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

HYPERINFLATION WATCH - NUMBER 3

August 12, 2018

Benchmarked Velocity of Money Is on the Rise

Annual Growth in July 2018 Monetary Base and Money Supply Weakened, as the FOMC Squeezed Liquidity Out of a Possible, Nascent Economic Recovery

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PLEASE NOTE: ShadowStats *Hyperinflation Watch (HW)* updates are advised by e-mail and also are available directly at www.ShadowStats.com or by link from subsequent regular *Commentaries*. Sections *"Updated"* from the prior *Watch* are so noted in the *Contents* and in the text.

Updates follow as new details become available or as coverage is expanded to encompass new measures and approaches reflecting financial-system stability and federal-government, financial-market and consumer-liquidity conditions.

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 (August 12th) ***Hyperinflation Watch*** covers current monetary and financial conditions, updated for the latest detail and circumstances where indicated.

Contents – Hyperinflation Watch No. 3 Major Sections and Graphs

U.S. MONETARY AND FINANCIAL-MARKET CONDITIONS

Updated - OPENING COMMENTS

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

Minimally Updated: **Hyperinflation Watch August 2018.** The ShadowStats' *Hyperinflation Watch* section has evolved over the years, in context of an inevitable hyperinflation—full debasement—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 likely will be set off much 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 to the point in time is described and linked at the end of the *Definitions and Background* section in *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 in these standalone *Hyperinflation Watches* brings together the various Money Supply measures previously covered in the regular *ShadowStats 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.

Updated – JULY 2018 MONETARY CIRCUMSTANCES

Federal Reserve Chairman Jerome Powell's Congressional Testimony Reviewed a Strong Economy, Moderate Inflation and Further Rate Hikes, but Watch Out for "Unexpected" Economic Slowing. Interest rate hikes by the Federal Reserve Board's Federal Open Market Committee (FOMC) commonly are referred to as "tightenings," as in tightening liquidity, both systemic and consumer, and further rate hikes were promised by Fed Chairman Powell in his recent Humphrey-Hawkins Testimony before Congress. He also allowed for some increased accommodation, if activity should slow, a circumstance that ShadowStats views as most likely.

Systemic liquidity is tightened by FOMC actions by reducing growth in the Monetary Base and the domestic money supply. For consumers, liquidity conditions are exacerbated not only by Fed policy at present, but also by distorted oil-price-driven rising inflation—inflation that is not accompanied by the positive elements of strong economic growth. Negative liquidity stresses on the U.S. consumer flow through to the consumer-dependent domestic economic system (see *Consumer Liquidity Watch – No. 4* and as discussed in *Commentary No. 960*). *Commentary No. 959-B* discussed circumstances suggestive of the why the recent low level of headline U.3 unemployment was a sign neither of a booming nor of a healthy economy, while *Commentary No. 963* discussed how the broad economy appeared to be off bottom, growing quarter-to-quarter and year-to-year since early 2017, yet still well shy of a formal recovery from the economic collapse into 2009.

Killing a Nascent Economic Recovery. Today's (August 12th) *Commentary No. 965* reviews tightening liquidity conditions due both to FOMC activity and to sharply rising inflation, which again is driven by oil-price distortions, not by an overheated economic expansion. With the Federal Reserve's targeted "Core" annual inflation rate just having hit a 10-year high in July 2018, and given the headline 4.1% growth boom in GDP, Federal Reserve tightening likely will intensify in the months ahead, if the FOMC's interest-rate hawks get their way. Such likely would kill any a potential or nascent economic recovery and would throw the U.S. domestic financial system and financial markets into renewed turmoil, as discussed in the later *FOMC, the U.S. Dollar and Financial Markets* section.

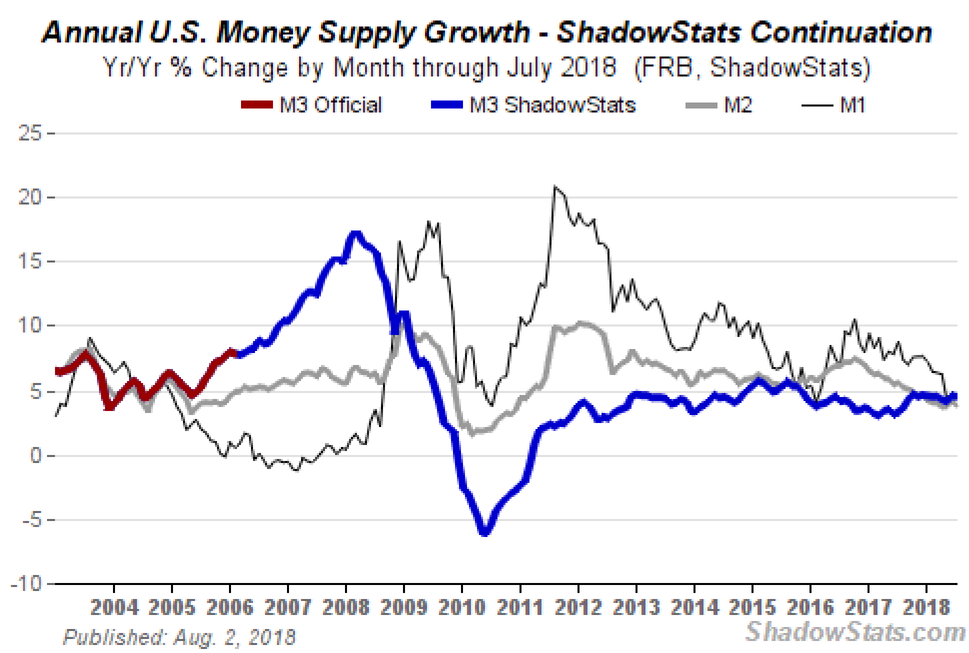
Chairman Powell Allowed for the Possibility of Shift to More-Accommodative Monetary Policy. Where the economy is not as strong as hyped or headlined, the Fed most likely recognizes that, internally, and Chairman Powell also has indicated that he remains open to shifting policy, when the headline economy slows. Where the Fed and the banking system very much would like to see higher interest rates, the economy indeed is slowing anew, as should be increasingly obvious in better-quality economic releases of the month or two ahead. The banking system remains far from normal or "pre-crisis" conditions. As liquidity stresses on the banking system intensify from the weakening economy, that should be enough to have the Fed pull the trigger on altering policy. Intensifying liquidity stresses on Main Street U.S.A., by itself, does not appear to be enough to trigger FOMC action. Circumstances have to begin to threaten ever-fragile, banking-system solvency, before FOMC action is taken.

