

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

COMMENTARY NUMBER 664
Market and Economic Instabilities

October 10, 2014

Broad U.S. Economy Is Not Growing

**Sharp Deterioration Likely Will Continue in Domestic and Global
Financial-Market, Economic and Political Stability**

Confluence of Crises: U.S. Economy, Stocks and Dollar

PLEASE NOTE: The next regular Commentary is planned for Wednesday, October 15th, covering September retail sales and the PPI, followed by a Commentary on Thursday, covering industrial production, and by one on Friday, covering housing starts.

SEPARATELY: Some market and economic instabilities are reviewed in today's relatively brief missive, including an updated Hyperinflation Outlook Summary. Given no major economic releases in this last week, however, there is no regular Reporting Detail section in today's missive.

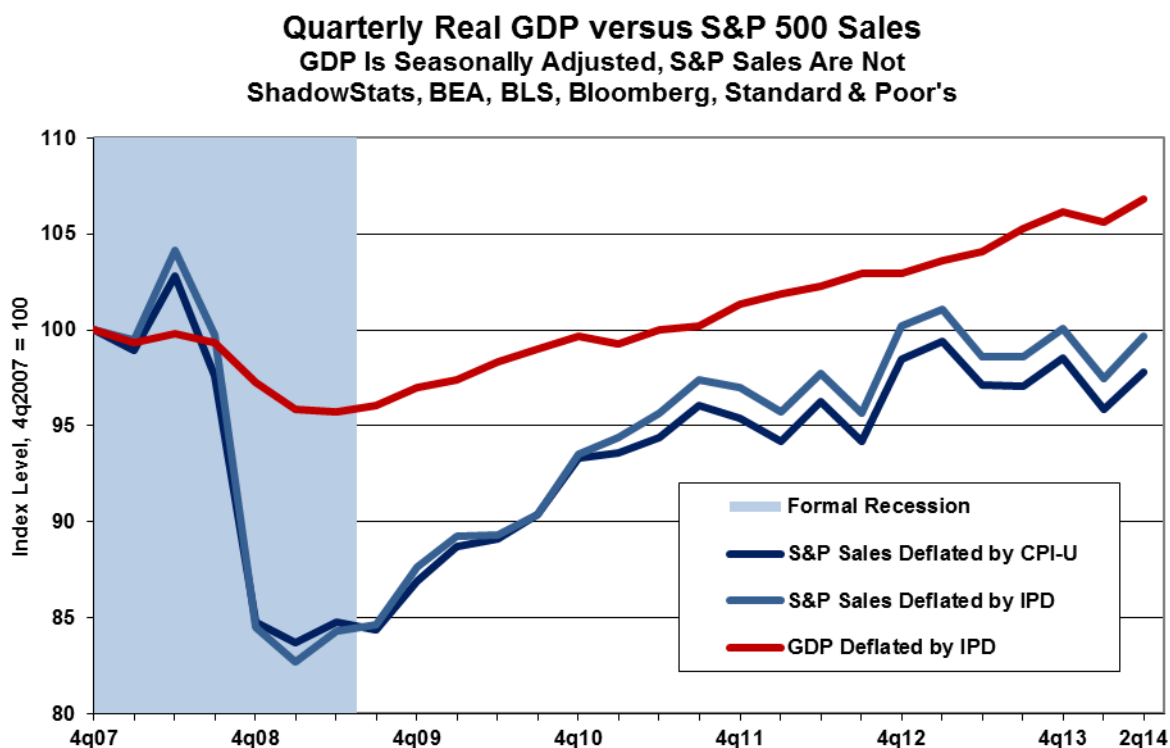
Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

U.S. Economy Is Not Growing. Further to the discussion of a "false-dawn" in [Commentary No. 661](#), and to the discussion on no recovery in actual business activity in [Commentary No. 663](#), ShadowStats has prepared a graph of real (inflation-adjusted) quarterly sales revenue for the S&P 500 versus quarterly

