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

Issue Number 40

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Irrespective of Any Looming Central Bank or Central Government Interventions or Other Activity, the Financial-Economic-Systemic Crisis Is Going to Get Much Worse

Fed Abandons Inflation Fight

Depression or Recession Depends on Depth of Downturn

Gold Buying and Dollar Selling Muted by Covert Intervention?

OVERVIEW -- OPENING COMMENTS

The systemic solvency/liquidity crisis has intensified at an accelerating pace, with three major, emergency Federal Reserve actions seen in the eight days through Friday. As we go to press Sunday afternoon, no new actions have been announced, but circumstances are so unstable that most anything is possible, including massive interventions in the markets as well as unconventional actions by central banks or central governments, coordinated or otherwise. *Flash Updates* or *Alerts* will be posted as needed to address developments.

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.

Regardless of any official actions, the broad, long-range outlook for a deepening inflationary recession -- one that eventually will become a hyperinflationary depression -- remains in place, along with a long-range outlook for continued heavy selling of the U.S. dollar and strong buying of gold, a severe bear market in equities, and a spike in long-term U.S. Treasury yields as dollar dumping ultimately turns to flight-to-safety outside the U.S. dollar.

On the economic and inflation fronts, the data are showing a consistent picture of a deepening contraction in business activity, and -- with the exception of February's fudged "no inflation" report -- a consistent pattern of rapidly mounting inflationary pressures.

And the Money Keeps Rolling Out in All Directions. Looking to Tuesday's (March 18th) regularly scheduled Federal Open Market Committee (FOMC) meeting, market participants anticipate a 50 to 100 basis-point (0.50% to 1.00%) rate cut in the targeted fed funds rate to 2.50% to 2.00%. Such is not in spite of the Fed's recent emergency actions, but largely because the Fed's panic suggests the severity of the deepening problems within the banking system. Again, the current circumstance is highly volatile.

Going back to Friday, March 14th, per the Federal Reserve Board, "The Federal Reserve is monitoring market developments closely and will continue to provide liquidity as necessary to promote the orderly functioning of the financial system. The Board voted unanimously to approve the arrangement announced by JPMorgan Chase and Bear Stearns this morning."

Thus, through the New York Federal Reserve Bank's discount window, money was lent to JPMorgan Chase to bailout Bear Stearns, which otherwise was on the verge of collapse.

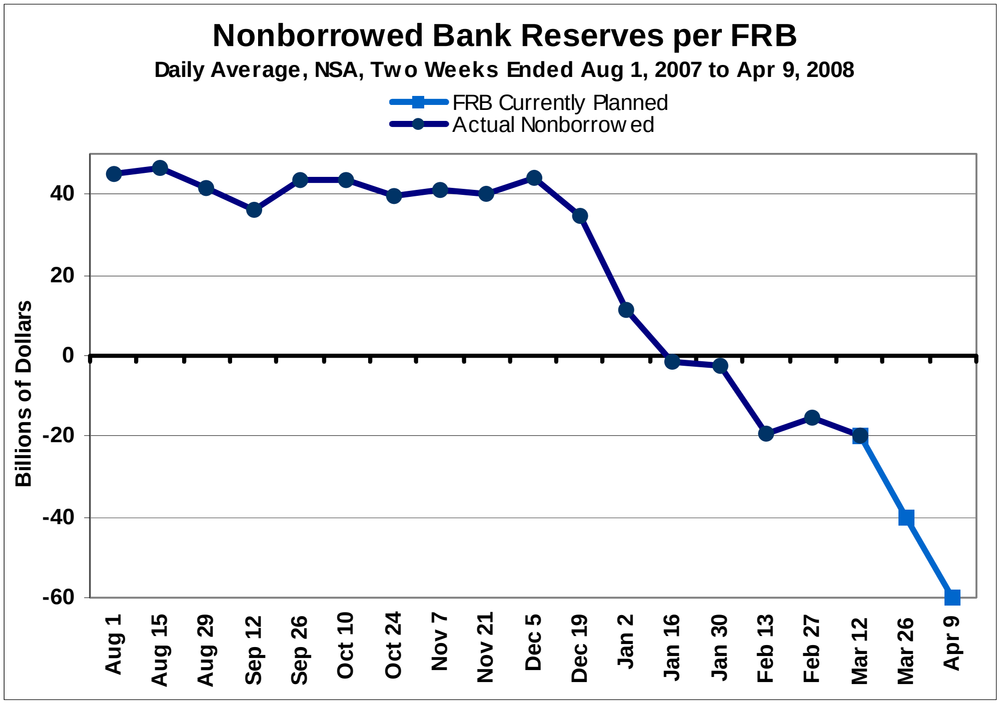
Further back, on Tuesday, March 12th, the Fed announced the creation of a Term Securities Lending Facility (TSLF), which would lend up to $200 billion of Treasury securities to primary dealers on term basis, and which would accept otherwise illiquid mortgage-backed securities as collateral. The Fed also increased its existing currency swap lines with the European Central Bank and the Swiss National Bank.

That action followed the announcement on Friday, March 7th, that the Fed was increasing the size of the Term Auction Facility (TAF) at its discount window for troubled banks to $100 billion from $60 billion. The Fed also promised a further $100 billion in emergency funding in the form of term repos, which could be structured against otherwise illiquid mortgage-backed securities.

As shown in the accompanying graph, nonborrowed bank reserves had dropped to roughly a negative $20 billion as of the last reporting. Assuming that total bank reserves hold in the low $40 billion range over the next several weeks, nonborrowed bank reserves would drop to roughly a negative $60 billion by April 9th, given the currently announced size of the TAF auctions. Such reflects neither the $100 billion term repos, nor the $200 billion in TSLF lending, which are not counted as borrowed reserves.

On the other hand, the bailout funding for Bear Stearns puportedly was made through the discount window, which would further increase the magnitude of the negative nonborrowed reserves by the cost of that bailout. Those numbers are not reflected in the nonborrowed reserve graph, but the amount should be reflected in the numbers for the two weeks ended March 26th, to the extent the lending remains on the Fed's books.

As evidenced now by two months of subsequent reporting, money supply growth has surged to a record high in conjunction with the TAF facility. What appears to be happening is that the Fed has been accepting otherwise illiquid assets as collateral in its TAF discount window lending, in turn providing troubled banks with needed liquidity. It is not clear that the Fed is fully neutralizing, or that it wants to neutralize fully, the monetary impact of its solvency-crisis lending.