Some systemic-liquidity specifics are reviewed in the *FOMC, the U.S. Dollar and the Financial Markets* section. The July 2018 Money Supply and Monetary Base measures reviewed here, generally show already-intensifying liquidity pressures as created by the FOMC.

Updated: July 2018 Money Supply and the Monetary Base

Annual Growth Rates in the Money Supply and the Monetary Base Are Slowing or Deepening in Downturn. Annual growth in Money Supply M1, M2 and the ShadowStats Ongoing Estimate of M3 are slowing anew, based on detail reported August 2nd by the Federal Reserve Board. The Saint Louis Fed's Adjusted Monetary Base estimate, where the Monetary Base traditionally has been the FOMC's tool for targeting growth in the Money Supply (and inflation and economic activity) also was released then for the two-week period ended August 1st. It showed a deepening annual contraction.

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



Money Supply M1, M2 and M3 in July 2018. Reflected in *Graph HW-1*, and detailed on the Alternate Data tab of www.ShadowStats.com, monthly average annual growth in July 2018 M3 dropped a notch to 4.49%, from a near-term peak of 4.57% in June 2018, yet July 2018 M2 annual growth just slowed to 3.91%, its lowest level since December 2010, while M1 July 2018 annual growth just slowed to 3.88%, its lowest level since June 2008 (M2 includes M1; M3 includes M2, see the *Money Supply Special Report* for full definitions of those measures).

Fed Policy Actions Have Moved Towards Restraining Headline Economic Activity. Before any consideration for inflation, nominal 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, with inflation continuing to rise in June and July 2018. Where the annual growth in M1, M2 and particularly M3 jumped in June, they did not jump by enough to offset inflation meaningfully. 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.

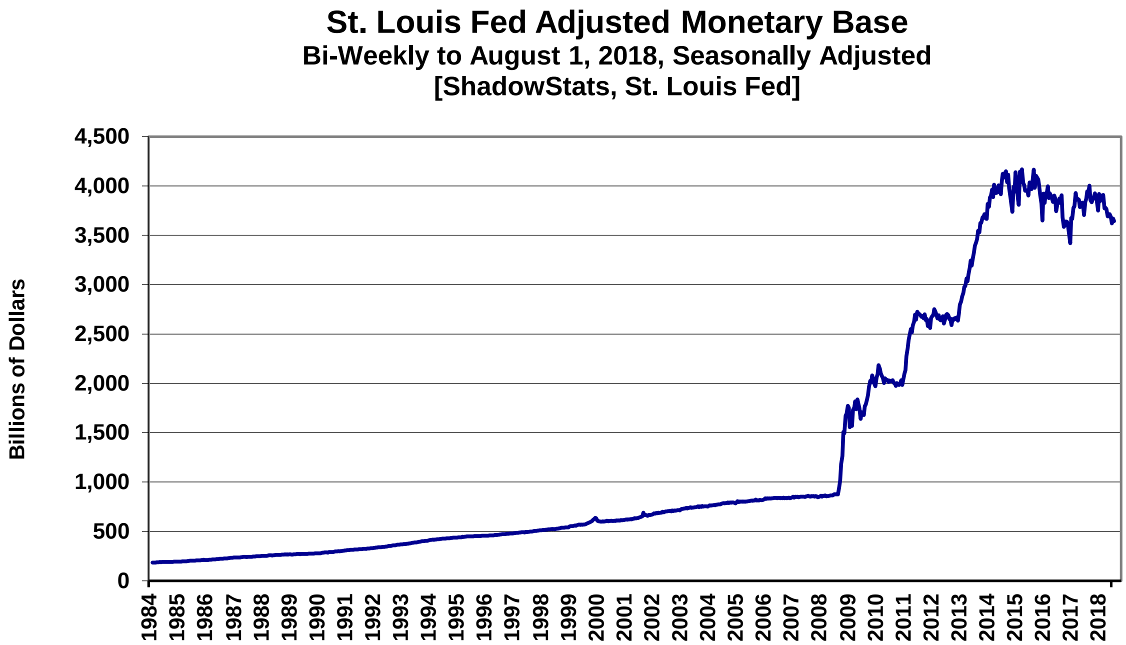
The previous relative weakness in annual M3 growth, versus M2 and M1 (M2 includes M1; M3 includes M2) had reflected a shift over time in funds from accounts included just in M3, such as large time deposits and institutional money funds, into accounts in M2 and M1. The recent relative strength in annual 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 reflect and/or will tend still to induce softening business activity, particularly net of inflation consideration. The latest estimates of level and annual changes for July 2018 M3, M2 and M1, and for earlier periods are detailed in the Alternate Data tab of www.ShadowStats.com, with the plot of nominal year-to-year change shown in *Graph HW-1*. See the *Money Supply Special Report* for full definitions of those money supply measures.

Annual Growth in the Saint Louis Fed's Adjusted Monetary Based Is Down 5.9% (-5.9%) Year-to-Year, Its Fifth Consecutive Monthly Year-to-Year Decline. For the two weeks ended August 1st, the Saint Louis Fed's Monetary Base was down year-to-year by 5.92% (-5.92%), its steepest annual decline since January 2017, and a solid indicator of the Federal Reserve Board's Federal Open Market Committee (FOMC) continuing actions to tighten domestic liquidity. The headline Money Supply measures and headline, inflation-adjusted real U.S. economic measures likely will follow in downturn (see *Graphs HW-2* and *HW-3*).

