gain in June. For M1 in July 2014, year-to-year growth was up by 11.7%, versus a revised 12.1% increase (previously an 11.9% gain) in June, with a month-to-month July gain of 0.8%, versus an unrevised 1.5% gain in June.

**Fed Has Monetized 91.2% of Net Treasury Debt Issuance for the Public, Calendar-Year-to-Date.** In the context of reduced purchases of U.S. Treasuries—the continued “tapering” in the Federal Reserve’s quantitative easing program QE3—effective monetization of Treasury debt continues at an increasing pace.

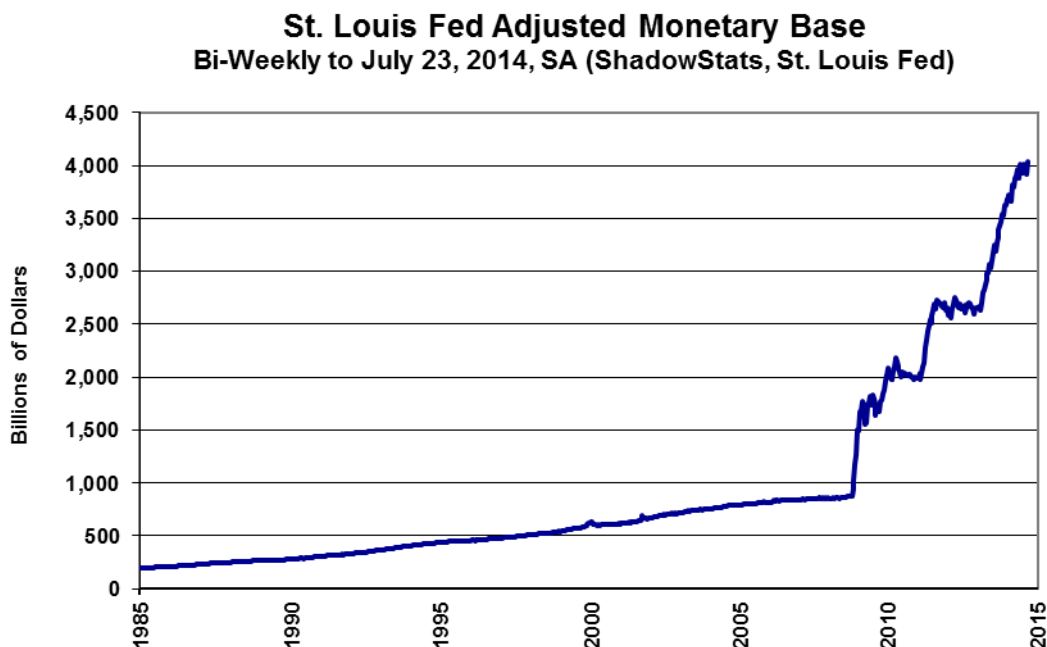
The Fed’s net acquisition of U.S. Treasury securities so far in calendar-year 2014 (through July 30th), versus net debt issuance of the U.S. Treasury for the public in the same period, has reflected effective monetization of 91.2% of the increase in debt. That is a rising portion from the effective monetization of 69.7% of the net issuance of publicly-held debt in the full calendar-year 2013, due partially to some slowing of debt issuance by the Treasury.

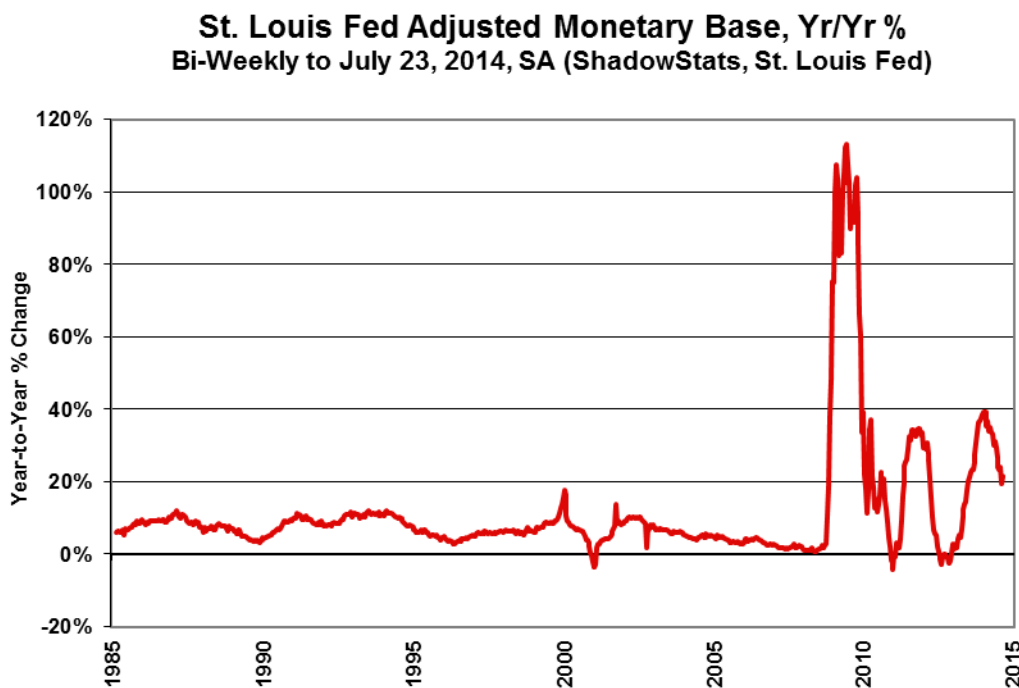
That means that from the onset of expanded quantitative easing QE3 in January 2013 to date, the Fed has monetized 74.7% of the increased Treasury debt held by the public. Against the net increase in total gross

