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

HYPERINFLATION WATCH - NUMBER 1

July 5, 2018

The United States Faces Eventual Hyperinflation, Unless the U.S. Treasury's Long-Range Solvency Issues Are Addressed

Annual Growth Jumped in June 2018 M3 and M2, but So Too Did Inflation

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NOTE TO SHADOWSTATS SUBSCRIBERS: This is the first ShadowStats *Hyperinflation Watch (HW),* posted as a standalone document, previously published as a feature in various forms (all combined here) throughout a given month of regular ShadowStats *Commentaries*.

As with the *Consumer Liquidity Watch (CLW),* similarly introduced recently as a standalone report, updated *HW* postings will be advised by e-mail. Both *Watches* always are available directly at www.shadowstats.com, as well as by link from the latest ShadowStats *Commentary*. Updates follow as new details become available and as coverage is expanded to encompass new measures and approaches that reflect financial-system stability and federal-government, financial-market and consumer-liquidity conditions.

Today's *HW* includes a *Table of Contents* with links to key sections and graphs, including current monetary conditions and to financial market conditions, including the U.S. dollar, gold and silver.

Please contact me if you have any questions, suggestions or otherwise would like to talk, at (707) 763-5786 or by e-mail at johnwilliams@shadowstats.com.

— Best wishes, John Williams

Today's (July 5th) *Hyperinflation Watch* covers June 2018 monetary conditions, with some degree of update throughout the various assembled sections.

Contents – Hyperinflation Watch No. 1 Major Sections and Graphs

U.S. MONETARY AND FINANCIAL-MARKET CONDITIONS

OPENING COMMENTS

Unless Long-Range U.S. Treasury Solvency Is Addressed, Hyperinflation Is Inevitable

Hyperinflation Watch June 2018. The ShadowStats' *Hyperinflation Watch* section has evolved over the years, in context of an inevitable hyperinflation—full debasement—of the value of the U.S. dollar, due to the long-term insolvency situation facing the U.S. government. While ShadowStats forecasts of hyperinflation in 2014 did not materialize, underlying fundamentals only have deteriorated since. Unless the United States addresses the long-range solvency issues currently in play for the U.S. Treasury, a hyperinflation will hit the United States, and it could be set off earlier than most anticipate, by any number of factors that could trigger a panicked sell-off in the U.S. dollar.

ShadowStats noted in *Hyperinflation 2014—The End Game Begins (Revised), No. 614*, of April 2, 2014: "The [ShadowStats] forecast of a U.S. hyperinflation has been in place since at least 2006. Those who have read the various ShadowStats reports on hyperinflation—as opposed to just catching occasional sensationalized headlines in the press—usually recognize that the forecast has been of a future circumstance, in what used to be the distant future. In the early writings, the outside time limit for the crisis was 2018 or 2019, the end of the current decade. That outside timing was moved in closer in time, to 2014, following the near-collapse of the financial system in 2008. For those interested, the full series of hyperinflation reports is described and linked at the end of the *Definitions and Background* section [*No. 614*]."

The most-recent ShadowStats update of the *Hyperinflation Outlook* was in *Special Commentary No. 935* of February 12, 2018. The full circumstance will be reviewed in these *Watches* over the next several months, including a full update of the latest Financial Statements of the United States Government, based on generally accepted accounting principles (GAAP).

Those statements reflect a current net present value of the total U.S. government's deficit net worth at an order of magnitude of $100 trillion. That is the amount of cash needed in hand today, in today's dollars, to cover U.S. net obligations going forward. In today's dollars, with a total U.S. GDP at roughly $20 trillion, there is no chance of the U.S. covering existing obligations under stable monetary conditions.

In the current circumstance, unless the U.S. government meaningfully overhauls its planned expenses (a significant reduction in spending) and/or increases its revenues (a significant increase in tax revenues) going into the future, it has no chance of covering its net obligations going forward, other than by just printing the dollars needed (dollar-basement and hyperinflation). More will follow in later *Hyperinflation Watches.*

Material reviewed into today's *Watch* brings together the various Money Supply measures regularly covered in the *Commentaries*, including updated annual growth, both before (nominal) and after (real)

adjustment for inflation, and their relationships to economic activity, updated monthly levels and annual growth in the Monetary Base and the Velocity of Money (Nominal GDP/Nominal Money Supply). Financial market circumstances are reviewed from the standpoint of the U.S. Dollar and the precious metals Gold and Silver. Those areas act something like the proverbial Canary in a Coalmine, as early warning of serious trouble in the U.S. financial-system and/or in inflationary developments.

JUNE 2018 M3 ANNUAL GROWTH AND MONETARY CIRCUMSTANCES

After Five Straight Months of Weakening Annual Growth, June Growth Strengthened for M3 and M2, Held Steady for M1, Against Six Months of Weakening/Contracting Monetary Base Growth. Based on three-plus weeks of reporting, June 2018 annual change in M3 and M2, bounced off recent multi-month lows in positive growth rates, with annual growth in June M1 holding even with May.

Nonetheless, given a strong chance of another sharp jump in June 2018 annual CPI-U inflation (reported on July 12th), much of the pick-up in the headline nominal annual in money supply growth will disappear, in real terms, again net of inflation reporting, confirming a continued tightening in real systemic liquidity, as plotted through May 2018 in *Graph HW-4*. That would be an ongoing negative signal for headline broad real economic activity.

M3 Annual Growth in June 2018 Picked up Against Some Upside Revision to May Activity. Moving on top of M2, the estimate of nominal annual growth for the ShadowStats Ongoing M3 Money Supply in June 2018 rose sharply to 4.5%, versus and upwardly-revised 4.1% [previously 4.0%] in May 2018. In turn, May 2018 growth was down from unrevised annual gains of 4.2% in April 2018, 4.5% in March 2018, 4.5% in February 2018, 4.5% in January 2018, 4.6% in December 2017, 4.5% in November 2017 and 4.7% in October 2017. That October year-to-year change was highest seen since November 2015.

Those M3 growth rates were against unrevised annual gains of 4.2% in September 2017, 3.6% in August 2017 and irregular notching of annual growth lower back in time, to an unrevised 3.0% in March 2017, which was the weakest year-to-year change since July 2012.

M2 Annual Growth Also Increased in June 2018 Against an Upside Revision to May. Separately, nominal year-to-year growth for M2 rose to 4.2% in June 2018, versus an upwardly revised 3.8% [previously 3.6%] in May 2018. That was against unrevised annual growth of 3.7% in April 2018, 4.0% in March 2018, 4.1% in February 2018, 4.2% in January 2018, 4.7% in December 2017, 4.6% in November 2017, 5.0% in October 2017, 5.2% in September 2017, 5.3% in August 2017, 5.6% in July 2017, 5.6% in June 2017 and 5.9% in May 2017.