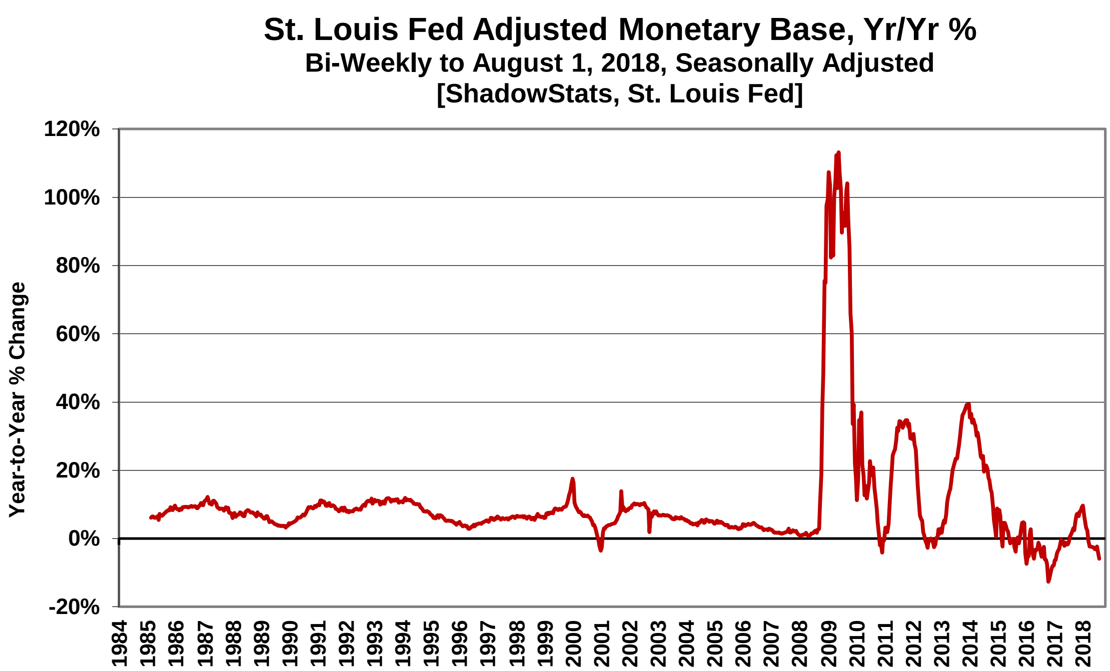
In the wake of near-term volatility surrounding recent rate hikes by the FOMC, and the related market efforts by New York Fed to establish or stabilize a consistent trading-range activity for the targeted federal funds rate, the level of the monetary base had been reasonably stable, with annual percentage change fluctuating around zero. The benchmark was structured so that monthly levels changed, but not the annual growth rates in recent years. Yet, 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 25th, down year-to-year by 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, down in the July 4th period by 2.3% (-2.3%) and now down by 5.9% (-5.9%) in the August 1st period, the steepest annual decline since the two weeks end January 18, 2017, as the government was transitioning from the Obama Administration to the Trump Administration. Accompanying *Graphs HW-2* and *HW-3,* reflect that detail.

Graph HW-2: Saint Louis Fed Monetary Base, Billions of Dollars (1984 to August 1, 2018)



Graph HW-3: Year-to-Year Percent Change, Saint Louis Fed Monetary Base (1985 to August 1, 2018)



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.

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-month jump in annual M2 and M3 money growth in June. Intended negative economic consequences already have started to flow, as discussed in the opening of the *FOMC, the U.S. Dollar and the Financial Markets* section.

Updated: Real Annual Growth in M3 as a Leading Indicator to GDP

A Leading Indicator to Broad Economic Activity, Inflation-Adjusted Money Supply M3—July 2018—Annual Change Moved Back Towards Its Thirteen-Month Low. Annual growth in nominal July 2018 M3 notched lower to 4.49%, versus 4.57% in June 2018 and up from 4.10% in May 2018. At the same time, year-to-year change in the July 2018 CPI-U increased to 2.95%, from 2.87% in June 2018 and 2.80% in May 2018, which minimally muted the increase in real annual M3 growth to 1.54% in July 2018, versus 1.69% in June 2018 and 1.30% in May 2018. The May reading was the weakest since April 2017. Other than for May 2018, July 2018 annual growth was the softest since June 2017.

On a quarterly basis, second-quarter 2018 annual real growth in Money Supply M3 stood at 1.60%, the weakest since 1.44% in second-quarter 2017 and then 0.66% in first-quarter 2017, which was the weakest seen since a long series of outright monthly year-to-year contractions throughout 2010 and 2011.

Discussed in the *CPI Section* of *Commentary No. 965*, 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 over a 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 (FOMC) began more-aggressive tightening in December. 2017. The previous recession signal of December 2009 had remained in place, despite real annual M3 growth having rallied into positive territory post-2011.

[Note: If realistic, not headline, inflation numbers were used here, there would be no question of an ongoing negative real annual growth in M3, or a renewed deepening of the economic collapse into 2009, as discussed in *Commentary No. 957* and *Public Commentary on Inflation Measurement*.]

