

John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

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Inflationary Recession and Banking Crises Intensify

4th-Quarter 2007 Gross Domestic Income Contracted 1.0%

Covert Intervention in Currency and Gold Markets Likely

OVERVIEW -- OPENING COMMENTS

Obfuscation and More Obfuscation

Underlying economic and banking system fundamentals rapidly are getting worse, not suddenly better as touted in Wall Street's fantasies. Another tall tale is of the Fed's valiant fight against recession, while containing inflation. Now that the economy has been turned, the story goes, the Fed can slowdown or eliminate its easing so as to concentrate on its inflation fight. What nonsense! The Fed's primary concern remains preventing a systemic financial collapse; everything else is secondary. The Fed has very limited ability at present either to stimulate the economy or to contain inflation, despite severe problems in both areas.

Mr. Bernanke made the decision to sacrifice the U.S. dollar and inflation containment months ago. Any move now to a slower pace of interest rate cutting is due primarily to the targeted fed

funds rate nearing its practical lower limit. If the Fed kept cutting rates at the same pace as seen earlier this year, fed funds would be at 0.00% before July.

As will be discussed further, nearly all statistics that underlie GDP suggest a first-quarter contraction, but politics likely will keep the number positive. Recent inflation reporting has been understated, yet market recognition is growing of a serious inflation threat. With oil

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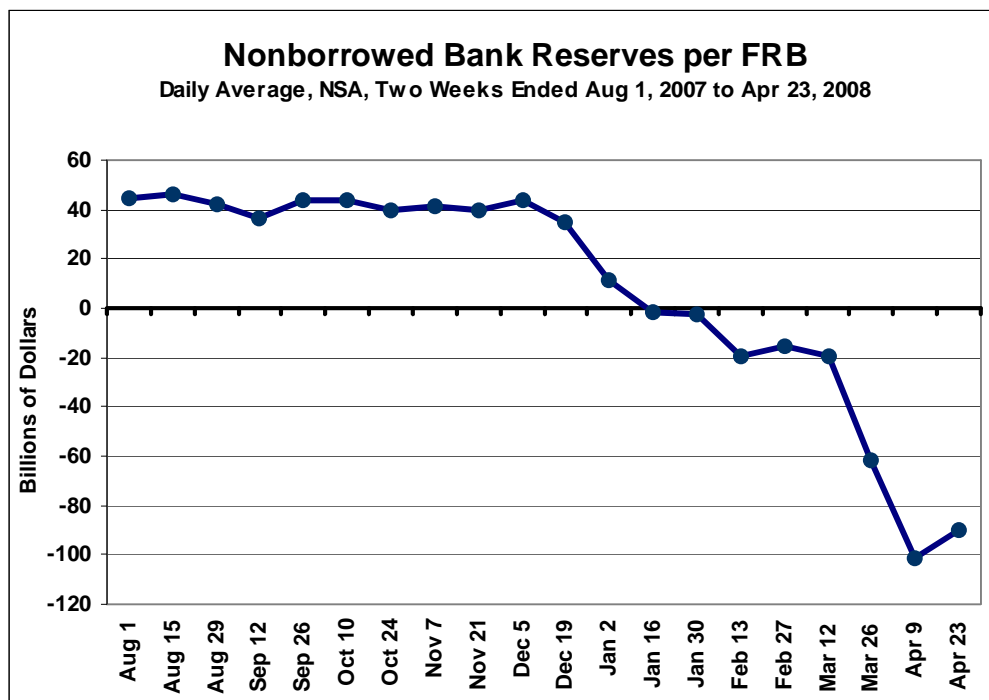
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prices hitting new record highs, the outlook for inflation cannot be good, as explored in this month's Reporting/Market Focus. Inflation pressures also are in play from food supply disruptions, a weak dollar and excessive growth in the broad money supply.

Nonetheless, the equity markets have rallied, as has the U.S. dollar in conjunction with some gold selling. The equity markets rarely are rational, but the currency markets have been subject to heavy central-bank jawboning, which historically usually has been reinforced with covert market intervention. The gold market, in turn, has been hit with overt intervention. Jawboning and intervention tend to be short-lived in impact. The

long range outlook remains dismal for the U.S. dollar and extremely bullish for gold.

Banking Solvency Crisis Continues. Little has changed in terms of the banking solvency/liquidity crisis, except for the passage of some time. The news continues to be bleak, as central banks keep pushing liquidity into the system. As shown in the accompanying graph, the Fed now reports non-borrowed bank reserves at something close to \$100 billion. These funds obviously have little to do with banks meeting their reserve requirements, but more generally reflect the Fed's net lending of cash and assets of approximately \$140 billion as a liquidity infusion for troubled banks.



With the ability to create money and its mandate to protect the banking system, the Fed has both the wherewithal and the will to bailout the financial system. The cost of such salvation, however, will come in the sharp rise of inflation in goods and services, as a monetary inflation starts to kick in. As banks have offered illiquid collateral to the Fed for loans of liquid assets, the re-liquefied banks in

turn have been able to act more like solvent banks, making loans and expanding the money supply.

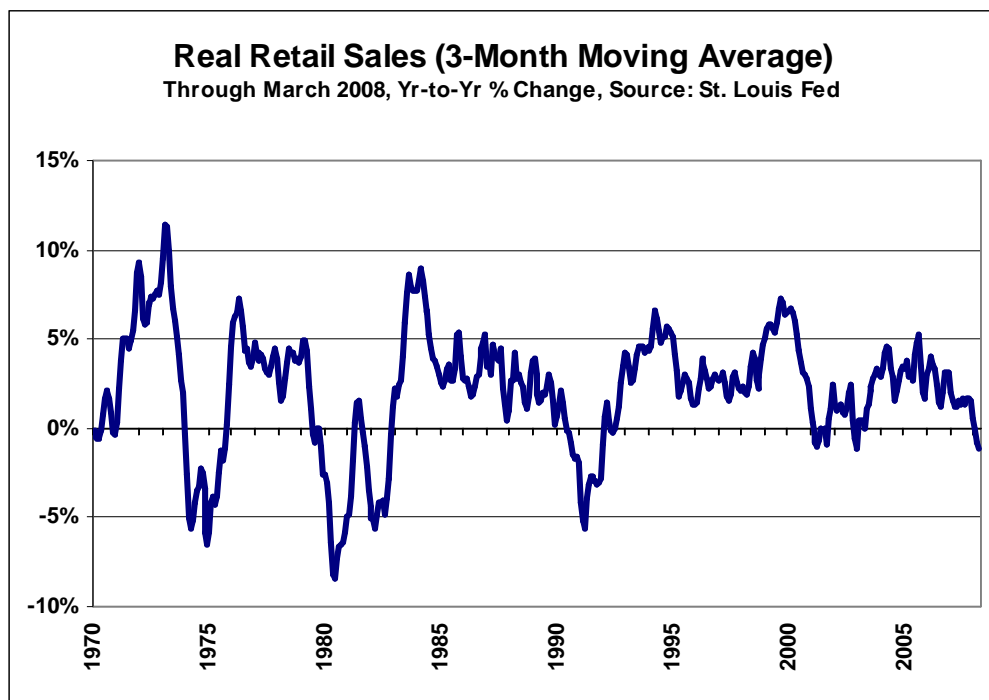
Looking to today's and tomorrow's (April 29th and 30th) Federal Open Market Committee (FOMC) meeting, the markets appear to be expecting a 25 basis-point (0.25%) rate cut in the targeted Fed Funds rate to 2.00%, with a possible cessation of rate cuts thereafter. The pace of cuts had to slow

down as the fed funds rate otherwise would quickly move to nil, if recent trends were continued.

With Wall Street addicted to rate cuts, stories that there really is not going to be a recession are being used to salve the markets' interest-rate-cut withdrawal pains. Yet, the economy clearly is in a recession, and despite what games may be played with tomorrow's first-quarter GDP estimate, there still will be upcoming negative shocks in a number of economic series, as well as likely further negative surprises out of the financial system. What happens to the markets and the pressures on

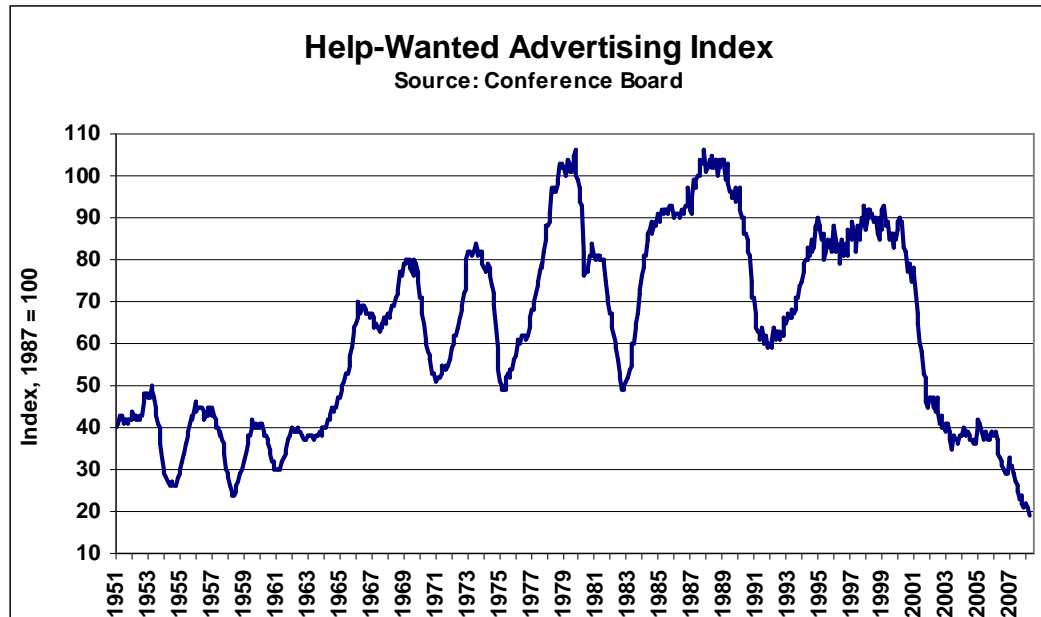
the Fed when the latest current wishful thinking collapses?

Hidden Recessions. Recessions have been hidden by poor-quality GDP data, before, such as the downturns around 1987 and 1995. Even the official recession of 2000 largely has disappeared now, as the result of revisions to GDP data. The current recession certainly has been masked and can be masked further by bad reporting -- at least for a while -- but the economic contraction eventually should be deep enough and long enough to show up even in official reporting.



As shown in the graph above, inflation-adjusted retail sales, smoothed using a three-month moving average, shows the year-to-year change in the key consumer series falling still deeper into recession territory in March. As indicated in the graph following, the help-wanted advertising index hit its lowest level since the series was first calculated

near the end of the Truman administration. While some of the historic weakness is due to the shifting of advertisements to the Internet in the last decade, the recent near-term plunge in activity nonetheless reflects a sharp decline in employment activity.



These and other series, as they may relate to GDP reporting, are detailed in the First-Quarter Underlying Data section. Again, these numbers suggest that a particularly severe recession in terms of depth and duration -- one not easily hidden for long -- is in the process of unfolding.

Did Greenspan Put on His Smokey-the-Bear Hat Too Often? I often have compared the necessity and natural occurrence of recessions in the business environment to the necessity of sleep for people. Sleep helps to repair and refresh the body, enabling you to take on fresh challenges in the day ahead. If you go without sleep -- especially using stimulants to stay awake -- your efficiency drops off markedly and eventually you crash into a deep sleep. One recent evening, I was making that point in conversation with my son, daughter-in-law and grandson out here in beautiful California -- an area that has had more than its share of tragic wild fires. More environmentally savvy and sensitive than I, my daughter-in-law suggested that I might want to consider using a wildfire analogy, which upon reflection, indeed I find is a good one, even though I may have added a word or two, here or there, to the text she gave me.

As explained to me, wildfires or forest fires are a natural and healthy part of some wild forest ecosystems. Naturally occurring fires usually are caused by lightning, and, as part of an undisturbed natural ecosystem, provide a sort of 'house cleaning' for the forest. They consume brush and buildup, clear the forest floor for new vegetation, and put nutrients back into the soil, basically fertilizing the soil. Some plants and trees are even triggered by fire to germinate, such as pine cones that open up in the heat and release seeds into the newly refreshed and fertilized earth. Large, established trees can easily weather this sort of cyclic wild fire.

As civilization has encroached on forestlands, structures, property and human life have been put at risk from fires. Accordingly, it has become commonplace for authorities to put out most wildfires in order to protect life and property, irrespective of risk to same. In turn, those efforts have had unintended consequences. As a result of the disruption of the natural wildfire cycle -- where the forest floor never has its regular house cleaning -- the leveraged buildup of brush and kindling makes the forest ever more vulnerable to an unnaturally large, fast and wilder fire. Fire risk is increased by carelessness ranging from cigarette

butts to campfire ashes, by arson, by poorly structured collateralized debt obligations, etc.

