

John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

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Inflation Surges as Economic Activity Plunges

System Nears Abyss and Fed Moves to Sit on Its Hands Again

Dollar and Gold Movements Are Just Beginning

OVERVIEW -- OPENING COMMENTS

Wall Street Pushes Hard for Interest Rate Fix That Cannot Work and May Not Happen

In fairness, there is little that Federal Reserve Chairman Ben Bernanke can do, except to play out a losing hand. It was a hand laid off on him by Alan Greenspan, aided and abetted by the U.S. Congress and recent Administrations. As dependent as a drug addict on his next fix, the U.S. stock market is addicted to interest rate cuts, and the pressures on the Fed for another fix are tremendous. Yet, the Fed continues to signal, as clearly as it signals such things, that there is no rate cut coming.

Accordingly, upcoming data likely will be used to paint a picture of strong enough business activity for the Fed not to have to ease. This will be accompanied by Fed officials jawboning, hinting at real inflation concerns and down-playing real recession fears. As the December 11th FOMC meeting nears, if market expectations still are for a rate cut, as they are now, then Mr. Bernanke will face a tough

decision: cave in to market pressures or pull the rug out from under the stock market. Complicating the picture may be possible political pressures from the Administration. Mr. Bernanke is not so stupid as to believe that "the dollar does not matter," irrespective of the pabulum he must feed the markets. If he does believe it, he should not be Fed Chairman. Such, however, does not preclude members of the Bush Administration from using the faux dollar argument in favor of an interest-rate fix for the stock market. Since the Administration can control the reporting of the economic statistics, a

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particularly weak November jobs report might signal a major rift between the Fed and the Administration. Regardless, the next two weeks will be very telling, where the new Fed Chairman will have a chance to salvage some his credibility in the global markets or risk triggering the financial Armageddon over which both he and Alan Greenspan have had recurring nightmares.

A Clash of Monsters. The Fed is a privately owned corporation dedicated to maintaining the profitability and solvency of the U.S. banking system. Guidance from the federal government as to maintaining sustainable economic growth and containing inflation are secondary concerns, to which the Fed pays significant public lip service. The simplistic view put forth by the Wall Street is that the Fed can raise rates to contain inflation or cut rates to stimulate the economy. The Fed can do neither at present, despite there being both recession and inflation problems. Further, the U.S. central bank faces a severe profitability/solvency problem within its base banking system.

The economy is in a long-term structural contraction that cannot be stimulated by low interest rates. Unless growth in consumer income can be sustained at a pace greater than that of inflation -- which it cannot at present -- then there can be no sustained growth in the economy. Short-lived economic growth has been generated by debt expansion or savings liquidation, areas to which Alan Greenspan pandered with his stock-market and housing bubbles.

From the inflation standpoint, commodity price distortions are the drivers behind current pricing problems, although monetary policy and a weak dollar are starting to add their own upside pressures. Unlike inflation driven by strong economic demand, commodity supply problems generally do not respond to interest rate hikes.

Beyond all the gimmicks tied to maintaining appearances, what the Fed faces is a banking system crisis, recession and inflation, with the U.S. financial markets extremely dependent on foreign capital for liquidity. Serious movement out of the dollar has started and threatens to turn explosive. Such threatens liquidity in the U.S. financial markets, and can act as a selling trigger for both the equity and credit markets. Indeed, the dollar does matter.

What exacerbated recent dollar selling were Mr. Bernanke's rate cuts. He knows the dangers of a systemic financial meltdown that could result from something as simple as a further easing. Yet, he is cornered by the uncontrollable greed of an interest-rate-addicted Wall Street, a monster created over the decades by Alan Greenspan's Pavlovian conditioning. Greenspan also helped to create another monster over the decades from dollar and fiscal neglect. This sleeping giant is the excessive foreign holdings of U.S. dollar-denominated instruments. Both the Greenspan monsters now are active and about to clash. Bernanke is the one who has to try to avoid the conflict, get the demons back in their cages or otherwise referee the fight. Facing the challenge with his hands tied behind his back, the Fed Chairman faces a no-win situation, a conflict that cannot have a happy ending.

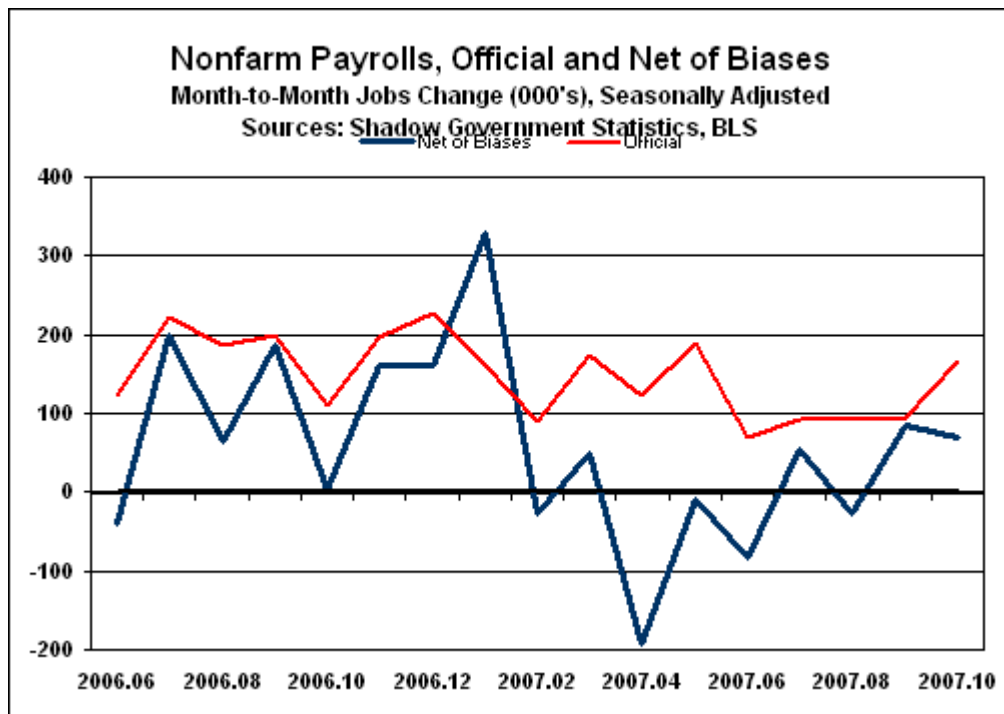
Banking Crisis Deepens. Although the recent hemorrhaging in the commercial paper market appeared to have stabilized in October, commercial paper outstanding resumed its plunge in the first two weeks of November. Also, the latest reporting on troubled-bank borrowing from the Federal Reserve's discount window is on the rise, again, net of seasonal borrowings. More than doubling, average daily borrowings rose to \$479 million in the two weeks ended November 21st, up from \$191 million in the prior period.

Anecdotal evidence of severe problems within the banking industry continues, with stories abounding of troubled institutions and instruments, and of back-door actions taken by worried central banks. As the U.S. recession deepens, the problems with structured financial instruments will widen quickly, extending far beyond the issues with problem mortgages. The Federal Reserve can be expected to spend every dollar it needs to create in order to maintain the solvency and stability of the domestic banking system.

Recession Deepens. Putting aside the nonsensical political propaganda being published under the guise of GDP reporting (surging economic activity), most recent economic reporting showed a deepening recession. Political/financial-market manipulation of economic data appears centered on the GDP, the trade deficit, payroll employment and retail sales, as discussed in the related sections. Even with the overstatement of retail sales, however, month-to-month gain turned into contraction for October, net of official CPI reporting.

Industrial production took a big hit in October, with all industry groups down, except for aerospace and transportation. Real weekly earnings fell, while new claims for unemployment insurance rose and consumer confidence/sentiment plunged. The purchasing managers manufacturing index eased in October, nearing a recession level, while the production component confirmed the contraction seen in the Fed's industrial production series. On the housing front, the picture remained bleak as discussed in this month's Reporting/Market Focus.

Bias Factor Creates 60% of Reported New Jobs. As to employment, despite overstated monthly payroll growth that seems aimed at relieving the FOMC of some easing pressures, annual growth continued at recession-signal levels in October. As suggested by the following graph, however, much of the reported monthly jobs growth simply is not there, in reality.



A monthly payroll bias factor was added into the monthly jobs creation process in the 1980s, after it was discovered that Bureau of Labor Statistics (BLS) mistakenly had understated jobs growth coming out of the double-dip recession early in that decade. The error was blamed on the undetected creation of some small companies. The additional 150,000 jobs or so add-on per month was called a bias factor, and simply was a plug number aimed at inflating reported monthly jobs growth in perpetuity.

In an effort to legitimize the bias factor in recent years, the BLS went through extensive modeling to come up with its replacement "birth/death model" of companies and their employees. While that gussied-up and redistributed some of the bias numbers by month, they still remained mindless plug numbers used to goose the monthly jobs data.

Where the process never was designed to handle an economic downturn (those things just do not happen any more in official government reporting), consider the bias components in October's reported payroll employment. Of the 166,000 seasonally-adjusted monthly payroll gain, 102,000 were bias factor (103,000 unadjusted). On an unadjusted basis, the aggregate bias included gains of 14,000 jobs in construction and 25,000 in financial activities.

Again, these plug numbers are mindless. The BLS would do better to go back to its old system of just adding so many jobs per month. Then it would appear only to be manipulative, not stupid, as well.

As to impact, of the 2,515,000 jobs reported created since the BLS's benchmark revision of May 2006, 1,543,000 jobs, or 60%, were created by the bias factor. Only 981,000 showed up in actual BLS surveying of U.S. employers. That is an average actual monthly jobs-creation pace of 58,000, which is not enough to keep the economy above water.

Inflation Surges. As expected, annual CPI and PPI inflation surged in October, as annual comparisons moved against periods of overstated energy-price reductions in 2006. The pattern should continue to certain extent in November's reporting. Despite ongoing underreporting of inflation, for October, annual CPI jumped to 3.5% from 2.8% in September, while annual PPI inflation soared to 6.1% from 4.4% in September. "Core" inflation rates continue to appear heavily massaged, in order to forestall market recognition of further conflicts for the Fed.

