John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

COMMENTARY NUMBER 733
May Trade Deficit, June M3, Systemic Uncertainties

July 7, 2015

Mounting Global Instabilities in a System Increasingly Out of Control

May 2015 Trade Deficit Showed Minimal Deterioration;
Advance-June Trade Estimate Should Rattle Second-Quarter GDP

Headline June Reporting on Production and Retail Sales
Also Should Soften GDP Expectations

Late-Month Jump Pushed June M3 Annual Growth to 5.2%,
Up from 5.0% in May

PLEASE NOTE: The next regular Commentary*, scheduled for Tuesday, July 14th, will cover June 2015 nominal Retail Sales, followed by a* Commentary *on the 15th, covering June Industrial Production and the Producer Price Index (PPI), and a further missive on the 17th, covering June Housing Starts and the Consumer Price Index (CPI).*

Best wishes to all — John Williams

OPENING COMMENTS AND EXECUTIVE SUMMARY

And the "Rearranging the Deck Chairs on the Titanic Award" Goes to . . . the U.S. Treasury! Since March 15th, the U.S. Treasury has been operating with a legislated debt ceiling of $18,113,000,000,000. Accordingly, U.S. borrowing has been held and capped at $18,112,975,000,000—just $25,000,000 under the limit—with the Treasury using a variety of extraordinary measures, accounting gimmicks and reporting loopholes to keep the U.S. government functioning. Such measures include not making otherwise-planned investments to federal-employee retirement funds.

With guesstimates still running towards October or November 2015, before there is any real risk of a U.S. debt default, one still might hope that the U.S. Treasury would be concentrating primarily on maintaining the fiscal health of the U.S. government and the health and stability of the U.S. economy and the U.S. financial markets. Instead, the Treasury's recent big issue appears to have been removing Alexander Hamilton's portrait from the ten-dollar bill.

Economy Is Beyond the Positive Control of the U.S. Government and/or the Federal Reserve. The U.S. Congress and the White House still are politically unwilling to address the long-term sovereign-solvency issues of the United States. Labor-market conditions are faltering (see *Commentary No. 732*), with the U.S. economy slowing markedly, effectively in a new recession. Liquidity constraints on the consumer continue to prevent sustainable growth in personal consumption, which, along with related housing investment, constitutes in excess of 70% of the GDP. No meaningful effort is underway to assure long-range solvency, or to help the economy and/or consumer liquidity. Instead, the White House and Congress have pushed ahead a trade deal that most assuredly will have net-negative impact on aggregate U.S. economic and labor-market conditions (see *Commentary No. 726*).

The Federal Reserve can do little to stimulate domestic economic activity, having used recent domestic economic weakness primarily as political cover for bailing out/supporting the banking system. The Fed's apparent recent inability to raise interest rates, despite its purportedly wanting to do so, is not due directly to a lack of broad economic recovery. Instead, the lack of a Fed rate hike by now most likely is due to continuing concerns of the Central Bank as to banking- and financial-system stability (see *Commentary No. 726* and *Commentary No. 729*).

U.S. Data in the Week Ahead Should Rattle Second-Quarter GDP Expectations. The headline May 2015 trade deficit widened in line with consensus expectations. It was enough to turn the quarterly trade impact on the GDP minimally-negative, but it was not enough to change consensus expectations. The trade numbers should continue to deteriorate markedly, with the minimal widening in the May deficit possibly something of an artefact from recent labor-dispute disruptions to the trade-reporting patterns. With a change in reporting by the Bureau of Economic Analysis (BEA), however, much of the June trade detail will be available for the first-estimate of second-quarter GDP, on July 30th, and that still should be heavily negative for the broad economy.

Separately, reporting of June retail sales and industrial production in the week ahead should be negative enough to weaken consensus expectations seriously, as to broad economic activity. The headline second-quarter GDP still should contract, but the timing of consensus expectations for same likely is not going to be before the GDP release on July 30th. More will follow in pending *Commentary No. 736* of July 17th.

Greece and the Unexpected. Greece defaulted, and euro area uncertainties and disruptions likely will continue to unfold. The euro—eventually—should undergo reorganization. Whatever currency can be structured feasibly to encompass Germany will have the potential of becoming the dominant global currency going forward.

If governments and central bankers have foreknowledge of a problem, there is much that they can do to stabilize and/or control the financial markets. It is from surprises to the system—from unexpected financial failures to economic shocks—that turmoil in the currency and financial markets can erupt. Domestic and global circumstances rarely have been so fragile and unstable. Central governments and central banks rarely have had such limited control and options. The major issues of the Panic of 2008 never were resolved, generally just pushed into the future. Now is a good time to have your hedges in place for difficult times ahead, see *No. 692 Special Commentary: 2015 - A World Out of Balance*.

Today's Missive (July 7th). The balance of today's *Opening Comments* concentrates on the detail from the headline reporting of the May U.S. trade deficit.

The *Hyperinflation Watch* section updates monetary conditions and the ShadowStats Ongoing M3 Measurement for June. The *Hyperinflation Outlook Summary* has not been revised from the prior *Commentary*.

The *Week Ahead* section previews the June retail sales, industrial production and housing starts reporting scheduled for next week, along with an outlook for the pending CPI and PPI inflation detail.

Trade Deficit—May 2015—Monthly Deficit Widened; Second-Quarter Deficit Trend Shifted to Minimal Deterioration from Minimal Improvement. The nominal (not-adjusted for-inflation) trade deficit widened to $41.9 billion in May 2015, from a revised $40.7 billion in April 2015. The April deficit, in turn, had narrowed versus an unrevised $50.6 billion deficit in March. Recent monthly data through April had reflected volatility from labor-dispute-disrupted trade flows, and that circumstance may have had some lingering impact on headline trade activity in May 2015.

In the context of a narrowing of the nominal April trade deficit in revision, the headline $41.9 billion shortfall in May was close to consensus expectations of $42.1 billion [MarketWatch] and $42.7 billion [Bloomberg].