federal debt, the Fed effectively has monetized 79.3% of the net debt increase so far in 2014, 59.0% of the total in 2013, and 63.6% of the net debt issuance since the onset of expanded QE3. These numbers have been revised slightly from prior estimates in order to reflect U.S. Treasury revisions to its calendar-year-end debt-level estimates.

The ongoing monetization of the Treasury debt likely has been a contributing factor to the recent pickup, albeit minimal, seen in broad money supply (M3) growth. It also continues to confirm that the market in U.S. Treasury securities remains anything but free and open, with artificially-depressed yields and artificially-inflated bond prices.

**Monetary Base at Record High.** As reflected in the following graphs, again, despite the “tapering” in debt purchases, the monetary base (St. Louis Fed measure) moved to an all-time high in the two weeks ended July 23, 2014, at \$4.040 trillion, topping the prior record level of \$4.012 trillion in the two weeks ended April 16, 2014. Year-to-year growth, however, had started to slow recently, with flat-to-minus levels of current activity measured against a year-ago period of rapid growth. Year-to-year growth, however, also rose in the latest period, up to 21.5% from 19.6% in the prior period.





**Hyperinflation Outlook Summary.** *[PLEASE NOTE: The main text has been updated, with major new or revised text underlined (other than for hyperlinks). The prior version was as published in [Commentary No. 644](#).]* 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, along with ongoing updates in the regular *Commentaries*. The pending crises also were reviewed in [Commentary No. 639](#).

**Primary Summary.** The primary and basic summary of the broad outlook and the story of how and why this crisis has unfolded and developed over the years—particularly the last decade—is found in the *Opening Comments* and *Overview and Executive Summary* of that *First Installment Revised* (linked above). The following section summarizes the underlying current circumstance.

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 the total loss of U.S. dollar purchasing power.

**Current Economic Issues versus Underlying U.S. Dollar Fundamentals.** U.S. economic activity has turned down anew, with headline first-quarter 2014 GDP having contracted at an annualized real pace of 2.11% (-2.11%), following 3.50% fourth-quarter 2013 growth, per the July 30th GDP benchmark revisions. Although the headline second-quarter 2014 GDP growth came in at 3.95%, such was heavily overstated and subject to major downside revisions. By the time the now-unfolding headline third-quarter



2014 GDP growth is reported in contraction, the second-quarter GDP growth estimate should have revised to close to flat, if not worse. Consensus expectations still face downside shocks in the months ahead, moving the popular outlook towards a “new recession,” with the shifts in the consensus likely to disrupt stability in the financial markets.

As financial-market expectations increasingly shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, 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 stresses on an already-impaired banking system, hence a perceived need for expanded, not reduced, quantitative easing. The highly touted “tapering” by the FOMC is pre-conditioned by continued “happy” economic news. Banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs likely still will be provided as needed by the Fed, under the ongoing political cover of a weakening economy, a renewed, deepening contraction in business activity.

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 based on cash-based, not GAAP-based accounting, and comparative year-ago cash numbers are against Treasury and government activity operating *sub rosa* in order to avoid the limits of a constraining debt ceiling.

All these crises will combine against the U.S. dollar, likely in the very-near future.