With oil pushing \$100 per barrel and food prices soaring, inflation pressures are not about to abate. Such is particularly true with the U.S. dollar under major selling pressure, and with the SGS-Ongoing M3 measure showing 15.3% annual growth, a level not seen since President Nixon closed the gold window in August 1971.

PLEASE NOTE: A "General background note" provides a broad background paragraph on certain series or concepts. Where the language used in past and subsequent newsletters usually has been or will be identical, month-after-month, any text changes in these sections will be highlighted in bold italics upon first usage. This is designed so that regular readers may avoid re-reading material they have seen before, but where they will have the material available for reference, if so desired.

General background note: The U.S. economy is in a protracted and deepening structural recession that will prove to be the second leg of a double-dip recession, which began in 2000/2001. The current downleg was signaled in mid-2005 by a series of leading indicators used for that purpose by SGS. With neither

traditional fiscal nor monetary stimulus available to help turn economic activity, the current circumstance is likely to evolve into a hyperinflationary depression (see December 2006 SGS).

Increasing Market Turmoil. With gold and oil prices pushing higher, at or near historic highs, with the various dollar indices setting successive new lows, with systemic liquidity risks being openly discussed in the popular financial media, U.S. equity prices appear to have entered something of a sporadic downturn.

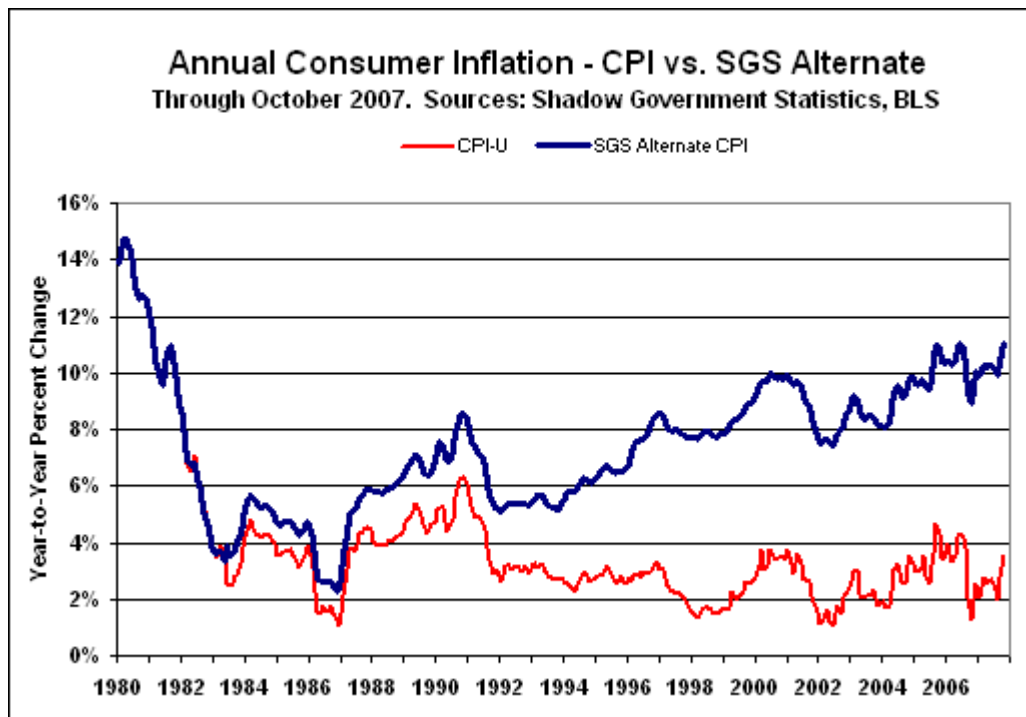
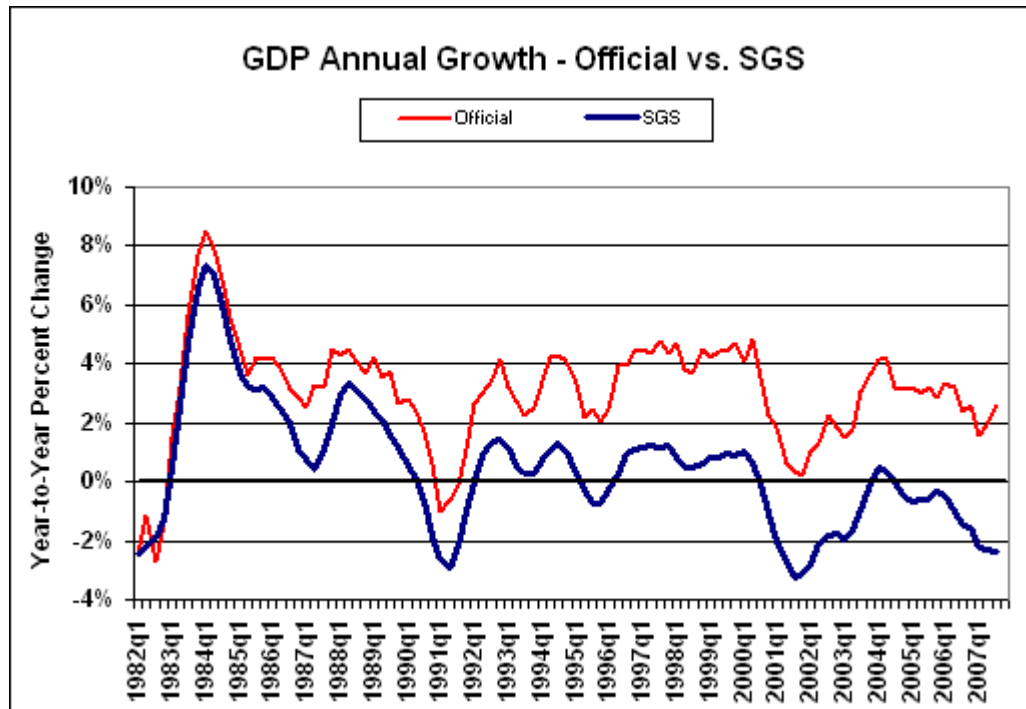
While recent market movements may reverse sharply in profit taking, the dollar and gold movements still have a long way to go, as does an eventual sell-off in equities. The only positive movement afoot is that U.S. Treasury yields have continued lower, with the Treasury market continuing to absorb flight-to-safety capital movements. It is this circumstance that will change and that has to concern Mr. Bernanke about his December 11th activities.

At some point, U.S. dollar selling and dollar dumping will reflect not just a movement out of the U.S. currency, but an unusual flight-to-safety out of the U.S. dollar. This is the circumstance at risk with another easing. This is the circumstance that eventually will force the Fed to increase rapidly its monetization of U.S. debt and to begin its unavoidable journey down the path towards hyperinflation.

Alternate Realities. *General background note:* This section updates the Shadow Government Statistics (SGS) alternate measures of official CPI and GDP reporting. When a government economic measure does not match common public experience, it has little use outside of academia or the spin-doctoring rooms of the Federal Reserve, White House and Wall Street. In these alternate measures, the effects of gimmicked methodological changes have been removed from the official series so as to reflect more accurately the common public experience, as embodied by the post-World War II CPI and the pre-Reagan-Era GDP. The methodologies for the series are discussed in the August 2006 SGS (see Archives page at www.shadowstats.com).

GDP. The alternate third-quarter GDP growth reflects the "advance" estimate, with many of the methodological gimmicks of recent decades removed. The alternate third-quarter inflation-adjusted annual growth rate (year-to-year, as opposed to the popularly-touted annualized quarter-to-quarter rate) for GDP was a decline of roughly 2.3% versus the official, rallying year-to-year gain of 2.6%.

General background note: Historical data on both the official and SGS-Alternate GDP series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate GDP numbers tend to show deeper and more protracted recessions than have been reported formally or reflected in related official reporting. Nonetheless, the patterns shown in the alternate data are broadly consistent with the payroll employment and industrial production series (as revised), which are major indicators used by the National Bureau of Economic Research in determining the official timing of U.S. business cycles.



CPI. The annual non-core annual inflation rates spiked again in October and should continue rising in November, while the so-called "core" inflation rates continued their orchestrated malingering, notching slightly higher. Food and oil-related price pressures increasingly are a problem, due primarily to supply

issues, but those pressures have been reflected only minimally in much of the government's reporting of the non-core inflation, so far. Continued sharp increases in market prices, however, will make it increasingly difficult for the BLS to mask the mounting inflationary pressures.

Eight Levels of Inflation
Annual Inflation for July to October 2007

Measure	2007			
	Jul	Aug	Sep	Oct
I.1 Core PCE Deflator	1.9%	1.8%	1.8%	n.a.
I.2 Core Chained-CPI-U	1.8%	1.7%	1.7%	1.8%
I.3 Core CPI-U	2.2%	2.1%	2.1%	2.2%
I.4 PCE Deflator	2.1%	1.8%	2.4%	n.a.
I.5 Chained-CPI-U	2.1%	1.8%	2.3%	3.0%
I.6 CPI-U	2.4%	2.0%	2.8%	3.5%
I.7 Pre-Clinton CPI-U	5.7%	5.4%	6.1%	6.9%
I.8 SGS Alternate Consumer Inflation	10.1%	9.9%	10.4%	11.1%

Notes: I.1 to I.3 reflect the core inflation rates, respectively, of the substitution-based personal consumption expenditure (PCE) deflator, the Chained-CPI-U and the geometrically-weighted CPI-U. I.4 to I.6 are the same measures with energy and food inflation included. The CPI-U (I.6) is the measure popularly followed by the financial press, when the media are not hyping core inflation. I.7 is the CPI-U with the effects of geometric weighting (Pre-Clinton Era as estimated by SGS) reversed. This is the top series in the CPI graph on the SGS home page www.shadowstats.com. I.8 reflects the SGS Alternate Consumer Inflation measure, which reverses the methodological gimmicks of the last 25 years or so, plus an adjustment for the portion of Clinton-Era geometric weighting that is not otherwise accounted for in BLS historic bookkeeping.