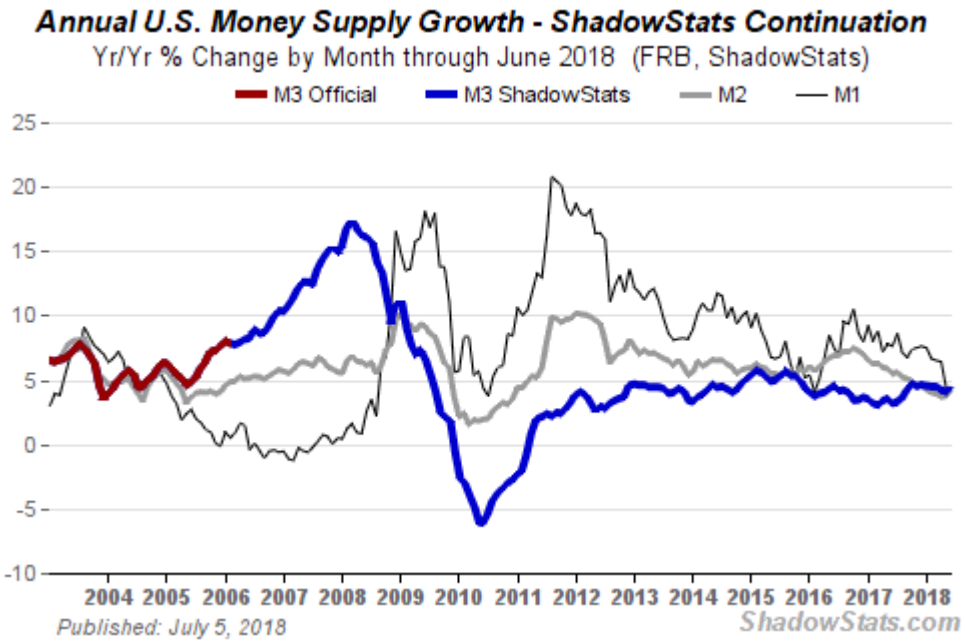
M1 Annual Growth Still at a Multi-Year Low. Annual nominal growth in June 2018 held at 4.5%, against an upwardly-revised 4.5% [previously 4.3%] in May 2018, with 4.5% the lowest level of annual growth in the M1 series since the one-month low of February 2016, otherwise at its lowest level since July 2010. The May 2018 growth of 4.5% was down from an unrevised 6.5% in April 2018, 6.6% in

March 2018, 6.7% in February 2018, 7.5% in January 2018, 7.7% in December 2017, 7.6% in November 2017, 7.4% in October 2017, 6.8% in September 2017, 7.2% in August 2017, 8.7% in July 2017, 7.7% in June 2017 and 7.9% in May 2017. Going backwards in time, the monthly annual change in M1 tends to notch higher, hitting a near-term peak annual of 10.6% in October 2016, which was the strongest growth since 10.7% in September 2014.

For those living in the headline money-supply world comprised of just the Fed's M1 and M2, annual money growth had been relatively stronger in recent years for both M1 and M2, versus M3, until January 2018, when annual M3 growth overtook M2, in conjunction with interest rates being pushed higher by the FOMC. Nonetheless, the monthly annual growth in each of M1, M2 and M3 has slowed consistently since December 2017, near-term, along with the year-to-year contractions in the Monetary Base, all reflecting Federal Reserve policy.

Fed Policy Actions Have Moved Towards Restraining Headline Economic Activity. Annual M3 growth had been declining in tandem with M1 and M2, at the same time as annual year-to-year CPI-U inflation was on the rise in February through May 2018, again with a likely continued rise in June. Allowing for the impact of rising annual inflation, these patterns are suggestive of weakening or declining economic activity, of the FOMC actively pushing to slow domestic economic growth, which still largely never recovered from the banking-crisis-induced economic collapse of 2008.

Graph HW-1: Comparative Money Supply M1, M2 and M3 Yr-to-Yr Changes through June 2018



The relative weakness in annual M3 growth, versus M2 and M1 (M2 includes M1; M3 includes M2) had reflected a shift over time in funds from accounts included just in M3, such as large time deposits and institutional money funds, into accounts in M2 and M1. The recent relative strength in annual M3 growth, however, reflected a returning flow of cash from M2 back into M3 accounts, again, such as large-time deposits, institutional money funds and Fed funds repurchase agreements. Still, the recent, softening headline details likely reflects and/or will tend to induce softening business activity, particularly including the June gain net of inflation consideration. The latest estimates of level and annual changes for June

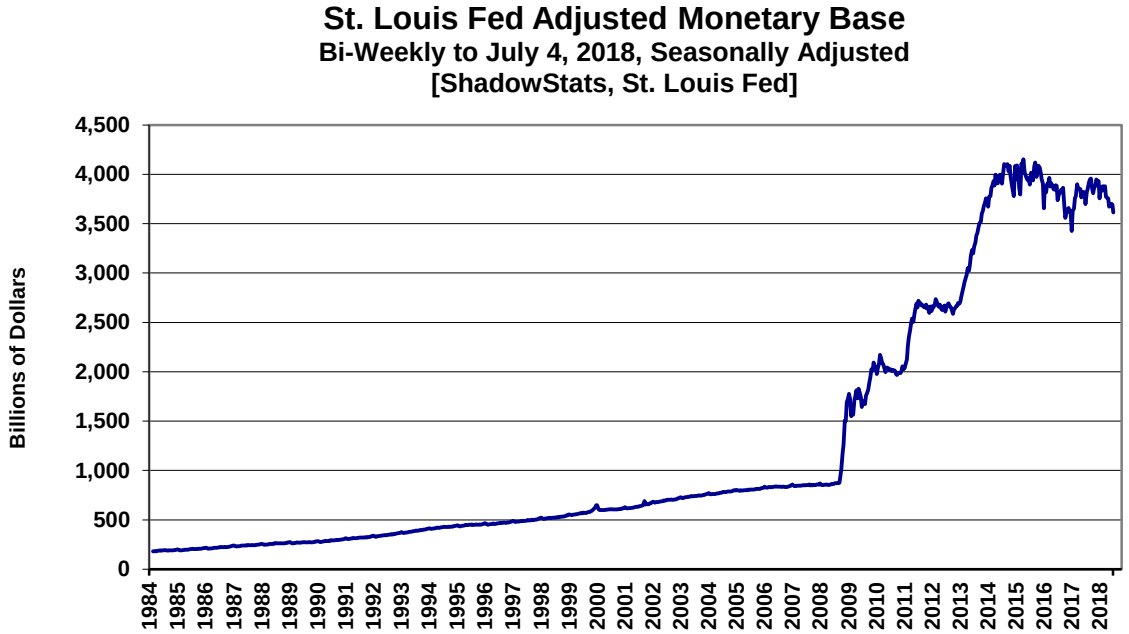
2018 M3, M2 and M1, and for earlier periods, are detailed in the Alternate Data tab of www.ShadowStats.com. See the *Money Supply Special Report* for full definitions of those measures. *Commentary No. 960* will update the inflation-adjusted annual M3 growth for June 2018.

Dropping Sharply Month-to-Month, the June 2018 Monetary Base Declined Year-to-Year for the Fourth Straight Month. As annual growth in M3 jumped in late 2017 so, too, did annual growth in the Monetary Base**.** In the wake of near-term volatility surrounding recent rate hikes by the FOMC, and the related market efforts by New York Fed to establish or stabilize a consistent trading-range activity for the targeted federal funds rate, the level of the monetary base had been reasonably stable, with annual percentage change fluctuating around zero.