Nonborrowed Bank Reserves per FRB
Daily Average, NSA, Two Weeks Ended Aug 1, 2007 to Apr 9, 2008
FRB Currently Planned
Actual Nonborrowed
Billions of Dollars
40
20
0
-20
-40
-60
Aug 1
Aug 15
Aug 29
Sep 12
Sep 26
Oct 10
Oct 24
Nov 7
Nov 21
Dec 5
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Jan 2
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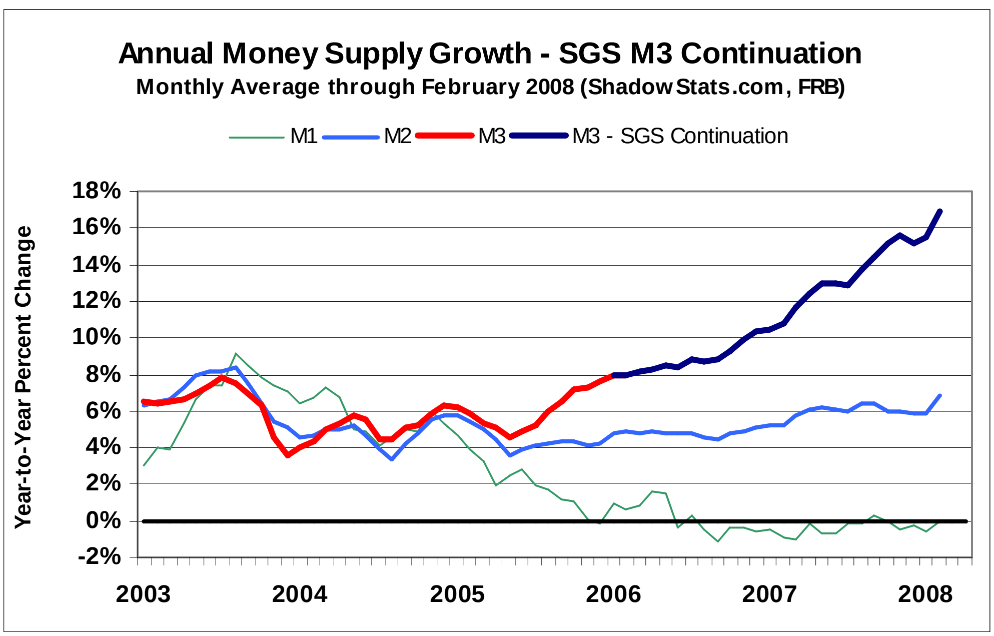
Jan 30
Feb 13
Feb 27
Mar 12
Mar 26
Apr 9


Annual Money Supply Growth - SGS M3 Continuation
Monthly Average through February 2008 (ShadowStats.com, FRB)
M1
M2
M3
M3 - SGS Continuation
Year-to-Year Percent Change
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
-2%
2003
2004
2005
2006
2007
2008

Clearly, the Fed is lending beyond needed reserve levels, taking in illiquid mortgage backed securities and providing liquidity to the banking system for other purposes. Those other purposes are highlighted now by the Bear Stearns bailout. The added funds, as new or refreshed liquidity, have been spiking money supply measures M2 and M3 (the SGS-Ongoing M3 estimate), flowing through in some instances to accounts that have no reserve requirements. One example is the institutional money funds of M3, which stood at over $2.0 trillion in February, up by 50% year-to-year, versus $7.6 trillion in all of M2, which, even at 6.9% annual growth in February, has seen seeing accelerating growth.

M3 Growth at All-Time High. The monthly-average annual growth in the SGS-Ongoing M3 for February was 16.9%, the highest monthly growth rate ever seen for the M3 series (the Federal Reserve's calculation of the broad money measure dates back to January 1959). As shown in the money supply graph, M3 growth dipped in December, when the banking solvency crisis forced the Fed to introduce the TAF. Growth since then has been accelerating and even has been reflected partially in rising M2 growth (see the money supply section for detail).

Monetary Inflation Pressures Will Mount. The prior record monthly annual growth for M3 was 16.4% in June 1971, and the inflation from excessive money creation at the time was a key factor pressuring the greenback, leading up to President Nixon's closing the gold window and imposing wage and price controls in August of that year. The current surge in broad money supply growth has equally ominous implications for monetary inflation and dollar pressures during the next nine to 12 months, well into 2009.

Officially, though, such does not bother the Fed, since it contends that neither M3 growth nor a weak dollar have much to do with inflation. Mr. Greenspan and company concluded back in November 2005 that "M3 does not appear to convey any additional information about economic activity that is not already embodied in M2 and has not played a role in the monetary policy process for many years." Since M3 purportedly had no meaning, its reporting was terminated in March 2006.

Perhaps not too coincidentally, the Fed's announcement of its emergency funding measures on Friday, March 7th, was accompanied by a speech given by Federal Reserve Governor Frederic S. Mishkin concluding that a weak dollar had "fairly small effects on consumer prices." This was despite "Traditional monetary theory regard[ing] excessive money creation as a common source of instability in both the exchange rate and price level. In the presence of large monetary shocks, price inflation and exchange rate depreciation should, therefore, be closely linked."

Mr. Bernanke Abandons the Inflation Fight. Mr. Bernanke and company can ignore such factors as M3 growth and dollar weakness as they rationalize their now aborted inflation fight. Such, however, is intended more as Pablum for Wall Street's spinmeisters to dish out; it does not reflect the real world. I have argued previously that M3, as the broadest money measure at the time of its dismemberment, had (and still has) the best causal and predictive relationship of any of the money measures to inflation (see the August 2006 SGS Newsletter). As to the U.S. dollar, weakness there has a very direct and major impact on commodity price inflation -- particularly oil -- and oil inflation permeates the general economy. Then again, Mr. Bernanke concentrates on "core" inflation measures, net of food and energy costs, another source of Pablum for the markets.

As a separate issue, not too long ago, the debate raging on Wall Street and purportedly at the Fed was whether the Fed should ease to fight recession, or tighten to fight inflation. Not that raising rates would have done much to fight inflation, but the tightening scenario clearly has lost out now, as the Fed largely has given up the pretext of easing to help the economy and instead openly has eased to support the flailing banking system. Faltering broad business activity and rising inflation now are combined into a toxic inflationary-recession that will continue to deepen irrespective of the Fed's activities.

Recession, Depression and Great Depression. "The United States is in a recession that could be 'substantially more severe' than recent ones." So began a March 14th Reuters story quoting National Bureau of Economic Research (NBER) President Martin Feldstein. Feldstein noted, "The situation is very bad, the situation is getting worse ... There is no doubt that this year and next are going to be very difficult years."

The reason I am quoting Feldstein here is that the NBER is the official arbiter of when the United States economy is in recession. His comments were not an official announcement of recession by the NBER's Business Cycle Dating Committee, but they suggest the direction in which the Committee is heading.