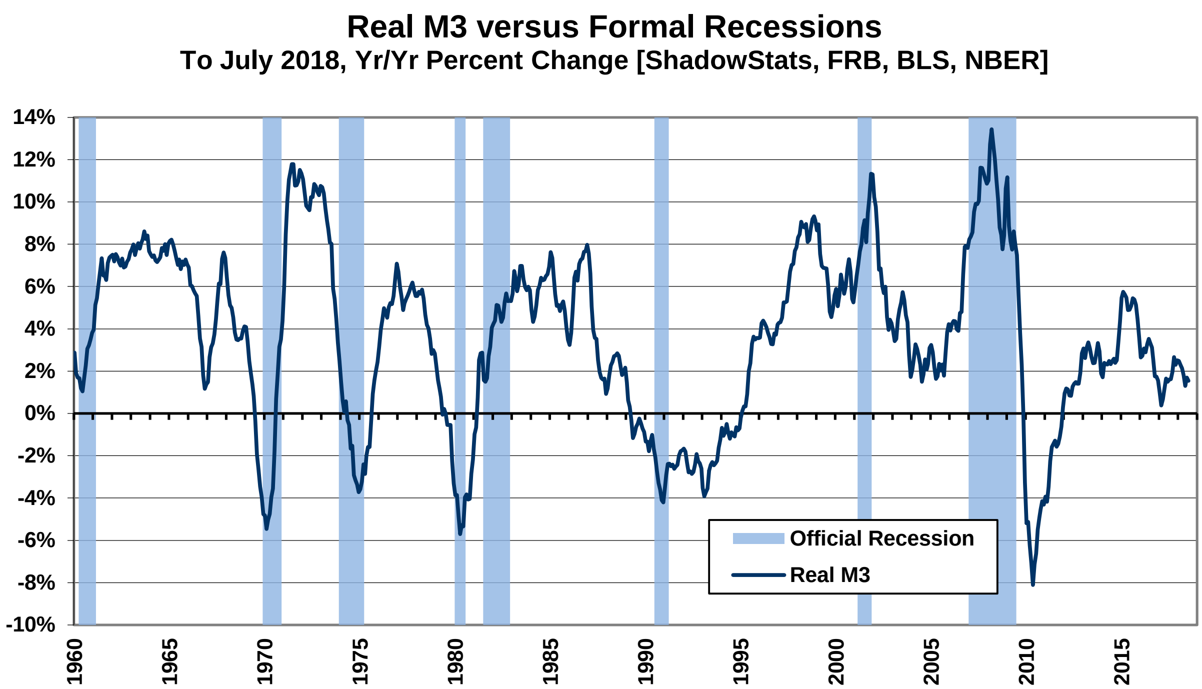
FOMC Policy Is Setting Up a Formal, "New" Economic Downturn. A formal recession signal from low-level or negative annual real money supply growth has become increasingly likely in the near term.

That reflects a continued, general weakening trend in nominal annual M3 growth, driven by FOMC policy, in combination with a continued pick-up in annual CPI inflation. Headline inflation generally has surged, recently, driven by unstable political/supply conditions in the oil markets, not by an overheating U.S. economy, as the FOMC tends to tout.

Shown in *Graph HW-4*, based on July 2018 CPI-U reporting and the recent money supply benchmark revisions, the ShadowStats-Ongoing M3 Estimate of annual inflation-adjusted growth in July 2018 M3 was 1.54%, down from 1.69% in June 2018, versus 1.30% in May 2018. That was against 1.79% in April 2018 and annual growth rates of 2.14% in March 2018, 2.30% in February 2018 and 2.49% in January 2018. Those patterns broadly have reflected successive, downside benchmark revisions to the Federal Reserve's money measures, again, versus upside movement in annual CPI-U inflation. Those levels of activity were against a near-term peak growth of 2.66% in October 2017, and against the February 2015 and cycle-high peak growth of 5.74%.

Again, as noted in the opening paragraph of this section, second-quarter 2018 annual real growth in Money Supply M3 stood at 1.66%, its weakest showing in a year, having slowed from 2.31% in first-quarter 2018 activity.

Graph HW-4: Real Annual M3 Growth versus Formal Recessions (1960 to July 2018)
(Updated same as Graph 5 of Commentary No. 965)



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. The signal for a downturn or an intensified downturn in economic activity 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 the *Opening Comments* of *Commentary No. 963*. 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. 963*).

Updated: Velocity of Money

Second-Quarter 2018 Velocity of Money Turned Higher Across-the-Board, for Money Supply M1, M2 and M3, in a Manner Not Seen Since the Economy Bottomed in 2009. [This section incorporates the 2018 Comprehensive Benchmark Revisions to Gross Domestic Product (GDP) back to 1929, as well as initial reporting of Second-Quarter 2018 GDP, and recent benchmark revisions to the Money Supply data. Only quarterly data from 1959-on are used, where that is the starting point of consistent, historical estimates of Money Supply M1, M2 and M3. Where the Federal Reserve ceased publishing its M3 measure in 2006, ShadowStats began publishing a continuing M3 estimate based as closely as possible on the Federal Reserve definitions. This Velocity of Money analysis is updated from coverage of the pre-benchmarked "advance" estimate of First-Quarter 2018 GDP reviewed in *Hyperinflation Watch – No. 2*.]

Reflecting the headline spike in nominal second-quarter GDP, annual GDP benchmark revisions and recent benchmark revisions and weakening annual growth in the headline money supply measures, the second-quarter 2018 Velocity of Money increased for Money Supply M1, M2 and M3. All velocity measures turned higher in a manner not seen since bottoming of the economic collapse in 2009, as reflected in *Graphs HW-5* and *HW-6*. Velocity is a measure of how many times the money supply turns over in a year, versus the broad economy (GDP). The higher the velocity, usually the higher the pace of inflation and often the level of economic activity.

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.

Both before and after the various recent benchmark revisions, 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 recently in the broader measures in fourth-quarter 2017 and first-quarter 2018.

Consider that perhaps 70% or more of the cash-in-circulation component of that M1 (with cash accounting for about 43.3% 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 11.2% of M2 and 8.4% of M3).