In summary, the fundamental issues threatening the dollar could not be worse. They include, but are not limited to:

- A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew, including a sharply widening trade deficit, as reflected in headline second-quarter reporting.
- The U.S. government will not address its long-term solvency issues. Current fiscal “good news” is based on cash-based, not GAAP-based accounting. The GAAP-based version continues to run in the \$6-trillion-plus range, while those in Washington continue to increase spending and to take on new, unfunded liabilities.
- Monetary malfeasance by the Federal Reserve is seen in its process of seeking to provide liquidity to a troubled banking system, and also to the U.S. Treasury, with a current pace of monetization at 91.2% of effective net issuance of the federal debt to be held by the public in calendar-year 2014 (through July 30th), 74.7% since the January 2013 expansion of QE3.
- Mounting domestic and global crises of confidence in a dysfunctional U.S. government, where the relative positive rating by the public of the U.S. President tends to have a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. Positive ratings for both the President and Congress are pushing, if not setting, historic lows.
- Mounting global political pressures contrary to U.S. interests, political and military, as well as financial and economic, are accelerating.
- Mounting global efforts to dislodge the U.S. dollar from its primary reserve-currency status.

Intensifying weakness in the U.S. 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. Both dollar weakness and the resulting higher inflation 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.

---

## REPORTING DETAIL

### U.S. TRADE BALANCE (June 2014)

**Narrowing of June Trade Deficit Minimally Reduced Trade-Related Downside-Revision Pressure on Second-Quarter GDP Growth.** Skewed by poor-quality seasonal adjustments to oil imports, the headline June 2014 trade deficit narrowed by \$3.1 billion for the month, with the trade improvement reflected in a \$2.9 decline in imports and a \$0.3 billion increase in exports (with a rounding difference). Although revisions to the headline nominal data only affected May reporting, revisions to the real data went back to January 2014, influencing patterns of relative quarter-to-quarter change.

With full reporting now in place for the second-quarter 2014 trade balance, the second-quarter deficit widened versus the first-quarter 2014 by a somewhat smaller amount than had been imputed previously, based on just the two months of reporting available for the advance GDP estimate.

Nonetheless, the real second-quarter deficit widened versus the first-quarter, subtracting growth from the GDP. Allowing for the current level of trade-deficit reporting, some downside trade-deficit-related revision to second-quarter GDP growth is due. Today's trade reporting has reduced that downside-revision pressure only minimally from what was evident with the initial guess by the Bureau of Economic Analysis at second-quarter GDP growth.

***Nominal (Not-Adjusted-for-Inflation) June 2014 Trade Deficit.*** The BEA and the Census Bureau reported today, August 6th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for June 2014, on a balance-of-payments basis, narrowed to \$41.538 billion from a revised \$44.663 (previously \$44.392) billion in May 2014, but widened sharply versus \$36.552 billion in June 2013.

The reported monthly swings in imports and exports remained erratic across a broad spectrum of goods, with the seasonally-adjusted narrowing of the monthly deficit by \$3.125 billion reflecting a \$0.265 increase in exports and a \$2.860 billion decline in imports. Nonetheless, where a seasonally-adjusted



decline in dollar-denominated oil imports accounted for a third of the reduction in total imports, unadjusted oil imports actually rose for the month, reflecting both higher prices and increased physical volume.

*Energy-Related Petroleum Products.* For June 2014, the not-seasonally-adjusted average price of imported oil rose to \$96.41 per barrel, from \$96.12 in May, but was down from \$96.97 per barrel in June 2013. Also not-seasonally-adjusted, physical oil import volume in June 2014 averaged 7.131 million barrels per day, up from 6.876 million in May, and down from 7.825 million in June 2013.

*Ongoing Cautions on Data Quality.* As seen in today's headline reporting, and previously discussed, potentially heavy distortions in headline data continue from seasonal adjustments. The same issues have been seen in other economic releases, such as retail sales and payrolls, where the headline number reflects month-to-month change. Discussed frequently (see [2014 Hyperinflation Report—Great Economic Tumble](#) – *Second Installment* for example), the extraordinary length and depth of the current business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not rely heavily on the accuracy of the monthly headline data.

*Real (Inflation-Adjusted) June 2014 Trade Deficit.* Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, used for GDP deflation), the June 2014 merchandise trade deficit (no services) narrowed to \$48.757 billion, from a revised \$52.007 (previously \$51.956) billion in May, but widened versus \$44.458 billion in June 2013. The headline monthly revision to May was in the context of monthly revisions since January 2014, which altered the relative real (inflation-adjusted) quarterly deficits as they affect the net-export account in the GDP.