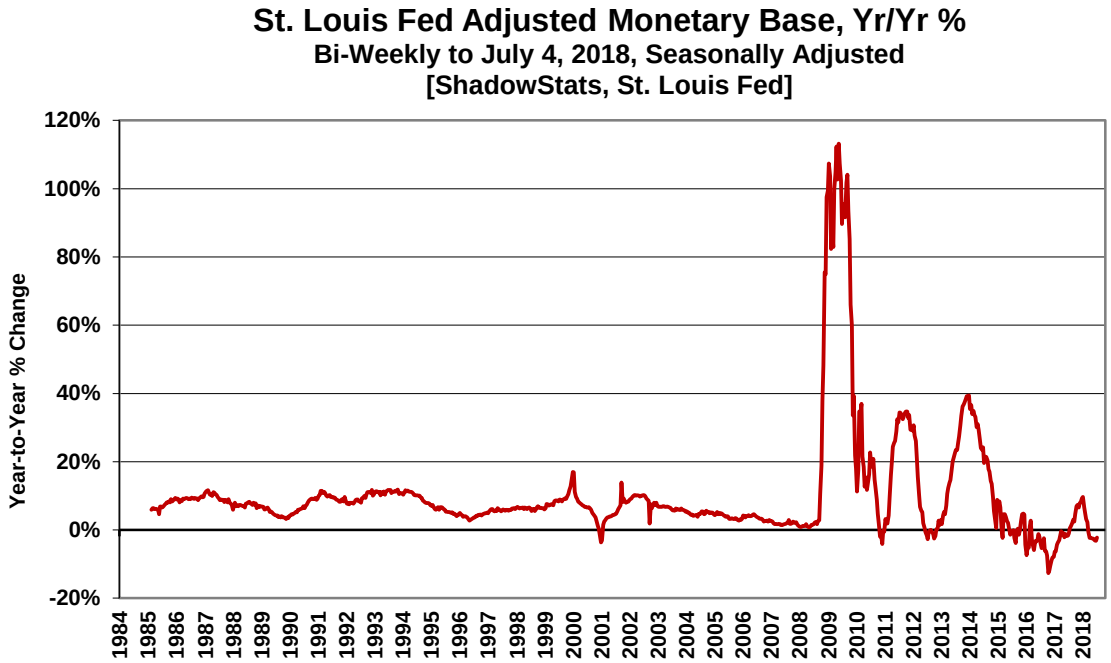
Still, in late-2017, the pace of annual growth had turned higher, rapidly moving to consecutive, multi-year highs, pulling back in roughly parallel timing with M3. Annual growth in both series peaked near-term in December 2017, at multi-year highs. The Monetary Base was up by 9.7% year-to-year in the two weeks ended January 3, 2018, eased to 4.9% in the two weeks ended January 31st and to 2.3% in the period ended February 28th, down year-to-year 2.3% (-2.3%) the March 28th period, down by 2.4% (-2.4%) in the April 25th period, down by 2.6% (-2.6%) in the May 23rd period, and the Saint Louis Fed's estimate of the Monetary Base was down by 2.3% (-2.3%) year-to-year in the two weeks ended July 4th. Accompanying *Graphs HW-2* and *HW-3*, reflect that detail.

Aside from short-term gyrations around the timing of change in the targeted federal funds rate (as could have affected the late-March 2018 data), circumstances generally should remain relatively stable, until the Fed sells its Treasuries and Mortgage-Backed Securities more heavily, as part of its planned "balance sheet normalization." More speculatively, the Fed still could fall back on expanded quantitative easing, amidst mounting liquidity stresses in the banking system, generated by deteriorating economic conditions.

Graph HW-2: Saint Louis Fed Monetary Base, Billions of Dollars (1984 to July 4, 2018)



Graph HW-3: Year-to-Year Percent Change, Saint Louis Fed Monetary Base (1985 to July 4, 2018)



While the level of the Monetary Base remains within the bounds of activity seen of the last several years, it is trending lower. Prior to Quantitative Easing, changing the level of the Monetary Base had been the primary tool of the FOMC for targeting growth in the money supply. Late-2017 upside movements in annual growth for M3 and the Monetary Base have reversed, dropping off sharply, together. With the current activity confirming a sharp tightening in FOMC policy, despite a one-period jump in annual M2 and M3 money growth. Intended negative economic consequences already have started to flow, as discussed in the opening of the *FOMC, THE U.S. DOLLAR AND FINANCIAL MARKETS* section.

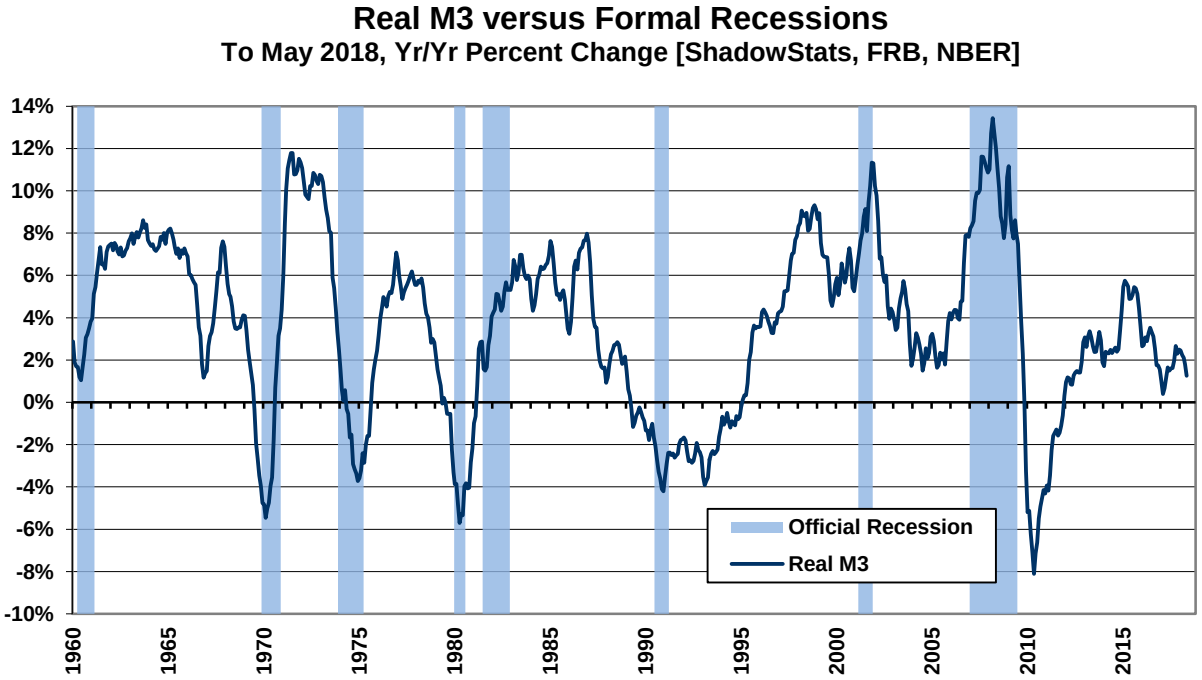
A Leading Indicator to Broad Economic Activity, Inflation-Adjusted Money Supply M3—May 2018 (June 2018 Pending)—Annual Change Continued Sinking, Now at a Thirteen -Month Low. *[This section will be updated fully subsequent to the publication of the June 2018 CPI-U detail, scheduled for release on July 12th.]* Although annual growth in nominal M3 rose by an increased annual rate of 4.5% in June 2018, versus 4.1% in May 2018, an increased year to-year change in June CPI-U likely will be offsetting much of that increase in real or inflation-adjusted terms.

Discussed in the *CPI Section* of *Commentary No. 955*, The signal for a double-dip, multiple-dip or simply protracted, ongoing recession, based on annual contraction in the real broad money supply (M3), had been re-triggered/intensified one year ago, in February 2017. Yet, that signal then softened or flattened out with a contrary bounce from May 2017 into December 2017, turning down anew after the Federal Reserve's Federal Open Market Committee's (FOMC) began more-aggressive tightening in December. The previous recession signal of December 2009 had remained in place, despite real annual M3 growth having rallied into positive territory post-2010.