With Feldstein raising the prospects that the current downturn could be the worst U.S. recession since the Great Depression -- I fully agree that it will be -- it is worth taking a moment to review definitional differences between a recession, depression and a great depression.

A couple of decades back, I tried to tie down the definitional differences with the Bureau of Economic Analysis (BEA), the NBER and a number of private economists. I found that there was no consensus on the matter, so I set some definitions that the various parties (neither formally nor officially) thought were within reason.

If you look at the plot of the level of economic activity during a downturn, you will see something that looks like bowl, with activity recessing on the downside and recovering on the upside. The term used to describe this bowl-shaped circumstance before World War II was "depression," while the downside portion of the cycle was called "recession." Before World War II, all downturns simply were referred to as depressions. In the wake of the Great Depression of the 1930s, however, a euphemism was sought for future economic contractions so as to avoid evoking memories of that earlier, financially painful time.

Accordingly, a post-World War II downturn was called "recession." Officially, the worst post-World War II recession was from November 1973 through March 1975, with a peak-to-trough contraction of 5%. Such followed the Vietnam War, Nixon's floating of the U.S. dollar and the Oil Embargo. The double-dip recession in the early-1980s may have seen a combined contraction of roughly 6%. I contend that the current double-dip recession that began in late-2000 already is rivaling the 1980s double-dip as to depth. (See the Reporting/Market Focus of the October 2006 SGS for further detail.)

Definitions:

Recession: Two or more consecutive quarters of contracting real (inflation-adjusted) GDP, where the downturn is not triggered by an exogenous factor such as a truckers' strike. The NBER attempts to refine its timing calls, on a monthly basis, through the use of economic series such as payroll employment and industrial production, and it no longer relies on the two quarters of contracting GDP rule.

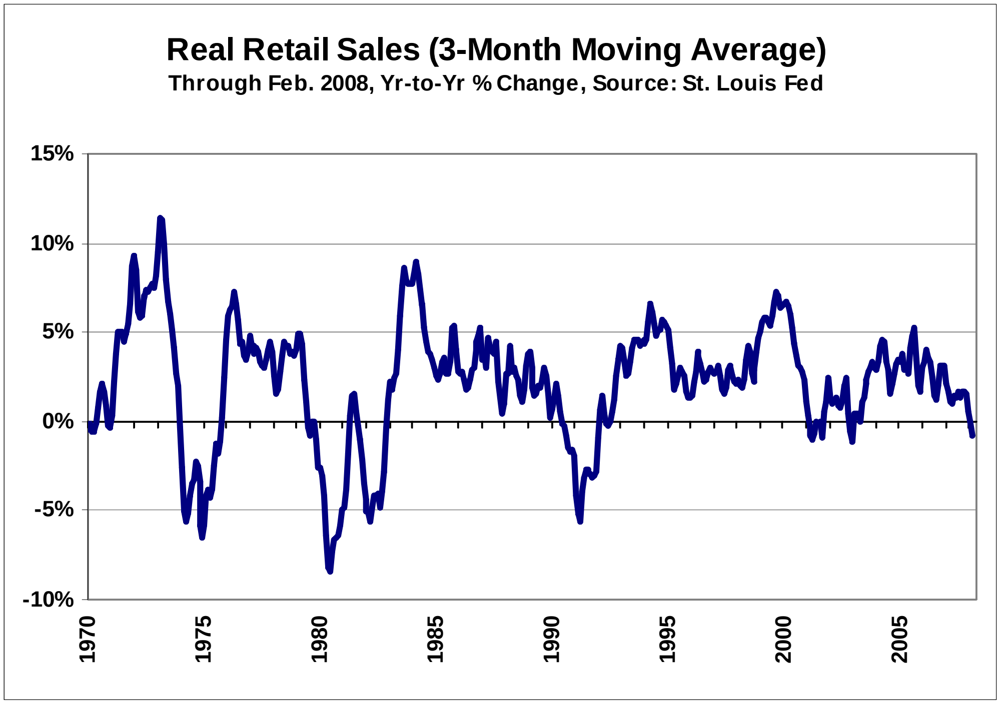
Depression: A recession, where the peak-to-trough contraction in real growth exceeds 10%.

Great Depression: A depression, where the peak-to-trough contraction in real growth exceeds 20%.

Rapid Economic Deterioration in Key Data. Already hammered by an onslaught of negative data, a number of analysts jumped into the recession camp in response to the understated drop in February payrolls. With the jobs report, the Administration almost seems to have thrown in the towel, opting to accept recession recognition. Perhaps there have been lessons learned from when the earlier President Bush declared an end to his recession, only to find that the electorate thought he increasingly was out of touch with reality.

Recession signals in the last month or so continued to come from new orders for durable goods, the purchasing managers surveys, initial claims for unemployment, and help wanted advertising. Hints of recession were even seen in annual declines in tax revenues in the monthly federal budget accounting.

Then there is the consumer. February consumer confidence plummeted deep into recession territory, while the housing market remained in serious trouble and retail sales plunged, both on a monthly and on an annual basis, net of inflation.