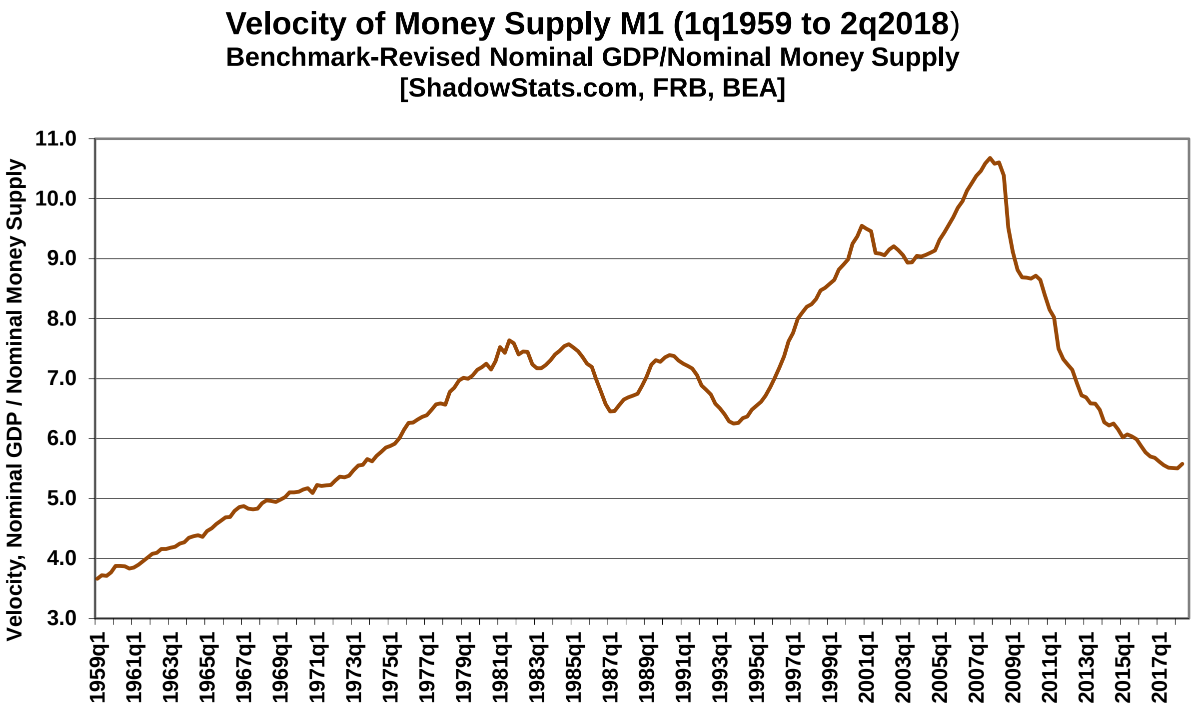
M3, versus M1 and M2, had been showing opposite patterns since 2011, because growth in M3 had been weaker than growth in M1 and M2, a pattern that had intensified. The reason behind that difference was that much of the relatively stronger M1 and M2 growth reflected cash moving out of M3 categories—such 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 annual growth rates, in tandem.

Subscribers often ask for specifics on the velocity of the money supply, with the result that this section has become a standard feature for *Hyperinflation Watches* and *Commentaries* covering the "advance" GDP reporting of a given quarter. 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.

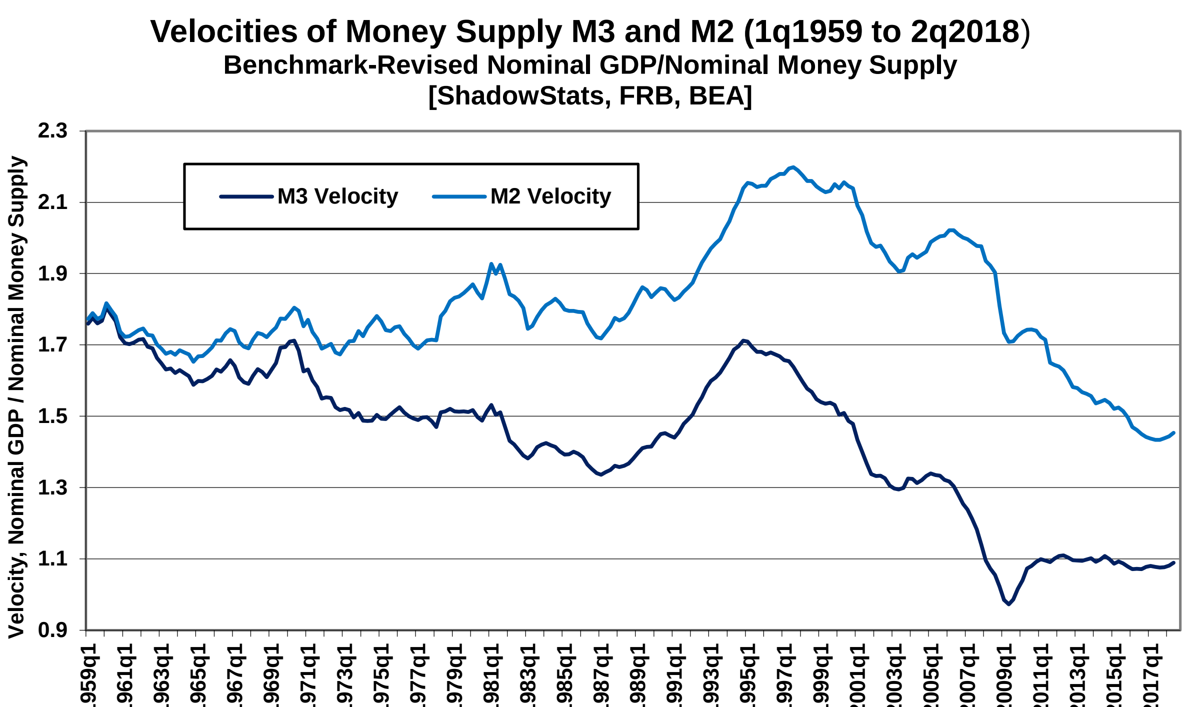
Velocity has theoretical significance. In combination with money-supply growth, it should be a driving force behind inflation. Yet, since velocity is a ratio of two not-particularly-well or realistically-measured numbers, its actual estimate is of limited value. As an inflation predictor, it has to be 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 July 2018 discussed here and in the earlier *Money Supply* section, detailed on the Alternate Data tab of www.ShadowStats.com.