In the context of continued weakening annual growth in M3 (policy action of the Federal Reserve Board's Federal Open Market Committee [FOMC]), and continued pick-up in annual CPI inflation, driven by unstable, surging political conditions in the oil markets (not a direct function of a "strong" U.S.

economy), a formal recession signal from low-level or negative annual real growth has become increasingly likely in the near term. Shown in *Graph HW-4*—based on May 2018 CPI-U reporting and the latest ShadowStats-Ongoing M3 Estimate (see the discussion on slowing annual money supply growth in the *Opening Comments* and *Hyperinflation Watch* of *Commentary No. 953-A*)—annual inflation-adjusted growth in May 2018 M3 dropped to a thirteen month low of 1.26%, down from a revised 1.81% [previously 1.83%] in April 2018. That was against minimally-revised growth rates of 2.01% in March 2018, and unrevised real annual growth rates of 2.24% in February 2018, 2.45% in January 2018, 2.49% in December 2017 and 2.30% in November 2017. Those patterns reflected successive, downside benchmark revisions to the Federal Reserve's money measures and, again, upside movement in annual CPI-U inflation. Those levels of activity were against a near-term peak growth of 2.64% in October 2017, and against the February 2015 cycle-high peak growth of 5.75%.

Graph HW-4: Real M3 Annual Growth versus Formal Recessions



The current low level of real annual M3 growth reflected a 10-month low in annual nominal M3 growth (before inflation adjustment) and net of a 74-month high in annual growth in the CPI-U.

What recently had been higher, albeit tepid, real annual growth likely was a temporary reversal in the pattern of plunging annual growth, which had held at levels last seen in plunging growth into the 2009 economic collapse, a level never seen outside an economy falling into, or already in a recession.

The signal for a downturn or an intensified downturn is generated when annual growth in real M3 first slows sharply, approaches zero and turns negative in a given cycle; the signal is not dependent on the depth of the downturn or its duration. Breaking into positive territory does not generate a meaningful signal one way or the other for the broad economy. The previous "new" downturn signal was generated in December 2009, even though there had been no upturn since the economy purportedly hit bottom in mid-2009. The ongoing issue here confounding the regular signal is that the U.S. economy never has recovered fully from its collapse into 2009 (see *Commentary No. 877*, *Commentary No. 902-B* and

Commentary No. 957. The initial economic downturn never evolved into a meaningful or sustainable recovery. The current level and pattern of real annual M3 growth generally has been followed by annual contraction and a recession signal.

When real M3 growth breaks above zero, there is no signal; the signal is generated only when annual growth moves to zero and into negative territory, from which it has backed off at present. The broad economy tends to follow in downturn or renewed deterioration roughly six-to-nine months after the signal. Weaknesses in a number of economic series have continued to the present, with significant new softness in recent reporting, separate from short-lived activity generated by the destruction and resulting recovery from particularly-severe hurricane and California wildfire seasons. Actual post-2009 economic activity has remained at relatively low levels—in protracted stagnation—with no actual recovery (see the *ECONOMY* section of *Special Commentary No. 935* and, again, *Commentary No. 957*).

Despite the purported, ongoing growth seen in headline GDP activity, a renewed downturn in official data appears to be underway. What continues to unfold here likely will gain official recognition as a "new" recession, within the year ahead. Underlying reality remains that the collapse into 2009 was followed by a plateau of low-level economic activity—no meaningful upturn, no full recovery from, or end to, the official 2007 recession, no new economic expansion—where the unfolding "new" downturn remains nothing more than a continuation and re-intensification of a downturn that began unofficially in 2006.

VELOCITY OF MONEY

First-Quarter 2018 Velocity of Money Declined Minimally for M1, Gained Minimally for M2 and M3. Text here has not changed from *Commentary No. 947*, covering the "advance" estimate of First-Quarter 2018 GDP, other than for minor language corrections, references to the timing of the related numbers, and for *Graphs HW-5* and *HW-6* having been updated for the latest GDP and Money Supply revisions, although they effectively are visually indistinguishable from their initial renditions. That latter circumstance results from subsequent downside revisions to first-quarter GDP growth moving in tandem with downside revisions to first-quarter Money Supply estimates.

In the context of the initial, somewhat stronger nominal, annual growth in First-Quarter 2018 GDP and somewhat weaker nominal annual growth in First-Quarter 2018 Money Supply measures versus fourth-quarter 2017, the velocity of money in the first-quarter 2018 was slightly higher for the broader money supply measures M2 and M3, versus fourth-quarter 2017. The pace of money supply velocity for fourth-quarter M1, however, slowed minimally, having been down or flat for the last ten quarters, suggestive of somewhat greater physical cash relative to the GDP in the system, although that could be offshore. Velocity is a measure of how many times the money supply turns over in a year, versus the broad economy (GDP).

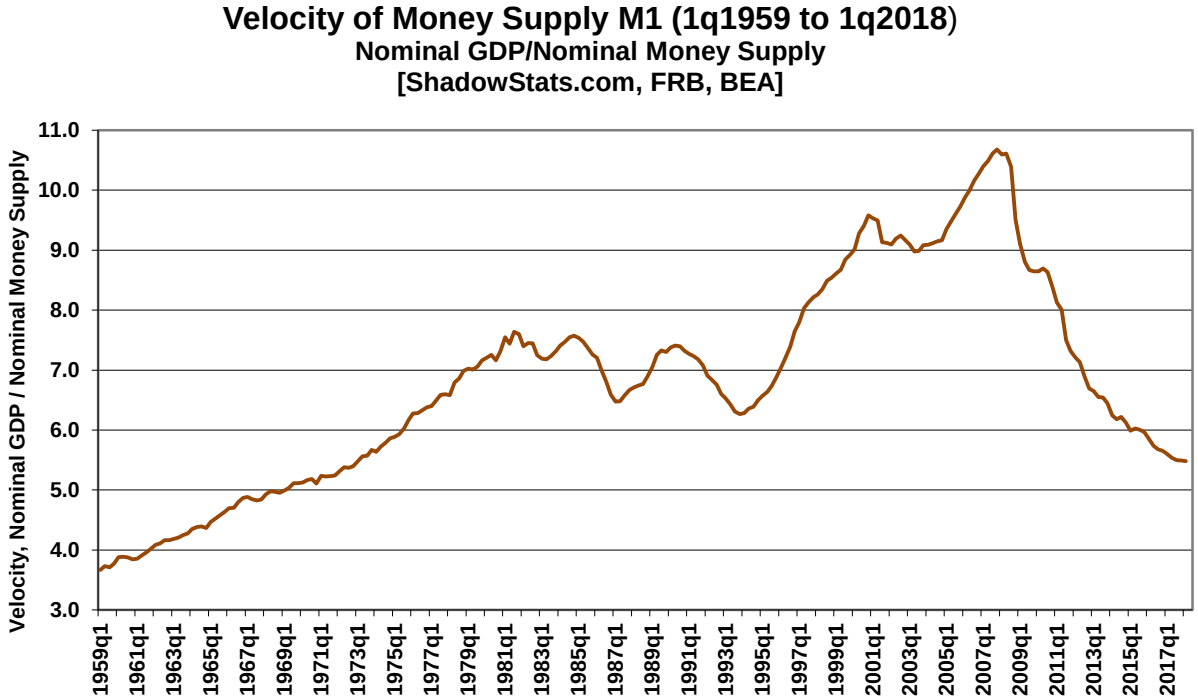
Velocity is calculated simply as the ratio of the nominal GDP to the nominal money supply measure. Nominal GDP is in the numerator and the nominal money measure is in the denominator of the velocity ratio. Slowing velocity indicates a relatively slower pace of nominal economic growth versus the money supply growth, and vice versa.