Each time that a fire is put out by the local authorities or the central bank, it is that much more important that the next one be put out, as the fuel build up would make the next fire that much stronger and dangerous. With this unnatural fuel buildup, it is likely that a wildfire could burn out of control, beyond the capacity of human containment. A fire of this unnatural strength would decimate the forest, because even old, strong, established trees cannot withstand fires of such magnitude. It has even gotten to where some park services -- the forests' regulators -- have programs to utilize "controlled burn" fires to safely reduce the fuel load on the forest floor. Even so, fires that have been designed to be controlled have, on occasion, gotten out of hand with disastrous consequences. Still, in most places regulatory oversight is lax. Such is obvious, given the increasing intensity of fire storms seen in each successive fire season of recent years.

In his protracted term as Fed Chairman, Alan Greenspan was noted for encouraging ever more creative bubbles in efforts to forestall financial-market days of reckoning and related severe economic downturns. Further, as top regulator of the banking system, not only did he fail to clear away unnecessary deadwood, but also he actually encouraged the creation of new types of kindling in the form of derivative and structured instruments. Now Ranger Ben is tackling the worst financial wildfire of the last 70 years, fighting hard to save the large established banks. Fortunately for Bernanke, he has the ability to dump whatever water or fire retardant he needs. He can save the big trees, yet lose the forest in the process.

Gross Domestic Income Contracted 1.0% in the Fourth Quarter. Gross Domestic Income (GDI) is the income-side equivalent to the GDP's consumption-side measure. As in double-entry

bookkeeping, both sides should equal each other, with both measures showing the same rates of growth. Such rarely is the case, however, and sometimes the pattern of differences between the two series is suggestive of more than simple reporting inconsistencies. The differences between the two series are resolved mathematically by adding a statistical discrepancy account to the income side, and the discrepancies have been soaring.

The amount of discrepancy (not adjusted for inflation) moved from a negative \$40.8 billion in second-quarter 2007, to a positive \$84.8 in the third quarter, to a positive \$139.9 billion in the fourth quarter. The positive discrepancy means that GDP is being overstated relative to GDI.

As a result, where third- and fourth-quarter real (inflation-adjusted) growth rates were 4.9% and 0.6% for the GDP, the GDI saw a growth rate of just 1.2% in the third quarter and a contraction of 1.0% in the fourth quarter. Both sets of numbers are supposed be legitimate, but the GDI is showing the economy already to be in contraction. The details here will be updated in a month or two, when the first-quarter GDI is released.

Pending GDP Manipulation. While the popularly followed Gross Domestic Product measure was reported with 4.9% annualized real growth in the third quarter and with 0.6% growth in the fourth quarter, those numbers were artifacts of data massaging aimed at hiding the current recession. In like manner, data likely will be gimmicked so as to show continued growth in first-quarter 2008 GDP (due tomorrow, Wednesday, April 30th). If so, the manipulation process is about to become much more obvious.

As noted in the April 23rd *Flash Update*, with President Bush assuring the American people that, "We're not in a recession, we're in a slowdown [Reuters, April 22]," it is almost a sure bet that the

"advance" estimate of first-quarter GDP growth will not show a contraction but rather likely will at least meet consensus forecasts of 0.4% growth.

Separately, the FOMC is expected to announce tomorrow afternoon (April 30th) the slowing or cessation of its interest rate cuts. According to Wall Street spin, this shift is due at least partially to recession having been avoided. It could be awkward for the Fed to take a less-aggressive stance against recession, if the morning news were to carry the story of an unexpected contraction in first-quarter GDP.

By law, neither the White House nor the Fed is supposed to get an advance look at the GDP data until after the markets close today (April 29th), but political practicality prevents the President or the Fed chairman from being embarrassed by data surprises, and those data surprises most certainly never occur when the numbers are being massaged to meet political or financial-market needs. In any event, at the time of the President's statement, the Bureau of Economic Analysis (BEA) already had a pretty good idea of what it would be reporting.

In the event that first-quarter GDP is reported to have contracted, what follows will help explain why it happened.

First-Quarter Underlying Data Show Contracting Business Activity, Surging Inflation.

As explained in the April 23rd *Flash Update*, and as detailed in the next two tables, the underlying fundamentals that drive GDP not only are suggesting a quarterly contraction in first-

quarter GDP but also generally are consistent with what should have been a contraction in fourth-quarter GDP.

The popularly-followed GDP growth rate is reported net of inflation, with the quarter-to-quarter rate of change annualized (raised to the fourth power). All the data in the tables have been prepared in a similar manner, so as to be consistent with and comparable to the reported or expected GDP growth and to the GDP inflation rate (implicit price deflator) used to adjust the GDP for inflation.

Where the consumer accounts for roughly three-quarters of GDP, in personal consumption expenditure and residential investment, the underlying numbers in terms of retail sales and housing starts have been in contraction for at least two quarters. Confirming underlying weakness in the consumer sector are collapsing consumer confidence measures and employment indicators. What is more of a guesstimate in early BEA data compilations -- allowing for some gimmicking -- is the services consumption area, covering such components as health care, travel and housing.

Business investment usually runs parallel to industrial production, which is in contraction, along with the various new orders measures.

Two months worth of trade data (all the BEA has to work with for the "advance" GDP estimate) suggest a widening of the deficit in net exports in the first quarter versus the fourth quarter.

The remaining GDP components that will have to more than counterbalance the negative components, in order to generate a positive

Underlying Data for First-Quarter 2008 GDP

All rates of change are adjusted for inflation and are at a seasonally adjusted annualized rate (SAAR), based on quarter-to-quarter change, unless otherwise indicated

<i>Indicator</i>	<i>4th-Q 2007</i>	<i>1st-Q 2008</i>	
GDP	+0.58%	+0.4%	(Consensus estimate)
CONSUMER SPENDING/HOUSING			
Retail Sales	-1.34%	-4.15%	
Consumer Confidence			
- Conference Board	-45.32%	-50.89%	
- University of Michigan	-33.23%	-21.71%	
Employment			
- Payroll Survey	+0.79%	-0.31%	
- Household Survey	+0.75%	-0.60%	
- New Claims - Unemployment	+10.66%	+22.56%	(Gain here is a negative)
- Help-Wanted Advertising	-29.39%	-44.37%	
- NAPM Mfr Employment	-9.59%	-16.59%	
- NAPM Non-Mfr Employment	+7.20%	-38.72%	
Housing Starts	-38.62%	-34.54%	
Building Permits	-45.55%	-42.43%	
Home Sales			
- New	-35.05%	-43.03%	
- Existing	-29.69%	-3.68%	(Reflects increasing foreclosures)
INDUSTRY INVESTMENT/MFR			
Industrial Production	+0.40%	-0.11%	
New Orders			
- Durable Goods			
Before Inflation Adjustment	-5.90%	-8.53%	
After Inflation Adjustment	-10.44%	-12.29%	
- Purchasing Managers - Mfr	-27.60%	-17.39%	
NET EXPORTS			
Merchandise Trade Deficit	+6.75%	-1.49%	(Negative number means deteriorating deficit, net of inflation and oil price changes)
- Petroleum Deficit	-16.01%	-12.39%	

Notes: (NSA) not seasonally adjusted. (SA) seasonally adjusted. (Purchasing Managers) - ISM purchasing managers survey, (mfr) manufacturing, (non-mfr) non-manufacturing. Trade data were based on February 2008 reporting that will be used in the first-quarter GDP "advance" estimate. All data used here are as used elsewhere in the newsletter, with identical definitions and sources. Consensus estimates are per Briefing.com.

first-quarter GDP number include: the services side of personal consumption expenditure, a buildup of unwanted business inventories and government consumption.

A common gimmick used to boost GDP growth artificially is deflation with underestimated inflation. In theory, the BEA first estimates GDP in nominal terms, not adjusted for inflation. Then each component is deflated by its appropriate inflation measure, with aggregated real (inflation-adjusted) GDP compared with prior periods for estimating growth rates. If too low an inflation rate is used in the deflation process, the real number ends up overstated. From a practical standpoint, the real GDP has to be determined

first, in order to have the desired result, with the nominal estimates backed out with appropriate deflators.

For example, in the table below, the 2.4% overall deflation rate was used in determining real fourth-quarter GDP growth of 0.6%. Had the deflator been 0.6% points higher at 3.0%, real GDP growth would have been nil. Differences in monthly inflation of 0.05% and 0.03% are all that stand in the way of respective quarterly contractions for both fourth- and (expected) first-quarter GDP estimates

Underlying Data for First-Quarter 2008 GDP Implicit Price Deflator

All rates of change are at a seasonally adjusted annualized rate (SAAR) based on quarter-to-quarter change, unless otherwise indicated

<i>Indicator</i>	<i>4th-Q 2007</i>	<i>1st-Q 2008</i>	
GDP Implicit Price Deflator	+2.41%	+3.0%	(Consensus estimate)
Other Inflation Measures			
CPI-U	+5.03%	+4.03%	
PPI	+9.25%	+9.04%	
Purchasing Mgr - Mfr (NSA)	+26.96%	+96.44%	
Purchasing Mgr - Non-Mfr (SA)	+59.20%	-3.66%	
Inflation Precursors			
Oil Price (WTI)(NSA)	+109.66%	+35.14%	
U.S. Dollar (NSA)			
- Financial-Weighted (SGS)	-15.32%	-8.24%	(Weaker dollar means higher inflation)
- Trade-Weighted (FRB)	-17.89%	-6.89%	
Money Supply - M3 (SGS)	+19.23%	+18.30%	
Gold Price (NSA)	+79.16%	+91.32%	

Notes: See notes to prior table.

The point of the above table is to suggest that inflation measured by the implicit price deflator is too low, with a resulting offsetting upside bias in

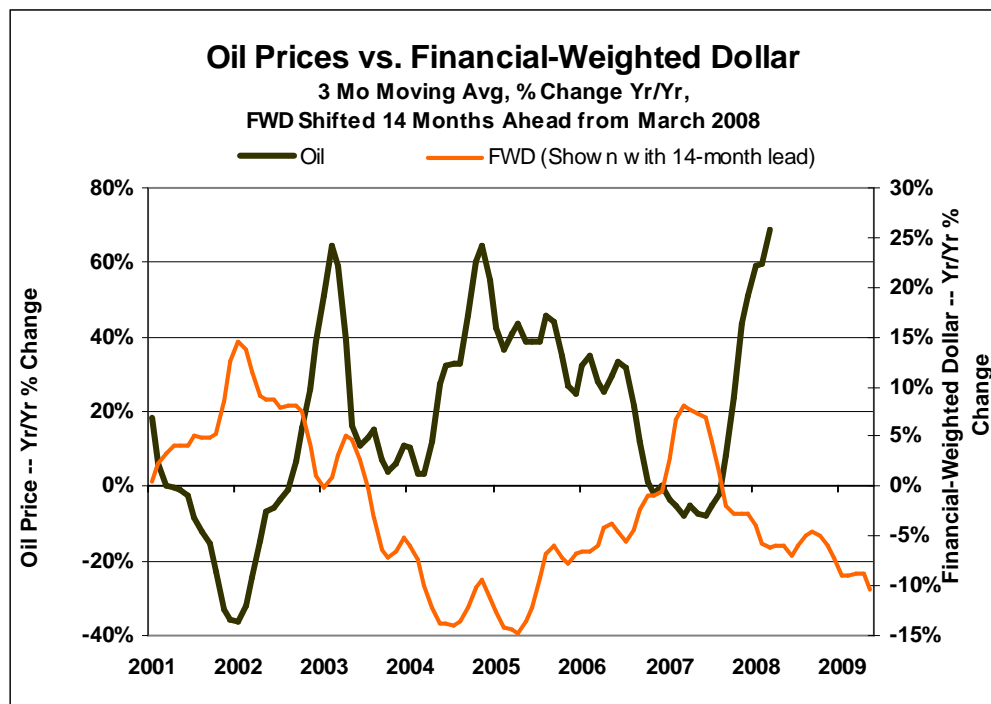
the reported real GDP growth rate. Assuming first-quarter GDP growth comes in on the plus side,

odds strongly will favor the use of a too-low implicit price deflator.

Inflation Outlook Remains Grim. With a number of the key inflation measures summarized in the preceding table, the general outlook for broad inflation remains strongly on the upside. Much of what is seen at present is due to rising oil prices, discussed in this month's Reporting/Market Focus. Food supply distortions also have started to have inflation impact in terms of common

experience, but food inflation is not yet fully reported in the official inflation statistics. With inflation pressures coming from commodity price distortions, rather than from strong economic demand, there is little the Fed can do to help.

Beginning to kick-in are inflation pressures from a weak dollar. Monetary inflation from strong M3 growth likely will start to show up in third-quarter 2008. These factors are not triggering a hyperinflation, yet, only setting the stage for it, as discussed in the April 8th *Hyperinflation Special Report*.