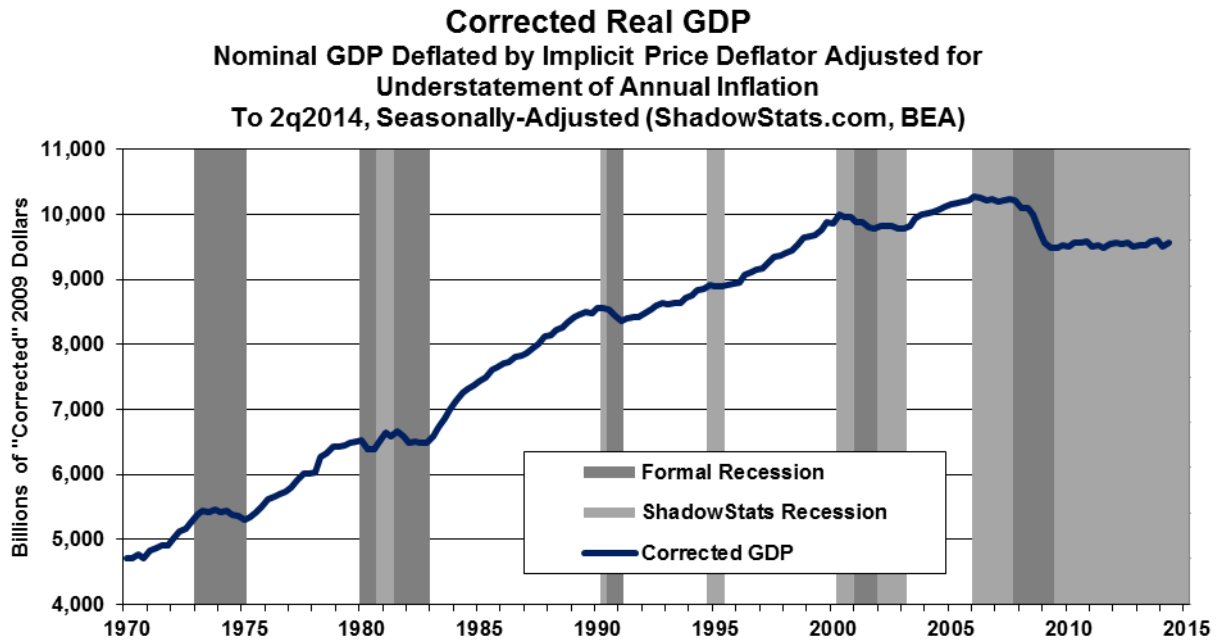
GDP. Based on the sales of the component companies of the S&P 500, the real economy has been stagnant-to-down since early 2013, and it still is shy of recovering fully from the recession.

Historically, sales of the S&P 500 provide a broad indication of underlying economic activity, but unlike the GDP, they are not modeled or massaged heavily by the Bureau of Economic Analysis (BEA). The accompanying graph shows both the S&P 500 Sales and GDP plotted from the formal onset of the recession in fourth-quarter 2007 (indexed to fourth-quarter 2007 = 100), through second-quarter 2014, with both series deflated by the GDP's implicit price deflator (IPD). The S&P 500 revenues also are shown deflated by the CPI-U. An attempt has been made to show the S&P quarterly sales adjusted for changes in outstanding share volume, impacted by stock splits and buybacks. Heavy buybacks in recent years have tended to inflate revenues per share. Even so, the basic picture and pattern of broad economic activity, which has not recovered, holds without those adjustments. Keep in mind, also, that the GDP is shown on a seasonally-adjusted basis, while the S&P 500 Sales are not seasonally-adjusted.



The plots of both the real GDP and the real S&P 500 Sales, however, significantly overstate actual economic activity, due to the understatement of inflation inherent in both the GDP's IPD and the CPI-U (see [Public Comment on Inflation Measurement](#) and [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)). Instead of the official growth pattern of real GDP, which plunges into mid-2009 and recovers thereafter, the next graph of the ShadowStats version of real growth corrected for

official inflation understatement shows the economy in a pattern of plunge and stagnation. Similar adjustments to the S&P 500 Sales would show an even more-negative pattern.