Going forward, look for a sharp widening of the headline nominal and real trade shortfalls in the "advance" reporting of June 2015 trade activity on July 30th, and in the subsequent full reporting for June.

Quarterly Deficit Deterioration Net of Inflation. Nonetheless, where the average April-May trade shortfall narrowed versus the average first-quarter shortfall, before inflation, the April-May trade deficit widened in real terms (after inflation adjustment). Such is an important factor in terms of GDP activity, where a widening real deficit subtracts from real GDP activity. The headline May reporting turned the headline real trade deficit from a prospective minimally-positive to a minimally-negative contributing factor to second-quarter 2015 GDP growth. "Advance" June trade-deficit reporting, which will be available to the Bureau of Economic Analysis (BEA) for the initial estimate of second-quarter GDP growth, should take the real, quarterly trade shortfall sharply negative.

In real terms (chained 2009 dollars), the May 2015 merchandise trade deficit was $58.4 billion versus a revised $56.9 billion in April, a two-month average of $57.7 billion. That was little changed versus a real first-quarter 2015 average of $57.6 billion, but the balance shifted from minimally positive to minimally negative versus first-quarter 2015, and it was significantly wider than the fourth-quarter 2014 average of $50.5 billion, and the year-ago second-quarter 2014 average of $51.1 billion.

Nominal (Not-Adjusted-for-Inflation) May 2015 Trade Deficit. The headline, seasonally-adjusted monthly trade deficit in goods and services for May 2015, on a balance-of-payments basis, widened by $1.173 billion to $41.871 billion, versus a revised $40.698 in April 2015. The May 2015 nominal deficit narrowed minimally versus a $42.070 billion trade shortfall in May 2014.

In terms of month-to-month trade patterns, the headline $1.173 billion widening in the May 2015 deficit reflected a decline of $1.472 (-$1.472) billion in monthly exports, partially offset by a decline in monthly imports of $0.299 (-$0.299) billion [difference is in rounding]. Oil imports had negligible impact on the headline deficit.

Real (Inflation-Adjusted) May 2015 Trade Deficit. Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), the May 2015 merchandise trade deficit (no services) widened to $58.369 billion, from a revised $56.943 billion in April 2015. The May 2015 shortfall widened sharply versus a $51.287 billion real deficit in May 2014.

As currently reported, the annualized quarterly real merchandise trade deficit stood at $554.8 billion for fourth-quarter 2013, $597.8 billion for first-quarter 2014, $613.4 billion for second-quarter 2014, $588.6 billion for third-quarter 2014, $605.5 billion for fourth-quarter 2014, and $691.2 billion for first-quarter 2015. Widening quarter-to-quarter real trade deficits subtract growth from the quarterly real GDP estimates and vice versa.

Based solely on the headline reporting for the real April and May 2015 deficits, the average of those two months annualized to a quarterly real trade shortfall of $691.9 billion for second-quarter 2015. Where the annualized reporting of just the April 2015 detail was $686.2 billion, the implied second-quarter real trade shortfall has moved from a minimal narrowing to a minimal widening. With the release of the "advance" June 2015 trade shortfall on July 30th, the "advance" second-quarter GDP estimate on the same date will reflect that detail. The June reporting likely will result in a relatively-sharp quarterly deterioration and a directly related, negative contribution to second-quarter real GDP growth.

[The* Reporting Detail *section provides further information on the May trade balance.]

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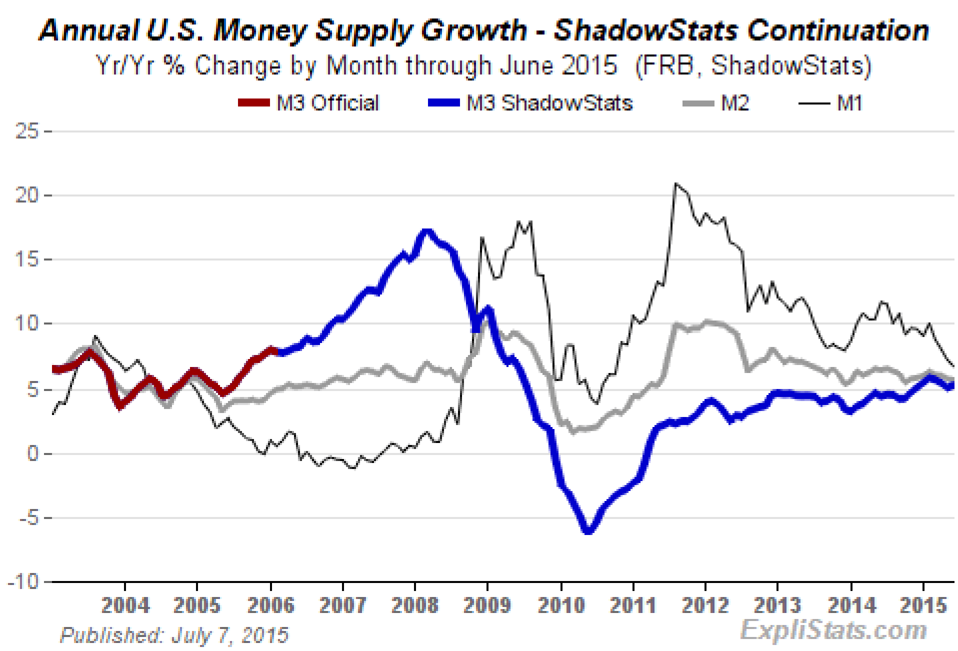
HYPERINFLATION WATCH

MONETARY CONDITIONS

Broad Money Supply Bounced Higher in June 2015. Late in 2014, the Federal Reserve ceased net new purchases of U.S. Treasury securities as part of its quantitative easing QE3, but its holdings of Treasury securities have remained stable, near record levels. Despite relative stability in the monetary base during the last six weeks—about five-percent shy of the peak base level in April 2015—annual growth in June 2015 money supply M3 increased to 5.2%, from a revised 5.0% in May, but that still was down from a recent near-term high of 5.8% in February 2015.