The value of the U.S. dollar impacts the pricing of oil, which remains denominated primarily in U.S. dollars, at the moment. When the dollar drops against the yen, for example, the effect is the same as an oil price cut for Japan. Market forces tend to offset that effect, with the price of oil then rising in dollar terms, as a result. There also appears to a longer-term effect that has been in place since the U.S. trade deficit went exponential in the mid-1990s. A major decline or increase in the annual rate of change in the greenback is followed roughly 14 months later by an opposite move in oil prices.

This is shown in the above graph, where the plot of the U.S. dollar has been shifted 14 months into the future, so as to show the strong negative correlation between the two series. Such suggests that recent dollar weakness may tend to provide some longer-term underpinning to recent sharp oil inflation.

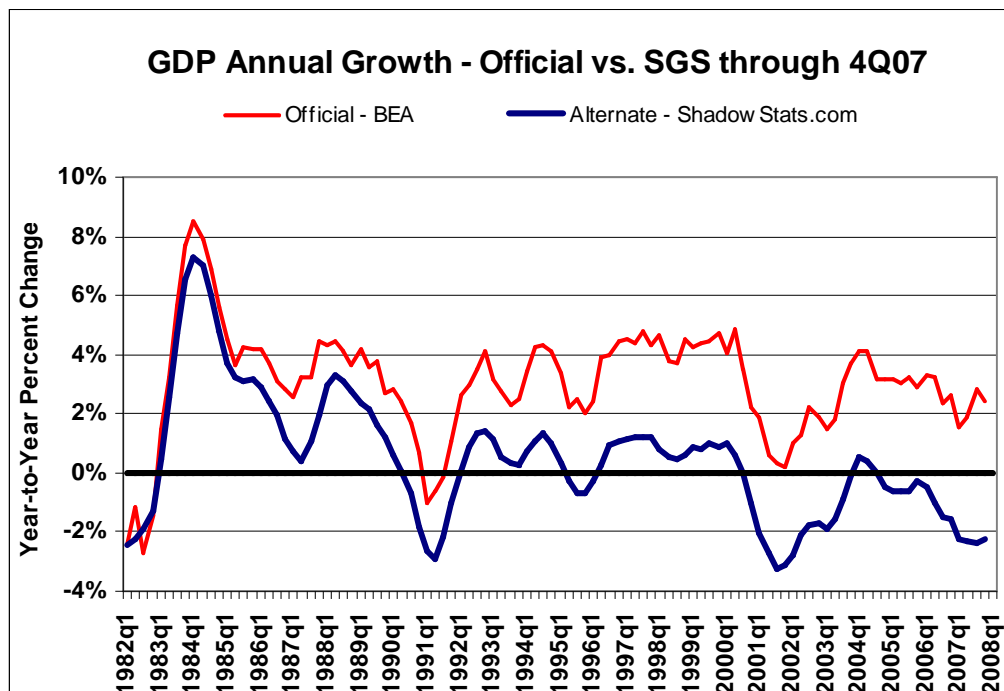
Market Turmoil Is Not Over. With the banking solvency liquidity crisis continuing and with the inflationary recession intensifying, whatever happy stories are being spun on Wall Street will unwind at some point, as increasingly nightmarish

scenarios begin to capture market thinking. The underlying fundamentals remain miserable for equities and bonds. A severe and protracted bear market in equities already likely is underway. Fed easings and flight-to-quality have depressed Treasury yields, but inflation and developing U.S. dollar woes eventually will push long-term Treasury yields much higher, a process that already may have started. Recent minor strength/stability in the U.S. dollar and weakness in gold will prove as fleeting as the related central bank jawboning and intervention. Heavy dollar selling and strong gold buying remain good bets in the months ahead.

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.

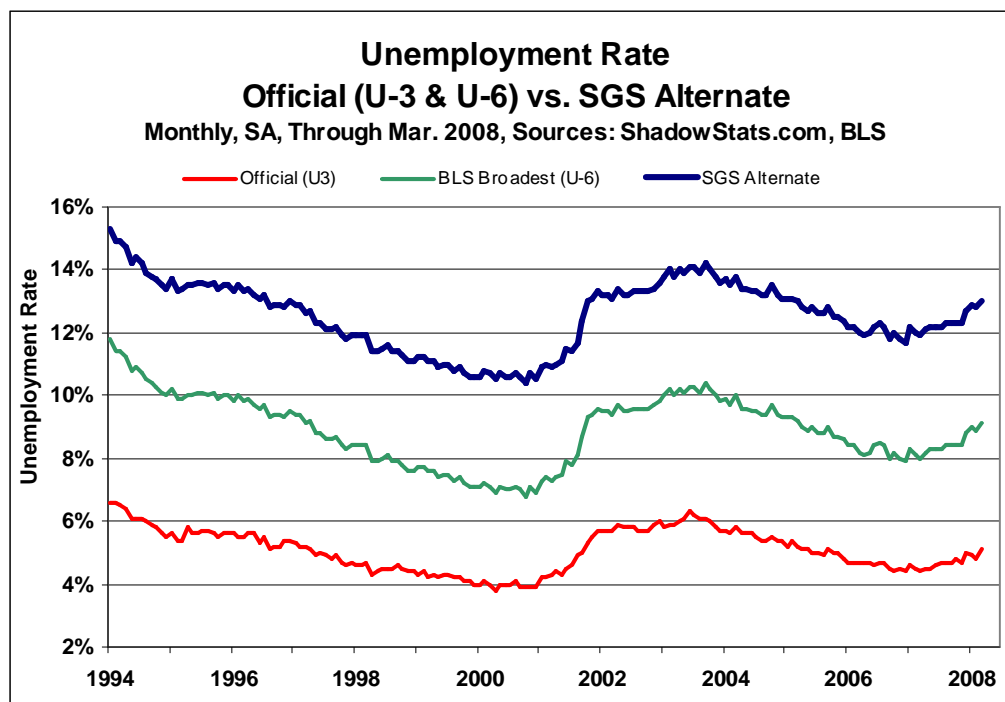
Alternate Realities. This section updates the Shadow Government Statistics (SGS) alternate measures of official GDP, unemployment rate and CPI reporting. When a government economic measure does not match common public experience, it has little use outside of academia or the spin-doctoring rooms of the 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 pre-Reagan-Era CPI and GDP and the pre-Clinton Era unemployment rate. Methodologies for the GDP and CPI series are discussed in the August 2006 SGS.



GDP. The alternate fourth-quarter 2007 GDP growth reflects the "final" estimate, with many of the methodological gimmicks of recent decades removed. The alternate fourth-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, slowing year-to-year gain of 2.5%.

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.



Unemployment Rate. Shown are two official seasonally-adjusted unemployment measures, U.3 and U.6, and the SGS-Alternate Unemployment Measure. All three measures moved higher in March in response to rapidly deteriorating labor conditions, standing respectively at 5.1%, 9.1% and 13.0%, up from 4.8%, 8.9% and 12.8% in February.

U.3 is the popularly followed unemployment rate published by the Bureau of Labor Statistics (BLS), while U.6 is the broadest unemployment measure published by the BLS. U.6 is defined as total

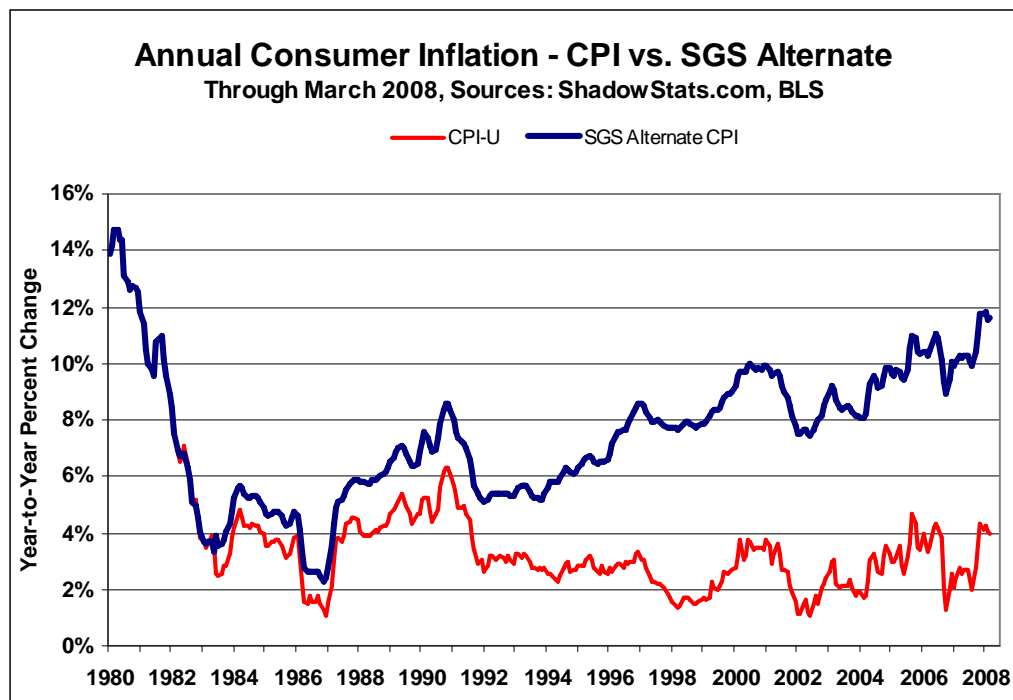
unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers. Marginally attached workers include the discouraged workers who survived redefinition during the Clinton Administration. The SGS-Alternate Unemployment Measure simply is U.6 adjusted for an estimate of the millions of discouraged workers defined away during the Clinton Administration -- those who had been "discouraged" for more than one year.

General background note: Historical data on both the official and SGS-Alternate unemployment series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate numbers are reported from the 1994 series redefinitions forward. It is planned to take the series further back in time.

CPI. March's annual non-core inflation rates tended to hold at prior-month levels, while the core measures notched higher. Generally, though, annual inflation should continue rising well into

2009, with mounting inflationary pressures reflecting the increasing impact of energy-cost damages in the general economy, combined with pressures from a crumbling dollar and soaring monetary growth.

Outright data manipulation appears to be an ongoing issue, as discussed more broadly elsewhere. Recent food and oil-related price pressures have been reflected only minimally in current reporting, and that increasingly has caused some in the financial media to question the accuracy of official inflation reporting.



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. 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.

Eight Levels of Consumer Inflation
Annual Inflation for December 2007 to March 2008

Measure		2007	2008		
		Dec	Jan	Feb	Mar
I.1	Core PCE Deflator (r)	2.2%	2.0%	2.0%	n.a.
I.2	Core Chained-CPI-U	2.1%	2.2%	2.0%	2.1%
I.3	Core CPI-U	2.4%	2.5%	2.3%	2.4%
I.4	PCE Deflator (r)	3.5%	3.5%	3.4%	n.a.
I.5	Chained-CPI-U	3.7%	3.9%	3.7%	3.6%
I.6	CPI-U	4.1%	4.3%	4.0%	4.0%
I.7	Pre-Clinton CPI-U	7.4%	7.6%	7.3%	7.3%
I.8	SGS Alternate Consumer Inflation	11.7%	11.8%	11.6%	11.6%

(r) Revised.

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.

MARKETS PERSPECTIVE

Partially reversing first-quarter activity, month-to-date April has seen some rebound in the U.S. equity markets and the U.S. dollar, with selling in the precious metals and upside movement in interest rates.