[Graphs HW-5 and HW-6 follow on the next page.]

Graph HW-5: Velocity of Money Supply M1 through 2q2018 ("Advance" 2q2018 GDP and Benchmarking)



Graph HW-6: Velocities of Money Supply M2 and M3 to 2q2018 ("Advance" 2q2018 GDP and Benchmarking)



Updated - FOMC, THE U.S. DOLLAR AND FINANCIAL MARKETS

Promising Further Rate Hikes, the Fed Still Cannot Escape from the Panic of 2008

Intended Consequences: Beware "Unexpected" Economic Weakness and FOMC Policy Change! [Portions of this section are repeated from *Hyperinflation Watch - No. 1*, *Hyperinflation Watch – No. 2* and *Hyperinflation Watches* of earlier *Commentaries*.] Discussed in *Commentary No. 959-B*, despite the 49-year-low unemployment rate in May 2018 and some up and down bouncing in June and July 2018, underlying labor-market stresses continued and weak annual growth in payroll employment signaled economic trouble ahead. Private surveying of jobs-market conditions (the Conference Board's Help-Wanted Online Index™, HWOL), Real Median Household Income, Real Average Weekly Earnings and Real Consumer Credit Outstanding also suggest that recent headline, economic strength has not been as advertised.

Economic reporting in the week and weeks ahead likely will disappoint consensus expectations. At the same time, consider seriously-conflicting policy issues for the Federal Open Market Committee (FOMC) of the Board of Governors of the Federal Reserve System. While overseeing tightening systemic liquidity at a "moderate" pace, Federal Reserve Chairman Jerome Powell also has a primary responsibility to maintain banking-system solvency/liquidity.

Yet, the current tightening in monetary policy threatens to damage, or to exacerbate, underlying weakness in major sectors of U.S. economy (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 anew.

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 within the year, to revert again towards expanded quantitative easing, as openly allowed for in 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. Banking-system liquidity and solvency remain the dominant policy consideration of the FOMC, not the headlined "maintaining relative strength of the economy." That has been demonstrated frequently from the 2008-banking crisis to date.

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 of economic series, excepting the recent GDP benchmarking (see *Commentary No. 954*, for example).

Shifting Global Interest-Rate and Global-Political-Stability 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 has 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; more will follow per Federal Reserve Chairman Powell, as reinforced by the surging headline GDP numbers and the 10-year high level of the Fed's targeted "Core" inflation rate (see today's *Commentary No. 965*). Yet, from the consumer's standpoint, the headline inflation that is impairing areas such as real earnings has been driven by commodity price distortions, not by strong, underlying economic activity, and the FOMC knows that.

In such a circumstance, where rising inflation is not offset by consumer liquidity gains, such as rising income, then broad 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 as discussed in *Commentary No. 960*.

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 and July (see *Graphs HW-7* and *HW-8*) where annual change in the Trade Weighted Dollar has pushed into positive territory as of current reporting.

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 again should bring the Fed around to reversing policy, re-embracing quantitative easing. In turn, 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.

Some of the issues here have been slower to break than expected by ShadowStats, but they all remain in play. Issues and 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 updated in *Consumer Liquidity Watch – No. 4*.
- Headline economic reporting of July, August and September data increasingly should disappoint expectations, weakening the broad consensus outlook on U.S. economic conditions.
- Those factors combined could be enough to start moving financial-market expectations rapidly towards a possible easing shift in FOMC monetary policy.
- 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 standard *Hyperinflation Watch 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 U.S. Treasury bonds.

Watch Out for the U.S. Dollar! Despite the heavily gimmicked headline GDP boom, the real-world U.S. economy is not recovering or booming as advertised, despite heavy hype in the press of a full-employment economy, and in the context of continued FOMC tightening actions. Watch headline details in the weeks ahead!

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, Protecting the Purchasing Power of One's Wealth and Assets. The increasing, fundamental disconnection between the happy hype in the media, the financial markets and from the FOMC 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 eventually should be forced to 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. Recent weakness in precious metals prices and relative strength in the U.S. dollar should prove to be fleeting in the weeks ahead.

Holdings of 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 August 10th.

U.S. Dollar, Some Near-Term Strength but Beware! *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. Current relative strength in the U.S. dollar broadly reflects a flight to "safety," in the context of deteriorating global political circumstances.

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.