General background note: Historical data on both the official and SGS-Alternate CPI series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate CPI numbers tend to show significantly higher inflation over time, generally reflecting the reversal of hedonic adjustments, geometric weighting and the use of a more traditional approach to measuring housing costs, measures all consistent with the reporting methodology in place as of 1980. ***Now available as a separate tab at the SGS homepage www.shadowstats.com is the SGS Inflation Calculator that calculates the impact of inflation between any two months, 1913 to date, based on both the official CPI-U and the SGS-Alternate CPI series.***

MARKETS PERSPECTIVE

Global financial markets are in an ongoing state of extreme agitation, with the globally-dominant U.S. economy, financial markets and financial system all in increasing states of instability. As a result, the U.S. dollar -- the world's primary reserve currency -- has come under heavy selling pressure. Partially in response, oil and gold prices have soared. U.S. Treasuries continue to take something of their traditional safe-haven status, but that can turn quickly, particularly if Mr. Bernanke appears to place determination of Federal Reserve policy in the hands of Wall Street speculators. Despite what may be near-term extreme volatility in the various trading arenas, the long-term outlook for the U.S. markets remains for a severe sell-off in equities, a sharp spike in long-term interest rates, severe selling of the U.S. dollar against the major Western currencies, and a massive rally in the price of gold.

General background note: The U.S. economy remains in a severe **and sustained** structural inflationary recession, saddled with an impotent Fed and a federal government that is fiscally bankrupt in all but name. In combination, these factors offer the worst of all environments to the financial markets. Ahead lie higher long-term interest rates and much lower U.S. equity prices. On the plus side is the outlook for gold, which provides a solid hedge against many of the problems that have started to surface. Key to the near-term movements of these markets remains the fate of the U.S. dollar, which **likely has** started a major downside move.

U.S. Equities -- The U.S. equity markets have begun to soften, but they still remain well removed from rationality and continue to be spiked and roiled by the gimmicks and rantings of Wall Street's hypesters. As discussed in the Opening Comments, the Fed may be approaching its Day of Reckoning with the December 11th FOMC meeting. If not then, that day is not far off.

General background note: As the equity markets catch up with the underlying economic and looming financial fundamentals, the downside adjustments to stock prices should be quite large, eventually rivaling the 90% decline in equities seen in the 1929 crash and ensuing several years. The decline might have to be measured in real terms (net of inflation), as a hyperinflation eventually will kick in as the Fed moves to liquefy the system. Stocks do tend to follow inflation, since revenues and earnings get denominated in inflated dollars. Hence with a hyperinflation, a DJIA of 100,000 or 100,000,000 could be expected, but such still would be below today's levels, adjusted for inflation.

General background note: The approaching financial maelstrom already has come over the horizon and now is nearing landfall. When it hits, those investors who have taken shelter in cash, gold and outside the U.S. dollar will be the ones with the wealth and assets available to take advantage of the extraordinary investment opportunities that should follow.

U.S. Credit Market -- Key to the U.S. credit markets remains the global attitude towards the U.S. dollar. At such time as the flight from the dollar becomes a flight-to-safety out of the dollar, U.S. interest rates will be forced higher in a mounting liquidity squeeze resulting from foreign dumping of dollar denominated securities. Increasingly, those assets will have to be absorbed in the U.S. markets, depressing prices of equities, bonds, etc.

General background note: Credit market activity has continued to be dominated by the still unfolding liquidity crisis and general financial-market and global-political instabilities that have fostered continued flight-to-safety effects. Over time, inflation traditionally has been the dominant force behind interest rate movements. The worsening inflation outlook and mounting flight from the dollar both favor higher long-term interest rates, with a steepening, positively-sloped yield curve.

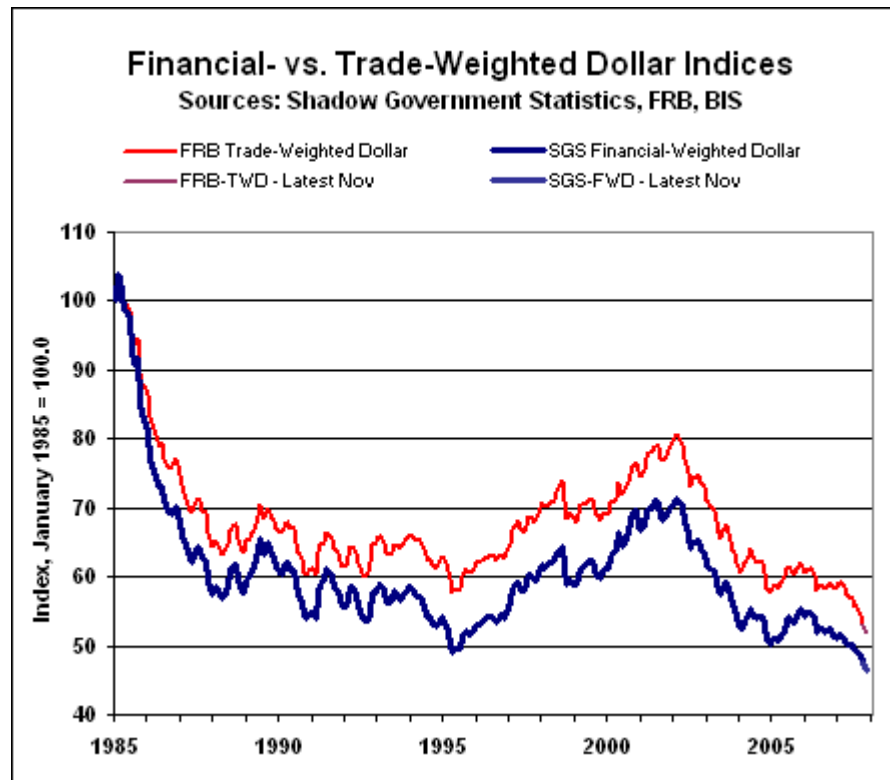
U.S. Dollar -- The selling pressure against the U.S. dollar has intensified, but pressures have shifted in recent weeks with the heaviest selling having been against the Japanese yen, Swiss franc and the euro. As flight from the dollar increasingly becomes a flight-to-safety outside the dollar, the Swiss franc likely will be one of the better performing currencies. Dollar weakness, however, should remain broadly based, against the major Western currencies, with heavy dollar selling still ahead, despite any near-term volatility or central bank intervention.

Potentially exacerbating the circumstance are continued stories of the central banks of Communist China and other Asian central banks moving out of the greenback, and mounting pressures within OPEC to abandon the U.S. dollar as the pricing mechanism for oil. The U.S. markets remain particularly vulnerable, at the moment, to "surprises" from those countries that are not so friendly to the United States, or even from those who simply would like to avoid large losses on the dollars they hold. The more the Fed eases, the greater the shift will be out of the U.S. dollar.

General background note: Outside of further Federal Reserve rate cuts or additional major negative news out of the liquidity/funding crisis, the proximal trigger for a *full* dollar panic could come from a bad economic statistic (statistics appear increasingly to be massaged in a dollar-friendly manner), political missteps by the Administration, negative trade or market developments in Asia, or a terrorist attack or even the increasingly likely expansion of U.S. military activity in the Middle-East. When the trigger hits, the broad selling pressure should be strong enough to overwhelm short-lived central bank intervention.

General background note: In terms of underlying fundamentals that tend to drive currency trading, the dollar's portfolio could not be worse. Relative to major trading partners, the U.S. economy is much weaker, interest rates are lower and anticipated possibly to go lower still, inflation is higher, fiscal and trade-balance conditions are abysmal, and relative political concerns are rising sharply at the same time. The President's approval rating commonly has moved currency trading in the past, and, despite any near-term bouncing, it remains lower than has been seen for any other U.S. President in the post-World War II era. Relative political stability issues are compounded by the presence of a Congress that is hostile to the President, and that is rated even lower by the American people than is the President. Generally, the greater the magnitude of the dollar selling, the greater will be the ultimate inflation pressure and liquidity squeeze in the U.S. capital markets.

As shown in the following graph, the U.S. dollar continued to fall sharply in October and so far in November, regularly setting new record lows on both a financial- and trade-weighted basis. The added latest November data points are as of November 23rd.



General background note: Historical data on both dollar series are available for download on the Alternate Data page of www.shadowstats.com. See the July 2005 SGS for methodology.

U.S. Dollar Indices The Shadow Government Statistics' Financial-Weighted U.S. Dollar Index (FWD) is based on dollar exchange rates weighted for respective global currency trading volumes. For October 2007, the monthly dollar average fell by 2.39% after a decline of 1.63% in September. The October 2007 average index level of 47.43 (base month of January 1985 = 100.00) was down 9.85% from October 2006, with September down 6.95% from the year before. The index again has set a new historic monthly-average low. The downward trend continued in November, with the index at 46.32 as of November 23rd.

Also setting a successive new all-time monthly-average low, October's level of the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD) was down 2.61% from September, which, in turn, was down by 2.07% from August. The October 2007 index level of 52.14 (base month of January 1985 = 100.00) was down 10.23% from October 2006, against September's 6.96% annual rate of decline. As of November 23rd, the TWD closed at 51.93.

Gold -- On November 8th, the London afternoon gold fix was set a 27-year high \$841.10 per troy ounce, within striking distance of the all-time high of \$850.00 of January 21, 1980. As noted in the November 19th Flash Update, we are -- at subscriber request -- publishing estimates of the January 1980 gold price peak (London afternoon fix) of \$850.00 per troy ounce in terms of today's dollar. The thinking behind the request was that since central bank intervention and manipulation have been used to depress the price of gold over time, what could have been expected in terms of the current gold price if inflation were truly and fully reflected.