Financial-Market Indicators at Year-End 2007, March 31 and April 25, 2008 Closes

<i>Indicator</i>	<i>Second-Quarter 2008 to Date April 25, 2008</i>			<i>First-Quarter 2008</i>			<i>Fourth-Quarter 2007</i>		
	<i>Level</i>	<i>QTD/Qtr</i>	<i>Yr/Yr</i>	<i>Level</i>	<i>Qtr/Qtr</i>	<i>Yr/Yr</i>	<i>Level</i>	<i>Qtr/Qtr</i>	<i>Yr/Yr</i>
Equity Market									
DJIA	12,891.86	5.13%	-1.51%	12,262.89	-7.55%	-0.74%	13,264.82	-4.54%	6.43%
S&P 500	1,397.84	5.68%	-6.53%	1,322.70	-9.92%	-6.91%	1,468.36	-3.82%	3.53%
Wilshire 5000	14,089.21	5.68%	-6.76%	13,332.00	-10.44%	-7.48%	14,819.60	-3.53%	3.94%
NASDAQ Comp	2,422.93	6.31%	-4.90%	2,279.10	-14.07%	-5.89%	2,652.28	-1.82%	9.81%
Credit Market (1)									
Fed Funds Target	2.25%	0bp	-300bp	2.25%	-200bp	-300bp	4.25%	-50bp	-100bp
3-Mo T-Bill	1.34%	-4bp	-363bp	1.38%	-118bp	-366bp	3.36%	-46bp	-166bp
2-Yr T-Note	2.44%	82bp	-219bp	1.62%	-143bp	-296bp	3.05%	-92bp	-177bp
5-Yr T-Note	3.20%	74bp	-135bp	2.46%	-99bp	-208bp	3.45%	-78bp	-125bp
10-Yr T-Note	3.91%	46bp	-75bp	3.45%	-59bp	-120bp	4.04%	-55bp	-67bp
30-Yr T-Bond	4.61%	31bp	-22bp	4.30%	-15bp	-54bp	4.45%	-38bp	-36bp
Oil (2) US\$ per Barrel									
West Texas Int.	121.57	19.67%	86.69%	101.59	5.81%	54.20%	96.01	17.56%	57.24%
Currencies/Dollar Indices (3) US\$/Unit									
Pound Sterling	1.9833	-0.11%	-1.04%	1.9855	0.06%	0.72%	1.9843	-2.68%	1.31%
Euro	1.5634	-1.08%	14.56%	1.5805	8.23%	18.18%	1.4603	2.70%	10.65%
Swiss Franc	0.9676	-4.01%	16.40%	1.0080	14.20%	22.23%	0.8827	3.02%	7.64%
Yen	0.0096	-4.15%	13.87%	0.0100	11.88%	17.74%	0.0090	2.92%	6.54%
Canadian Dollar	0.9840	1.11%	9.67%	0.9732	-3.83%	13.34%	1.0120	0.79%	17.92%
Australian Dollar	0.9330	2.17%	11.96%	0.9132	4.06%	12.71%	0.8776	-0.89%	11.31%
<i>Weighted Currency Units/US\$ Jan. 1985 = 100</i>									
Financial (FWD)	45.10	0.87%	-9.53%	44.71	-5.40%	-10.62%	47.26	-0.92%	-7.64%
Change US\$/FX	--	-0.86%	10.53%	--	5.70%	11.88%	--	0.93%	8.27%
Trade (TWD)	51.13	1.07%	-10.05%	50.59	-4.04%	-12.70%	52.72	-1.51%	-10.00%
Change US\$/FX	--	-1.06%	11.17%	--	4.21%	14.55%	--	1.54%	10.01%
Precious Metals (4) US\$ per Troy Ounce									
Gold	891.50	-4.50%	30.34%	933.50	11.96%	38.97%	833.75	12.21%	31.92%
Silver	16.68	-7.28%	20.96%	17.99	21.88%	34.76%	14.76	8.13%	14.41%

bp: Basis point or 0.01%. (1) Treasuries are constant maturity yield, US Treasury. (2) Department of Energy. (3) Shadow Government Statistics, FRB (see Dollar Index Section for definitions). (4) London afternoon fix, Kitco.com.

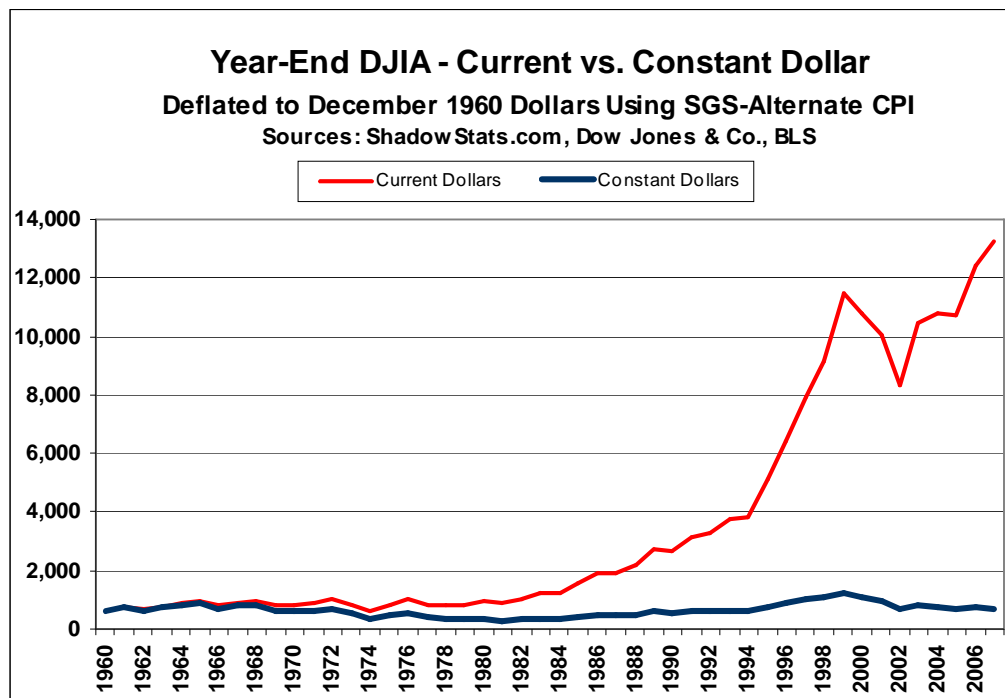
With the exception of interest rates, these market movements have been despite continued deterioration in key underlying fundamentals tied to the intensifying inflationary recession -- including surging oil prices that are at all-time highs -- as well as to the still unfolding banking-solvency crisis and central bank response to same.

Oil prices cannot explode, inflation cannot soar, and economic activity cannot collapse without some consequence in the financial markets. Irrespective of possible massive market intervention, including recent covert and overt interventions in the currency, gold and oil markets, the underlying fundamentals have not changed. Over time, the underlying fundamentals should win out.

General background note: As a general strategy under the current circumstances, looking to

preserve wealth and assets needs to be a primary concern, along with the liquidity and safety of investments. The approaching financial maelstrom already has come over the horizon and may be making 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. Equities -- At subscriber request, I provide the following graph, which shows the year-end value of the Dow Jones Industrial Average both in nominal and real terms, where the inflation adjustment is based on the SGS-Alternate CPI measure. While stocks do tend to move with inflation and provide something of an inflation hedge, they also remain vulnerable to major shifts in the way investors value equities.



I contend that stocks already have turned down into what will prove to be a particularly protracted and savage bear market (see the *Hyperinflation Special Report*). As equities catch-up with the underlying economic, financial and systemic fundamentals, the downside adjustments to stock

prices should be quite large over some years, eventually rivaling the 90% decline in equities seen in the 1929 crash and ensuing four years. The decline might have to be measured in real terms, as a hyperinflation eventually will kick in, with the Fed moving to liquefy the system and

monetize federal debt. 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 well below today's levels, adjusted for inflation.

As to more current market conditions, recent market euphoria certainly appears to lack an anchoring in underlying reality. Corporate profits will suffer in the unfolding inflationary recession; the banking solvency crisis -- though likely to be resolved over time -- still is terribly unsettled; eventual intense dollar selling will lead to dumping of dollar-denominated assets (stocks and bonds), and, in combination with higher inflation, the dollar crisis will push longer-term interest rates significantly higher. Despite ongoing wild gyrations in U.S. equity prices that may continue for some time, the frailties of the financial system and sharply negative economic fundamentals promise an eventual massive downside for the major U.S. stock indices.

U.S. Credit Market -- With panicked rate cutting by the Fed in response to the burgeoning banking system solvency crisis and with flight-to-safety in U.S. Treasuries, short-term U.S. Treasury yields plunged in the first quarter, with a sharp steepening of a positively-sloped yield curve. With the Fed now expected to ease by only 25 basis points (0.25%) tomorrow (April 30th), with inflation concerns mounting, and with dollar weakness beginning to discourage some foreign investors, interest rates have backed up in the last month.

With the 30-year Treasury bond yield at 4.61% -- 61 basis points higher than official annual CPI inflation rate -- it is the only active Treasury issue that does not suffer a negative real interest rate. With rapidly mounting inflationary pressures, rapid money growth, explosive federal deficit growth (and borrowing needs), and a soon to be seen flight from the dollar that evolves into a flight-to-safety outside the dollar, the longer range outlook continues for long-term Treasury yields to

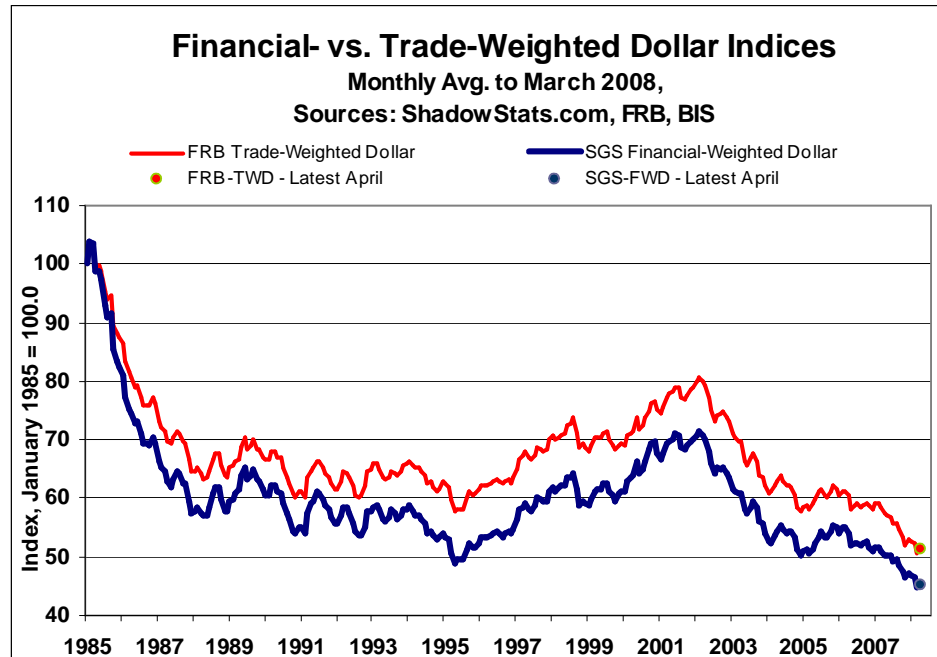
back up by several hundred basis points, approaching a normal spread in long-term Treasuries over inflation. With a normal spread, the current 4.61% yield on the 30-year Treasury bond would be pushing 7.50%.

General background note: 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, spiking Treasury yields.

U.S. Dollar -- Despite recent dollar gyrations that at least partially were encouraged by certain central banks, the underlying fundamentals for the U.S. currency remain abysmal and are deteriorating. The long-term outlook for the dollar remains for a continued massive sell-off, with flight from the dollar eventually evolving into a flight to safety outside the dollar.

When fundamentals move sharply in directions that normally would trigger heavy dollar selling and gold buying, but early moves in those directions suddenly reverse sharply for no apparent reason, more often than not a central bank has sent a message to those betting against the greenback. Heavy jawboning in support of the dollar, as seen recently from the European Central Bank, often is backed by covert intervention, making the jawboning appear more powerful than it may be in reality. Other banks appear to have been involved in some pro-dollar activity back in March.

Indeed, covert intervention has been a factor in moving the U.S. dollar off its March 17th lows against the Swiss franc and Japanese yen, and in recent days against the April 22nd low against the euro. Whatever the gimmick, jawboning and intervention are short-lived factors, unless underlying fundamentals also have been shifted, or the intervention is in line with, instead of opposed to, market forces.



As shown in the above graph, the U.S. dollar continued to fall sharply in March 2008, setting historic lows, but it has rebounded somewhat in April. The latest data points shown for the financial- and trade-weighted indices are as of Friday, April 25th.

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 Newsletter for methodology.

In terms of underlying fundamentals that drive relative currency values, 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; rising fiscal and trade-balance conditions are horrendous, with the fiscal deficit exploding; and relative political/systemic concerns are rising sharply with President's and Congress's approval ratings bottom-bouncing at all-time lows.

Beyond renewed capitulation by the Federal Reserve to the solvency/funding crisis, the proximal trigger for a full dollar panic could come

from a bad economic statistic, political missteps by the Administration, negative trade or market developments outside the United States, or a terrorist attack or expansion of U.S. military activity in the Middle-East or South America. When the trigger is pulled, what likely will be broad selling pressure will turn to an outright panicked dumping of the greenback, which should overwhelm any short-lived central bank intervention and roil the domestic financial markets. 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, on top of an otherwise deteriorating systemic crisis.

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 March 2008 the monthly FWD fell by 3.53%, after dropping by 0.80% February. The March 2008 average index level of 44.86 (base month of January 1985 = 100.00) was down by 12.01% from March 2007, while February was down 9.81% from the year before. As of April 25th, the FWD stood at 45.10.

Also down in February was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The March 2008 average was down by 3.10% from February, which, in turn, had been down 0.67% from January. The March 2008 index level of 50.60 (base month of January 1985 = 100.00) was down 13.43% year-to-year, versus an 11.58% annual decline in February. As of April 25th, the TWD closed at 51.13.

Gold -- The price of gold has dropped nearly 12% since its record-high London p.m. fix of \$1,011.25 per troy ounce on March 17, 2008, but, placing things in perspective, gold is up by 30% from a year ago, while the S&P 500 is down about 7% from a year ago. The long-term outlook for gold remains extremely bullish, with recovery to \$1,000-plus levels and higher likely sooner, rather than later, given the extraordinary strength of the underlying fundamentals.