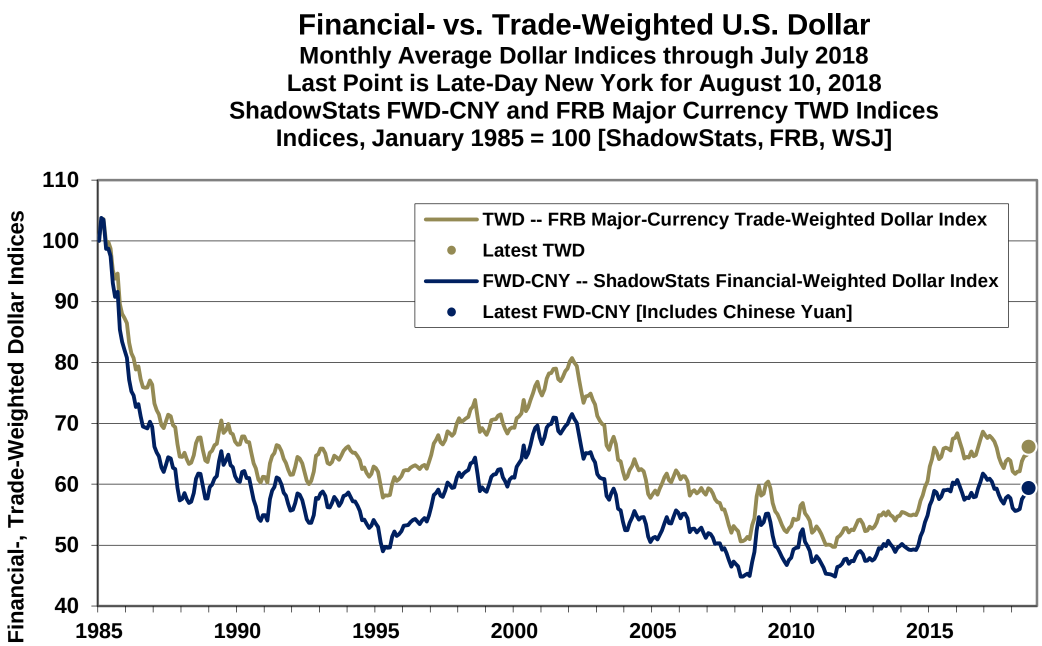
Gold and Silver, and Gold versus Stocks. *Graphs HW-9* and *HW-10* show plots of the price level of the S&P 500 Total Return Index (all dividends reinvested) versus the price of physical gold, with both series indexed to January 2000 =100, with the first plot showing both series in nominal terms and 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).

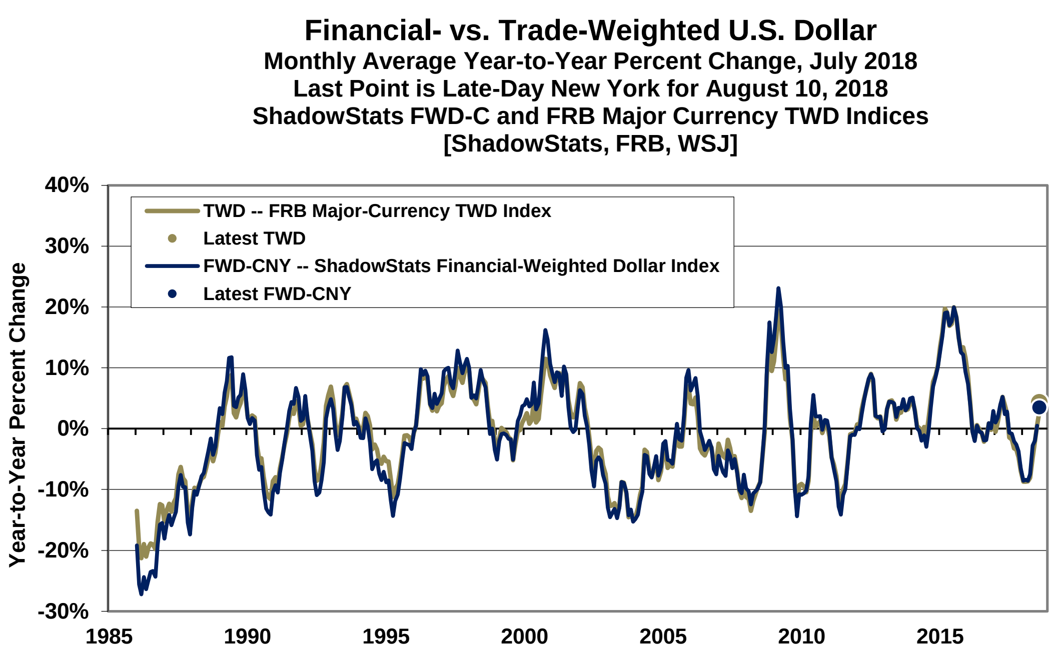
Again, the final price points in the various graphs reflect the closing or late-day New York quotes of Friday, August 10, 2018, unless indicated otherwise.

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

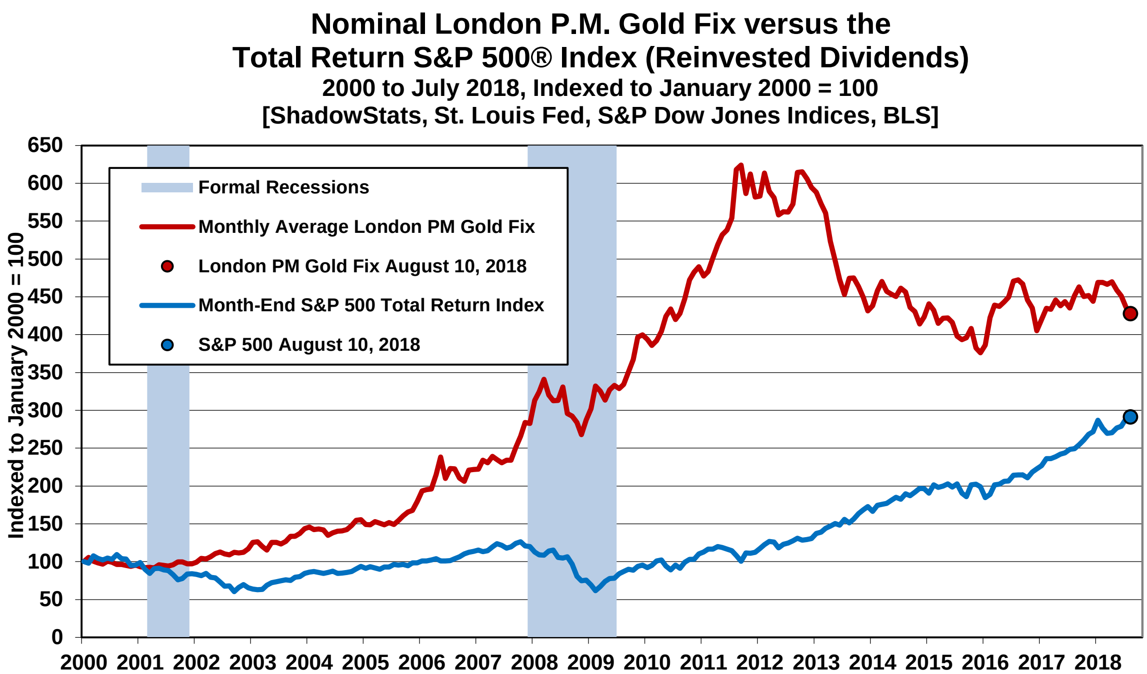
Graph HW-7: Financial- versus Trade-Weighted U.S. Dollar