Velocity had plunged into first-quarter 2015 for M1 and M2. Since the end of 2010, however, the broader measure of M3 velocity had been reasonably steady through third-quarter 2014, when it also turned lower. With the exception of an uptick in second-quarter 2015, all velocity measures had been declining since late-2014, except for the flattening or small increase seen in the broader measures in the last two quarters.

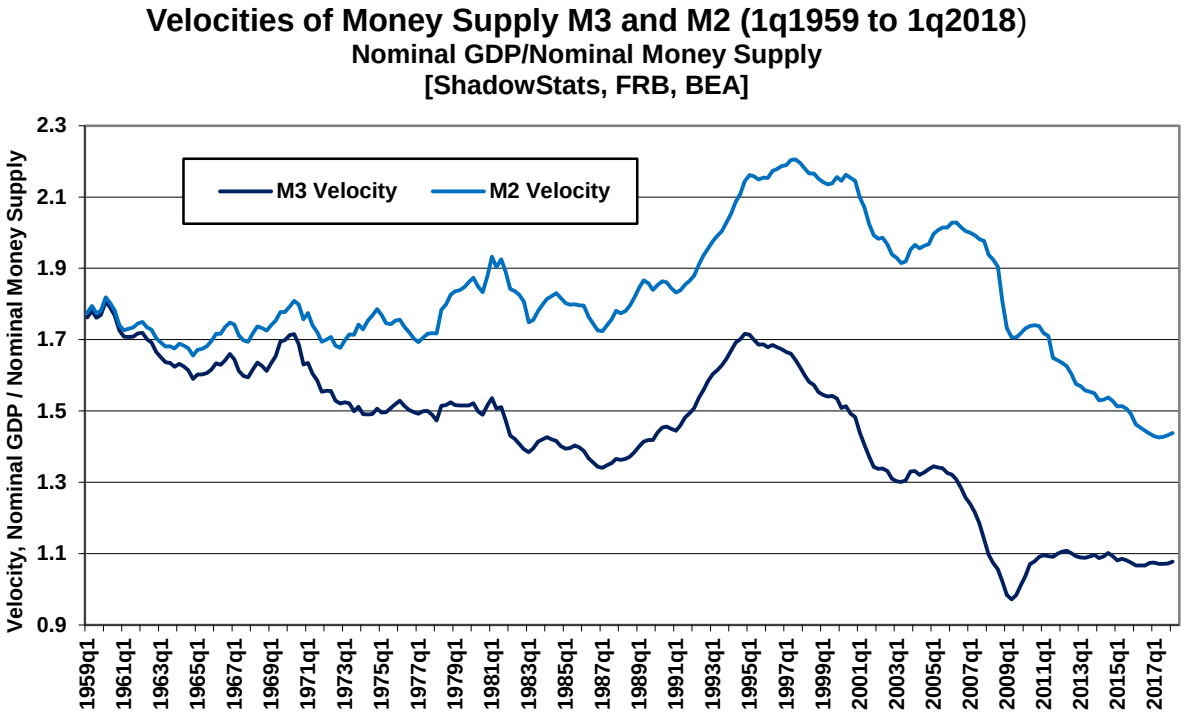
Consider that perhaps 70% or more of the cash-in-circulation component of that M1 (with cash accounting for about 42% of M1) could be physically outside the United States, per the Federal Reserve. Where that has been an increasing trend, a true measure of domestic M1 velocity well could be showing a significant uptrend. In like manner, where M1 includes cash, M2 includes M1, and M3 includes M2, M2 and M3 velocities also would be higher (headline cash accounts for roughly 11% of M2 and 8% of M3).

M3, versus M1 and M2, had been showing opposite patterns since 2011, because growth in M3 had been weaker than growth in M1 and M2, a pattern that had intensified. The reason behind that difference was that much of the relatively stronger M1 and M2 growth reflected cash moving out of M3 categories—such as large time deposits and institutional money funds—into M2 or M1 accounts. The clarity of what happened there is why ShadowStats still tracks what had been the broadest money measure (M3) available. More recently, M3 had started to rise anew, with M1 and M2 annual growth rates starting to reverse. Since third-quarter 2017, however, all three monetary aggregates have been showing sharply slowing pace of annual growth rates, in tandem.

Graph HW-5: Velocity of Money Supply M1 through 1q2018 (Third-Estimate of 1q2018 GDP)



Graph HW-6: Velocities of Money Supply M2 and M3 through 1q2018 (Third Estimate of 1q2018 GDP)



Subscribers often ask for specifics on the velocity of the money supply, with the result that this section has become a standard feature for *Commentaries* covering the "advance" GDP reporting of a given quarter (the "advance" second-quarter 2018 GDP will accompany annual GDP benchmark revisions back to 1929). The nature of velocity is discussed in further detail in the 2008 *Money Supply Special Report*. Again, velocity simply is the number of times the money supply turns over in the economy in a given year, or the ratio in nominal terms (not adjusted for inflation) of GDP to the money supply. It is a residual number, not otherwise open to calculation or independent surveying.

Velocity has theoretical significance. In combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is a ratio of two not-particularly-well or realistically-measured numbers, its actual estimate is of limited value. As an inflation predictor, it has to be viewed in the context of accompanying money-supply growth, and vice versa, generally as a coincident indicator. Again, full definitions can be found in the *Money Supply Special Report*, with headline money supply estimates for June 2018 discussed in the earlier *June 2018 M3 ...* section.

[The FOMC Section Begins on the next page.]

FOMC, THE U.S. DOLLAR AND FINANCIAL MARKETS

Federal Reserve Still is Unable to Extricate Itself from the Panic of 2008

Intended Consequences: Beware "Unexpected" Economic Weakness/FOMC Policy Change! *[Portions of this section are repeated from* Hyperinflation Watches *of recent* Commentaries.*]* Discussed in *Commentary No. 955*, despite the 49-year-low unemployment rate in May 2018, underlying labor-market stresses and continued weak annual growth in payroll employment signal economic trouble ahead. Private surveying of jobs-market conditions (the Conference Board's Help-Wanted Online Index™, HWOL) and Real Median Household Income, for example, also suggest that recent headline, economic strength is not as advertised. Released today, July 5th, the June HWOL tanked sharply, but not because there were no people to fill the jobs, as was alibied in the popular media as to why an early-payroll growth number was soft. There are some issues, as will be discussed in tomorrow's *Commentary No. 959-A*.

Separately, seriously-conflicting policy issues for the Federal Open Market Committee (FOMC) of the Board of Governors of the Federal Reserve System include tightening systemic liquidity, at the same time as trying to maintain banking-system solvency/liquidity. The current tightening in monetary policy threatens to damage (or to exacerbate current, underlying weakness in) major sectors of U.S. economic activity (see the earlier comments on real M3 growth and related *Graph HW-4*). In conflict, such an intensifying economic downturn would stress banking-system liquidity.

The U.S. central bank's primary concern remains the maintenance of solvency and liquidity in a still-troubled banking system. Intensifying economic and financial stresses on that system remain likely to cause the FOMC to back off its current pattern of promised rate hikes and balance-sheet liquidation, to revert again towards expanded quantitative easing, as openly allowed for in current FOMC policy.

As the mounting economic/systemic stresses continue to unfold, market pressures and expectations should shift sharply towards the FOMC pulling back from further tightening. Accordingly, consensus expectations as to the timing and frequency of future rate hikes by the Fed increasingly should begin to waver, with negative impact on the U.S. dollar and an upside push to a commodity-driven (oil) U.S. inflation, despite what is or will be recognized as a weakening economy. Again, banking-system liquidity and solvency are the dominant policy consideration for the FOMC, not the relative strength of the domestic economy, as has been demonstrated frequently from the 2008-banking crisis to present.