Weekly Jump in Broad Money. A week ago, June M3 was on track for 5.0% annual growth, but surging M2, institutional money funds and large time deposits in the most recent week (week-ended June 22nd for M3) pushed the likely monthly average up to 5.2%. The component M3 numbers generally are seasonally-adjusted by the Fed, a process, in theory, that should smooth out variations tied to tax-payment periods, etc. The monthly M3 estimate will be updated over the coming weekend for the next week's reporting detail.



Money Supply M3 Annual Growth Tentatively Rose to 5.2% in June 2015, versus 5.0% in May. Year-to-year growth in June 2015 M3 (ShadowStats-Ongoing Measure) rose to 5.2%, versus a revised 5.0% (previously 5.1%) annual gain in May. The June growth remained off the 68-month high of 5.8% of February 2015, then the strongest showing since June of 2009. Any revisions in the accompanying data are due to frequent, regular and irregular benchmark revisions by the Federal Reserve to the underlying monthly detail.

In 2015, the pattern of annual growth in M3 has closed in on M2, reflecting some shifting of funds in M1 and M2 into the larger M3 categories (ex-M2), where institutional money funds and large time deposits now are showing growth patterns more in tandem with the aggregate M2.

Monthly year-to-year growth in M3 began to slow, after the series hit an interim 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, with annual growth recovering to 4.6%. Annual growth pulled back to 4.4% in June 2014, but rose again to 4.5% in July, easing back to 4.2% in September and October. Growth then jumped to 4.7% and 5.1%, respectively, in November and December 2014, rising to 5.4% in January 2015, and then hitting a five-year high of 5.8% in February. Again, annual growth has been falling off since February, hitting 5.0% in May, with a tentative upside bounce to 5.2% in June.

The seasonally-adjusted, early estimate of month-to-month change for June 2015 money supply M3 was roughly a gain of 0.4%, versus an unrevised gain of 0.2% in May 2015. Estimated month-to-month M3 changes, however, remain less reliable than are the estimates of annual growth.

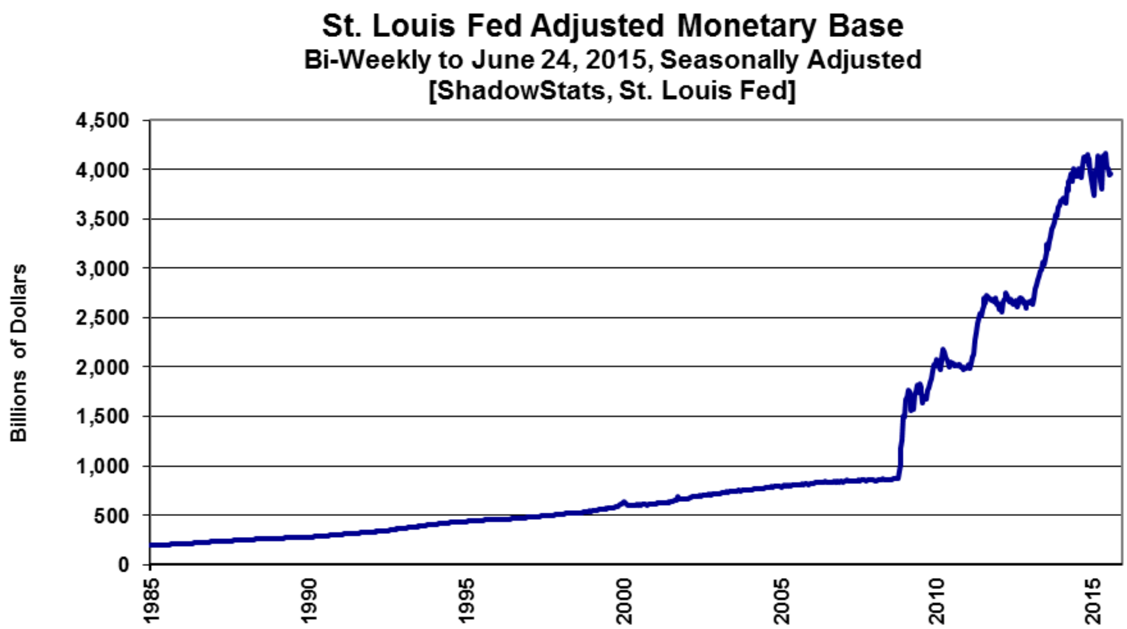
Initial estimates for annual growth in M3, M2 and M1 for June 2015 have been updated on the Alternate Data tab of www.ShadowStats.com.