Consistent with today's headline June reporting, the annualized quarterly real merchandise trade deficit stood at an unrevised \$554.7 billion as of fourth-quarter 2013, at a revised \$591.0 billion (previously \$591.7) billion as of first-quarter 2014, and at \$618.6 billion for second-quarter 2014 (last imputed at \$635.0 billion, based on reporting for just April and May). The narrowed estimate for the second-quarter trade deficit did not change enough to reverse the likely pending, trade-related downside revision to second-quarter GDP growth, but it minimally reduced the likely magnitude of the revision (see [Commentary No. 646](#)).

---

## WEEK AHEAD

**Much-Weaker-Economic and Stronger-Inflation Reporting Likely in the Months and Year Ahead.** Although shifting to the downside, amidst wide fluctuations, market expectations generally still are overly optimistic as to the economic outlook. Expectations should continue to be hammered, though, by ongoing

downside corrective revisions and an accelerating pace of downturn in headline economic activity. The initial stages of that process have been seen in the recent headline reporting of many major economic series (see [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)), including the sharp pace of economic decline seen in real first-quarter 2014 GDP, which largely survived the GDP benchmark revisions. The initial strong bounce-back guesstimated at by the Bureau of Economic Analysis, for headline second-quarter GDP, should prove to be fleeting, both with looming downside revisions and with a likely GDP contraction in the third-quarter.

Indeed, weakening, underlying economic fundamentals indicate still further deterioration in business activity. Accordingly, weaker-than-consensus economic reporting should become the general trend until such time as the unfolding “new” recession receives general recognition, which likely would follow the next reporting of a headline contraction in real GDP growth.

Stronger inflation reporting also remains likely, as has been seen in recent reporting. Upside pressure on oil-related prices should reflect intensifying impact from global political instabilities and a weakening U.S. dollar in the currency markets. Food inflation has been picking up as well. The dollar faces pummeling from the weakening economy, continuing QE3, 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 weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected inflation.

***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). These issues have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

### ***PENDING RELEASE:***

**Retail Sales (July 2014).** The Census Bureau’s July 2014 retail sales estimate is scheduled for release on Wednesday, August 13th. As discussed regularly in these *Commentaries* (see for example [Commentary No. 639](#) and [Commentary No. 643](#)), the consumer remains in an extreme liquidity bind. Accordingly, odds continue to favor ongoing headline retail sales reporting, which not only should continue to disappoint market expectations regularly, but also is likely to turn negative, net of inflation, in the July reporting.

Separately, the headline July CPI-U (due for publication on August 19th) is a good bet to top any headline nominal gain in sales, again, pushing inflation-adjusted or “real” retail sales growth into monthly contraction, if the nominal reporting has not done so already. Watch out for downside revisions to prior-period reporting.

**Index of Industrial Production (July 2014).** On Friday, August 15th, the July 2014 index of industrial production will be released by the Federal Reserve Board. July production is a good bet to come in below whatever market expectations indicate, to show an outright monthly contraction, due to underlying fundamental economic weakness and in line with weakening retail sales. As usual, this series is subject to large prior-period revisions, which should tend to be to the downside. ShadowStats coverage of the new production data will be in *Commentary No. 650* of August 18th.

**Producer Price Index—PPI (July 2014).** The July 2014 PPI also is scheduled for release on Friday, August 15th, by the Bureau of Labor Statistics (BLS), and related ShadowStats coverage will be in *Commentary No. 650* of August 18th. A month-to-month increase is a reasonable bet, despite somewhat negative seasonal-factor adjustments to oil related inflation, and downside unadjusted movements in energy related prices. Inflation in food, “core” goods (everything but food and energy), and the spreading inflationary impact from hard-goods into the soft-services sector, all are likely.

Depending on the oil contract followed, not-seasonally-adjusted monthly-average oil prices were down by 1.9% to 4.4% for the month of July, along with a 2.1% unadjusted monthly drop in average retail gasoline prices. Again, PPI seasonal adjustments for energy costs should be somewhat to the downside-side in July.

The wildcard in this revamped PPI remains the newly-added services sector, which largely is unpredictable, volatile and of limited meaning due to its inflation measurements having minimal relationship to real-world activity. Although the new series is less dependent on the increasingly “antiquated” concepts of oil, food and “core” (ex-food and energy) inflation, services costs increasingly are reflecting inflationary pressures—and shrinking profit margins—from rising prices in the “hard” economy. Accordingly, the aggregate headline July PPI inflation most likely still will show at least a minimal headline monthly increase.

---