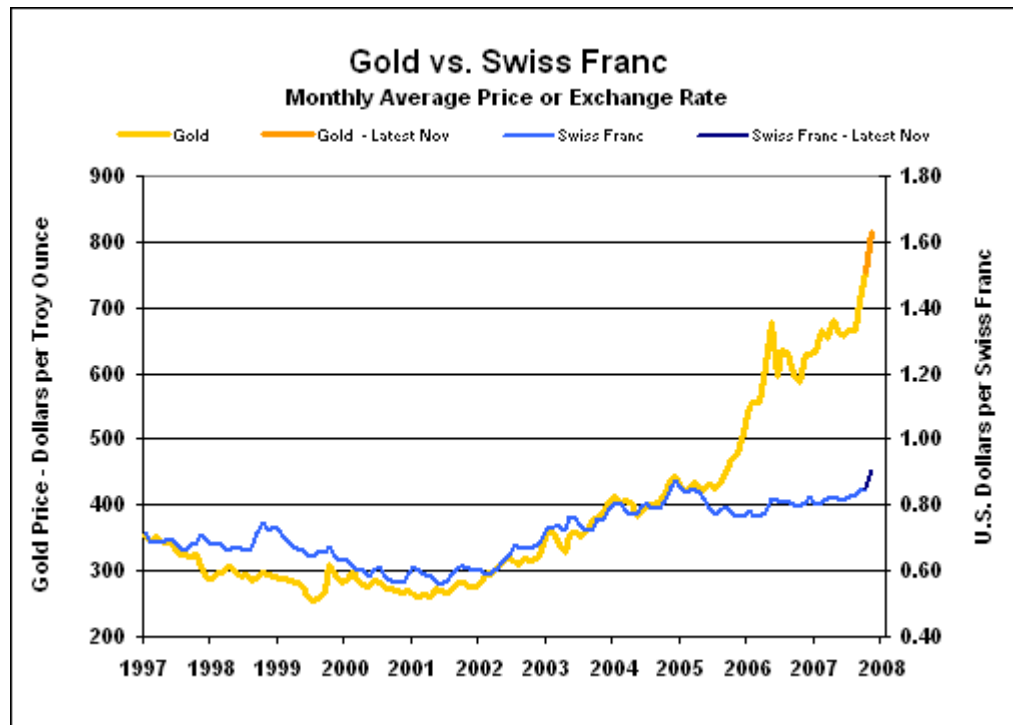
As can be determined using the Inflation Calculator referenced in the Alternate Realities section, inflation-adjusted peak gold would be \$2,283 per troy ounce based on October 2007 CPI dollars, and \$6,030 per troy ounce in terms of October 2007 SGS-Alternate CPI dollars. The suggestion is that the price of gold still faces some catch-up.

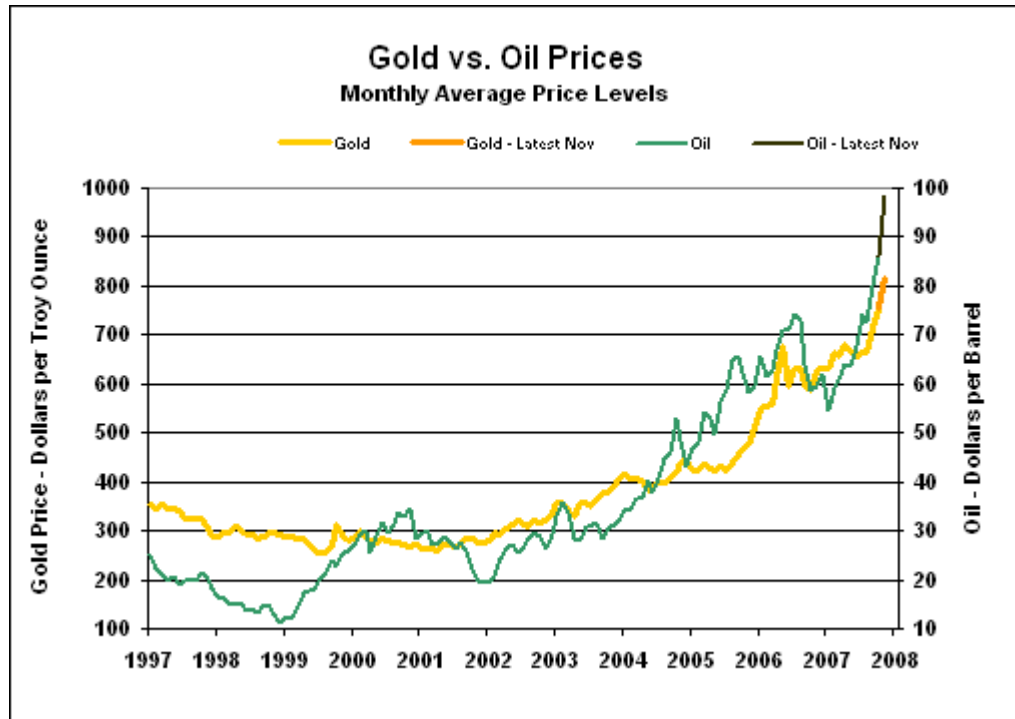
As of Friday (November 23rd), London gold closed at \$815.25 per troy ounce, with silver at \$14.55. For October, the monthly-average gold price (London afternoon fix per Kitco.com) averaged a record high \$754.60 per troy ounce, versus \$712.65 per troy ounce in September. Silver averaged \$13.67 per troy ounce in October, versus \$12.83 in September.

Soaring oil prices, soaring inflation, collapsing dollar and intensifying global political uncertainties all are fodder for the gold market, and the price of gold has rallied, as might be expected. While gold price volatility likely will continue, prices generally should move higher in the months ahead. Of some risk here remains the possibility of covert or overt central bank intervention in tandem with intervention aimed at muting the effects of dollar selling. Despite any central-bank machinations or intervention, the upside potential for the precious metals remains explosive, and eventual new record high prices loom.

General background note: As discussed in the Hyperinflation Series (see the December 2006 to March 2007 SGSs), the eventual complete collapse of the U.S. dollar -- the world's reserve currency -- will force the creation of a new international currency system. Gold likely will be structured into any replacement system, in an effort by those organizing the new currency structure to gain public acceptance.

The updated gold versus oil and Swiss franc graphs show October averages as well as added points for closing prices on November 23rd. As of Friday's closing prices, gold was at \$815.25 and oil at \$98.18, while the Fed's published noon buying rate had the Swiss franc at \$0.9069. Again, all three measures should trade significantly higher in the months ahead.





REPORTING PERSPECTIVE

The Big Three Market Movers

Recognition of rapidly deteriorating systemic problems and increasingly unstable financial markets explains the Fed's almost openly balking at further rate cuts. Mr. Bernanke needs a stable U.S. currency and as much support as possible from upcoming economic data. The dollar largely is beyond the Fed's control, now, but that is not the case for upcoming economic reporting. Accordingly, near-term rigging of key U.S. economic data is at high risk, with a likely bias to the upside for reports of economic growth and to the downside with the inflation numbers. Nonetheless, the reality of a recessionary economy beset by inflation problems will continue to dominate honest economic reporting.

Also, the continued tanking and bottom-bouncing of the President's positive rating generates added pressure on the government's statistical agencies to add in happy biases to the economic numbers. Where statistical games are being played for both the perceived political needs of the Administration and the increasingly heavy financial-market needs of severely constrained Federal Reserve, the need for rigged numbers continues to border on what might be considered as national security issues.

Nonetheless, absent manipulation, and against lagging and still largely distorted market expectations, most near-term economic reporting should tend to surprise the markets on the downside, while most inflation reporting should surprise expectations on the upside.

Employment/Unemployment -- As discussed in the November 2nd Flash Update, the Bureau of Labor Statistics reported seasonally-adjusted October payrolls up by 166,000 (156,000) net of revisions +/- 129,000, following September's revised 96,000 gain (previously 110,000). Unadjusted year-to-year payroll growth notched higher in October to 1.18%, up from September's revised 1.17% (previously 1.19%). Once, again, the report was not credible and was highly suggestive of manipulation aimed at reducing pressure on the Federal Reserve to ease further.

As discussed in previous newsletters, with monthly seasonal factors being readjusted each month as needed, the BLS can generate any desired result. Consistent adjusted and unadjusted annual growth rates suggest that October otherwise would have been reported as a 123,000 gain.

Also, as discussed and graphed in this month's Opening Comments, October's monthly upside bias factor was 103,000. With the November 2006 bias dropping to 36,000 from 108,000 in October 2006, this add-on gimmick will tend to reduce November 2007's monthly payroll gain. This in an environment where the BLS has announced that the next benchmark revision will show that unadjusted March 2007 payrolls were overstated by roughly 297,000 jobs. That means the currently reported levels will be revised downward by perhaps 500,000 as the BLS models readjust history.

In the statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including those of multiple job holders), seasonally-adjusted October employment plunged by 250,000, after having risen by 463,000 in September. The seasonally-adjusted October U.3 unemployment rate was reported at 4.73% +/- 0.23%, little changed from

the 4.70% reported for September, while unadjusted U.3 eased to 4.4% in October from 4.5% in September. The broader October U.6 rate held at an adjusted 8.4% but eased to 7.9% from 8.0% in September. Net of the "discouraged workers" defined out of existence during the Clinton Administration, the actual unemployment rate continues to run around 12%.

The October employment gain was against a background of bottom-bouncing help-wanted advertising, rising new claims for unemployment insurance, and weak, but mixed employment numbers in the October purchasing managers surveys (see respective sections). These background numbers remain consistent with continued weakness in official jobs and unemployment reporting.

Next Release (December 7): Based on underlying economic activity, the November payroll survey should show intensifying economic weakness, with the household survey indicating a rising unemployment rate. Given the simplistic spin in the U.S. financial markets that a recession means Fed easing, and given the Fed's indicated reluctance to ease further, however, data massaging likely will keep the November results strong enough to help give the U.S. central bank some breathing room. Such assumes that the Fed can call the numbers. If the dollar-doesn't-matter Administration is calling the numbers, a weak jobs report could be used to pressure the Fed for another cut.

Gross Domestic Product (GDP) -- The "advance" estimate of annualized real (inflation-adjusted) growth for the third quarter of 2007 was 3.90% +/- 3%, per the Bureau of Economic Analysis (BEA), up slightly from the 3.82% reported for the second quarter. From the standpoint of year-to-year growth, real GDP grew by 2.59% in the third quarter, up from 1.89% in the second quarter.

Adjusting for methodological distortions built into GDP reporting over time, the SGS-Alternate GDP measure suggests economic reality is much weaker than officially reported. A third-quarter annual contraction of roughly 2.3%, the same as in the second quarter, would have been more in line with underlying fundamentals and past methodologies (see the graph in the Alternate Realities section of the Opening Comments).

The "advance" results show stronger than average economic growth, but the numbers still are utter nonsense, in terms of underlying economic fundamentals. Keep in mind that at least 90% of the GDP in the advance estimate is guesstimated. From a political standpoint for the Fed and the Administration, of course, the numbers make good sense, sending the message that times are good and further Fed easing is not necessary.