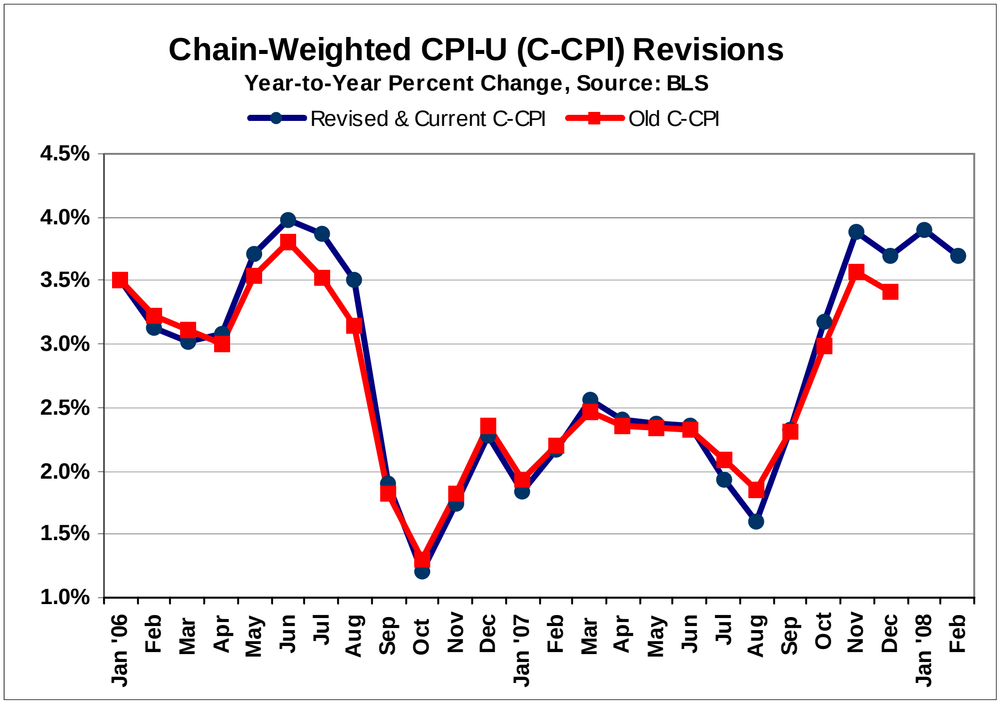


As shown in the accompanying graph, looking at real (inflation-adjusted) year-to-year change in the three-month moving average of retail sales, the current annual contraction has never been seen outside of a full blown recession, with the possible exception of unusual gyrations in annual growth seen in the months following the 9/11 terrorist attacks and the year following.

The outlook for a hyperinflationary-depression, and how the current circumstance likely will evolve into such a circumstance has been discussed in recent newsletters (see the January SGS Newsletter for a discussion of Mr. Bernanke's role and background), detailed in a three-part series that began with the December 2006 SGS, and will be updated and expanded upon shortly in the pending *Hyperinflation Special Issue*, which effectively will supplement the comments in this newsletter.

Inflation Still Shows Mounting Problems Despite Understated February CPI. As discussed in the CPI section, February's reading of no month-to-month inflation was not credible. Nonetheless, with the Fed abandoning inflation containment, record growth in broad money supply, record high oil prices, a record low in the U.S. dollar and a rapidly widening federal budget deficit all promise much higher inflation and reporting of same in the near future.

As has been noted for the last several SGS Newsletters as to retail sales reporting, the implied inflation data show upside revisions to estimated gasoline and food prices in subsequent months. The same pattern now has been seen in the reporting of the Chain-Weighted CPI-U (C-CPI), the fully substitution-based estimate of monthly consumer inflation.



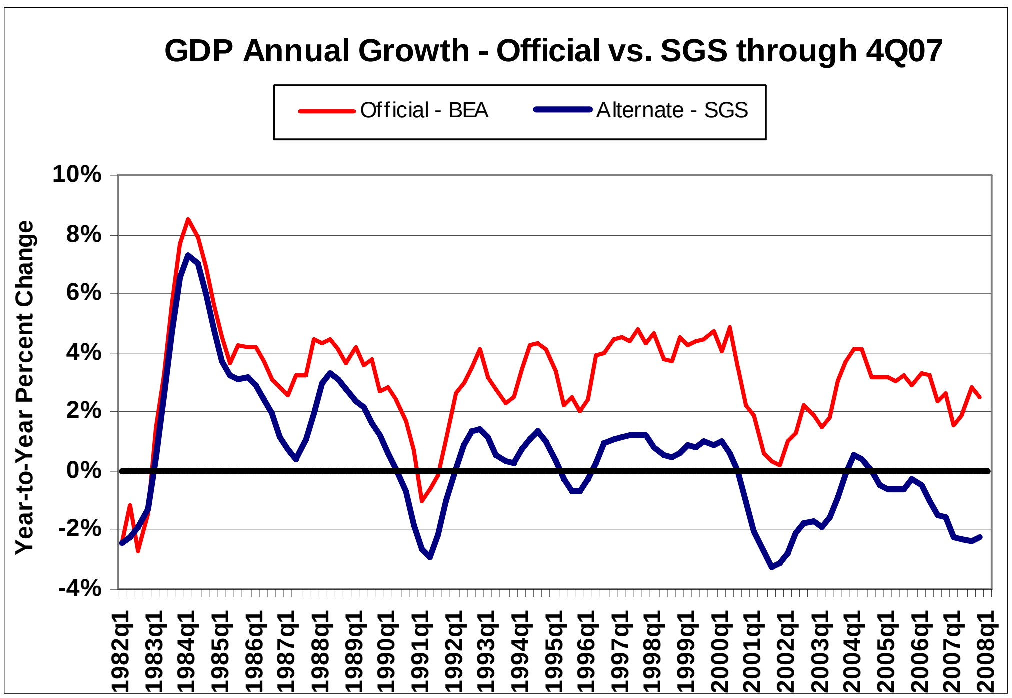
As shown in the accompanying graph the periods of mid-2006 and late-2007 are showing meaningfully higher inflation, in revision, largely in the food and energy sectors. Since the formal CPI-U never gets revised, CPI inflation will not be altered. The C-CPI, however, has a close counterpart in the Personal Consumption Expenditure (PCE) deflator in the GDP, and parallel revisions there would result in historical downward revisions to previously reported GDP growth, possibly allowing for a later, annual benchmark revision for fourth-quarter 2007 GDP into negative territory, allowing for an official onset of the current recession.

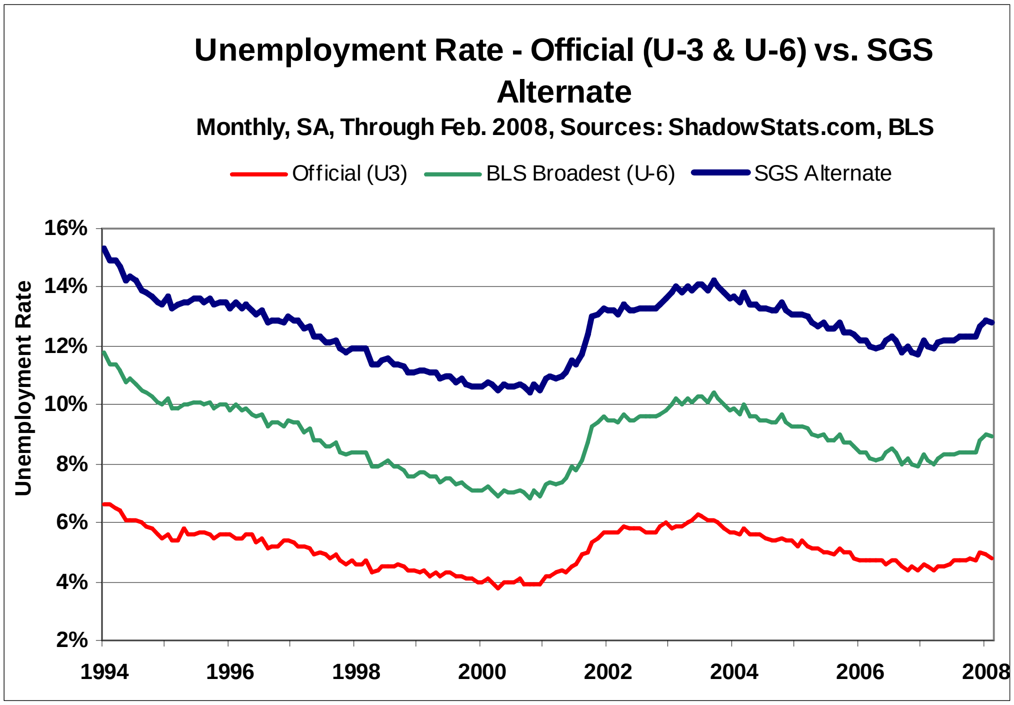
Ongoing Market Turmoil to Parallel Systemic Instabilities. With the systemic liquidity crisis and the inflationary-recession both deteriorating rapidly, the financial markets increasingly are sensing the nightmarish scenario that is unfolding. Underlying fundamentals cannot be turned easily, and a severe and protracted bear market in equities already likely is underway. Fed easings and flight-to-quality have depressed Treasury yields, but inflation and a developing U.S. dollar panic eventually will push long-term Treasury yields much higher.