While the gold market remains extremely volatile, the underlying fundamentals generally have improved during the last month, with soaring oil prices, high monetary growth and mounting global political tensions. The weakness in the dollar remains a plus, which will be intensified with renewed, heavy dollar selling. Occasional profit taking can be expected with sharply rallying assets, but with gold, sharply rallying prices also invite central bank intervention. That has taken place, along with apparent covert intervention aimed at propping the U.S. dollar.

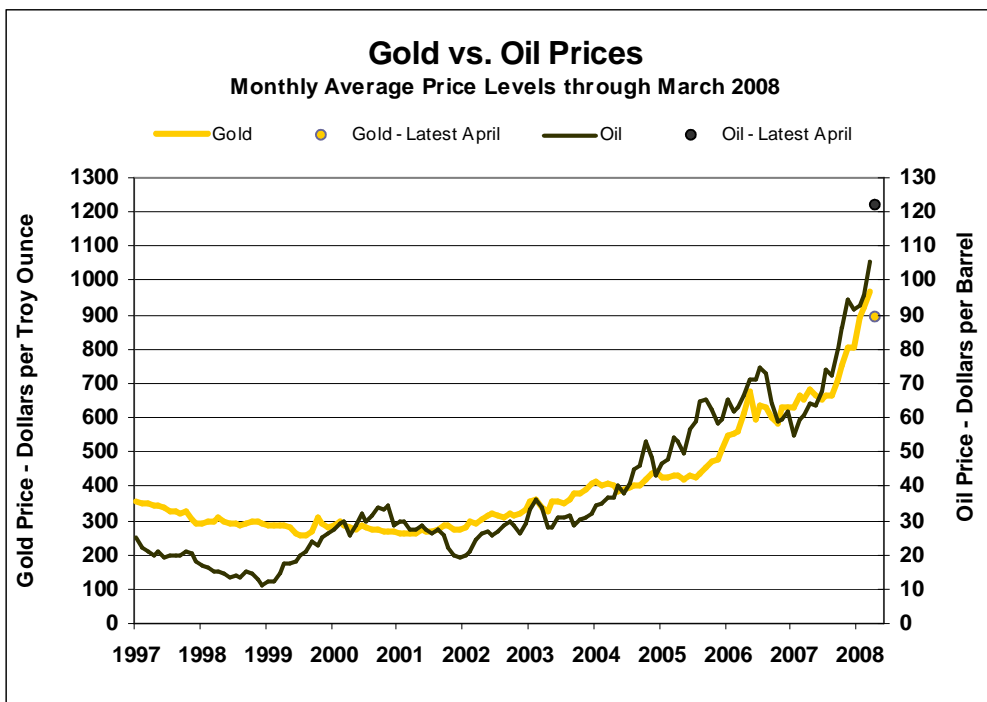
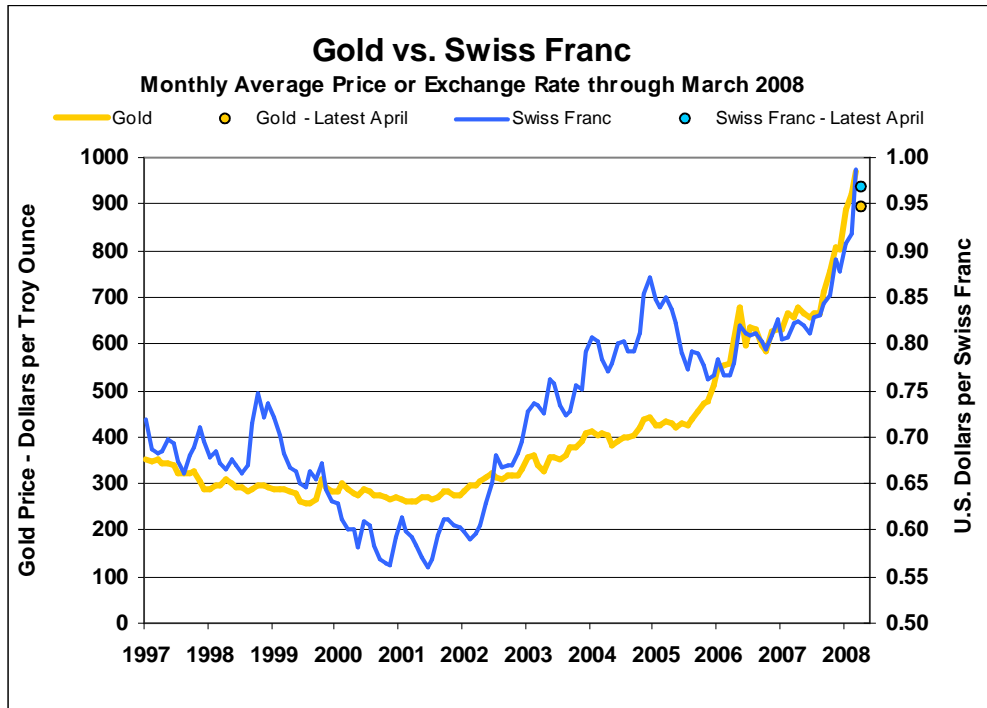
For March (based on Kitco.com), the monthly average London gold afternoon fix was \$968.43 versus \$922.30 in February. Silver averaged \$19.51 per troy ounce in March, up from \$17.57 in February. Respective closing prices on April 28th were \$890.50 and \$16.94 per troy ounce.

Outside of the current period's March 17th high of \$1,011.25, the earlier all-time high of \$850.00 (London afternoon fix) of January 21, 1980 still has not been hit in terms of inflation-adjusted dollars. Based on inflation through March 2008, the 1980 gold price peak would be \$2,333 per troy ounce, based on not-seasonally-adjusted CPI-adjusted dollars, and would be \$6,438 per troy ounce in terms of SGS-Alternate CPI adjusted dollars.

General background note: Near-term gold price volatility likely will continue and could be significant. Upside price pressures from mounting inflation, a weakening dollar and increasing global political, financial and systemic instabilities, face offsets with bouts of profit taking and with intensified overt and covert central bank interventions in the gold and currency markets, aimed at propping the greenback. Despite any central-bank machinations or intervention, the upside potential for the precious metals remains explosive.

General background note: As discussed in the *Hyperinflation Special Report*, the eventual 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 the March averages, as well as added points for closing prices on April 25th, with gold at \$891.50, oil at \$121.57 and the Fed's published noon buying rate for the Swiss franc at \$0.9676. Again, all three measures should trade significantly higher in the months ahead.



REPORTING PERSPECTIVE

The Big Three Market Movers

Nothing has changed but the story from the spinmeisters. U.S. financial system stability and economic and inflation conditions have deteriorated markedly, and little can be trusted in current economic reporting. The stories being told are that the economy will dodge a recession and that the Fed is containing inflation. Mr. Bernanke still needs a stable U.S. currency, particularly under the circumstances of his expanding bailout of the domestic financial system and his otherwise ongoing capitulation to Wall Street pressures, while the Administration's political needs remain great. With financial circumstances threatening national security, almost anything is possible in the arena of data and market manipulations.

With President Bush advising that the economy is not in recession, how the upcoming "advance" estimate of first-quarter GDP gets reported will be very telling of what is to follow in other key series (see Opening Comments). Absent manipulations, and against market expectations that have moved further away from reality during the last month, most near-term economic reporting still should tend to surprise the markets on the downside, while most inflation reporting still should surprise expectations on the upside.

Employment/Unemployment -- As discussed in the April 4th *Flash Update*, the reported third consecutive decline in monthly payrolls as of March did reinforce some recession outlooks, with first-quarter payroll levels now below those of fourth-quarter 2007. Such gives the National Bureau of Economic Research (NBER) -- official arbiter of U.S. recessions -- its first timing mark for calling the current recession. The second timing mark may be industrial production.

Nonetheless, employment data remain severely gimmicked, understating the monthly declines in

payroll employment, thanks to the usual statistical shenanigans at the Bureau of Labor Statistics (BLS). Net of gimmicks, the decline in payrolls and the rise in the unemployment rate were statistically significant.

Payroll Survey. The BLS reported a seasonally-adjusted jobs loss of 80,000 (a loss of 147,000 net of revisions) +/- 129,000 for March 2008, following a revised 76,000 (previously 63,000) jobs loss in February. The prior period revisions, however, were stretched further back in time, so that the revised February decline otherwise would have been 130,000. Although, officially, the March decline was statistically indistinguishable from a gain, the apparent decline net of gimmicks and revisions would be a statistically-significant contraction. Annual growth in total nonfarm payrolls slowed further to a recessionary 0.35% in March, from 0.59% in February.

Bias Adjustment. One element continuing to add upside pressure to the numbers was the monthly bias factor (birth-death model), which was a net addition of 142,000 jobs in March, following a net addition of 135,000 jobs in February. The March add-factor mindlessly spiked construction jobs by 28,000 and financial activities jobs by 6,000, irrespective of anecdotal evidence of trouble in those areas.

Seasonal-Factor Gimmicks. Year-to-year growth should be virtually identical in both the seasonally-adjusted and unadjusted series, and applying the unadjusted annual change to the seasonally-adjusted year-ago numbers for February and March suggests that the seasonally-adjusted month-to-month change should have been a contraction of 124,000. This reporting gimmick is made possible by the "recalculation" each month of the monthly seasonal factors. If the

process were honest, the suggested differences would go in both directions. Instead, the differences almost always suggest that the seasonal factors are being used to overstate the current month's relative payroll level, as seen last month, and the month before.

Household Survey. The usually 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), showed household employment dropped by 24,000 in March, against a 255,000 decline in February.

The March 2008 seasonally-adjusted U.3 unemployment rate showed a statistically-significant increase to 5.08% +/- 0.23% from 4.81% in February. Unadjusted, U.3 held at 5.2% in March. The broader U.6 unemployment rate rose to an adjusted 9.1% (9.3% unadjusted) in March, versus 8.9% (9.5% unadjusted) in February. Adjusted for the "discouraged workers" defined away during the Clinton Administration, actual unemployment, as estimated by the SGS-Alternate Unemployment measure, rose to 13.0% in March, up from 12.8% in February (see the Alternate Reality section).

Employment Environment. The continued and deepening employment decline reported in March, though still far short of reality, continued moving in the same direction suggested by some of the better-quality employment-environment indicators, which also signal contracting jobs for April: March help-wanted advertising hit an historic low, new claims for unemployment insurance continued to surge, and recession-level employment readings were seen again for both March purchasing managers surveys.

Next Release (May 2): Based on continued deterioration in underlying economic activity, the April payroll survey should show continued month-to-month contraction, and the household survey should show a continued rise in the unemployment rate. If the GDP number comes in

on the plus side, such would argue for a happy, politicized, better-than-expected number for April payrolls, where current expectations are running around a 75,000 monthly contraction. The number simply can be brought in at whatever level is desired by the Administration.

Gross Domestic Product (GDP) -- The Bureau of Economic Analysis (BEA) reported the "final" estimate revision of annualized real (inflation-adjusted) growth rate for fourth-quarter 2007 GDP at 0.58% +/- 3%, which remained statistically indistinguishable from a meaningful contraction. The reported growth was almost unrevised against the "preliminary" estimate of 0.63% and the "advance" estimate of 0.64%, and it was down from the nonsensical growth of 4.91% reported for the third quarter. Annual growth for the fourth quarter reportedly held at 2.46%, in revision, versus the previous estimates of 2.47%, and down from 2.84% in the third quarter.

The GDP's fourth-quarter implicit price deflator (inflation measure) rose at an annualized rate of 2.41%, revised lower from the previously estimated 2.65%, and versus a 1.03% rate in the third quarter. The lowered inflation rate was needed in order to prevent a downward revision to the 0.6% annualized real GDP growth rate. Artificially-low inflation, when used in deflating the GDP, results in an overstatement of the inflation-adjusted GDP growth. This is a standard reporting gimmick for the series.

The most recent report included alternate GDP measures for the fourth quarter, estimates of Gross National Product (GNP), where GDP is GNP net of trade in factor income (interest and dividend payments), and Gross Domestic Income (GDI), which is the theoretical income-side equivalent to the GDP's consumption-side measure.

Annualized real quarter-to-quarter GNP in the fourth quarter was reported up by 1.9%, following a 0.6% increase in third quarter. Year-to-year growth was 3.1% in the fourth quarter versus 3.2% in the third quarter.

As discussed in the Opening Comments, annualized real quarter-to-quarter GDI in the fourth quarter showed an annualized contraction of 1.0%, following a 1.2% increase in third quarter. Year-to-year growth was 1.1% in the fourth quarter. The distortions here are suggestive of the manipulation rampant in the more widely followed GDP number.

General background note: Adjusting for methodological distortions built into GDP reporting over time, the SGS-Alternate GDP measure suggests that economic reality is much weaker than officially reported. A fourth-quarter year-to-year contraction of roughly 2.3% would have been more in line with underlying fundamentals, past methodologies and the ongoing recession (see the graph in the Alternate Realities section of the Opening Comments). Such reflects some bottom-bouncing with the annual contraction little changed from the SGS-Alternate GDP third-quarter estimate.