The nominal (not adjusted for inflation) numbers, though, show a pattern of slowing growth. Annualized third-quarter growth slowed to 4.67% from 6.56% in the second quarter. The reason that "real" growth increased, of course, is that annualized inflation, as reflected by the GDP deflator, sank to 0.77% in the third quarter from 2.64% in the second quarter. The weaker the inflation rate used to deflate the GDP growth, the stronger will be the resulting inflation-adjusted growth.

Recognizing that the data in the "advance" estimate are of such poor quality, the BEA avoids further embarrassment by not publishing its estimates of two broad alternate GDP measures for another month or two. Gross National Product (GNP) is the first, where GDP is GNP net of trade in factor income (interest and dividend payments), and Gross Domestic Income (GDI) is the second, which is the theoretically-equivalent income number that matches the GDP's consumption number.

General background note: Although the GDP report is the government's broadest estimate of U.S. economic activity, it is also the least meaningful and most heavily massaged of all major government economic series. Published by the BEA, it primarily has become a tool for economic propaganda.

Next Release (November 29): The "preliminary" estimate revision of annualized quarterly real GDP growth for the third quarter should be showing a contracting economy, but that thanks to a false improvement to the trade data reported for September and October, expectations are for the "advance" 3.9% growth rate to revise sharply upward, into boom territory. Only the spinmeisters on Wall Street, at the Fed and in the White House, along with the severely gullible, will believe or purport to believe such propaganda. Those results certainly would help the FOMC argue that it does not need to ease further at this point in time.

Consumer Price Index (CPI) -- The Bureau of Labor Statistics (BLS) reported the seasonally-adjusted CPI-U (I.6) up by 0.29% (0.21% unadjusted) +/- 0.12% for the month, following September's 0.27% (0.28% unadjusted) increase. Against last year's overestimation of falling energy prices, annual CPI inflation surged to 3.54% in October, up from 2.76% in September and 1.97% in August.

That monthly surge in annual inflation likely will continue in November 2007. Where the adjusted November 2006 CPI was reported up just 0.05% for the month, any monthly increase in November 2007 CPI beyond 0.05% will add directly to October's annual inflation rate of 3.54%.

Annualized year-to-date inflation through the first ten months of the year was 3.6% adjusted, 4.3% unadjusted. The accounting for both CPI-U and PPI inflation once again was suspiciously shy in the areas of energy and food inflation, and reporting of so-called "core" inflation continues to appear to be managed, staying conveniently placid for the needs of the Federal Reserve.

Annual inflation for the Chain Weighted CPI-U (C-CPI-U) (I.5) -- the substitution-based series that increasingly gets touted by the manipulators and inflation apologists as the replacement for the CPI-U, and which has no relationship whatsoever to a cost of living measure that reflects maintaining a constant standard of living -- was 2.99% in October, up from 2.31% in September.

Adjusted to pre-Clinton (1990) methodology (I.7), annual CPI growth was about 6.9% in October, up from 6.1% in September, while the SGS-Alternate Consumer Inflation Measure (I.8), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was roughly 11.1% in October, up from 10.4% in September. The eight levels of annual inflation, I.1 to I.8, are detailed in the table in the Alternate Realities section, along with the graph of SGS-Alternate Consumer Inflation.

Next Release (December 14): Assuming some ongoing pick-up in monthly inflation for November, annual inflation should spike for a third month and generally continue rising into 2008. Seasonally-adjusted, monthly CPI-U rose by just 0.05% in November 2006. Accordingly, any monthly reporting above or below that for the pending release of November 2007 CPI will add or subtract directly to or from the current annual CPI-U inflation rate. Reporting risks generally favor an upside surprise to market expectations, barring targeted manipulation. Significant upside movement in core inflation remains long overdue and is highly suspect by its absence.

Other Troubled Key Series

Federal Deficit -- The 12 month rolling, accounting-gimmicked federal deficit through October 2007 was \$169.1 billion, up from \$162.8 billion in September, but still down versus \$250.2 billion in the 12 months ended October 2006. With the debt ceiling increased, gross federal debt totaled \$9.079 trillion as of October 31, 2007, up \$72 billion from September and up \$495 billion from October 2006, which in turn was up by \$557 billion from October 2005.

General background note: The federal government's fiscal 2007 (fiscal year-end September 30th) accounting-gimmicked deficit narrowed to \$162.8 billion from \$248.2 billion in 2006. The U.S. Treasury's financial statement for 2007 (due mid-December), prepared based on generally accepted accounting principles (GAAP), likely will show an actual deficit in excess of \$4 trillion (it was \$4.6 trillion in 2006, up from \$3.5 trillion in 2005).

General background note: Although it lacks the accrual accounting of the GAAP numbers, the change in gross federal debt bypasses several of the reporting manipulations and is a better indicator of actual net cash outlays by the federal government than is the official, gimmicked deficit reporting. As of fiscal year-end 2007, the gross federal debt stood at \$9.007 trillion, up by \$500 billion from 2006, which was up \$574 billion from 2005.

General background note: The Administration and Congress continue playing bookkeeping games. Even so, the gimmicked deficit should widen in the next 12 months, as government finances begin to suffer from tax revenue losses due to the intensifying recession and relative tax receipt declines after the expiration of recent corporate tax incentives. While GDP growth estimates can be gimmicked, incoming tax receipts (based on consistently applied tax policies) remain an independent estimate of underlying economic reality and eventually will reflect the economy's mounting difficulties.

Initial Claims for Unemployment Insurance -- The trend in annual growth has continued to deteriorate. On a smoothed basis for the 17 weeks ended November 17th, annual growth rose to 2.1%, versus the 17 weeks ended October 20th, where annual growth was 1.0%. An increasing growth trend in new claims is an economic negative.

General background note: More often than not, week-to-week volatility of the seasonally-adjusted weekly claims numbers is due to the Labor Department's efforts to seasonally adjust these numbers around holiday periods, as seen most recently with the week that included Columbus Day, and as seen anew surrounding Veteran's Day and the upcoming Thanksgiving holiday **reporting**. The Labor Department has demonstrated an inability to do such adjusting successfully. When the new claims series is viewed in terms of the year-to-year change in the 17-week (four-month) moving average, however, such generally is a fair indicator of current economic activity.

Real Average Weekly Earnings -- October's seasonally-adjusted monthly real earnings fell by 0.2% versus September. September was virtually unchanged in revision, having been reported up by 0.1%, initially. Annual change in October turned negative for the first time since May 2006, as annual CPI inflation surged in some catch-up reporting.

General background note: Gyration in the poor quality of reported CPI growth account for most month-to-month volatility in this series. Adjusting for the major upside biases built into the CPI-W inflation measure used in deflating the average weekly earnings, annual change in this series shows the average worker to be under severe financial stress in an ongoing **structural** recession.

Retail Sales -- October's seasonally-adjusted monthly retail sales rose by 0.16% (unchanged net of revisions) +/- 0.9% (95% confidence interval), after a 0.65% (previously 0.58%) monthly gain in September. Net of reported CPI inflation, October sales contracted by 0.13%. On a year-to-year basis, October retail sales were up by 5.15% before inflation and by 1.61% after inflation, compared with respective annual growth numbers for September of 4.86% and 2.10%. Once again, the October data appear to have been inflated in an effort to soften pressure on the Fed for another easing.

Mixed reports on the Thanksgiving weekend shopping are less than robust. While an early Thanksgiving may draw business from December, the holiday season is not likely to be a strong one for retailers.

General background note: Real (inflation-adjusted) year-to-year growth in retail sales below 1.8% (using the official CPI-U for deflation) signals recession, and a signal first was generated in this business cycle back in June 2006.

Core Retail Sales. As discussed in the November 14th Flash Update, if the Fed and Wall Street hysteresis are going to tout "core" inflation, net of food and energy, at least they should be consistent and go to town over "core" retail sales, net of gasoline station and grocery store sales, which vary primarily based on those otherwise meaningless energy and food prices. In a recessionary inflation, where food and energy prices are major inflation components, related retail sectors will tend to show sales increases, but due to rising prices, not due to stronger demand.

Accordingly, "core" October retail sales was unchanged from September. We will update this series regularly -- at least for a while -- at subscriber request.

Next Release (December 13): While the retail sales series appears to be one used in trying to assuage market nervousness, such places upside risk on positive massaging of the monthly data, particular for a report due at the peak of the holiday shopping season. Nonetheless, November retail sales eventually should prove to have been much weaker than expected, and an ongoing monthly contraction, net of inflation, still should be evident.

Industrial Production -- Seasonally-adjusted industrial production plunged by 0.5% in October, across all industry groups, except for aerospace and transportation. This followed a revised 0.2% gain in September (previously reported at 0.1%). Annual growth in October slowed to 1.80% from September's 2.1% (previously 1.90%).

If the October production numbers hold in revision, the National Bureau of Economic Research (NBER), official arbiter of U.S. recessions, may have its first number locked in for timing the current recession.

Next Release (December 14): Look for November industrial production to decline further, setting a pattern of contraction, barring data massaging. Eventually, monthly contractions in this series should become regular, with the rapidly slowing annual growth turning negative.

New Orders for Durable Goods -- The series has not been updated since the October newsletter was published. Accordingly, the following text is little changed from last month. The October release is due on November 28th (Wednesday).

For September, the usually volatile durable goods orders fell by 1.7% (down by 2.3% net of revisions), seasonally adjusted, after having fallen by 5.3% in August (previously a 4.9% monthly drop). On an annual basis, durable goods orders declined by 8.4%, showing an ongoing pattern common for this series during recessions. The year-to-year change in the inflation-adjusted, six-month moving average of the series is in contraction.

The closely followed nondefense capital goods new orders rose by 4.4% for the month in September, after falling by 12.2% in August. September's annual change was a decline of 12.0%.

General background note: Durable goods orders lost its status as a solid leading economic indicator when the semi-conductor industry stopped reporting new orders in 2002.

Trade Balance -- The trade numbers again appear to have been targeted for manipulation, with a false improvement reported in the trade deficit being used as an inexpensive tool to impact the currency markets in favor of the U.S. dollar. Beyond the usual gimmicks with the services surplus, the importation of oil appears to be seriously understated in terms of both pricing and physical volume. Against the monthly movement in market prices, which the reported average oil import price started to follow when oil prices began falling-off late last year, the September 2007 oil import price appears shy by about 8%. The difference would have added roughly \$1.6 billion to the September deficit, without addressing the 4% decline in monthly, and 6% decline in annual, reported physical oil imports.