Regularly discussed here, unexpected, negative economic shocks lie ahead, not only in regular, near-term monthly reporting of popularly-followed series, but also as seen with recent annual benchmark revisions and potentially with the pending comprehensive benchmark revision to the GDP series (see *Commentary No. 958* and *Commentary No. 957*).

Shifting Global Interest-Rate Perceptions Recently Boosted the U.S. Dollar, Intensifying Risks of a Day of Reckoning for the U.S. Currency and the Financial Markets. A confluence of some unhappy factors have continued to evolve, where increasingly they could hit the U.S. financial system very hard in the next several months. Claiming a booming economy and recovered inflation, the FOMC boosted its

targeted federal funds rate by 0.25% on June 13th. Yet the headline inflation used to justify the rate hike was driven by commodity price distortions, not by strong, underlying economic activity, and the FOMC had to know that.

In such a circumstance, where rising inflation is not offset by consumer liquidity gains, such as rising income, then inflation of the current form is debilitating to consumer liquidity conditions and to broad economic activity. Raising interest rates in that circumstance only exacerbates the negative pressures on the U.S. economy.

Nonetheless, with U.S. interest rates rising and European rates recently indicated as likely to be flat for a while, and with the headline U.S. economic perceptions just booming along, the U.S. dollar jumped sharply in June (see *Graphs HW-7* and *HW-8*) where annual change in the Trade Weighted Dollar just pushed into neutral or positive territory in early-July.

What lies ahead is far from stability. The U.S. economy, which never recovered fully from its crash into 2009, now has been pushed to the headline stalling-point by underlying inflation issues combined with unfortunate FOMC policy. As the economy turns down anew, the banking system should come under renewed liquidity/solvency stresses. In turn, that should bring the Fed around to reversing policy once again, re-embracing quantitative easing. That should crash the U.S. dollar, along with an intensified flight of foreign capital from the United States, likely also crashing the U.S. stock and equity markets.

The issues here may have been slower to break than expected by ShadowStats, but they remain in play. Potential issues include:

- A marked and intensifying deterioration in current consumer liquidity conditions is underway (faltering Real Earnings, Real Consumer Credit Outstanding and Consumer Optimism), as discussed in *Consumer Liquidity Watch - No. 2*.
- Headline economic reporting in July and August increasingly should weaken the broad consensus outlook on U.S. economic conditions, again, exacerbated by likely negative downside revisions to the July 27th Gross Domestic Product (GDP) benchmarking.
- Those factors combined could be enough to start moving financial-market expectations towards a possible easing shift in FOMC monetary policy.
- Rapidly mounting, global currency and credit market concerns as to U.S. government finances (budget deficit and funding needs) and related long-term sovereign-solvency issues (see today's *Opening Comments*).
- Potential for trade deficit/tariff disputes to intensify.
- Potential for new conflict in the Middle East (oil supply disruption).
- Mounting turmoil tied to efforts (likely unsuccessful) by political adversaries to remove President Trump from office (see *Special Commentary No. 888*), where elements of the dispute may be coming to a head very shortly.

The circumstances here remain the tinder for igniting a financial-market firestorm, which likely would engulf the U.S. dollar in conjunction with intensifying flight of foreign capital from liquid U.S. financial assets, particularly stocks and Treasury bonds.

Watch Out for the U.S. Dollar! Increasingly obvious in recent headline data, the real-world U.S. economy is not recovering or booming as advertised, despite heavy hype in the press of a booming, full-employment economy, and in the context of continued FOMC tightening actions.

Again, current tightening actions by the FOMC will be instrumental in accelerating a new downturn in a U.S. economy that has yet to recover fully from its collapse into 2009.

An unhappy period of market readjustment to underlying real-world circumstances looms, where Wall Street's proponents of a never-ending stock-market rally had parlayed temporary, nonrecurring economic boosts from natural disasters into a year-end 2017 economic boom. Increasingly-negative economic "surprises" should shock the markets and the U.S. dollar on the downside. As the reported economic downturn intensifies in the months ahead, the FOMC eventually should face an "unexpected" policy retrenchment, reversing recent moves and moving back towards quantitative easing.

With Looming Turmoil, Physical Gold and Silver Provide a Hedge, Protect the Purchasing Power of One's Wealth and Assets. The increasing, fundamental disconnection between the happy hype in the media, the financial markets and the FOMC pronouncements as to a rapidly expanding U.S. economy, and the underlying reality of broad U.S. economic activity never having recovered its pre-recession 2007 peak, promises to disrupt FOMC policy and financial-market tranquility. Oncoming headline economic detail increasingly should confirm a renewed economic contraction (see *Special Commentary No. 935*).

Again, the FOMC likely will abandon its current path of policy tightening, for a renewed and expanded quantitative-easing program to bolster the still liquidity-challenged domestic banking system. The market response to, or anticipation of a shift in policy, should pummel the value of the U.S. dollar in the global markets, spiking gold, silver and oil prices. In turn, domestic equity and credit-market prices should fall sharply, as significant capital flees the weakening U.S. dollar and the domestic markets.

Holding physical gold and silver remain the ultimate hedges—stores of wealth—for preserving the purchasing power of one's U.S. dollar assets, in the context of liquidity and portability, during the difficult and highly inflationary times that lie ahead.

The graphs in this section reflect New York late-afternoon or closing prices of July 5th.

U.S. Dollar. *Graphs HW-7* and *HW-8* plot the Federal Reserve Board's (FRB) Major-Market Trade-Weighted Dollar (TWD), which reflects the U.S. dollar exchange rate weighted versus the Euro, Yen, Pound Sterling, Australian Dollar, Swiss Franc and the Canadian Dollar; and the ShadowStats Financial-Weighted Dollar (FWD), which reflects the U.S. dollar exchange rate weighted versus the same currencies, based on respective currency trading volume in the markets, instead of merchandise trade.

ShadowStats modified the FWD to add the Chinese Yuan, at such time as it was recognized as a global reserve currency by the Bank for International Settlements in 2015, but there was no resulting visual difference in the ShadowStats plot, until recently, given the relatively low weighting of the CNY at present, and the closely tied movement of the CNY to USD over time. The plots of the FWD versus the TWD both had shown recent weakness in the U.S. dollar, with the declining year-to-year change. Yet, there has been a short-term relative dollar rally, largely reflective of current global political instabilities and higher relative U.S. interest rates. In times of global political stress, the dollar often has been viewed as a safe-haven, as have gold and silver.