Given the relative mild response in some markets to the unfolding systemic crisis and panicked Federal Reserve reactions, it looks as though there may have been some covert intervention aimed at dampening dollar selling and gold and oil buying. Such is not unusual for the President's Plunge Protection Team (PPT), which has intervened openly in those markets at other potentially vulnerable times.

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 CPI and GDP reporting, and -- at subscriber request -- introduces with this newsletter an alternate measure of the unemployment rate. When a government economic measure does not match common public experience, it has little use outside of academia or the spin-doctoring rooms of the Federal Reserve, White House and Wall Street. In these alternate measures, the effects of gimmicked methodological changes have been removed from the official series so as to reflect more accurately the common public experience, as embodied by the post-World War II CPI and the pre-Reagan-Era GDP and the pre-Clinton Era unemployment rate. The methodologies for the GDP and CPI series are discussed in the August 2006 SGS.





GDP. The alternate fourth-quarter 2007 GDP growth reflects the "preliminary" 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%.

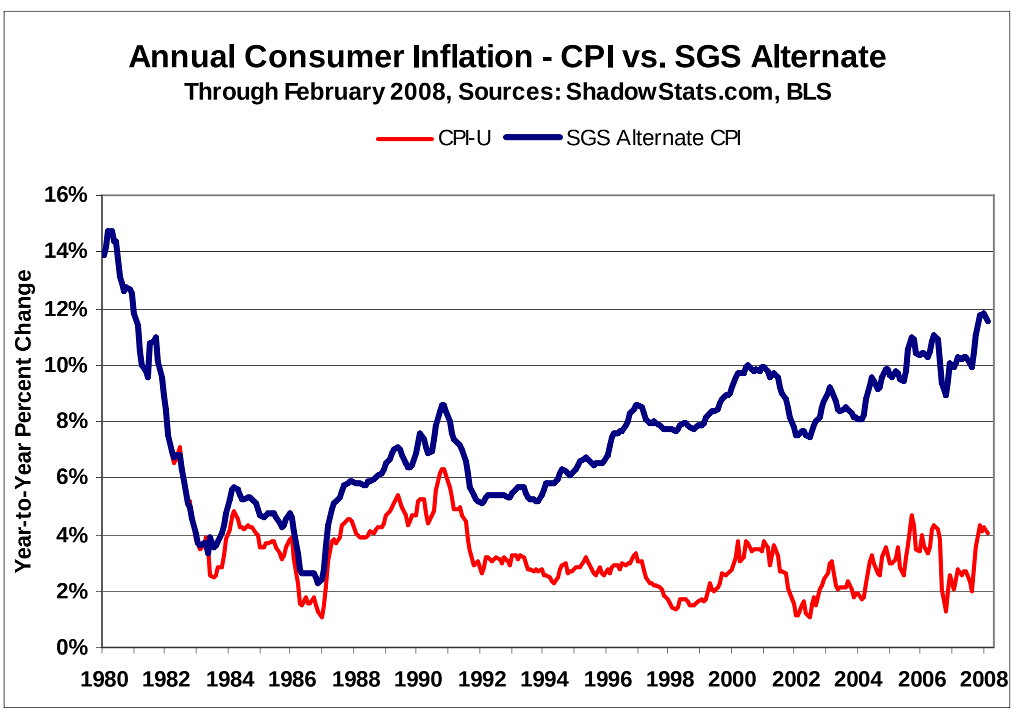
General background note: Historical data on both the official and SGS-Alternate GDP series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate GDP numbers tend to show deeper and more protracted recessions than have been reported formally or reflected in related 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. At subscriber request, we introduce with this newsletter the SGS-Alternate Unemployment Rate. Shown are two official, seasonally-adjusted unemployment measures, U.3 and U.6, and the SGS Alternate Unemployment Measure. U.3 is the popularly followed unemployment rate published by the Bureau of Labor Statistics (BLS), which stood at 4.8% as of February 2008. U.6 is the broadest unemployment measure published by the BLS, 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 (at 8.9% as of February), 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. The SGS-Alternate estimate is 12.8% for February.

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 in the for 1994 series redefinitions forward. It is planned to take series further back in time.

CPI. Both the annual non-core and core annual inflation rate measures notched higher in January, but eased back in February with what appears to have been an outright data manipulation, as discussed elsewhere. Generally annual inflation should continue rising well into 2008/2009. Food and oil-related price pressures still have been reflected only minimally in much of the government's reporting of the non-core inflation, and in the impact on the broader economy. Visibly sharp increases in market prices, however, should make almost impossible for the BLS to pull off another stunt in March, as they appear to have done in February. Mounting inflationary pressures reflect the increasing impact of energy-cost damages in the general economy, combined with pressures from a crumbling dollar and soaring monetary growth.

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 Inflation
Annual Inflation for November 2007 to February 2008

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

(r) Revised (see Opening Comments on C-CPI and PCE Deflator).
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

As shown in the accompanying table, U.S. stocks have continued trending lower; the Treasury yield curve has steepened, with sharply lower short-term yields; while the dollar sell-off has intensified in conjunction with soaring oil and precious metals prices. The U.S. banking-solvency crisis and an inflationary recession have started to open up nightmare scenarios for the traditional U.S. financial markets.