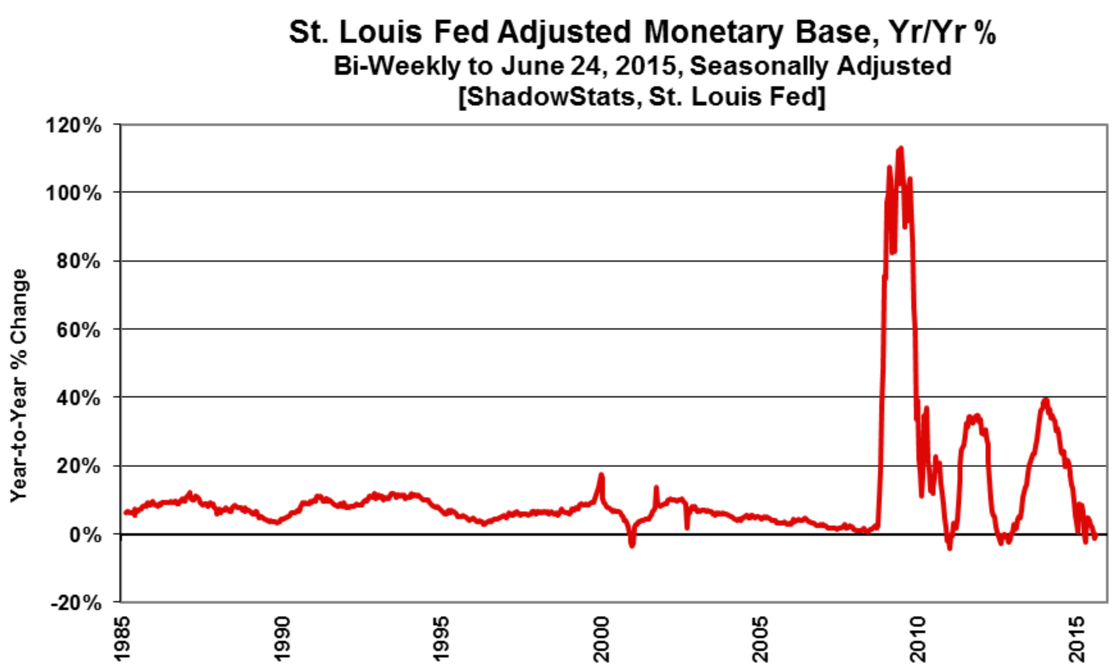
Growth for March M1 and M2. For June 2015, year-to-year and month-to-month changes follow for the narrower M1 and M2 measures (M2 includes M1; M3 includes M2). See the *Money Supply Special Report* for full definitions of those measures.

Annual M2 growth in June 2015 slowed to 5.7% from an unrevised 5.8% gain in May 2015, with a month-to-month gain of about 0.4% in June, versus 0.3% in May. For M1, year-to-year growth slowed to an initial estimate of 6.8% in June 2015, versus an unrevised 7.3% in May 2015, with a month-to-month gain of 0.6% in June, versus a revised contraction of 0.3% (-0.3%) [previously down by 0.2% (-0.2%)] in May 2015.

With the Monetary Base 5% off Its Record High, "Quantitative Easing" Remains Very Much in Play. Discussed in *No. 692 Special Commentary: 2015 - A World Out of Balance*, the Fed's primary mission is to keep the banking system solvent and afloat, but that was not working, coming into the Panic of 2008. Quantitative easing was introduced in 2008 and went through a number of phases, as reflected in the size of, and growth in the monetary base shown in the accompanying graphs. Where normally such growth would have translated into extraordinary growth in the money supply, it has not. Only as the Fed has pulled back from aggressive assets purchases did M3 begun to show a little, temporary upside movement.

The extraordinary level of asset purchases by the Fed did not flow through to the broad economy, because banks did not lend into the normal flow of commerce, and there was no resulting significant upside movement in money supply, as a result. Instead, banks turned the funds back to the Fed as excess reserves, earning interest and providing support to the stock market. As part of this process, the Fed ended up monetizing the bulk of the U.S. Treasury's funding needs during the period of active buying, paying back interest earned on the securities to the Treasury.





With the Fed having ceased purchases of new Treasury securities late in 2014 (maturing issues still are rolled over), the monetary base has continued its recent pattern of volatility at high-levels. Having set a record high level of $4.167 trillion in the two-week period ended April 15, 2015, the monetary base (Saint

Louis Fed measure) has backed off by about five percent since, holding at averages in the last six weeks that are within 0.1% of the average $3.953 billion in the latest period two-week period ended June 24th.

The Fed's Treasury asset holdings effectively have continued at or near an all-time high, in the context of ongoing QE3. The expressed desire by some in the Fed to push interest rates higher, to more-normal levels, combined with a failing economy that should provide a practical restraint to such action, is suggestive of an economic-and-monetary system that continues to move beyond effective control of the U.S. central bank and the federal government, as discussed in the *Opening Comments*.

HYPERINFLATION OUTLOOK SUMMARY

Broad Outlook Is Unchanged: Economy Remains in Downturn; Dollar Faces Massive Decline with Ongoing Implications for a Hyperinflation Crisis. The *Hyperinflation Outlook Summary* has not been revised from its prior publication.

The U.S. economy remains in ongoing downturn, while the U.S. dollar faces a massive decline, with implications for a meaningful upturn in inflation evolving into a great hyperinflationary crisis. Signs of systemic instability are increasing anew.

Background. Underlying this missive, *No. 692 Special Commentary: 2015 - A World Out of Balance* of February 2, 2015 updated the *Hyperinflation 2014* reports and the broad economic outlook. Previously, 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 2, 2014, and publication of *2014 Hyperinflation Report—Great Economic Tumble – Second Installment*, on April 8, 2014. The outlooks also are updated regularly in the weekly *Commentaries*. The two *2014 Hyperinflation Report* installments, however, remain the primary background material for the hyperinflation and economic analyses and forecasts. One other reference should be considered here, in terms of underlying economic reality, and that is the *Public Commentary on Inflation Measurement*.

Primary Summary. Current fiscal conditions show the effective long-term insolvency of the U.S. government, a circumstance that usually would have been met by unfettered monetization of the national debt and obligations, leading to an eventual hyperinflation by 2020, as first estimated by ShadowStats in 2004. That time horizon for the hyperinflation forecast was moved to 2014, as a result of the 2008 Panic, the near-collapse of the financial system, and official (U.S. government and Federal Reserve) response to same. That hyperinflation forecast remains in place, adjusted to 2015, as discussed in *No. 692*.

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 the *Hyperinflation Report—First Installment Revised* (linked earlier). The following summarizes the underlying current circumstance and recent developments.

The U.S. dollar rallied sharply from mid-2014 into early-2015, initially reflecting likely covert financial sanctions and oil-price manipulations by the United States, aimed at creating financial stresses for Russia, in the context of the Ukraine situation. Relative U.S. economic strength, and the relative virtuousness of Fed monetary policy versus major U.S. trading partners, were heavily picked-up on and heavily over-estimated by the global markets looking to support the dollar. Yet structural faults started to appear in the foundation underpinning U.S. dollar strength (see *Commentary No. 711*).