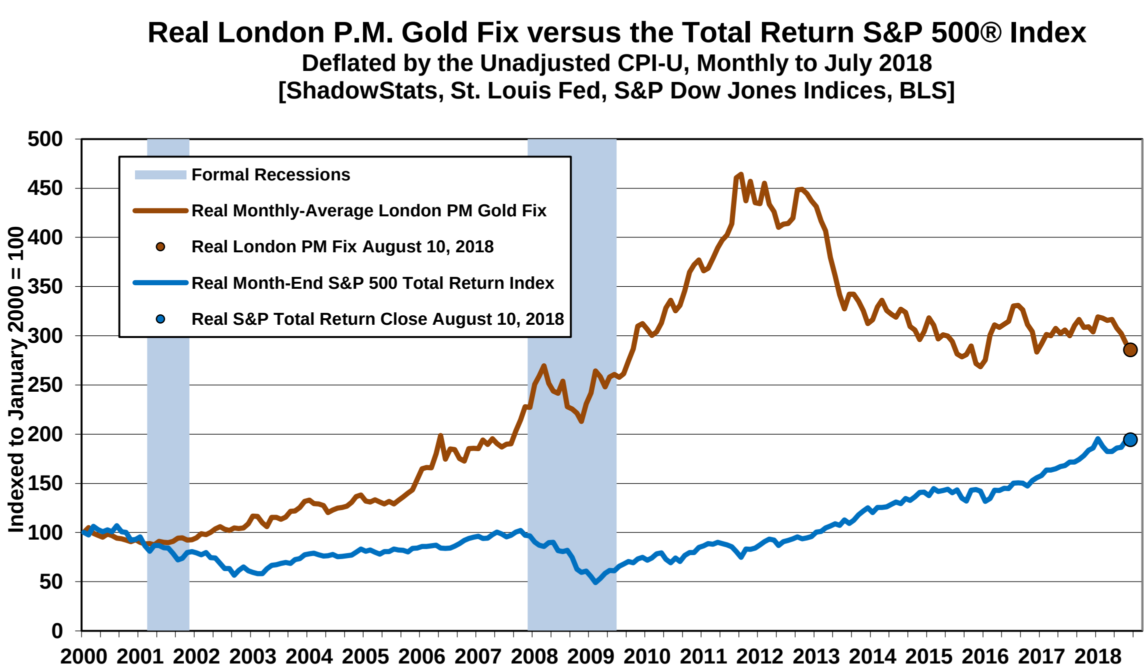
Graph HW-8: Year-to-Year Change, Financial- versus Trade-Weighted U.S. Dollar



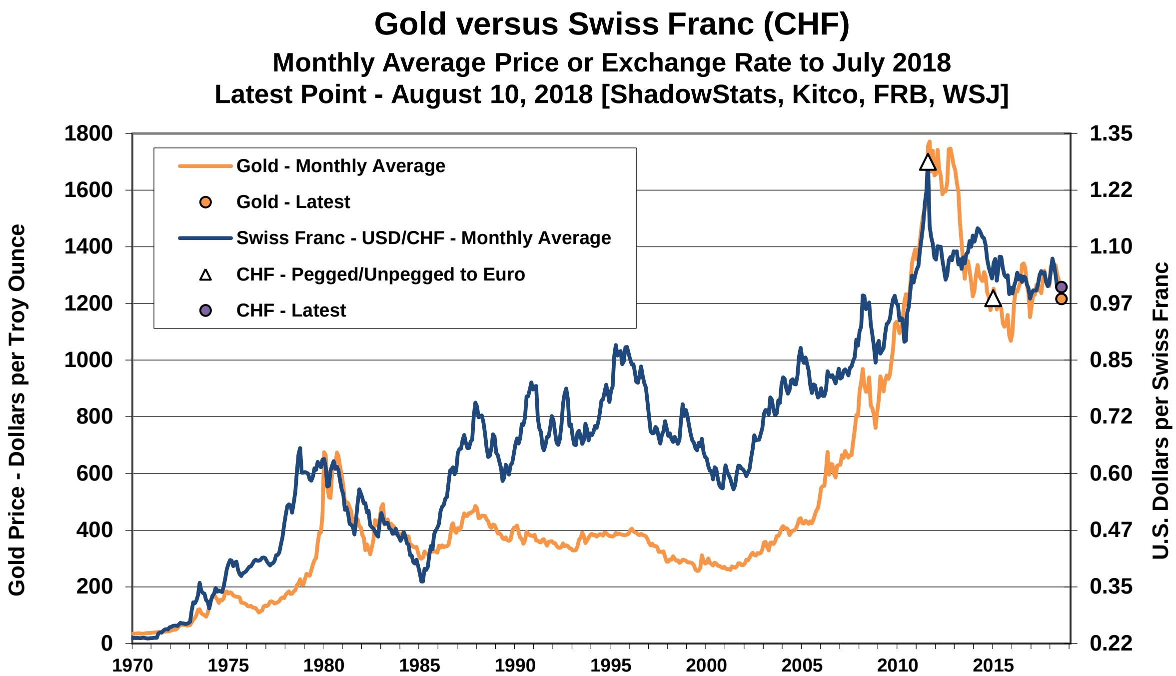
Graph HW-9: Nominal Gold versus the Nominal Total Return S&P 500



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