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 (April 30): As discussed in the opening comments, based on underlying fundamentals, the "advance" estimate of annualized quarterly real GDP growth for first-quarter 2008 should show a clear quarterly contraction. Yet, political suggestions and market expectations suggest another quarter of weak growth, and the political needs appear very likely to win out here.

Consumer Price Index (CPI) -- As discussed in the April 16th *Flash Update*, energy and food costs in the CPI once again were held artificially low against common experience. With gasoline reported up just 1.3% in March, following a 2.0% contraction in February, the new numbers did not

even offset the prior month's understatement. Food prices reportedly gained just 0.2% in March, following February's 0.4% increase. Again, even allowing for the BLS's current reporting methodologies, reported inflation is moving ever lower versus common experience. In like manner, the ongoing inability of energy costs to impact the "non-core" inflation reporting belies common sense and common experience. Oil prices as they relate to the CPI are discussed in this month's Reporting/Market Focus.

The Bureau of Labor Statistics (BLS) reported the seasonally-adjusted March CPI-U (I.6) gained 0.34% (0.87% unadjusted) +/- 0.12% for the month, versus the "virtually unchanged" gain of 0.03% (up 0.29% unadjusted) in February. March's annual CPI inflation eased minimally to 3.98% from February's 4.03%.

Year-to-year annual inflation would resume its upturn in April 2008 reporting, dependent on the seasonally-adjusted monthly gain exceeding the 0.32% monthly increase seen in April 2007. The difference would directly add to or subtract from March's annual inflation rate of 3.98%.

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 -- was 3.55% in March, down from 3.69% in February,

Adjusted to pre-Clinton (1990) methodology (I.7), annual CPI growth held at 7.3% in March, while the SGS-Alternate Consumer Inflation Measure (I.8), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, held at roughly 11.6%. The alternate numbers are not adjusted for near-term manipulations of the data. 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 (May 14): Monthly April CPI inflation should rise sharply, if the depressed energy and food prices reported in February and March are allowed to show anything close to a realistic catch-up. If seasonally-adjusted monthly CPI inflation for April exceeds 0.32%, which it

should, then annual CPI inflation will increase by the difference. Fundamental reporting risks generally favor an upside surprise to market expectations, but targeted manipulation, as has been seen recently, remains of high risk.

Other Troubled Key Series

Federal Deficit -- The rolling 12-month deficit through March 2008 stood at \$215.8 billion versus \$203.7 billion in March 2007, compared with the rolling 12-month deficit through February 2008, which stood at \$263.9 billion against \$192.7 billion in February 2007.

Viewing the change in gross federal debt bypasses several of the regular reporting manipulations and is a better indicator of actual net cash outlays by the federal government than is the official, gimmicked deficit reporting. Gross federal debt stood at \$9.438 trillion at the end of March 2008, up \$80 billion for the month and up \$588 billion from March 2007, which in turn was up \$479 billion from March 2006. Gross federal debt stood at \$9.358 trillion at the end of February 2008, up \$120 billion for the month and up \$580 billion from February 2007, which in turn was up \$508 billion from February 2006.

There is substantial evidence developing of weaker than anticipated tax collections at both the federal and state levels, due to the deepening recession. Such has negative implications both for the deficit and for U.S. Treasury funding needs.

General background note: The federal government's fiscal 2007 (year-ended September 30th) official accounting-gimmicked deficit narrowed to \$162.8 billion from \$248.2 billion in 2006. For 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.

As discussed in the December 2007 SGS Newsletter's Reporting/Market Focus, the GAAP-based deficit for fiscal-year 2007 topped \$4 trillion, which remains my best estimate at this time.

General background note: The Bush Administration now projects a gimmicked deficit of \$410 billion for fiscal 2008, up from \$163 billion in 2007. With no allowance for a recession in the assumptions underlying the deficit projections (the Administration forecasts real 2008 GDP growth at 2.7%), the final 2008 numbers should be much worse than the current Administration estimates. 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 have started to reflect the economy's mounting problems.

Initial Claims for Unemployment Insurance -- The trend in annual growth continued to deteriorate at an accelerating pace. On a smoothed basis for the 17 weeks ended April 17th, annual growth rose to 9.9%, up from 6.4% in the 17 weeks ended March 8th. A rising 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. 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 -- March's seasonally-adjusted monthly real earnings rose by 0.2%, thanks again to the unbelievably low CPI inflation reported for the month. The March number followed an unrevised 0.3% monthly increase in February. Annual change in March, however, deepened to a 1.0% contraction, from February's unrevised 0.8% contraction.

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 (see the *Hyperinflation Special Report* of April 8, 2008).

Retail Sales -- As discussed and graphed in the Opening Comments, real (inflation-adjusted) retail sales again is confirming a deepening recession in place, with the year-to-year real change in the three-month moving average version of the series turning more negative, and with real quarter-to-quarter contractions intensifying.

As discussed in the April 16th *Flash Update*, the Census Bureau reported seasonally-adjusted March retail sales increased by 0.15% (up 0.32% net of revisions) +/- 0.6% (95% confidence interval), following a revised 0.36% (previously 0.56%) monthly decline in February. On a year-to-year basis, March retail sales rose 1.97% versus a revised 2.92% (previously 2.58%) in February. The real monthly change continued negative, and the real annual change continued to show a deepening contraction.

Core Retail Sales. Consistent with the Federal Reserve's predilection for ignoring food and energy prices, "core" retail sales -- retail sales net of grocery store and gasoline station revenues -- were unchanged (plus 0.01%) in March, against the official 0.2% (0.15%) gain, following a revised 0.34% (0.36% official) decline in February. "Core" retail sales turned negative year-to-year, down 0.37% for much, following 0.66% gain in February.

Next Release (May 13 - Benchmark Revisions April 30): Underlying fundamentals suggest ongoing weakness and a likely weaker than expected showing for April retail sales. The monthly and annual changes should continue underwater, after inflation adjustment, consistent with an ongoing recession. Benchmark revisions should show historically weaker retail sales.

Industrial Production -- As expected, the benchmark revision lowered historic production levels, with an overall downward revision to February 2008's index level of 1.8%. The bulk of the downside adjustment was in 2006, when the current recession likely saw its first actual quarterly GDP contraction. Fully reflecting the revisions and March 2008 reporting, seasonally-adjusted first-quarter 2008 industrial production contracted at an annualized 0.1%, after a revamped 0.4% gain (previously a contraction) in fourth-quarter 2007. Manufacturing production fell at an annualized 0.5% in both quarters.

The quarterly contraction in production may give the NBER its second timing point for calling the current recession, with the first timing point being set by payroll employment reporting

As discussed in the April 16th *Flash Update*, seasonally-adjusted March industrial production gained 0.3% for the month, after a 0.7% decline in February, with annual production up 1.6% from the year before, versus a 1.1% annual gain in February. The series is showing unusual volatility tied to weather and possibly to systemic support manipulations.

Next Release (May 15): The April production numbers should resume a pattern of ongoing monthly contractions, with the erratic but generally slowing annual growth shortly turning negative. Such would be consistent with the manufacturing contractions signaled by the purchasing managers survey.

New Orders for Durable Goods -- The usually volatile durable goods put in another recessionary performance in March, with new orders falling by a seasonally-adjusted 0.3% (a gain of 0.7% net of revisions), following a revised February decline of 0.9% (previously a drop of 1.7%). On a year-to-year basis, March's new orders fell by 4.2% versus a 5.5% gain (previously 4.3%) in February. Smoothed using a six-month moving average, annual growth (net of inflation) remained negative and an ongoing recession signal. Average seasonally-adjusted first-quarter new orders contracted at an annualized pace of 8.5% from the fourth quarter, even before adjusting for inflation.

The closely followed nondefense capital goods new orders rose by 1.5% (2.9% net of revisions) in March, after easing by 0.3% (previously down by 1.0%) in February. March's year-to-year change was a decline of 3.3%, following a 14.1% increase in February.

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 -- As discussed in the April 14th *Flash Update*, despite significant continued understatement of oil imports (average oil import price was up to \$84.76 per barrel in February from \$84.09 in January), the seasonally-adjusted February 2008 trade deficit widened to \$62.2 billion from a revised \$59.0 billion (previously \$58.2 billion) in January.

Such was enough beyond market expectations to dampen first-quarter GDP growth, with a quarterly

deterioration now likely in the real (inflation-adjusted) next-exports account.

Next Release (May 9): Underlying reality (including sharply rising oil prices) favors further sharp deterioration in the monthly March trade deficit, but the government can play games with this series as long as it wants to play them. Given the potential impact of the series on otherwise shaky currency markets and on GDP reporting, realistic numbers still may not be seen for some time come.

Consumer Confidence -- March consumer confidence numbers continued to tumble, and the April reading on consumer sentiment continued in the same trend. For March 2008, the Conference Board Confidence measure plunged by 15.6% for the month, after falling by 12.5% (previously 14.1%) in February. March's year-to-year change was down by 40.4%, following February's 31.3% annual decline.

The Reuters/University of Michigan Sentiment measure plunged by 9.9% in April, following declines of 1.9% in March and 9.7% in February. April's year-to-year decline also continued to deepen, down by 38.1%, following March's 21.4% decline and February's 19.7% decline. These lagging, not leading, indicators tend to reflect the tone of the popular financial media and are fully consistent with an ongoing and deteriorating inflationary-recession.

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 **Reuters/Michigan** survey is unadjusted. How does one seasonally-adjust peoples' attitudes? Also, beware the mid-month Consumer Sentiment release from **Reuters/University of Michigan**. The sampling base is so small as to be virtually valueless in terms of statistical significance.

Short-Term Credit Measures -- Annual growth in commercial borrowing continued to reflect mixed pressures from the banking system's solvency crisis. The declining annual growth for commercial paper outstanding has been offset partially by growth in commercial and industrial bank loans. Consumer credit numbers continue to show softness in annual growth, against upwardly revised annual growth rates.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth was reported at 5.8% in February, against 5.8% (previously 4.5%) in January and against 5.7% (previously 4.1%) in December. 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 remains an ongoing constraint on economic growth.

Ongoing large revisions in the consumer credit series confirm the Fed's inability to track bank activities accurately, on a timely basis. Similar issues are evident in the Fed's quarterly flow-of-funds accounting for the banking system and, to a certain extent, are an exacerbating factor in the current solvency crisis.

Commercial borrowing growth varied sharply, once more. Annual change in March commercial paper outstanding showed a 10.4% contraction, versus a 9.1% contraction February and a 6.0% contraction in January. In contrast, annual growth in March commercial and industrial loans rose by

20.9%, versus 20.3% in February and 21.06% in January. The relative instability in commercial paper is ongoing but somewhat abated, with resultant credit difficulties continuing to inhibit broad business activity and continuing to disrupt banking system stability.

Producer Price Index (PPI) -- As discussed in the April 16th *Flash Update*, the seasonally-adjusted March finished goods PPI rose by 1.1% (1.9% unadjusted), versus February's 0.3% (0.2% unadjusted) gain. Annual PPI inflation for March rose to 6.9% from 6.4% in February. Seasonally-adjusted intermediate and crude goods in March rose by 2.3% and 8.0%, respectively, against February's 0.8% and 3.7% increases.

The relationship between changes in oil prices and the PPI are explored in this month's Reporting/Market Focus. As has been the case for a number of months, the impact of food and energy, by themselves and as felt throughout broad segments of economic activity, remain seriously understated.

Next Release (May 20): Given what appears to have been deliberate understatements of the February and March CPI and PPI inflation rates, the PPI could be subject to further understatement, or could face a catch-up rebound in April, in response to growing questions as to the accuracy of current inflation reporting. With the latter case eventually likely to prevail, and allowing for the regular random volatility of the monthly price variations, PPI inflation reporting over the next six-to-nine months generally should favor official results coming in well above market expectations, as the effects of oil prices increasingly permeate the broad economy.

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 -- The March 2008 manufacturing index remained in recession territory for the second month, notching higher to 48.6 from 48.3 in February. While the Institute for Supply Management (ISM) uses an index reading of 41.1 (in its recently reformulated index) as the break point between recession in the broad economy and expansion, a reading below 50.0 means a contracting manufacturing sector. The 50.0 mark works out still as a solid broad recession signal in my analyses.

The various components of the ISM composite indices are diffusion indices, which are calculated as the percent of positive responses from the ISM survey plus one-half of the neutral or unchanged responses. Hence, a reading below 50.0 indicates a contracting series.

The March new orders index showed a deepening contraction, falling to 46.5 from 49.1 in February. The new orders index has been in actual contraction now since December 2007. Distortions from the seasonal factors calculated by the Department of Commerce can be minimized by viewing the series using year-to-year change on a three-month moving average basis. On that basis, the March new orders index fell by 8.9%, following a 9.5% decline in February. The new

orders component of the purchasing managers survey is a particularly valuable indicator of economic activity. The measure gradually has notched lower from its peak annual growth of 35.5% in April of 2004. As an SGS early warning indicator of a major economic shift, new orders breached its fail-safe point in mid-2005, signaling pending recession.