Financial-Market Indicators at Year-End 2007 and March 14, 2008 Close

Indicator	First-Quarter 2008 To Date: March 14, 2008 Level	QTD/Qtr	Yr/Yr	Fourth-Quarter 2007 Level	Qtr/Qtr	Yr/Yr	Third-Quarter 2007 Level	Qtr/Qtr	Yr/Yr
Equity Market									
DJIA	11,951.09	-9.90%	-1.50%	13,264.82	-4.54%	6.43%	13,895.63	3.63%	18.98%
S&P 500	1,288.14	-12.27%	-7.14%	1,468.36	-3.82%	3.53%	1,526.75	1.56%	14.29%
Wilshire 5000	12,992.93	-12.33%	-7.50%	14,819.60	-3.53%	3.94%	15,362.02	1.00%	15.11%
NASDAQ Comp	2,212.49	-16.58%	-6.73%	2,652.28	-1.82%	9.81%	2,701.50	3.77%	19.62%
Credit Market(1)									
Fed Funds Target	3.00%	-125bp	-225bp	4.25%	-50bp	-100bp	4.75%	-50bp	-50bp
3-Mo T-Bill	1.18%	-218bp	-388bp	3.36%	-46bp	-166bp	3.82%	-100bp	-107bp
2-Yr T-Note	1.47%	-158bp	-307bp	3.05%	-92bp	-177bp	3.97%	-90bp	-75bp
5-Yr T-Note	2.37%	-108bp	-207bp	3.45%	-78bp	-125bp	4.23%	-69bp	-36bp
10-Yr T-Note	3.44%	-60bp	109bp	4.04%	-55bp	-67bp	4.59%	-44bp	-5bp
30-Yr T-Bond	4.35%	-10bp	34bp	4.45%	-38bp	-36bp	4.83%	-29bp	6bp
Oil(2)									
US$ per Barrel									
West Texas Int.	110.21	14.79%	89.46%	96.01	17.56%	57.24%	81.67	17.39%	29.80%
Currencies/Dollar Indices(3)									
US$/Unit									
Pound Sterling	2.0294	2.27%	4.95%	1.9843	-2.68%	1.31%	2.0389	1.65%	8.94%
Euro	1.5604	6.85%	17.97%	1.4603	2.70%	10.65%	1.4219	5.17%	12.08%
Swiss Franc	0.9929	12.48%	20.52%	0.8827	3.02%	7.64%	0.8568	4.87%	7.13%
Yen	0.0099	11.49%	16.10%	0.0090	2.92%	6.54%	0.0087	7.32%	2.63%
Canadian Dollar	1.0135	1.48%	19.13%	1.0120	0.79%	17.92%	1.0041	8.43%	12.06%
Australian Dlr	0.9371	6.78%	18.86%	0.8776	-0.89%	11.31%	0.8855	4.29%	18.68%
Weighted Currency Units/US$									
Jan. 1985 = 100									
Financial (FWD)	44.43	-5.93%	-12.11%	47.26	-0.92%	-7.64%	47.70	-4.66%	-9.14%
Change US$/FX	--	6.37%	13.77%	--	0.93%	8.27%	--	4.88%	10.06%
Trade (TWD)	50.11	-4.95%	-14.42%	52.72	-1.51%	-10.00%	53.53	-5.42%	-9.10%
Change US$/FX	--	5.21%	16.84%	--	1.54%	10.01%	--	5.74%	10.01%
Precious Metals(4)									
US$ per Troy Ounce									
Gold	1,003.50	20.36%	56.00%	833.75	12.21%	31.92%	743.00	14.22%	23.99%
Silver	20.41	38.28%	58.34%	14.76	8.13%	14.41%	13.65	8.85%	20.26%

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

At present, the markets are being driven by the banking-solvency crisis and the Federal Reserve's response to same. Regardless of possible massive intervention in the markets -- recent covert intervention in the currency, gold and oil markets is a strong possibility -- the underlying fundamentals will not change. A rapidly intensifying inflationary recession provides limits to any relief rallies in equities seen in response to the Fed or other's actions. The long-range outlook for a severe bear market in U.S. equities, heavy selling of the U.S. dollar, strong buying of precious metals and an eventual, significant spike in long-term U.S. Treasury yields, remains in place.

General background note: As a general strategy under the current circumstances, looking to preserve one's wealth and assets needs to be a primary concern, along with the liquidity and safety of investments.

U.S. Equities -- Wild gyrations in U.S. equity prices may continue from breaking crisis news to breaking crisis news, interspersed with cheerleading from the Fed, the Administration and intervention from the Plunge Protection Team and others intervening in stock futures to generate phony rallies aimed at sucking in naive and vulnerable investors. Nonetheless, the frailties of the financial system and sharply negative economic fundamentals promise an eventual massive downside to the major U.S. stock indices.

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

General background note: The approaching financial maelstrom already has come over the horizon and ***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. Credit Market -- Ongoing panic by the Fed and expected further easing the week ahead have lowered short-term interest rates, with flight-to-safety in U.S. Treasuries compounding the downside pressure on Treasury yields. With rapidly rising inflationary pressures, rapid money growth, a burgeoning federal deficit, and a soon to be seen flight from the dollar that evolves into a flight-to-safety outside the dollar, the longer range outlook is for long-term Treasury yields to back up several hundred basis points, approaching a normal spread in long-term Treasuries over inflation. With a normal spread, the current 4.35% yield on the 30-year Treasury bond would be well in excess of 7.50%.

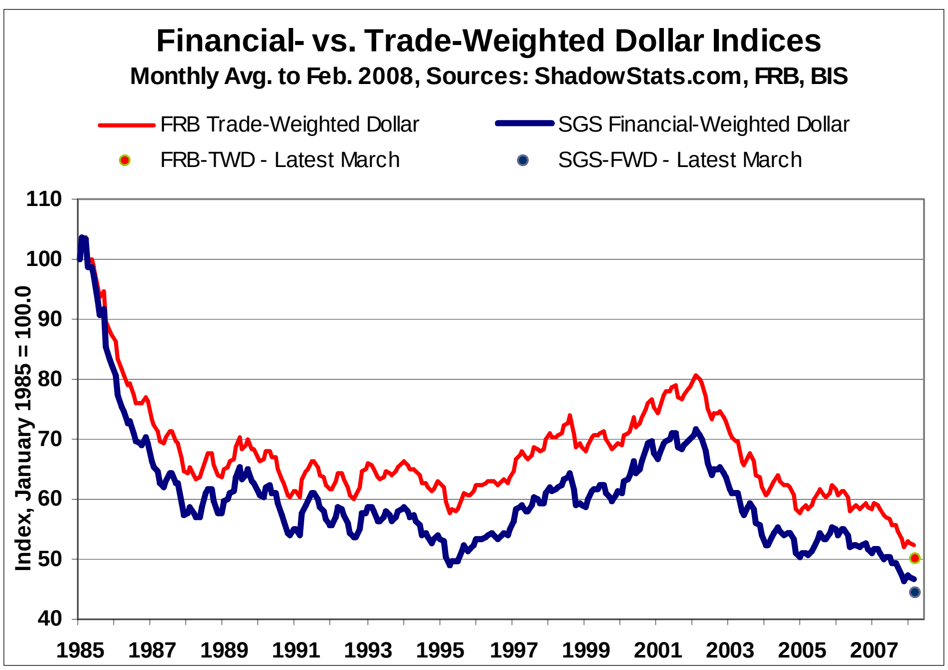
General background note: At such time as the flight from the dollar becomes a flight-to-safety out of the dollar, U.S. interest rates will be forced higher in a mounting liquidity squeeze resulting from foreign dumping of dollar denominated securities. Increasingly, those assets will have to be absorbed in the U.S. markets, spiking Treasury yields.