Consistent with the above referenced *Special Commentaries*, the unfolding, weakening domestic-economic circumstance in 2015, in confluence with other fundamental issues, had begun to raise doubts in the markets as to the sustainability of the purported U.S. economic recovery, and as to the imminence of meaningful monetary tightening by the U.S. Federal Reserve. As a result, the U.S. dollar backed off its recent highs, with some related upside pressure having been seen on oil prices, but those changes have been relatively small, so far.

First-quarter 2015 U.S. GDP contracted by 0.2% (-0.2%) as per its second and "final" revision, other than for benchmark revisions due on July 30th (*Commentary No. 731*). Although early reporting on the second-quarter economy indicated the likelihood of a second, consecutive quarterly GDP downturn, which would constitute a "new" recession, reporting of the last several weeks has been relatively strong, as discussed in the *Opening Comments* of *Commentary No. 726*. Such strong numbers should prove increasingly fleeting in the next four-to-five weeks, with a second-quarter GDP contraction still likely.

Nonetheless, the Fed could raise interest rates at any time, irrespective of economic activity. Where the stock and currency markets pretty much already have anticipated such action in their pricing, the big market moves ahead should come from areas such as downside surprises in U.S. economic reporting, which increasingly will show an ongoing contraction in activity.

Domestic economic data should continue to falter, increasingly moving market expectations towards an imminent new recession, not only further pummeling expectations for a significant tightening in Fed policy, if the Fed has not already tightened, but also renewing expectations for a more-accommodative or newly-accommodative Fed. While such could help to fuel further stock-market mania, any resulting rallies in equity prices likely will be more than offset in real terms, by percentage declines in the exchange-rate value of the U.S. dollar or in the eventual increases in headline consumer inflation.

Faltering expectations on the direction of domestic economic activity, should place mounting and eventually massive selling pressure on the U.S. dollar, as well as potentially resurrect elements of the Panic of 2008. Physical gold and silver, and holding assets outside the U.S. dollar, remain the ultimate primary hedges against an eventual total loss of U.S. dollar purchasing power. These circumstances should continue to unwind what had been the sharp and generally ongoing rally in the U.S. dollar's exchange rate since mid-2014, and the broadly-related selling pressures seen in the gold and silver markets.

A crash back to recognition of more-realistic domestic-economic circumstances began, then faltered recently, but should resume shortly, possibly a matter of weeks. It likely will be accompanied by a crash in the U.S. dollar versus major currencies, such as the Swiss franc, Canadian dollar and Australian dollar; and related rallies in precious metals and oil. Further, a sharp deterioration in the near-term outlook for domestic and global political stability continues and is of meaningful near-term risk for providing further fuel for heavy selling of the dollar.

***Current Economic Issues versus Underlying U.S. Dollar Fundamentals*.** U.S. economic activity is turning down anew, despite brief fluttering in unstable series. GDP and industrial production face heavy downside-benchmark revisions through the end of July. Other key series all have benchmarked to the downside. Weak, underlying economic reality generally has surfaced in headline reporting. That should become increasingly and painfully obvious to the financial markets in the detail and revisions of the weeks and months ahead, for series such as real retail sales, production, housing and construction, the trade deficit and payroll employment. Again, headline GDP will be in trouble.

As financial-market expectations resume shifting towards renewed or deepening recession, that circumstance, in confluence with other fundamental issues, particularly deteriorating domestic political conditions, should intensify mounting and eventually massive selling pressures against the U.S. dollar, more than fully reversing the dollar's gains since June 2014, and pushing the dollar once again to historic lows. Again, the nascent currency crisis also has meaningful potential to resurrect elements of the Panic of 2008.

Unexpected economic weakness intensifies the known stresses on an already-impaired banking system, increasing the perceived need for expanded, not reduced, quantitative easing. The highly touted "tapering" by the FOMC ran its course. Future, more-constructive Fed behavior—moving towards normal monetary conditions in what had been an unfolding, purportedly near-perfect economic environment—was pre-conditioned by a continued flow of "happy" economic news. Suggestions that all was right again with world were nonsense. Nonetheless, the Fed still likely would move to normalize interest rates (see *Opening Comments* of *Commentary No. 726*), if it could get away with it. The FOMC meeting of June 17th apparently concluded that the Fed could not get away with it (see *Opening Comments* of *Commentary No. 729*).

The Panic of 2008 never was resolved, and the Fed increasingly is finding that it has no easy escape from its quantitative easing (QE3), which continues. Only overt expansion of QE3 ceased; if the Fed does not act quickly to extricate itself from prior actions, QE4 will become the near-term question.

Unexpected economic weakness—a renewed downturn—also savages prospective federal budget deficit prognostications (particularly the 10-year versions). Such throws off estimates of U.S. Treasury funding needs and estimates as to how long the Treasury effectively can dodge the limits of the recently re-imposed debt ceiling. Current fiscal "good news" remains from cash-based, not GAAP-based and accounting projections and is heavily impacted by changes in business activity.

The economy has not recovered; the banking system is far from stable and solvent; and the Federal Reserve and the federal government still have no way out. Significant banking-system and other systemic (*i.e.* U.S. Treasury) liquidity needs will be provided, as needed, by the Fed, under the ongoing political cover of a weakening economy—a renewed, deepening contraction in business activity. The Fed has no choice. Systemic collapse is not an option for the Board of Governors. This circumstance simply does not have a happy solution.

Accordingly, any significant, renewed market speculation as to an added round of Federal Reserve quantitative easing, QE4, may become 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 thought it could, with continual, negative impact on the U.S. economy. The easings to date, however, appear to have been largely a prop to the increasingly unstable equity markets.

Again, in the event of a QE4, any resulting renewed boost to U.S. equities would be a fleeting illusion, at least in terms of real value (purchasing power of the dollar). Such gains would tend to be losses, in real terms, with the stocks valued in terms of Swiss francs, for example, or valued against what would become a rapidly-increasing pace of domestic U.S. inflation.