Also of significance, the manufacturing employment component remained in recession territory at 49.2 in March, versus 46.0 in February.

Service Sector Composite Index. This series 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. With that as background, the March services composite index remained below 50.0, at 49.6 versus 49.3 in February.

Both the services employment and prices paid components, however, have some meaning. Covering the real estate and banking industries, among others, the March employment component remained in contraction territory, holding at 46.9 for the second month. The prices paid component is covered in the Inflation Indicators.

Help-Wanted Advertising Index (HWA) -- As discussed and graphed in the Opening Comments, the Conference Board's seasonally-adjusted March help-wanted advertising index fell to a record low of 19, the lowest reading since the index was first calculated at the end of President Harry Truman's term in office.

The March reading was down from 21 in February and from 22 in January. Year-to-year change was down 34.5% in March, versus 32.2% in February, with the annual change in the three-month moving average falling by 31.9% versus a 31.2% decline

in February. Despite some of the historic weakness in the series being due to the loss of newspaper business to the Internet, the HWA is a solid leading indicator to the broad economy and to the monthly employment report, and it remains indicative of an ongoing, severe deepening in an ongoing recession.

Where the HWA series does not include a measure of on-line advertising, recent indices developed to measure Internet activity have serious definitional problems and still are too young to be meaningful indicators. That said, the Conference Board has reported that annual growth in its on-line measure of help-wanted advertising showed its first year-to-year decline in March (the series was started in May 2006).

Housing Starts -- The highly volatile housing numbers continued bottom-bouncing, with March's seasonally-adjusted housing starts down by 11.9% (down 11.1% net of revisions) +/- 13% (95% confidence interval). This followed a revised monthly decline for February of 0.7% (previously down 0.6%). March's year-to-year decline widened to 36.5% from a revised 27.7% (was 28.4%) in February, still shy of the 48.6% annual decline seen at the trough of the 1990/1991 recession.

March's building permits were down 5.8% for the month and 40.9% for the year, against a revised 7.3% (previously 7.8%) monthly decline in February. March new home sales fell by 8.5% month-to-month and by 36.6% year-to-year, following revised respective February declines of 5.3% (was 1.8%) and 31.5% (was 29.8%).

Existing home sales appear to be picking up some upside distortion from mounting foreclosure sales, as discussed in the *Flash Update* of March 30th. That said, March existing home sales fell by 2.0% month-to-month and by 19.3% year-to-year, following a revised February monthly gain of 2.9% and annual decline of 23.8%.

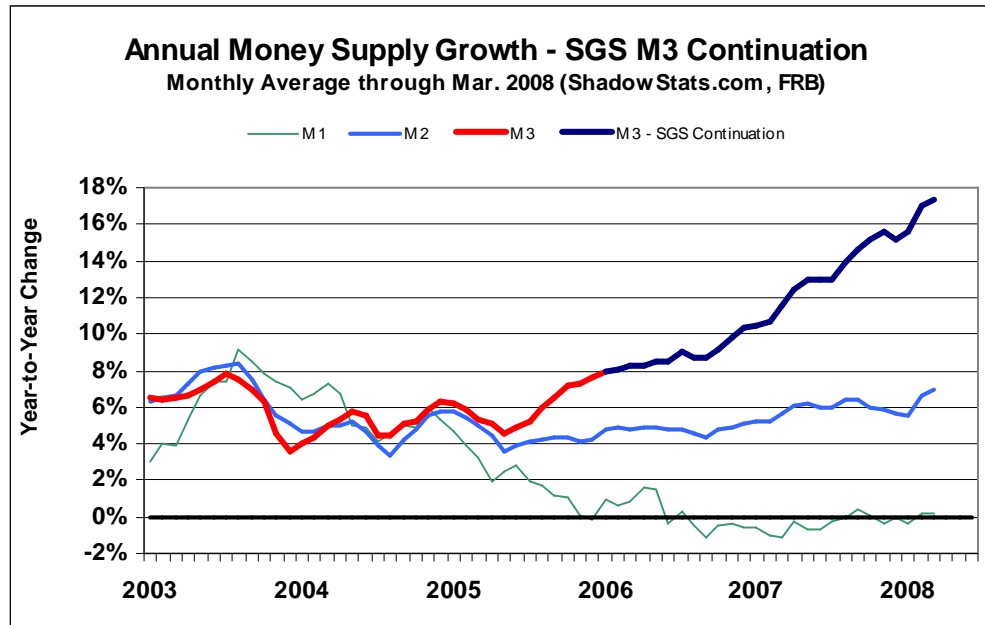
Also, as discussed in the March 30th *Flash Update*, there is a large problem as to the use and meaning of sales price data published with both the new and existing sales reports. The reported prices reflect only the mix of those homes that are selling, not the reported sales prices of a constant piece of real estate priced to varying market conditions. If low-priced homes are selling more easily than high priced ones, and such were the reverse of the year before, then a decline in the year-to-year average price would reflect shifting market mix, not the relative drop in the price of the same piece of real estate in the same market, year-to-year.

Inflation Indicators

Money Supply -- Annual growth in the seasonally-adjusted SGS-Ongoing M3 is estimated at a record-high 17.4%, up from 17.0% in February, with worrisome implications for a surge in monetary inflation. Outside of the last several months, the prior historic high of 16.4% was seen in June of 1971, prior to President Nixon closing the gold window and imposing wage and price controls. The latest estimates include significant benchmark and accounting revisions published by the Fed during the last month.

For March 2008, annual growth for monthly M1 was an annual gain of 0.2% for the second month, where pre-benchmark revision reporting had the series showing small annual contractions. March M2 annual growth surged anew to 7.0% from 6.6% in February.

Early April reporting, however, has shown some sharp slowing in growth for M2 and the non-M2 components of M3. If the current trends continue, the annual growth in the April average of the SGS-Ongoing M3 could slow to below 17%.



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

Feb 06	10.315	Sep 06	10.854	Apr 07	11.717	Nov 07	12.823
Mar	10.367	Oct	10.980	May	11.868	Dec	12.931
Apr	10.425	Nov	11.097	Jun	11.947	Jan 08	13.088
May	10.504	Dec	11.230	Jul	12.053	Feb	13.388
Jun	10.575	Jan 07	11.320	Aug	12.258	Mar (p)	13.574
Jul	10.673	Feb	11.441	Sep	12.439		
Aug	10.757	Mar	11.565	Oct	12.648		

(r) Revised, based on Federal Reserve benchmark revisions and accounting redefinitions to underlying series. (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.

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 Newsletter for methodology. The indicated M3 levels 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.

Purchasing Managers Surveys: Prices Paid Indices -- The March 2008 prices paid indices surged anew in both the purchasing managers composite surveys. The indices continued to reflect upside inflation pressures from a variety of factors, including high oil prices and a weaker U.S. dollar, and they continued to signal broad inflation problems ahead.

On the manufacturing side, the March price index exploded to 83.5 from 75.5 in February. On a three-month moving average basis, though, March's 32.4% year-to-year gain was slightly weaker than February's 37.6%. The manufacturing price indicator is not seasonally adjusted and, therefore, is generally the better indicator of pricing activity.

On the non-manufacturing side, the seasonally-adjusted March prices diffusion index rose to 70.8 from 67.9 in February. On a three-month moving-average basis, March's annual gain was 21.1% versus 24.5% in February.

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 -- With oil currently trading around \$120 per barrel, the implications for inflation and real GDP growth remain ominous for the balance of 2008. The strong relationship between oil price changes and broad inflation is examined in this month's Reporting/ Market Focus.

April's monthly average price appears likely to come in near \$113 per barrel (up roughly 77% year-to-year and 7.0% month-to-month), topping

the record-high just set in March. For March 2008, the monthly-average West Texas Intermediate spot price (St. Louis Fed) rose 10.7% to \$105.56 per barrel, up from February's \$95.35. Against last year's average, March's level was up by 74.3%, compared with February's 60.9%.

As of Friday, April 25th, West Texas Intermediate closed at \$121.57 per barrel, spot, yet another record high, and up by 86.7% from the year before. Oil price movement remains highly volatile, but generally should continue to trend higher and set new highs in the months ahead, despite a deepening U.S. recession and possible global recession. Irrespective of how high oil prices may go, or how much they may fall back in short-lived profit taking, current prices are well above levels that already have put debilitating U.S. inflation into play.

Regardless of any near-term price swings, meaningful upside risks to oil prices remain in place, with lagging impact from the still-unfolding dollar catastrophe (see the Oil vs. Financial-Weighted Dollar graph in the Opening Comments section), ongoing OPEC actions and rumblings, increasingly volatile Middle Eastern tensions, mounting political tensions in South America, and other supply and demand issues.

General background note: In the United States, high oil prices have spiked and will continue to spike basic inflation, and even the gimmicked "core" inflation measures -- net of changes in food and energy prices -- are beginning to inch higher. 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 swings, and "core" inflation eventually should catch-up with full inflation reporting (see this month's Reporting/Market Focus).

Reporting/Market Focus

Oil Prices Impact Inflation, Despite Wall Street's Wishful Thinking

With the financial markets largely ignoring oil prices as they push above \$120 per barrel, and with current CPI and PPI inflation numbers not fully reflecting the surge in oil prices, it is worth a look at the historical relationship between oil prices and official inflation reporting. It is not likely that what is happening to energy costs will pass unnoticed by consumers or, for that matter, eventually by the financial markets.

Following are three sets of graphs that plot year-to-year change in the price of oil versus various official measures of the consumer price index (CPI-U) and the producer price index (PPI finished goods). The first set of graphs shows annual oil inflation versus annual CPI and PPI inflation, the second shows oil versus annual CPI and PPI energy inflation, and the third shows oil versus annual CPI and PPI inflation ex-energy. The plot of annual oil inflation in each graph has been shifted ahead by the number of months that best shows the overall correlation of oil with the various CPI/PPI measures.

The relationship of oil versus the full CPI and the full PPI reflects the combination of the energy and ex-energy sub-indices, but it is dominated by the energy indices. Visually, there is a fair correlation between annual inflation in oil and annual inflation in the CPI, with the movement in oil tending to be followed two months later by movement in the CPI. The same is true with the PPI, but with a one-month lead time between oil price movements and finished goods inflation. The difference in timing makes some sense, where the PPI supposedly has something of a leading relationship to the CPI.

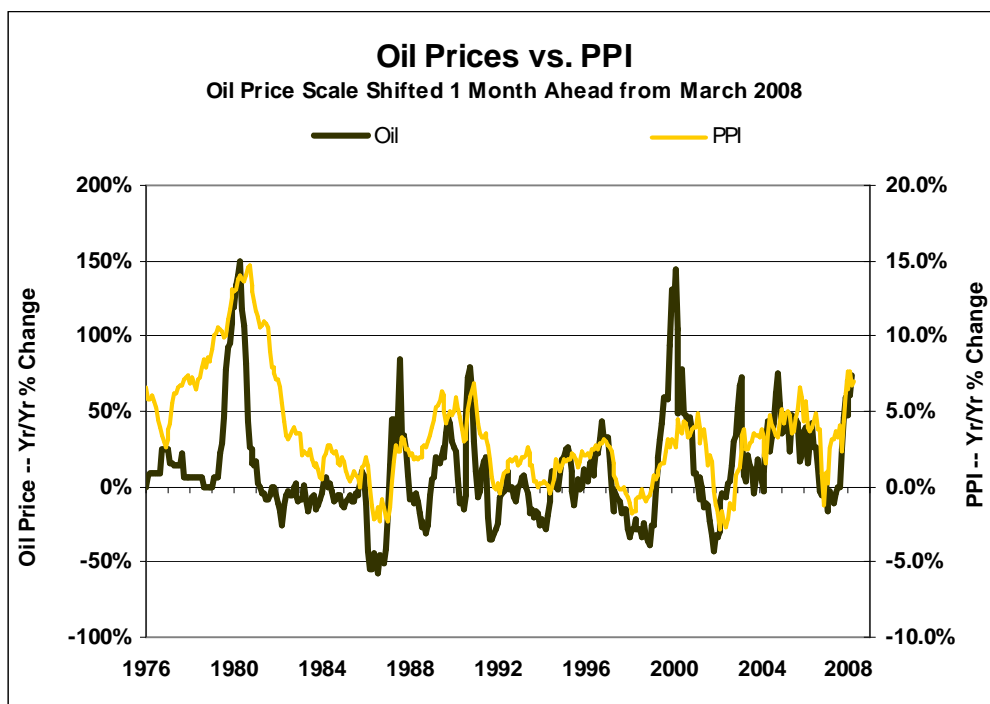
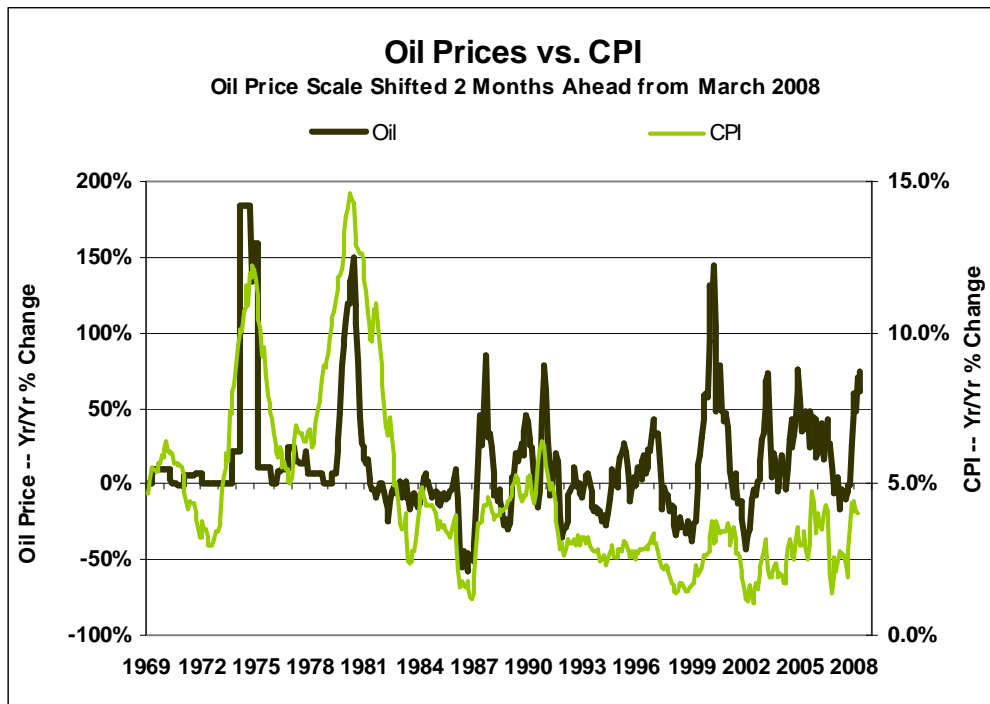
As could be expected, the CPI and PPI energy measures tend to move most closely with oil, lagging the change in oil inflation by one month, with something close to an 80% correlation.