As reported, the seasonally-adjusted monthly trade deficit for September narrowed to \$56.5 billion from a revised \$56.8 billion (previously \$57.6 billion) in August. Those results will help boost the "preliminary" estimate revision to third-quarter GDP growth.

Next Release (December 12): Underlying reality favors renewed, severe deterioration in the monthly trade deficit, but the government can play games with this series as long as it wants to play them. With some comments in the popular press in the last month about the lack of oil inflation in the trade numbers, perhaps the oil prices will be addressed in the October report. Reality stands behind the negative reporting risk; financial-market manipulation continues to dominate the positive reporting risk.

Consumer Confidence -- The October consumer confidence measures took hits in terms of both monthly and annual change. In October, the Conference Board Confidence measure fell by 3.9% for the month, 9.0% year-to-year. The University of Michigan Sentiment measure was down 3.0% in October and was down 13.6% year-to-year. On a smoothed, three-month moving-average basis, Confidence and Sentiment measures were down by 3.4% and 5.1%, respectively.

In the first reporting of November results, the Michigan Sentiment measure tumbled 5.9% for the month, and was down by 17.4% year-to-year (down 5.1% on a three-month moving-average basis).

These lagging, not leading, indicators tend to reflect the tone of the popular financial media and are showing that the inflationary recession has deteriorated sharply.

General background note: The Conference Board measure is seasonally adjusted, which can provide occasional, but significant distortion. The adjustment does not make much sense and is of suspect purpose, given that the Conference Board does not release the unadjusted number. The Michigan survey is unadjusted. How does one seasonally-adjust peoples' attitudes? Also, beware the mid-month Consumer Sentiment release from the University of Michigan. Its sampling base is so small as to be virtually valueless in terms of statistical significance.

Short-Term Credit Measures -- Patterns of annual growth in commercial borrowing have been shifted by the liquidity crisis, with the somewhat stabilized sharp fall-off in annual growth for commercial paper outstanding being countered partially by growth in commercial and industrial bank loans. Consumer credit numbers continue to show no impact.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth was reported at 5.1% in September against an upwardly revised 5.2% in August (previously 4.8%) and 5.1% (previously 4.8%) in July. In the current environment, where inflation-adjusted growth in income is not adequate to support meaningful growth in the personal consumption component of GDP, GDP growth only can come from temporary debt expansion or savings liquidation. Accordingly, stagnating growth in consumer debt expansion keeps an ongoing constraint on economic growth.

Commercial borrowing growth varied sharply, again, with annual change in October commercial paper outstanding showing 0.7% growth, after September's 0.8% decline, and August's 4.7% and July's 21.7% gains. In contrast, annual growth in October commercial and industrial loans continued to increase, up at an annual rate of 18.6%, following a 16.9% gain in September and a 13.4% gain in August. The relative stability seen in October commercial paper has started to fall apart anew in November. These credit difficulties will place a major dent in broad business activity.

Producer Price Index (PPI) -- The seasonally-adjusted October finished goods PPI rose by 0.1% (0.1% unadjusted), following a 1.1% (1.0% unadjusted) jump in September. Even so, annual PPI inflation for October rose to 6.1% from 4.4% in September. Seasonally-adjusted intermediate and crude goods rose 0.1% and 2.4%, respectively for the month, after increasing by 0.4% and 0.1% in September.

The weak October PPI number was due partially to a nonsensical 0.8% decline in October energy prices, while oil prices continued soaring past successive record highs.

Next Release (December 13): Despite the regular random volatility of the monthly price variations, PPI inflation reporting over the next six-to-nine months generally should come in above market expectations, as the effects of rapidly rising oil and food prices permeate the broad economy. As with the CPI, the core PPI inflation rate still is long overdue for an upside surprise, but such may be further delayed by the financial-market needs of the battered Federal Reserve.

Better-Quality Numbers

General background note: The following numbers are generally good-quality leading indicators of economic activity and inflation that offer an alternative to the politically-hyped numbers when the economy really is not so perfect. In some instances, using a three-month moving average improves the quality of the economic signal and is so noted in the text.

Economic Indicators

Purchasing Managers Survey: Manufacturing New Orders -- Maintaining its trend toward showing a recession in manufacturing, the overall October ISM manufacturing eased to 50.9 from 52.0 in September, with the October employment index notching higher to 52.0 from 51.7 in September. Nonetheless, the production measure plunged into recession territory, dropping to 49.6 in October from 54.6 in September. An accelerating decline in the broad series remains a good bet in the next several months, based on further declines in annual activity in a variety of underlying series. For example, the Fed's monthly industrial production measure plunged in October (consistent with the ISM production series), and durable goods orders are generating a recession signal.

The October new orders index dropped to 52.5 from 53.4 in September. Seasonal-factor distortions, which have been present, usually are overcome by viewing the series using year-to-year change on a three-month moving average basis. On that basis, the October new orders index slowed to a 0.2% annual gain from September's 1.1% increase.

General background note: Published by the Institute for Supply Management (ISM), the new orders component of the purchasing managers survey is a particularly valuable indicator of economic activity. The index is a diffusion index, where a reading below 50.0 indicates contracting new orders. The index gradually has notched lower from its peak annual growth of 42.6% in April of 2004. As an SGS early warning indicator of a major economic shift, the new orders measure breached its fail-safe point in mid-2005, generating a signal of pending recession.

Service Sector Index. The service-sector ISM index does not have much meaning related to overall business activity, since new order activity at law firms, dentists, hospitals or fast-food restaurants has little obvious relationship to broad economic activity. That said, the overall October services sector index rose to 55.8 from 54.8 in September. Both the services employment and prices paid components, however, have some meaning. The October employment component eased to 51.8 from 52.7 in September. The prices paid component is covered in the Inflation Indicators.

Help-Wanted Advertising Index (HWA) -- The help-wanted advertising index has not been updated since the October newsletter was published. Accordingly, the following text is unchanged from last month. The October index is due for release on November 29th (Thursday).

The Conference Board reported that seasonally-adjusted help-wanted advertising bottom bounced in September after hitting a five decade low in August. September's reading of 24.0 notched up from August's 23.0 nadir. Even allowing for the advertising volume lost to the Internet in recent years, the current weakness is severe enough to signal a deepening problem in the employment sector. The September number was down 17.2% from the year before, versus August's 23.3% annual contraction.

Viewed on a three-month moving-average basis, September's year-to-year contraction was 20.0% versus 20.4% in August. The series still indicates rapidly deteriorating employment conditions. Where the index never recovered from the 2000/2001 recession, its renewed and ongoing plunge has signaled a new and rapid contraction in economic activity. Continued deterioration remains likely in the months ahead.

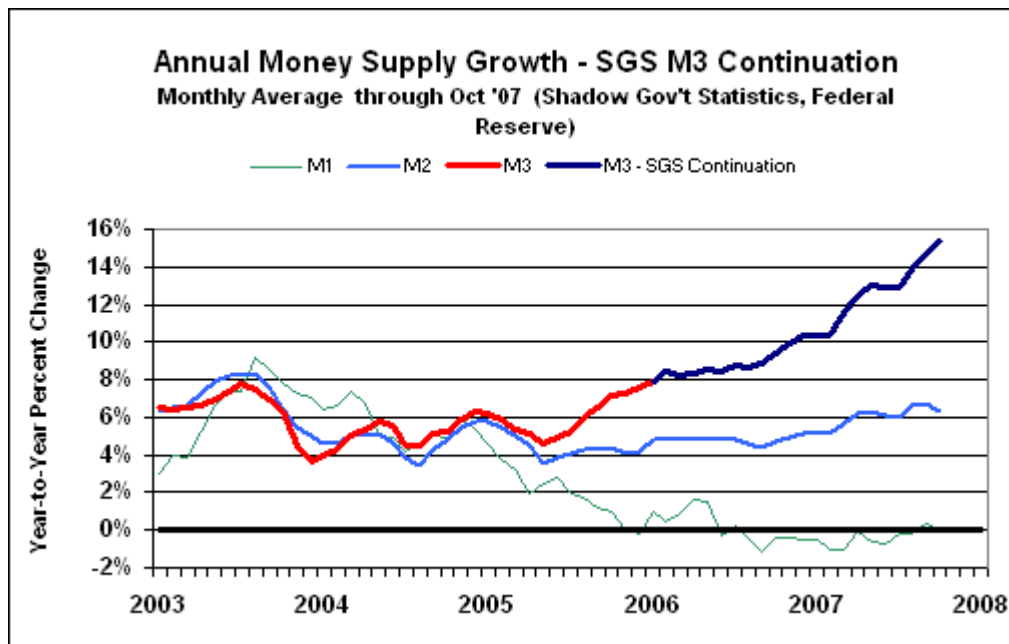
Housing Starts -- The housing data are revisited in this month's Reporting/Market Focus, and a deepening recession is evident, despite ongoing monthly volatility in key monthly series. October's seasonally-adjusted housing starts rose by 3.0% +/- 10% (95% confidence interval) for the month, after a decline of 11.4% (was 10.2%) in September. October's level was down 24.5% from the year before.

The monthly gain was attributed to gains in starts for multi-family dwellings, one-family homes were down by 7.3% for the month. Nonetheless, these numbers are so volatile and subject to revision that one month's data simply are not reliable. Also, one cannot rule out an attempt at the Census Bureau to make the numbers in this damaged sector look a little better.

The just-released building permits for October were down 6.6% for the month, 24.5% year-to-year. Previously confirming ongoing weakness in the housing sector, but not updated since the last newsletter, were September year-to-year contractions of 19.1% for existing home sales and 23.3% for new home sales. The new home sales number reflected an extraordinary 7.5% down revision to the prior month's level, which had the effect of making the monthly change look like a gain.

Inflation Indicators

Money Supply -- The SGS Ongoing M3 estimate of annual growth for October rose to 15.3% from 14.7% in September. The October growth rate is the highest since August 1971, when Richard Nixon closed the gold window. The current pace of growth has increasingly disturbing inflationary implications.