Strength in the U.S. dollar should continue to reverse sharply, in the context of underlying reality outlined here and in the sections that follow. The actual fundamental problems threatening the U.S. dollar could not be worse. The broad outlook has not changed; it is just a matter of market perceptions shifting anew, increasingly against the U.S. currency. That process may have started with the shift in Swiss National Bank policy early in the year, but it has become dominated by increasingly-negative global perceptions of stability in U.S. economic activity and the ability of the Federal Reserve to control its monetary policy. Key issues include, but are not limited to:

- ***A severely damaged U.S. economy, which never recovered post-2008, is turning down anew, with no potential for recovery in the near-term.*** The circumstance includes a renewed widening in the 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 (see details in the *Opening Comments* of *Commentary No. 729*). Sharply-negative economic reporting shocks, versus softening consensus forecasts, still remain a heavily-favored, proximal trigger for the intensifying the unfolding dollar debacle.

- ***U.S. government unwillingness to address its long-term solvency issues.*** Those controlling the U.S. government have demonstrated not only a lack of willingness to address long-term U.S. solvency issues, but also the current political impossibility of doing so. The shift in control of Congress did not alter the systemic unwillingness to address underlying fundamental issues, specifically to bring the GAAP-based deficit into balance. Any current fiscal "good news" comes from cash-based, not GAAP-based accounting projections. The GAAP-based version continues to run around $5 trillion for the annual shortfall, while many in Washington look to continue increasing 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; the initial fiscal-2014 details were discussed in *Commentary No. 672*, and the official GAAP-based financial statements for 2014 will be discussed fully, soon (see *Commentary No. 702*). This circumstance now operates in the context of the formal constraint of a renewed debt ceiling.

- ***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 end of the Federal Reserve's formal asset purchases, the U.S. central bank monetized 78% of the U.S. Treasury's fiscal-2014 cash-based deficit (see *Commentary No. 672*). The quantitative easing QE3 asset purchase program effectively monetized 66% of the total net issuance of federal debt to be held by the public during the productive life of the program (beginning with the January 2013 expansion of QE3). The monetization process was completed with the Federal Reserve refunding the interest income it earned on the Treasury securities to the U.S. Treasury. With highly tenuous liquidity conditions for the banking system and the Treasury, it would not be surprising in this period of increasing instability to see covert Federal Reserve activities masked in the purchases of Treasury debt by nations or other entities financially friendly to or dependent upon the United States. If the Fed does not move soon to boost interest rates, it may be trapped in a renewed expansion to quantitative easing, given ongoing banking-system stresses, vulnerable stock markets and weakening, actual U.S. economic activity. As has been commonplace, the Fed likely would seek political cover for any new or expanded systemic accommodation in any "renewed" economic distress.

- ***Mounting domestic and global crises of confidence in a dysfunctional U.S. government.*** The positive rating by the public of the U.S. President tends to be an indicative measure of this circumstance, usually 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. The positive rating for the President is off its historic low, but still at levels that traditionally are traumatic for the dollar. Chances of a meaningful shift towards constructive cooperation between the White House and the new Congress in addressing fundamental fiscal and economic issues are nil, except possibly for new trade legislation, which would compound domestic economic problems. Issues such as non-recovered, faltering economic activity, the consumer liquidity crisis and the nation's long-range solvency should continue to devolve into extreme political crises.

- ***Mounting global political pressures contrary to U.S. interests.*** Downside pressures on the U.S. currency generally are mounting, or sitting in place, in the context of global political and military developments contrary to U.S. strategic, financial and economic interests. Current conditions include the ongoing situation versus Russia and extraordinarily-volatile circumstances in the Middle East. U.S. response to Russian activity in the Ukrainian situation likely was behind part of the recent strength in the U.S. dollar and related weakness in oil prices, with U.S. actions aimed at causing financial distress for Russia. These situations have yet to run their full courses, and they have the potential for rapid and massive negative impact on the financial and currency markets.

- ***Spreading global efforts to dislodge the U.S. dollar from its primary reserve-currency status.*** Active efforts or comments against the U.S. dollar continue to expand. In particular, anti-dollar rhetoric and actions have been seen with Russia, China, France, India and Iran, along with some regular rumblings in OPEC and elsewhere. Temporary, recent dollar strength may have bought some time versus those who have to hold dollars for various reasons. Nonetheless, developing short-term instabilities and a quick, significant reversal in the dollar's strength should intensify the "dump-the-dollar" rhetoric rapidly.

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, likely in the year ahead.

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. Investors need to preserve the purchasing power and liquidity of their wealth and assets during the hyperinflation crisis ahead. Again, see Chapter 10, *2014 Hyperinflation Report—Great Economic Tumble* for detailed discussion on approaches to handing the hyperinflation crisis and *No. 692 Special Commentary: 2015 - A World Out of Balance*, for other factors afoot in the current environment.

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REPORTING DETAIL

U.S. TRADE BALANCE (May 2015)

May Trade Deficit Widened; Second-Quarter Real Merchandise Deficit Now on Track for Minimal Deterioration. The nominal (not-adjusted for-inflation) trade deficit widened to $41.9 billion in May 2015, from a revised $40.7 billion in April 2015. The April deficit, in turn, had narrowed versus an unrevised $50.6 billion deficit in March. Recent monthly data through April had reflected volatility from labor-dispute-disrupted trade flows, and that circumstance may have had some lingering impact on headline trade activity in May 2015.

In the context of a narrowing of the nominal April trade deficit in revision, the headline $41.9 billion shortfall in May was close to consensus expectations of $42.1 billion [MarketWatch] and $42.7 billion [Bloomberg].

Going forward, look for a sharp widening of the headline nominal and real trade shortfalls in the "advance" reporting of June 2015 trade activity on July 30th, and in the subsequent full reporting for June.