The economic pattern of plunge-and-stagnation is much closer to the reality of common experience than is the popular hype of an expanding recovery. With the liquidity-strapped consumer unable to fuel sustainable growth in 72% of the U.S. GDP, deteriorating economic activity and lack of recovery should prove out in the reporting of the months ahead. U.S. dollar-supportive hype, based on relative U.S. economic strength versus the rest of the world, is nonsense; the U.S. remains in recession, too. The recovering U.S. economy that has "enabled" the Fed to taper its quantitative easing also is not there.

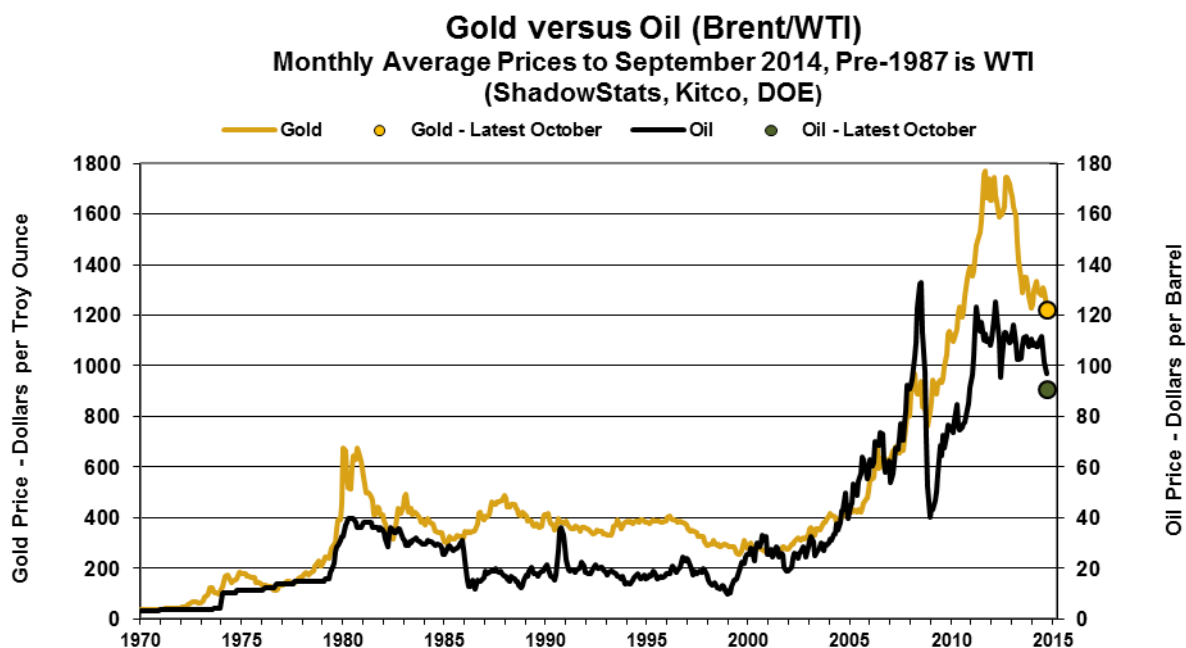
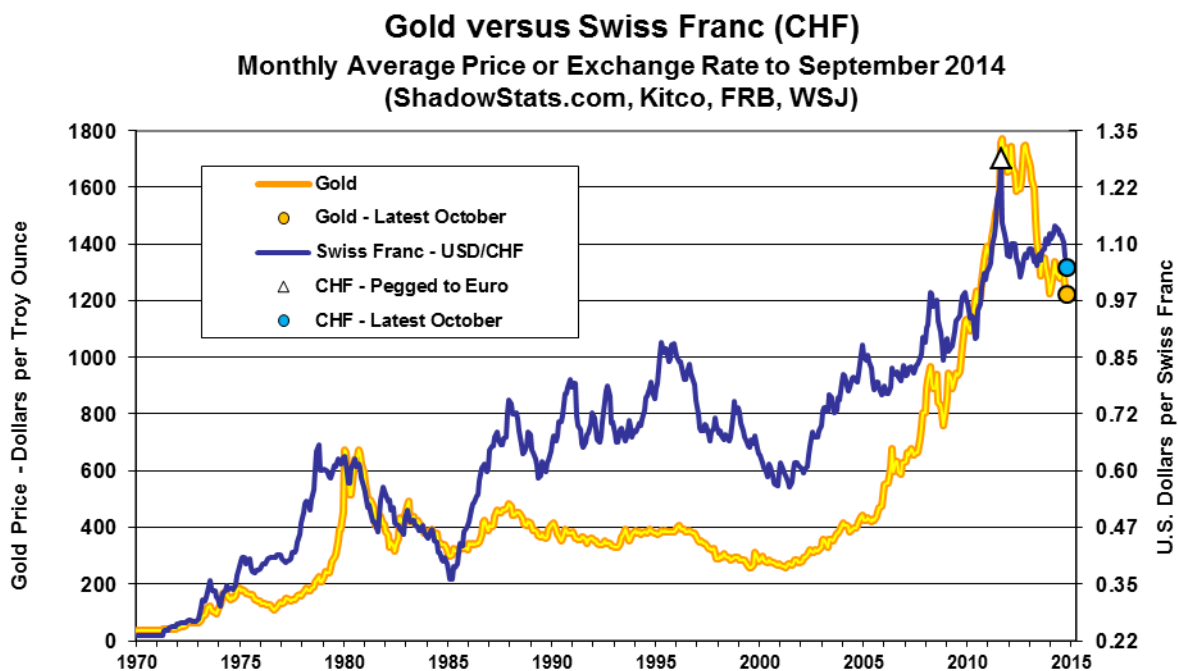
Extreme volatility has been seen in the domestic financial markets in recent weeks. Increasing instability in the markets can evolve quickly into big surprises, with little warning. Neither the stock market nor the currency market is based on underlying U.S. economic reality, and a wide variety of market shocks loom from recognition of same. Further, exogenous factors such as potential terrorist or public-health crises sit in the background, and none of those factors is market or system friendly. Risks continue to mount for systemic instabilities, along with increased chances for crashes and panicked selling in the U.S. dollar, and in the domestic equity and bond markets.