U.S. Dollar -- With the U.S. financial system in trouble, with the Fed abandoning its inflation fight, with recognition of the U.S. recession growing rapidly, selling of the U.S. Dollar has intensified sharply against the major Western currencies. The financial- and trade-weighted indices are at all-time lows and still dropping, despite heavy intervention to prop the U.S. currency. Of particular note is the Swiss franc hitting parity with the U.S. Dollar. A particularly sharp decline in the U.S. dollar against the Swiss franc will be a key signal of the developing flight-to-safety outside the dollar.

Where the Fed has opted for inflation as a trade-off in its effort to save the domestic banking system, and it appears ready to slash interest rates again, the lingering terrors of the Weimar Republic's hyperinflation of the 1920s have been holding the European Central Bank's interest rate targets relatively high in an effort to contain inflation. Such a dichotomy of interests holds the potential for even more intense and sustained dollar selling, again, with flight from the dollar soon becoming a flight-to-safety outside the dollar. As currency volatility intensifies, so too should sporadic central bank intervention.

In terms of underlying fundamentals that tend to drive currency trading, the dollar's portfolio could not be worse. Relative to major trading partners, the U.S. economy is much weaker; interest rates are lower and anticipated possibly to go much lower still; inflation is higher and rising fiscal and trade-balance conditions are abysmal with the fiscal deficit is exploding; and relative political/systemic concerns are rising sharply at the same time with President's and Congress's approval ratings bottom bouncing at all-time lows.

Beyond further 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 in Asia, or a terrorist attack or expansion of U.S. military activity in the Middle-East or South America. When the trigger is pulled, current 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 the otherwise deteriorating systemic crisis.



As shown in the preceding graph, the U.S. dollar continued to fall sharply in February 2008 and into March, setting new historic lows. The latest data points shown for the financial- and trade-weighted indices are as of Friday, March 14th.

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.

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 February 2008 the monthly FWD fell by 0.80% after dropping by 0.96% in January. The February 2008 average index level of 46.50 (base month of January 1985 = 100.00) was down by 9.81% from February 2007, while January 2008 was down 9.33% from the year before. As of March 14th, the FWD stood at a record-low 44.43.

Also down in February was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The February 2008 average was down by 0.67% from January, which, in turn, had been down 0.86% from December. The February 2008 index level of 52.22 (base month of January 1985 = 100.00) was down 11.58% year-to-year, versus an 11.30% annual decline as of January. As of March 14th, the TWD closed at a record-low 50.11.

Gold -- Despite increasing central-bank jawboning and intervention, the price of gold closed (London p.m. fix) at a new record high on March 14th at $1,003.50 in current dollars, above what had been the $1,000 per troy ounce psychological barrier. Outside of the current period, 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 January 2008, the 1980 gold price peak would be $2,313 per troy ounce, based on not-seasonally-adjusted CPI-adjusted dollars, and would be $6,363 per troy ounce in terms of SGS-Alternate CPI adjusted dollars. The indication remains that the price of gold -- albeit at a nominal high -- still faces some catch-up.

For February (based on Kitco.com), the monthly average London gold afternoon fix was $922.30 versus $889.60 in January. Silver averaged $17.57 per troy ounce in February, up from $15.96 per troy ounce in January. Respective closing prices on March 14th were $1,003.50 and $20.41 per troy ounce.

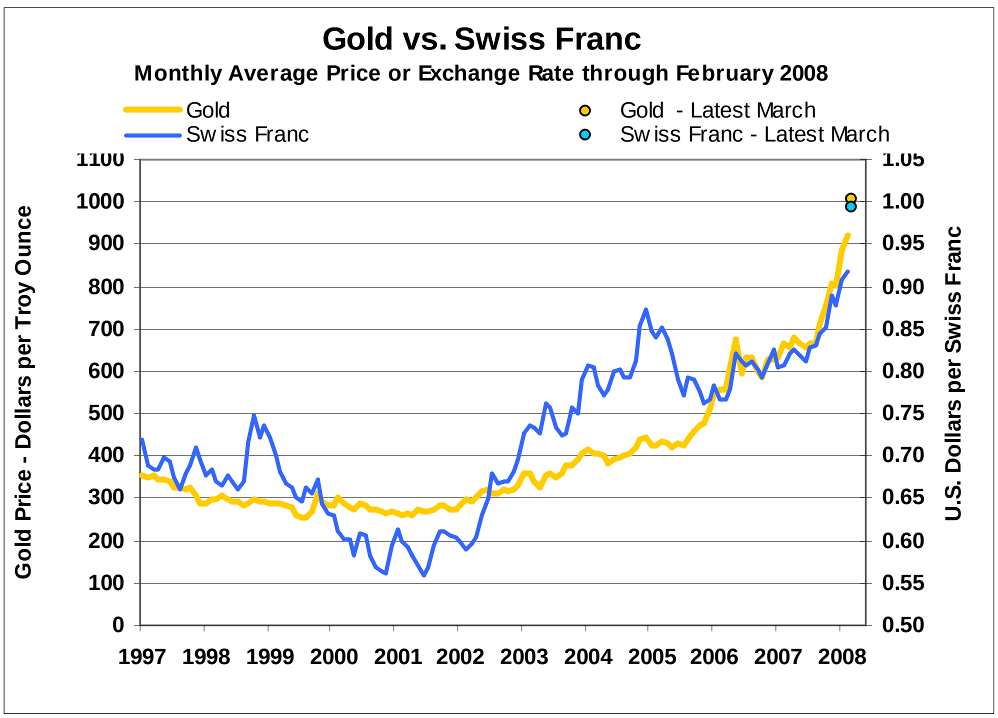
Gold Still Will Be a Buy When It Hits $10,000. One reader suggested that the $10,000 per troy ounce comment suggested in the March 10th *Flash Update* seemed rather extreme. With the $1,000 per troy ounce level breached, however, it is worth remembering that gold is a traditional store of wealth that enables the preservation of purchasing power that otherwise would be lost to inflation. The long-term "profits" realized in cashing in gold at any given point in time primarily are a measure of the purchasing power otherwise lost by the outright holding of U.S. dollars. The upside for gold is limited only by the downside to the dollar's purchasing power.