***Quarterly Deficit Deterioration Net of Inflation*.** Nonetheless, where the average April-May trade shortfall narrowed versus the average first-quarter shortfall, before inflation, the April-May trade deficit widened in real terms (after inflation adjustment). Such is an important factor in terms of GDP activity, where a widening real deficit subtracts from real GDP activity. The headline May reporting turned the headline real trade deficit from a prospective minimally-positive to a minimally-negative contributing factor to second-quarter 2015 GDP growth. "Advance" June trade-deficit reporting, which will be available to the Bureau of Economic Analysis (BEA) for the initial estimate of second-quarter GDP growth, should take the real, quarterly trade shortfall sharply negative.

In real terms (chained 2009 dollars), the May 2015 merchandise trade deficit was $58.4 billion versus a revised $56.9 billion in April, a two-month average of $57.7 billion. That was little changed versus a real first-quarter 2015 average of $57.6 billion, but the balance shifted from minimally positive to minimally negative versus first-quarter 2015, and it was significantly wider than the fourth-quarter 2014 average of $50.5 billion, and the year-ago second-quarter 2014 average of $51.1 billion.

Nominal (Not-Adjusted-for-Inflation) May 2015 Trade Deficit. The BEA and the Census Bureau reported this morning, July 7th, that the nominal, seasonally-adjusted monthly trade deficit in goods and services for May 2015, on a balance-of-payments basis, widened by $1.173 billion to $41.871 billion, versus a revised $40.698 (previously $40.879) in April 2015. The May 2015 nominal deficit narrowed minimally versus a $42.070 billion trade shortfall in May 2014.

In terms of month-to-month trade patterns, the headline $1.173 billion widening in the May 2015 deficit reflected a decline of $1.472 (-$1.472) billion in monthly exports, partially offset by a decline in monthly imports of $0.299 (-$0.299) billion [difference is in rounding]. Oil imports had negligible impact on the headline deficit.

Energy-Related Petroleum Products. For May 2015, the not-seasonally-adjusted average price of imported oil moved higher, to $50.76 per barrel, versus $46.52 per barrel in April 2015, but down from $96.12 per barrel in May 2014. Also not-seasonally-adjusted, physical oil-import volume in May 2015 averaged 6.512 million barrels per day, down from 7.864 million in April 2015, and down from 6.870 million in May 2014.

Ongoing Cautions on Data Quality. Potentially heavy distortions in headline data continue from seasonal adjustments. Similar issues affect 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 too heavily on the accuracy of the monthly headline data.

Real (Inflation-Adjusted) May 2015 Trade Deficit. Adjusted for seasonal factors, and net of oil-price swings and other inflation (2009 chain-weighted dollars, as used in GDP deflation), the May 2015 merchandise trade deficit (no services) widened to $58.369 billion, from a revised $56.943 (previously $57.180) billion in April 2015. The May 2015 shortfall widened sharply versus a $51.287 billion real deficit in May 2014.

As currently reported, the annualized quarterly real merchandise trade deficit stood at $554.8 billion for fourth-quarter 2013, $597.8 billion for first-quarter 2014, $613.4 billion for second-quarter 2014, $588.6 billion for third-quarter 2014, $605.5 billion for fourth-quarter 2014, and $691.2 billion for first-quarter 2015. Widening quarter-to-quarter real trade deficits subtract growth from the quarterly real GDP estimates and vice versa.

Based solely on the headline reporting for the real April and May 2015 deficits, the average of those two months annualized to a quarterly real trade shortfall of $691.9 billion for second-quarter 2015. Where the annualized reporting of just the April 2015 detail was $686.2 billion, the implied second-quarter real trade shortfall has moved from a minimal narrowing to a minimal widening. With the release of the "advance" June 2015 trade shortfall on July 30th, the "advance" second-quarter GDP estimate on the same date will reflect that detail. The June reporting likely will result in a relatively-sharp quarterly deterioration and a directly related, negative contribution to second-quarter real GDP growth.

WEEK AHEAD

Headline Economic Reporting and Revisions Should Trend Much Weaker than Expected; Inflation Will Rise Anew, Along with Rising Oil Prices. In a fluctuating trend to the downside, amidst mixed reporting in headline numbers, market expectations for business activity nonetheless respond primarily to the latest market hype. The general effect tends to hold the market outlook at overly-optimistic levels. Expectations exceed any potential, underlying economic reality.

GDP excesses from 2014 should face downside adjustments in the July 30, 2015 GDP benchmark, and subsequent to the current headline contraction in first-quarter 2015 GDP, expectations for headline growth in second-quarter 2015 should resume shifting to the downside, as headline economic reporting turns lower, particularly in the week ahead.

Headline CPI-U consumer inflation—recently driven lower by collapsing prices for gasoline and other oil-price related commodities—likely has seen its near-term, year-to-year low, having shown monthly declines in annual inflation of less than a full 0.1% (-0.1%) in the three months through March 2015, but dropping by 0.2% (-0.2%) in April 2015. A large jump in gasoline prices for May 2015 and a softening of negative seasonal-adjustments for gasoline promise generated a headline monthly increase in May 2015 CPI-U inflation of 0.4%, with annual inflation effectively pulling even with zero. Year-to-year CPI inflation increasingly will be going against negative year-ago numbers in the months ahead, and should move into relative positive territory with the upcoming headline June 2015 reporting.

Significant upside inflation pressures are building, as oil prices rebound, a process that should accelerate rapidly with the eventual sharp downturn in the exchange-rate value of the U.S. dollar. These areas, the general economic outlook and longer range reporting trends are reviewed broadly in *No. 692 Special Commentary: 2015 - A World Out of Balance* and in the *Hyperinflation Outlook Summary*.

A Note on Reporting-Quality Issues and Systemic-Reporting Biases. Significant reporting-quality problems remain with most major economic series. See *Commentary No. 722* as to recent market and political pressures on the Bureau of Economic Analysis (BEA) relative to GDP reporting. Any meaningful, overt shifts by the BEA in headline GDP reporting methodology, other than those already planned for the July 30, 2015 benchmarking, would be extraordinary in terms of BEA behavior and are not likely. Still, some gimmicked, less-negative summary numbers already have been planned for publication.