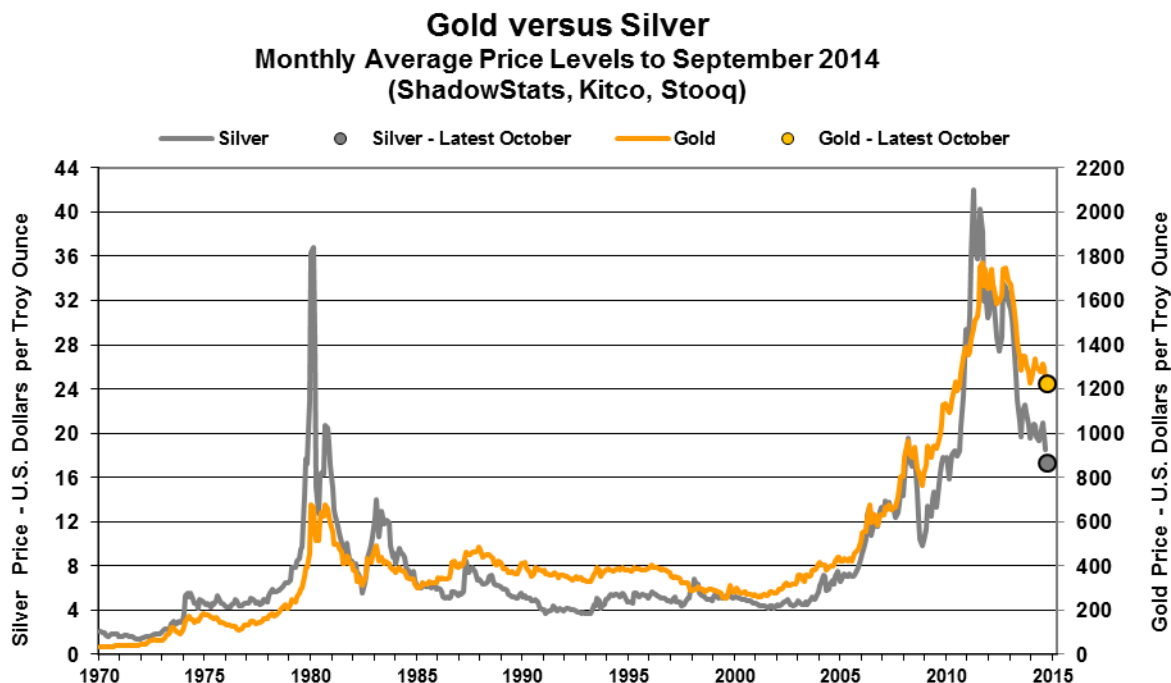
These issues are explored further in the updated *Hyperinflation Summary Outlook* in the *Hyperinflation Watch Section*.