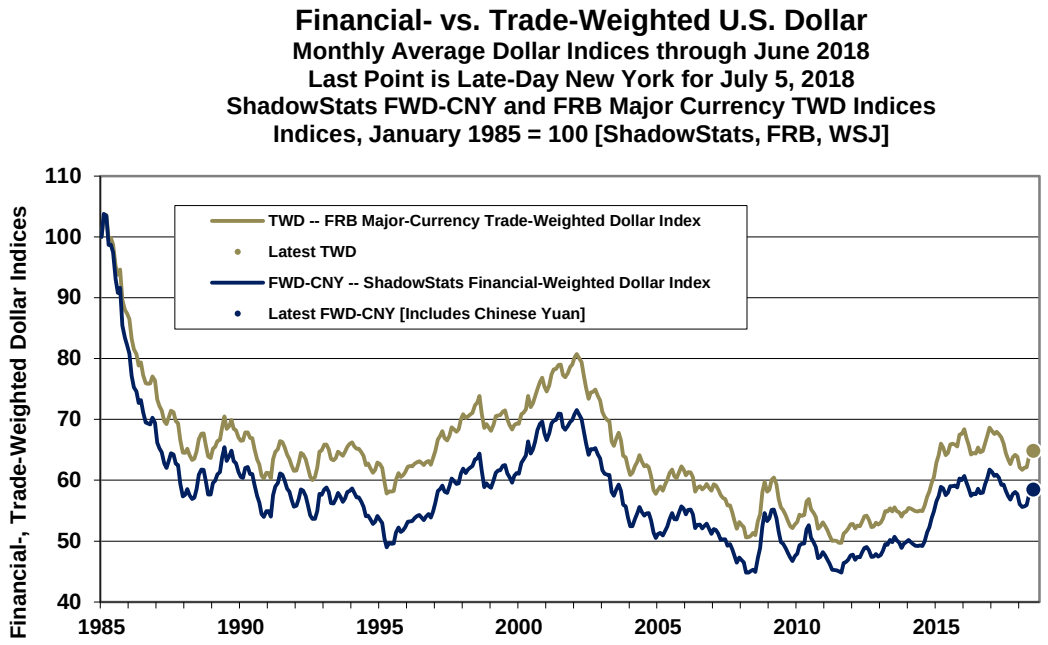
Gold and Silver, and Gold versus Stocks. *Graphs HW-9* and *HW-10* show plots of the price level of the S&P 500 Total Return Index (all dividends reinvested) versus the price of physical gold, with both series indexed to January 2000 =100, with the first plot showing both series in nominal terms and the second plot in real, inflation-adjusted terms, deflated by the CPI-U. While Gold has outperformed the S&P 500 since the beginning of millennium, it is interesting to note that the S&P 500, net of inflation, did not break above parity until 2013.

Graphs HW-11 to *HW-13* are the traditional ShadowStats gold graphs, respectively versus the Swiss Franc, versus Silver and versus Oil (Brent).

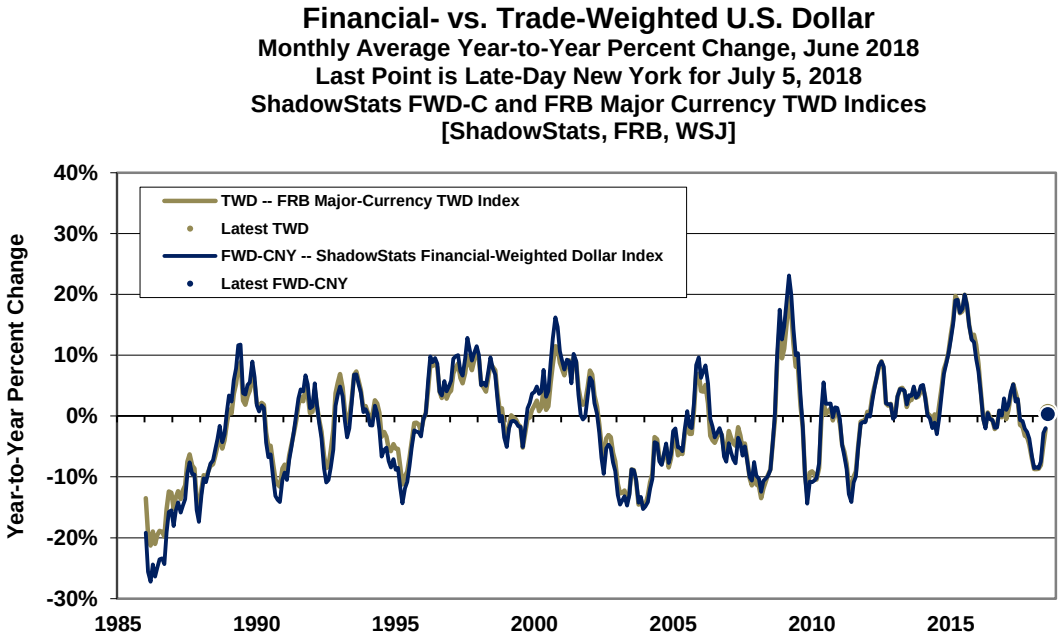
Again, the final price points in the various graphs reflect the closing or late-day New York quotes of Thursday, July 5, 2018, unless indicated otherwise.

[Graphs HW-7 to HW-13 begin on the next page.]

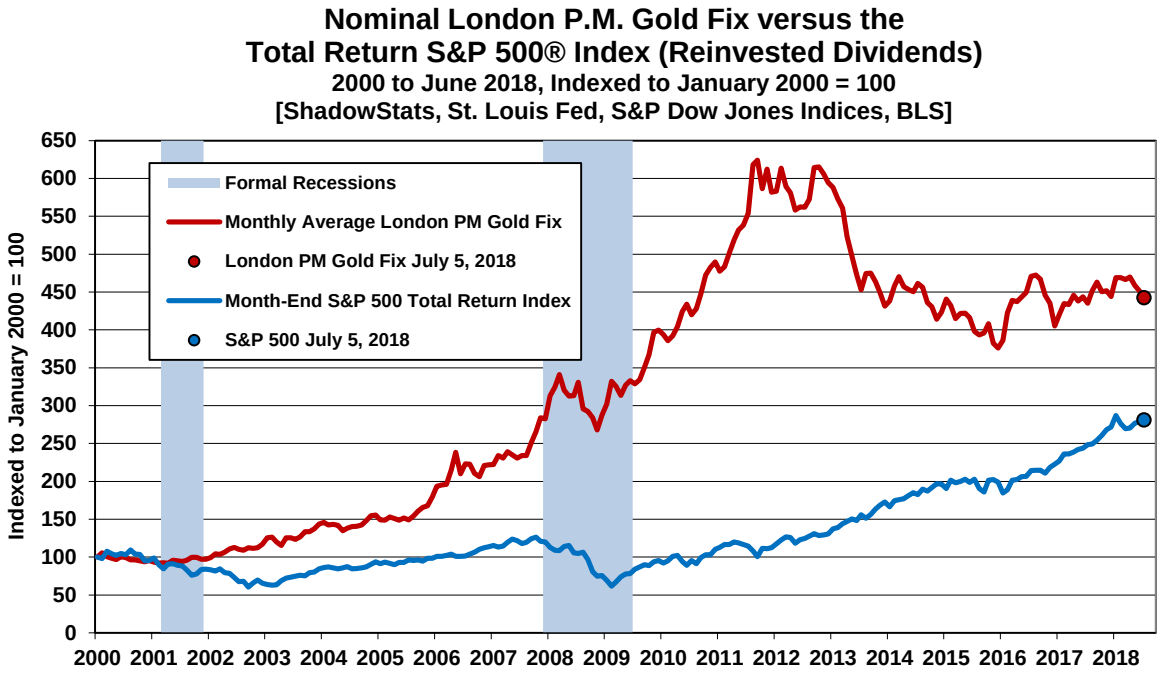
Graph HW-7: Financial- versus Trade-Weighted U.S. Dollar