Beyond the pre-announced gimmicked changes to reporting methodologies of the last several decades, ongoing headline reporting issues are tied largely to systemic distortions of monthly seasonal adjustments. Data instabilities were induced partially 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. The severity and ongoing nature of the downturn provide particularly unstable headline economic results, when concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data, explored in the labor-numbers related *Commentary No. 695*).

Combined with recent allegations of Census Bureau falsification of data in its monthly Current Population Survey (the source for the Bureau of Labor Statistics' Household Survey), these issues have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series (see *Commentary No. 669*).

PENDING RELEASES:

Nominal Retail Sales (June 2015). The Census Bureau has scheduled release of June 2015 nominal (not-adjusted-for-inflation) retail sales for Tuesday, July 14th. Real (inflation-adjusted) retail sales for June will be published in ShadowStats *Commentary No. 736* of July 17th, in conjunction with the detail on headline CPI-U reporting for June. Wherever expectations for June reporting settle, and expectations should be weak, headline reporting should be even weaker.

With this series, in the current environment, downside-reporting surprises usually are a good bet, including a weaker-than-expected headline number for June and potential downside revisions to the April and May detail. With an outright contraction in headline nominal retail sales a fair possibility, real (inflation-adjusted) sales should be even more negative, given a likely increase in the headline June CPI-U. Renewed weakness in the retail sales detail remains a good bet to dampen excessive growth expectations surrounding second-quarter GDP reporting.

Constraining retail sales activity, the consumer remains in an extreme liquidity bind, detailed most recently in the *Opening Comments* of *Commentary No. 729*, and as discussed in *No. 692 Special Commentary: 2015 - A World Out of Balance* (consumer liquidity conditions will be updated in the pending *Commentary No. 734* covering nominal June retail sales). Without sustained growth in real income, and without the ability and/or willingness to take on meaningful new debt in order to make up for the income shortfall, the U.S. consumer is unable to sustain positive growth in domestic personal consumption, including retail sales, real or otherwise.

Index of Industrial Production (June 2015). On Wednesday, July 15th, the Federal Reserve Board will release its estimate of the index of industrial production for June 2015. Whatever is reported on the 15th will be revamped on Tuesday, July 21st, in the context of annual benchmark revisions.

Wherever consensus expectations settle for June industrial production, and they should not be strong, downside-reporting surprises are likely in terms of headline monthly detail and/or prior-period revisions. Such has been the reporting pattern of recent months, and it likely will continue. Ongoing weakness in the new production detail remains a good bet to dampen excessive growth expectations surrounding second-quarter GDP reporting.

Producer Price Index—PPI (June 2015). The Bureau of Labor Statistics (BLS) will release the June 2015 PPI on Wednesday, July 15th. Odds favor a small headline monthly increase in wholesale inflation.

Unadjusted energy prices were mixed in June. Based on the two most-widely-followed oil contracts, not-seasonally-adjusted, monthly-average oil prices fell by 4.2% (-4.2%) and rose by 0.8% for the month, with an accompanying increase of 3.0% in unadjusted monthly-average retail-gasoline prices (Department of Energy). PPI seasonal adjustments for energy in June generally are negative, although they are minimally positive for gasoline. Given the vagaries of margin shifts in the dominant services sector, along with some likely added monthly inflation from wholesale food and "core" goods (everything but food and energy), the headline PPI change could be a small gain or decline, perhaps plus 0.1%.

Consumer Price Index—CPI (June 2015). The Bureau of Labor Statistics (BLS) has scheduled the June 2015 CPI for release on Friday, July 17th. The headline CPI-U should be on the plus-side, month-to-month, for the fourth straight month, with headline annual inflation turning positive for the first time in six months.

The average gasoline price moved higher in June 2015, up by 2.96% for the month on a not-seasonally-adjusted basis, per the Department of Energy (DOE). BLS seasonal adjustments to gasoline prices in June traditionally turn to the plus-side, pushing the headline, unadjusted gain in gasoline prices enough higher to contribute 0.14% to the headline CPI-U monthly inflation rate. With higher food and "core" (net of food and energy) inflation, a headline gain of 0.3% is likely.

Annual Inflation Rate. Year-to-year, CPI-U inflation would increase or decrease in the June 2015 reporting, dependent on the seasonally-adjusted monthly change, versus the adjusted, headline 0.17% monthly inflation gain for June 2014. The adjusted change is used here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for June 2015, the difference in June's headline monthly change (or forecast of same), versus the year-ago monthly change, should be added to or subtracted directly from the May 2015 negative annual year-to-year change of 0.04% (-0.04%). Headline monthly inflation of roughly 0.2% would be needed in order to push the headline annual June CPI-U inflation rate minimally into positive territory, and the headline monthly gain for June is a good bet to exceed that.

Residential Construction—Housing Starts (June 2015). The Census Bureau will release June 2015 residential construction detail, including housing starts, on Friday, July 17th. In line with common-reporting experience of recent years, monthly results are likely to be unstable and not statistically meaningful. Irrespective of the headline detail, the broad pattern should remain generally consistent with the low-level and down-trending stagnation seen currently in the series. Such is particularly evident with the detail viewed in the context of a six-month moving average of activity. This series also is subject to regular and extremely-large prior-period revisions.

As discussed in *Commentary No. 660* on the August 2014 version of this most-unstable of monthly economic series, the monthly headline reporting detail here simply is worthless, again, best viewed in terms of a six-month moving average. Not only is month-to-month reporting volatility extreme, but also those headline monthly growth rates rarely come close to being statistically significant.

Irrespective of where consensus expectations settle, the broad, general pattern of down-trending stagnation almost certainly continued in headline June 2015 activity.

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