Updated Gold-Related Graphs. In the context of the recent sharp rally in the value of the U.S. dollar, and of the recent heavy selling of gold, silver and oil, following are the regular gold-related graphs published with the monthly *CPI Commentary*. The detail will be updated again with the CPI, on October 22nd. Panicked selling of the U.S. dollar remains likely, as economic reality is hammered into the markets.

Timing of a major swing in market sentiment, by its nature, is difficult to call, but the shift to massive dollar selling easily could be before year-end. It likely will hit with little advance notice. The prices of oil and precious metals should rally sharply on a coincident basis with that currency crisis.

The "Latest October" price point is as of roughly mid-afternoon, New York time, October 10th.





HYPERINFLATION WATCH

Hyperinflation Outlook Summary. Updated from [Commentary No. 661](#), this *Summary* should be read in the context of today's (October 10th) *Opening Comments* on deteriorating domestic and global circumstances.

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*, including [Commentary No. 661](#). The two 2014 *Hyperinflation Report* installments remain the primary background material for the hyperinflation and economic analyses and forecasts.

Primary Summary. Current fiscal conditions show the long-term insolvency of the U.S. government, a circumstance that usually would be met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation. The 2008 Panic and near-collapse of the financial system, and

official (U.S. government and Federal Reserve) response to same, pulled the elements of the eventual hyperinflation crisis into the 2014 period. The primary and basic summary of the broad outlook and the story of how and why this fiscal, financial and economic crisis has unfolded and developed over the years—particularly in 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 and recent developments.

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 total loss of U.S. dollar purchasing power, despite sharp recent rallies in the U.S. dollar's exchange and related heavy selling in the gold and silver markets.

Current relative U.S. economic strength versus major U.S. trading partners is seriously over-estimated, with a crash back to recognition of realistic domestic-economic circumstances likely to be accompanied by a crash in the U.S. dollar versus major currencies, such as the euro, yen, pound, Swiss franc, Canadian dollar and Australian dollar; related rallies in precious metals and oil; and related sell-offs in the domestic stock and bond markets.

Current Economic Issues versus Underlying U.S. Dollar Fundamentals. U.S. economic activity is turning down anew. The headline contraction in first-quarter 2014 GDP was the reality; the headline second-quarter GDP boom was the aberration. Such should become increasingly and painfully obvious to the financial markets in the domestic economic reporting of the weeks and months ahead.

New reporting of relatively hard annual numbers from 2013 showed ongoing economic contraction, with no trend towards sustainable economic growth (see [Commentary No. 656](#)). Also, as discussed in today's *Opening Comments* section, real business activity—net of all the happy assumptions and modeling used by the Bureau of Economic Analysis in putting the GDP growth estimates together—is flat-to-minus.

Despite any short-term pre-election fluff, those basic underlying, increasingly negative economic conditions will show up in various series, such as the trade deficit, retail sales, industrial production and payroll employment, providing consensus expectations with downside shocks. In turn, that should shift the popular outlook quite rapidly towards a "new recession," with negative shifts in the economic consensus increasingly disrupting the already-disintegrating stability in the financial markets.