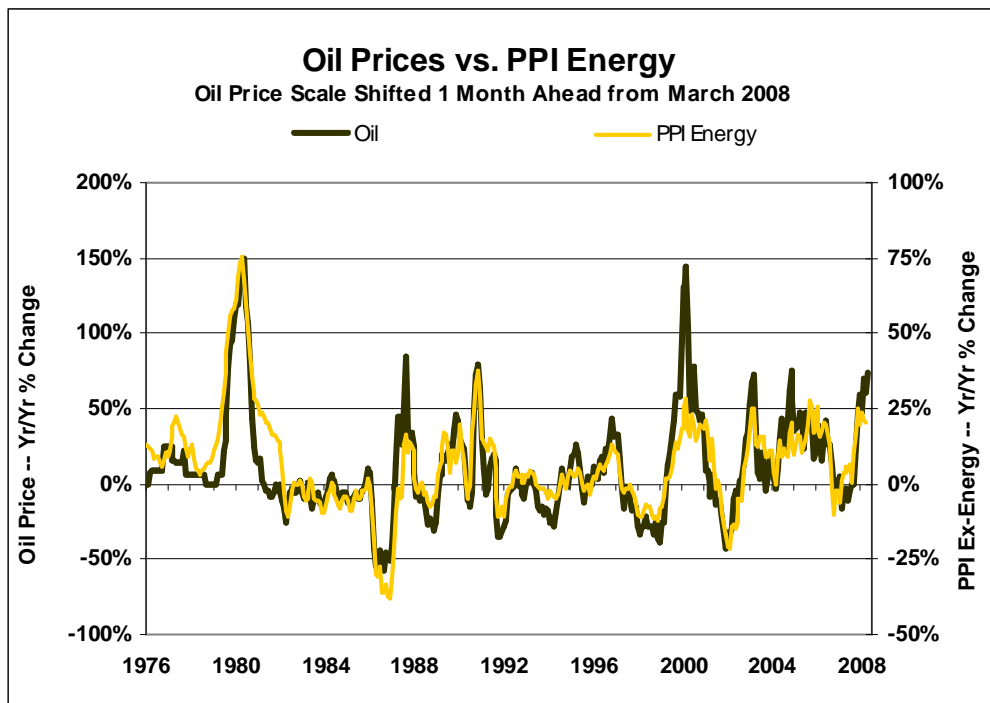
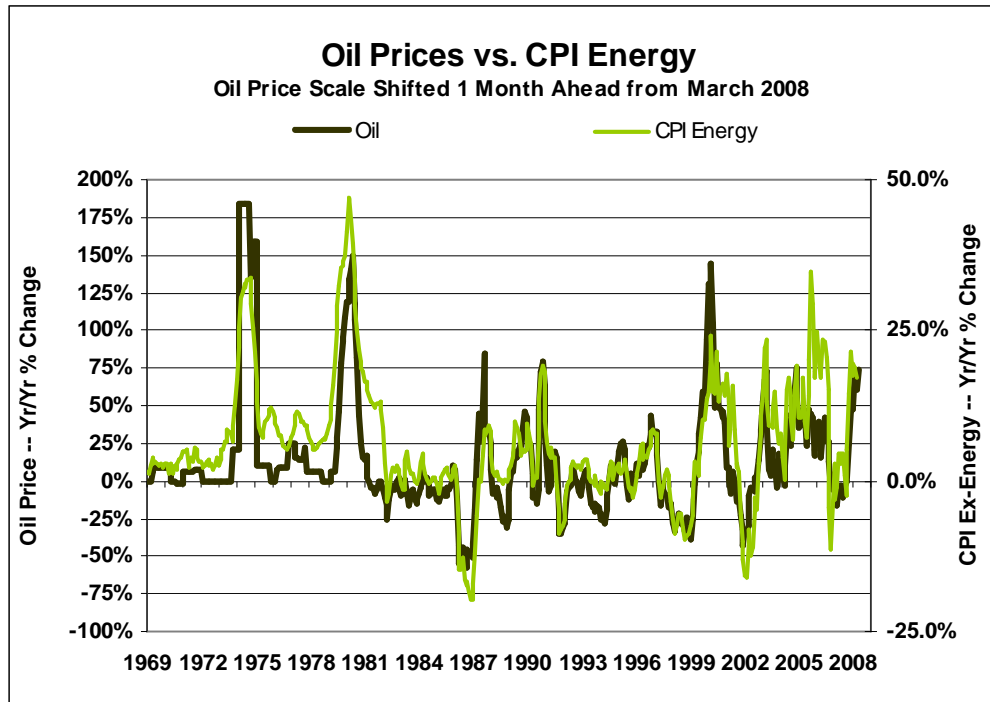
Perhaps the most interesting graphs are those of oil versus the ex-energy CPI and PPI measures. Where oil price changes affect nearly all levels of U.S. economic activity, ranging from transportation and energy costs, to material costs in the plastics, pharmaceutical, fertilizer, chemical industries, etc., eventually these quasi-core inflation measures (food prices are not backed out) should reflect changes in the price of oil.

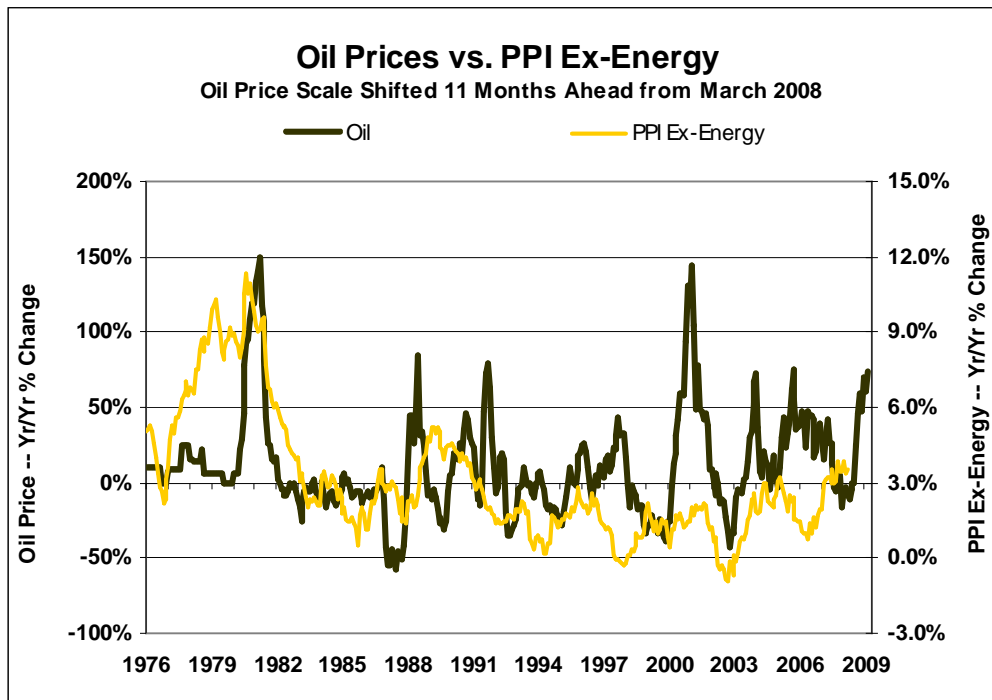
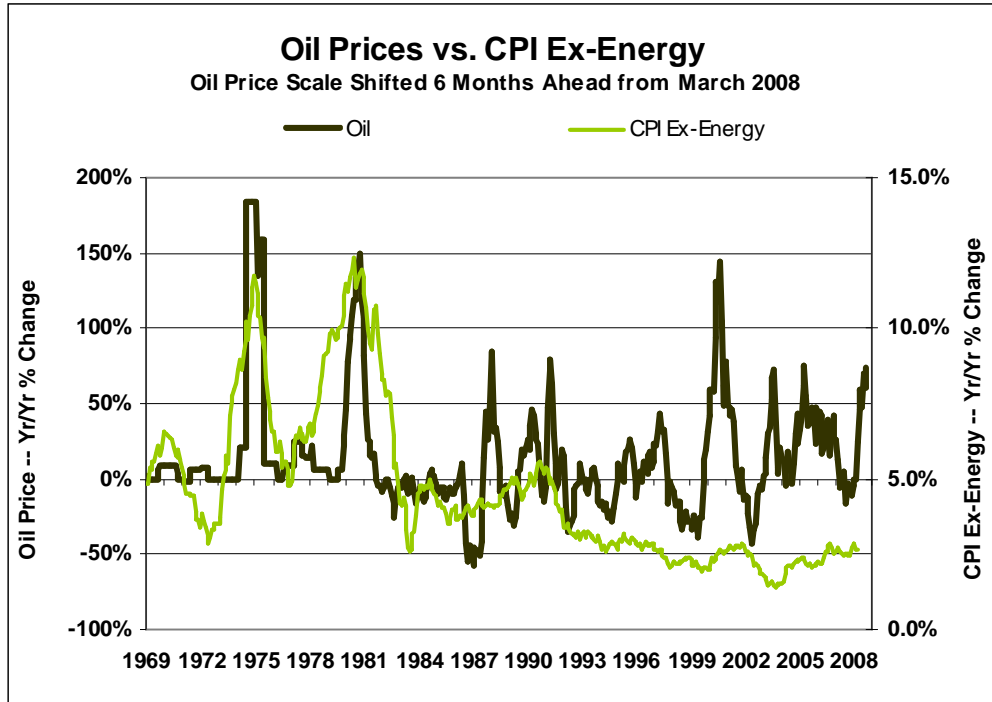
As shown in the ex-energy graphs, oil price movements tended to explain about 60% of core (ex-energy only) CPI inflation with a six-month lead time, up into the early 1990s. The oil effect has continued in more recent years, but with a muted impact. Against ex-energy PPI, the lead time works out to about 11 months, but the correlation is weaker and the lead time more volatile.

Part of the explanation for the "muted" impact of oil price swings on core CPI is that a dollar's worth of GDP has become less dependent on oil over time, thanks to increased operating efficiencies and the shifting of GDP away from a manufacturing- to a services-based economy. The muting, however, also may have roots in the various methodical shifts in inflation reporting of the last decade or so, which is being explored further.

The shown relationships are far from precise and are subject to reporting needs of the moment. The variability in lead time between oil price movement and reflection in official CPI and PPI is great. As a rough guide, on average, surging oil prices in April should have their greatest impact on May PPI and June CPI, with "core" inflation showing some upside reaction in late 2008 into early 2009.







Next Month's Reporting/Market Focus

For the next month or two, the newsletter's Reporting/Market Focus will continue to be based on factors deemed of significance to the evolving economic, market and financial-system conditions.

PLEASE NOTE: The next SGS Newsletter is targeted for around May 26th. Intervening Flash Updates and Alerts will continue to be posted in response to key economic or financial-market developments.

Earlier editions of the SGS Newsletter, referenced in the text, can be found on the Archives tab at www.shadowstats.com.

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