The bulk of the monthly increase in October's SGS-Ongoing M3 came from the Fed's reported series on M2, large time deposits and institutional money funds. The pace of annual growth in October reflected a minor deceleration in the pace of increase. Keep in mind that the SGS numbers reflect year-to-year changes and may not necessarily mirror not-seasonally-adjusted week-to-week activity by the Fed.

General background note: Historical annual growth data for the money supply series, including the SGS Ongoing M3 estimates, are available for download on the Alternate Data page of www.shadowstats.com. See the August 2006 SGS for methodology. The indicated M3 levels below are our best estimate and are provided at specific subscriber request. Keep in mind that regular revisions in the related Fed series affect historical M3. Usually, annual growth rates hold, although levels may shift a little. We have not attempted, nor do we plan to recreate a revised historical series for an M3 monthly-average level going back in time. The purpose of the SGS series was and is to provide monthly estimates of ongoing annual M3 growth. We are comfortable with those numbers and that our estimated monthly growth rates are reasonably close to what the Fed would be reporting, if it still reported M3. With those caveats on the table, here are the monthly-average levels for M3:

Shadow Government Statistics Ongoing M3 (r)
(Estimated seasonally-adjusted monthly average, \$ Trillions)

Feb 06	10.349	Aug 06	10.748	Feb 07	11.415	Aug 07	12.239
Mar	10.365	Sep	10.865	Mar	11.559	Sep	12.457
Apr	10.435	Oct	10.999	Apr	11.733	Oct	12.686 (p)
May	10.508	Nov	11.111	May	11.872		
Jun	10.564	Dec	11.227	Jun	11.925		
Jul	10.642	Jan 07	11.313	Jul	12.011		

(r)Revised based on FRB revisions to component numbers. (p)Preliminary.

NOTE OF CAUTION: The estimates of monthly levels best are used for comparisons with other dollar amounts, such as nominal GDP. While the estimates are based on seasonally-adjusted Federal Reserve data, great significance cannot be read into the month-to-month changes, as was the case when the Fed published the series. The most meaningful way to view the data is in terms of year-to-year change.

Based on October reporting, annual growth for monthly M1 remained slightly on the plus side, up by 0.07%, after September's 0.40% gain. October M2 annual growth eased to 6.33% from 6.72% in September. Data for the first two weeks of November suggest some further slowing of annual M2 growth, but continued surges in non-M2 large time deposits and institutional money funds indicate the November annual SGS-Ongoing M3 is likely to show a further increase in annual growth.

Purchasing Managers Surveys: Prices Paid Indices -- The October prices paid indices were mixed, likely for the last time, for a while, as they still are not reflective of the ongoing surge in oil prices, which looms in the upcoming data. The levels, however, remain high and in inflation territory, suggestive of ongoing inflation issues in both purchasing managers surveys.

On the manufacturing side, the October price index surged to 63.0 from 59.0 in September. On a three-month moving average basis, October's 2.2% gain sharply reversed September's annual decline of 29.1%, thanks to sharp oil price declines last year. The manufacturing price indicator is not seasonally adjusted and, therefore, is a generally the better indicator of pricing activity.

On the non-manufacturing side, the seasonally-adjusted October prices diffusion index eased to 63.5 from September's 66.1. On a three-month moving-average basis October's annual change also jumped to a gain, up 3.0% following September's 8.0% decline.

General background note: Published by the Institute for Supply Management (ISM), the prices paid components of the purchasing managers surveys are reliable leading indicators of inflationary pressure. The measures are diffusion indices, where a reading above 50.0 indicates rising prices.

Oil Prices – Oil prices have continued to soar, setting successive monthly average highs. As we go to press oil is trading near \$100 per barrel, a psychological price barrier that could fall at any time. That said, for October, the monthly-average West Texas Intermediate spot price (Department of Energy) jumped 7.8% from September to a record high monthly average of \$86.20 per barrel. Against last year's average, October's level was up by 46.4%, compared with September's 25.1% gain, and with August's 0.9% annual decline. Such just does not suggest happy news in the offing for annual CPI inflation.

As of Friday, November 23rd, West Texas Intermediate closed at \$98.18 per barrel. Oil price movement remains highly volatile, but broadly continues trending higher, and should continue setting new daily record highs. Irrespective of how high oil prices may go, or how much they may fall back in short-lived profit taking, current prices are an absolute disaster for pending U.S. inflation. Regardless of any near-term price swings, meaningful upside risks to oil prices remain in place, both from the intensifying dollar catastrophe and related OPEC rumblings, as well as from ever-volatile Middle Eastern political tensions.

General background note: Whether from supply and demand, geo-political or currency pressures, oil prices will remain at highly inflationary levels and will continue as a major contributing factor to U.S. inflation woes. Historically high oil prices still are working their way through all levels of U.S. economic activity, ranging from transportation and energy costs, to material costs in the plastics, pharmaceutical, fertilizer, chemical industries, etc. These broad inflationary pressures will remain intact despite any near-term oil price volatility. Although these pressures may be slow to surface in government reporting of the so-called "core" inflation measures, *thanks to creative data massaging*, they eventually will surface.

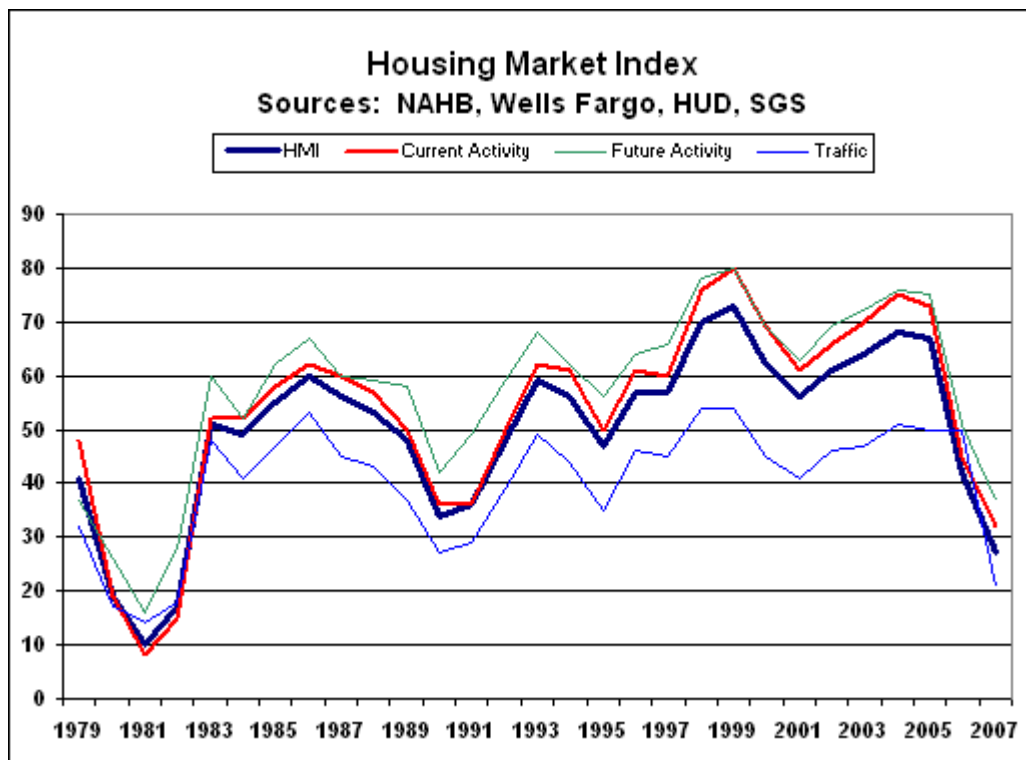
Reporting/Market Focus

Revisiting U.S. Housing Data -- Worst Downturn Since Early 1980s?

When broad U.S. housing data were last featured in the Reporting/Market Focus (June 2006 SGS), we noted that the housing starts series was "near generating a recession signal," although the downturn increasingly was evident in the home sales numbers. Subsequently, all the major housing indicators have signaled recession, with the level of the government's real (inflation-adjusted) residential investment series (a GDP account) turning down as of first-quarter 2006, as the result of a benchmark revision.

It is important to keep in mind that the current recession already was unfolding before the housing numbers began their terrible tumble, and that the housing problems were in play well before the leveraged junk mortgages brought the solvency of the banking/financial system into question. Accordingly, the current financial system disarray did not trigger the recession, it only exacerbated the circumstance.

As can be noted in a number of graphs that follow, the currently reported annual performance of housing starts, home sales and residential investment are rivaling but not yet exceeding the downturn seen in the early 1990s. There are indications, however, the current circumstance may come to rival the downturn of the early 1980s -- often considered the worst economic contraction of the post-World War II era -- or worse. Consider the expectations of U.S. home builders.