As financial-market expectations increasingly shift towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, specifically 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 known stresses on an already-impaired banking system, hence a perceived need for expanded, not reduced, quantitative easing. The highly touted and ongoing "tapering" by the FOMC is pre-conditioned by a continued flow of "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 covering of a weakening economy—a renewed, deepening contraction in business activity.

Accordingly, some speculation already has begun to circulate as to an added round of Federal Reserve quantitative easing, QE4. That would be a major factor behind crashing the dollar and boosting the price of gold. The Fed has strung out its options for propping up the system as much as it could, with continual, negative impact on the U.S. economy. The easing to date, however, appears to have been a prop to the equity markets (see [Commentary No. 663](#)). In the event of QE4, any resulting renewed boost to U.S. equities likely would be a fleeting illusion, at least in terms of real value (purchasing power of the dollar). Such gains would tend to be losses, with the stocks valued in terms of Swiss francs, for example, or valued against what would be a rapidly-increasing pace of domestic U.S. inflation.

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

All these crises should combine against the U.S. dollar, likely in the very-near future. That said, recent faux market perceptions of domestic economic, financial-system and monetary tranquility have boosted the U.S. dollar's strength significantly in global trading and have contributed to savaging the prices of precious metals. Again, such should not prevail in the context of underlying reality. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed. The key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008 and is turning down anew.*** The circumstance includes a sharply widening trade deficit, as well as ongoing severe, structural-liquidity constraints on the consumer, which are preventing a normal economic rebound in the traditional, personal-consumption-driven U.S. economy.
- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of will to address long-term U.S. solvency issues, but also the current political impossibility of doing so. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version has continued to run in the \$6-trillion-plus range for annual shortfall—and should have done so again in the just-completed fiscal-2014—while those in Washington continue to increase spending and to take on new, unfunded liabilities. The history and issues here are explored in the first installment of the *Hyperinflation Report*, as previously linked.
- ***Monetary malfeasance by the Federal Reserve, as seen in central bank efforts to provide liquidity to a troubled banking system, and also to the U.S. Treasury.*** Despite the "tapering" of the Fed's asset purchases, the current pace of the Fed's monetization is at 58.9% of effective net issuance of the federal debt to be held by the public in calendar-year 2014 (through October 8th). The pace of effective monetization has been 66.0% since the January 2013 expansion of QE3.
- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The relative positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, with a meaningful correlation with the foreign-exchange-rate strength of the U.S. dollar. The weaker the rating, the weaker tends to be the U.S. dollar. Positive ratings for both the President and Congress are at historic lows and still are sinking.

- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the situation in Ukraine versus Russia and the extremely-volatile circumstances in the Middle East.
- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar have been seen with Russia, China, France and India, along with some rumblings in OPEC and elsewhere.

When the selling pressure breaks massively against the U.S. currency, the renewed and intensifying weakness in the 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. These circumstances will trigger the early stages of a hyperinflation.

Both the renewed dollar weakness and the resulting inflation spike 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.

WEEK AHEAD

Against Overly-Optimistic Expectations, Pending Economic Releases Should Be Much Weaker; Inflation Releases Should Be Increasingly Stronger. Although having shifted some to the downside, again, amidst wide fluctuations, market expectations for business activity generally remain overly optimistic, well above any potential, underlying economic reality. Market outlooks increasingly should be hammered, though, by ongoing, downside corrective revisions and by an accelerating pace of downturn in broad-based headline economic activity.

Longer-Range Reporting Trends. The process of shifting economic-growth expectations to the downside has been sporadic, but the underlying fundamentals remain extraordinarily negative. Other than for nonsense-growth in the headline second-quarter GDP (see [Commentary No. 662](#)), renewed weakness has been, and increasingly will be seen in the headline reporting of other major economic series (see [2014 Hyperinflation Report—Great Economic Tumble – Second Installment](#)), particularly subsequent to the November 4th election. Indeed, weaker-than-consensus economic reporting should remain the general trend until the unfolding "new" recession receives broad recognition, which likely would follow the next reporting of a headline contraction in real GDP growth.