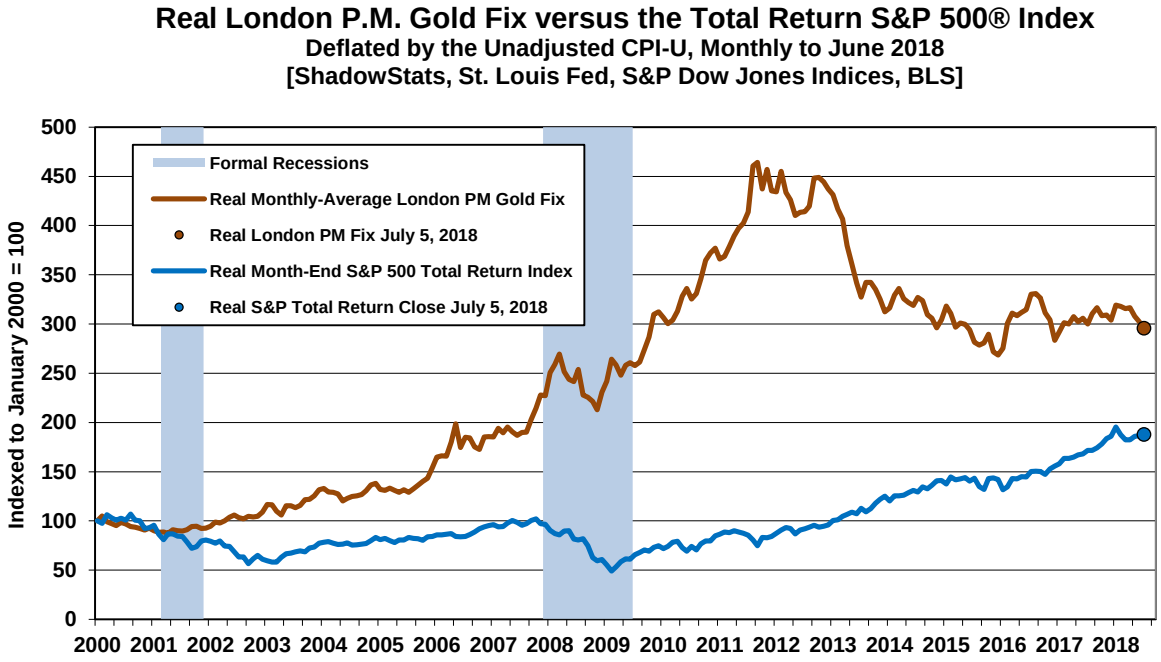
Graph HW-8: Year-to-Year Change, Financial- versus Trade-Weighted U.S. Dollar



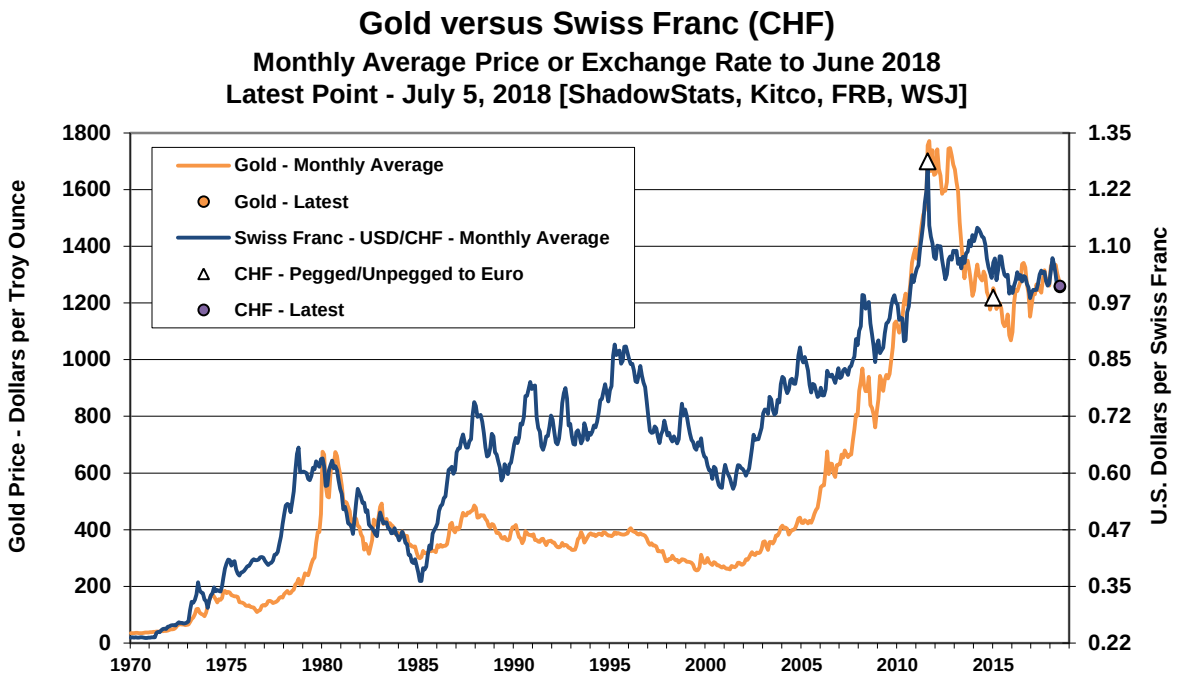
Graph HW-9: Nominal Gold versus the Nominal Total Return S&P 500



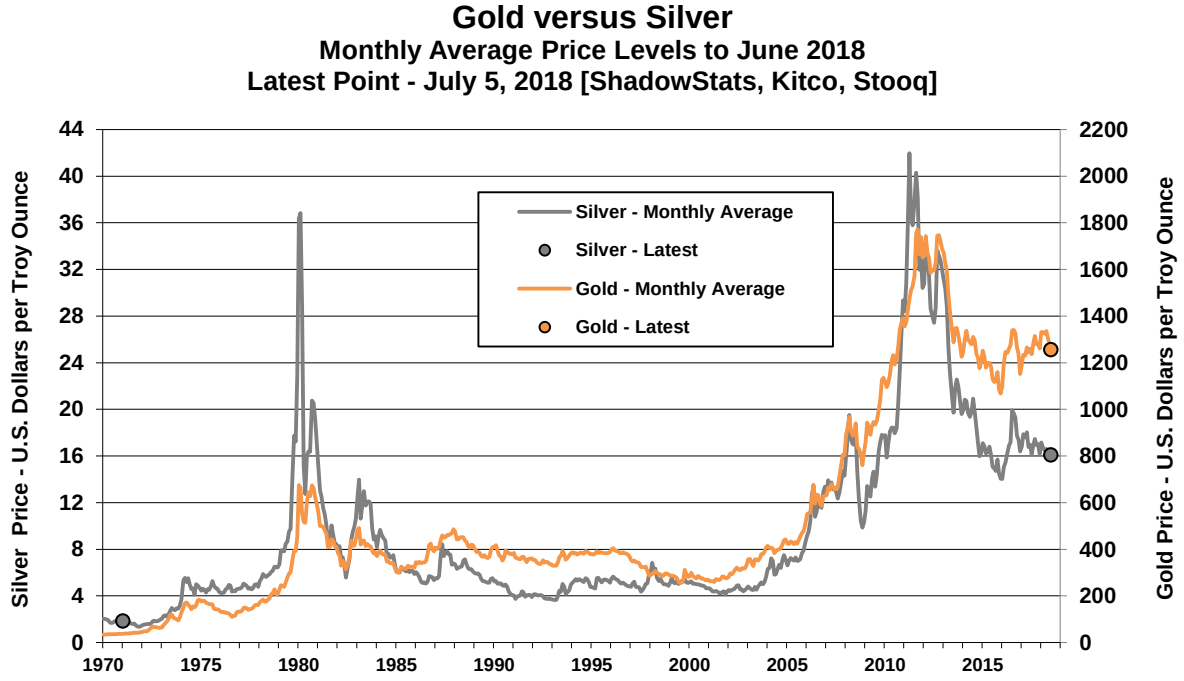
Graph HW-10: Real Gold versus the Real Total Return S&P 500



Graph HW-11: Gold versus the Swiss Franc



Graph HW-12: Gold versus Silver



Graph HW-13: Gold versus Oil