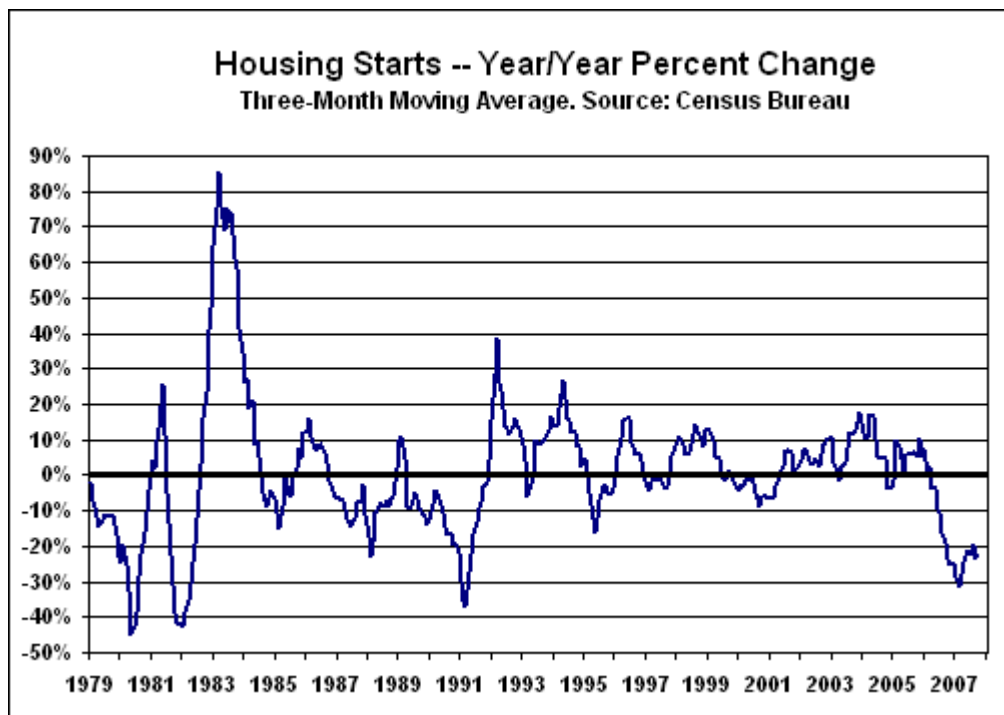
Of interest is the housing market index (HMI), published by the National Association of Home Builders and Wells Fargo. The index is like the purchasing managers survey, in that it is a diffusion index, where a

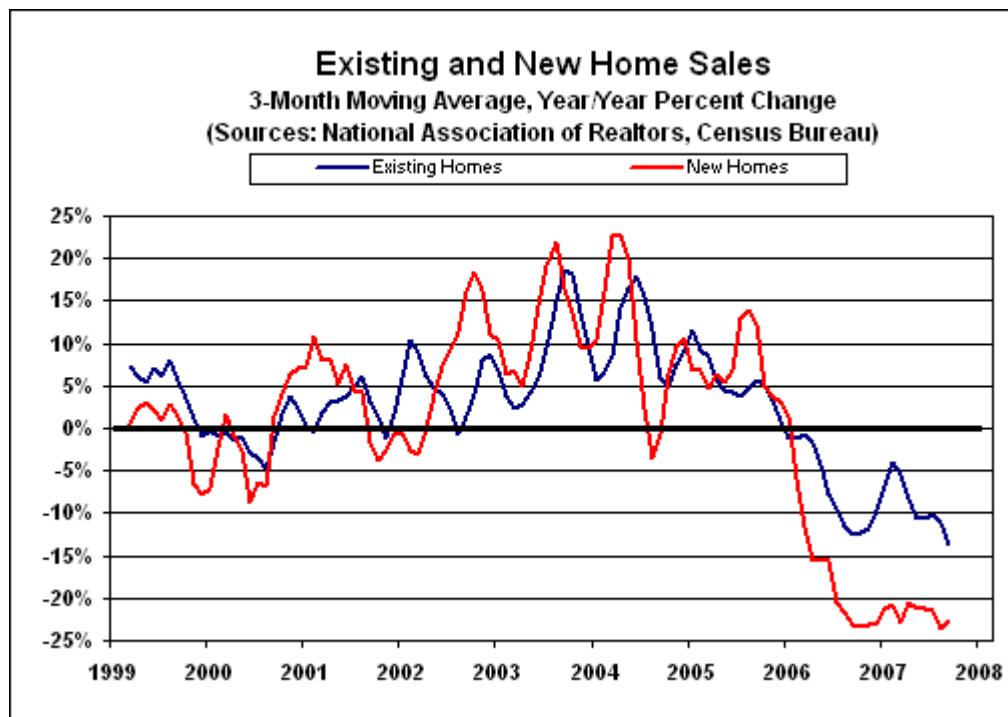
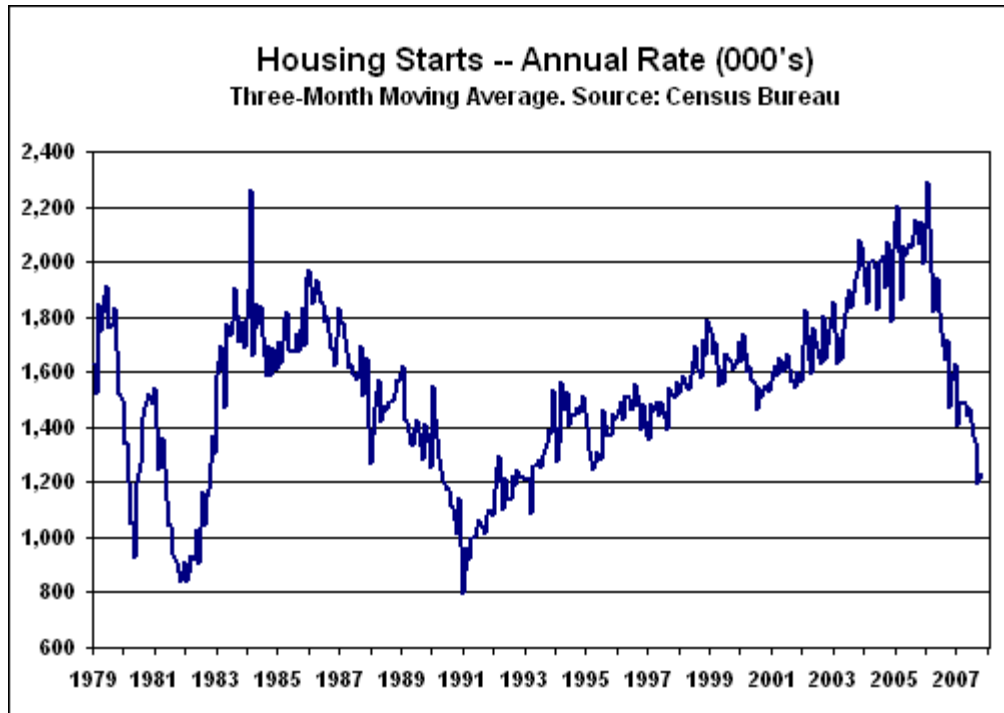
reading of 50 or above indicates as positive housing market climate, as viewed by home builders. The readings for the HMI and its three sub-components, as of November 2007 were: the HMI at 19, current sales at 18, future sales (next six months) at 15, traffic of prospective buyers at 17. The November HMI held even with the October reading, which was lowest since the official beginning of the monthly series in 1985.

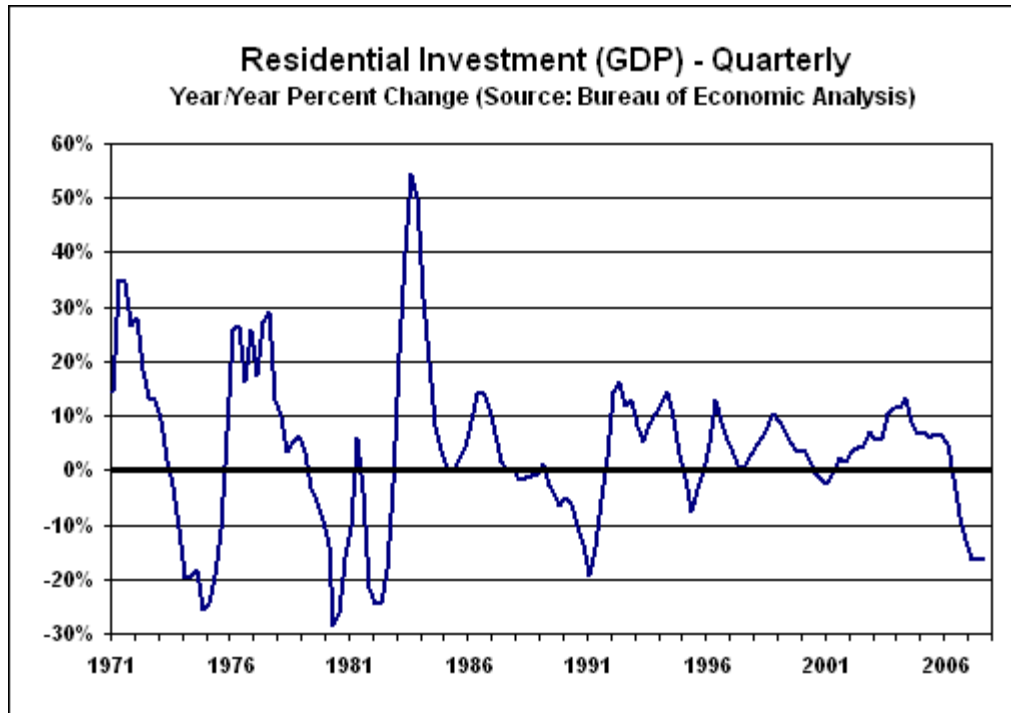
As shown in the preceding HMI graph, however, the Department of Housing and Urban Development (HUD) publishes the HMI or its components back to 1979 on an annual basis. SGS has estimated the HMI for 1979 to 1984, based on the weighting of the components series in the early series, and has estimated 2007 based on the 11 months reported so far for the year. Indeed, all the measures for 2007 appear to be headed for their lowest readings since before the early 1990s recession, which means builders are looking at the weakest environment they have seen since the early 1980s double-dip recession.

Due to a certain amount of random volatility in the housing numbers, the graphs of the monthly series are shown with data smoothed on a three-month moving-average basis. The pattern in each of these charts is consistent; the extent of the current reported downturn in housing is about as bad as it got in the 1990s recession. There is nothing in hand, however, to suggest the weak housing environment has run its course.

Indeed, with the problems surrounding adjustable rate mortgages (ARM), foreclosures and bank solvency still are unfolding, the current circumstance not only likely will degrade to an early 1980s environment as suggested by the home builders' outlook, but also the potential exists for something worse, a 1930s-style depression in housing activity. A look at these graphs again in six months may tell the story.







**Upcoming Reporting/Market Focus for December:
GAAP Financial Statements of the U.S. Government for Fiscal Year 2007**

Due in mid-December, this report from the U.S. Treasury promises to show an actual fiscal 2007 federal deficit in the trillions of dollars, not the \$163 billion reported in the gimmicked, official cash-based deficit. Details will be reviewed and placed in historical and economic/financial-market perspective.

PLEASE NOTE: The December "Shadow Government Statistics" newsletter currently is targeted for the week of December 17th, following the release of the GAAP-based government financial statements. Timing will be refined as the day nears. Postings on the Web site of monthly newsletters, interim Flash Updates and Alerts are advised immediately by e-mail.

The long-delayed Hyperinflation Special has evolved to include significant new material, beyond the original Hyperinflation series. The special edition now is planned as a supplement to the special year-end issue due in January 2008.

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