A generally stronger inflation trend remains likely to continue, as seen in recent months (August 2014 excepted). Beyond the spread of earlier oil-based inflation pressures into the broad economy, upside pressure on oil-related prices should continue and be rekindled from the intensifying impact of global political instabilities and a likely near-term weakening of the U.S. dollar in the currency markets. Such excludes any near-term efforts to push oil prices lower as an informal financial sanction against Russia.

The dollar faces eventual pummeling from the weakening economy, continuing perceptions of needed, ongoing quantitative easing, 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 significantly weakened dollar, reporting in the year ahead generally should reflect much higher-than-expected U.S. inflation, across the board.

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 RELEASES:

Retail Sales (September 2014). The Census Bureau has scheduled the release of September 2014 retail sales for Wednesday, October 15th. As discussed frequently in these *Commentaries*, the consumer remains in an extreme liquidity bind. Consensus expectations appear to be for an outright contraction in the headline number, reversing some of the bloated automobile sales reported for August. Although the headline number should show a deeper contraction than consensus estimates, such also could be reflected in a downside revision to August's reporting.

The September CPI-U estimate (due for publication on October 22nd) will determine the level of inflation-adjusted, or real, retail sales for the month. The headline CPI-U likely should be weak, but on the plus-side for September, placing further real downside pressure on what appears to be a likely negative headline nominal retail sales report.

Producer Price Index—PPI (September 2014). The September 2014 PPI also is scheduled for release on Wednesday, October 15th, by the Bureau of Labor Statistics (BLS). A small month-to-month increase is a reasonable expectation, despite a likely small, negative contribution from the energy sector. 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, again.

Depending on the oil contract followed, not-seasonally-adjusted, monthly-average oil prices were down by 3.3% to 4.5%, (-3.3%) to (-4.5%), for the month of September, along with a 2.3% (-2.3%) unadjusted

monthly drop in average retail-gasoline prices. PPI seasonal adjustments for energy costs in September largely should offset the decline in energy-related prices.

The wildcard in this revamped PPI remains the recently-added services sector, which largely is unpredictable, volatile and of limited meaning due to its inflation measurements having minimal relationship to real-world activity.

The services series, in theory, is much-less dependent on the increasingly “antiquated” concepts of oil, food and “core” (ex-food and energy) inflation of the “hard” production-based economy. Yet, services costs increasingly have reflected spreading, general inflationary pressures—and shrinking profit margins—from rising prices in that hard economy. Accordingly, the aggregate headline September PPI inflation most likely still will show at least a minimal headline monthly increase, which generally would be in line with early-consensus expectations.

Index of Industrial Production (September 2014). On Thursday, October 16th, the September 2014 index of industrial production will be released by the Federal Reserve Board. September production has a fair chance of surprising reasonably strong consensus-growth estimates on the downside.

Risks of such a surprise, including an outright September contraction, likely would be in the context of downside revisions to prior reporting, with implied downside adjustments to inventory building.

Residential Construction—Housing Starts (September 2014). The Census Bureau plans the release of September 2014 residential construction detail, including housing starts, on Friday, October 17th.

As discussed in [Commentary No. 660](#) on the August version of this wild-man series of monthly economic detail, the headline reporting simply is worthless. Month-to-month volatility is extreme, and the headline numbers rarely come close to being statistically significant. Consensus expectations appear to be for a large, though not meaningful monthly surge.

Despite extreme volatility seen regularly in the reporting of this series, month-to-month change likely will continue a pattern of statistical-insignificance, with ongoing stagnation and renewed downturn and/or downside revisions as seen a six-month moving-average of the series. This series also is subject to extremely-large prior-period revisions.

In the wake of a 75% collapse in aggregate activity from 2006 through 2008, and of an ensuing five-year pattern of housing starts stagnation at historically low levels, little has changed. As discussed frequently in these *Commentaries*, there remains no chance of a near-term, sustainable turnaround in the housing market, unless there is a fundamental upturn in consumer and banking-liquidity conditions. That has not happened and does not appear to be in the offing.