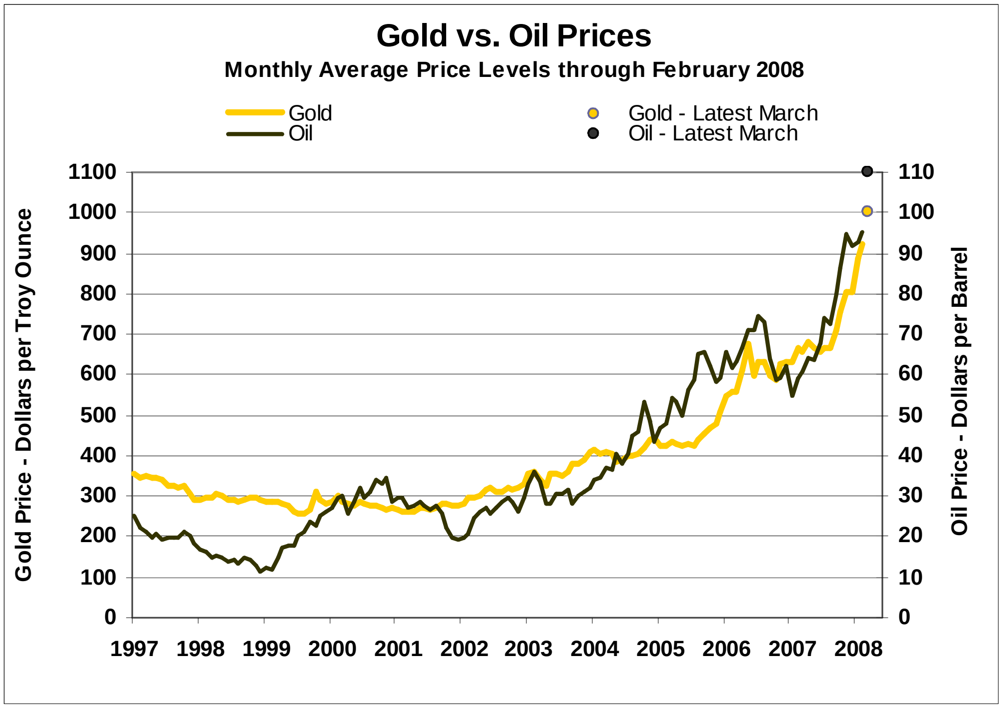
At such time as gold hits $10,000, which I would wager will be much sooner than most people expect, that price, again, will not reflect investment profits in a traditional sense, but rather primarily will reflect the preservation of wealth and the purchasing power lost otherwise by those who kept their assets in dollars. Gold at $10,000 will mean that raging inflation has been in play, and unless inflation has been brought under control, the precious metal's upside potential then, as now, will remain limited only by the dollar's downside. As variously discussed in my hyperinflation writings, the downside for the purchasing power of the U.S. dollar effectively is zero.

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 Series (see the December 2006 to March 2007 SGSs and the pending *Hyperinflation Special Issue*), 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 February averages as well as added points for closing prices on March 14th, with gold at $1,003.50, oil at $110.21 and the Fed's published noon buying rate for the Swiss franc at $0.9929. Again, all three measures should trade significantly higher in the months ahead.




Gold vs. Oil Prices
Monthly Average Price Levels through February 2008
Gold
Oil
Gold - Latest March
Oil - Latest March
Gold Price - Dollars per Troy Ounce
Oil Price - Dollars per Barrel
0
100
200
300
400
500
600
700
800
900
1000
1100
0
10
20
30
40
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1997
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REPORTING PERSPECTIVE

The Big Three Market Movers

U.S. financial system stability and economic conditions continue to deteriorate rapidly, and, as a result, little can be trusted in current economic reporting. Mr. Bernanke still needs a stable U.S. currency, particularly under the circumstances of his expanded move to bailout the domestic banking system and otherwise his 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.

Absent manipulation, and against lagging and increasingly realistic market expectations, 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 -- The reported decline in January payrolls moved a number of analysts into the "recession at hand" camp, but the decline in jobs was understated meaningfully, thanks to the usual statistical shenanigans at the Bureau of Labor Statistics (BLS). With two consecutive monthly contractions now seen in the payroll survey, however, the NBER has one of its trigger points in place for calling the timing of a recession.

Payroll Survey. The BLS reported a seasonally-adjusted jobs loss of 63,000 (a loss of 109,000 net of revisions) +/- 129,000 for February 2008, following a revised 22,000 (previously 17,000) jobs loss in January. The decline was statistically indistinguishable from a gain. Annual growth in total nonfarm payrolls slowed further to a recessionary 0.60% in February from 0.72% in January.

Bias Adjustment. One factor adding upside pressure to the numbers was the monthly bias factor (birth-death model), which was a net addition of 135,000 jobs, following a net subtraction of 378,000 jobs in January.

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 January and February suggests that the seasonally-adjusted month-to-month change should have been a contraction of 146,000 (a statistically significant contraction). 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.

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 255,000 in February, against a 540,000 decline in January, which really was a gain of 205,000, after removal of a 745,000 downward effect from population revisions.

The February 2008 seasonally-adjusted U.3 unemployment rate showed a statistically insignificant decline to 4.81% +/- 0.23% from 4.93% in January. Unadjusted, U.3 narrowed to 5.2% in February from 5.4% in January. The broader U.6 unemployment rate eased to an adjusted 8.9% (9.5% unadjusted) in February from 9.0% (9.9% unadjusted) in January. Adjusted for the "discouraged workers" defined away during the Clinton Administration, actual unemployment is running about 12.8%, as shown in the SGS-Alternate Unemployment Measure, introduced in this month's Alternate Realities section.

Employment Environment. The continued and deepening employment decline reported in February, though far short of reality, at least moved the same direction suggested by some of the better-quality employment-environment indicators, with collapsing January help-wanted advertising, surging new claims for unemployment insurance, and recession-level employment readings, again, for both the February purchasing managers surveys.

Next Release (April 4): Based on continued deterioration in underlying economic activity, the March payroll survey should show continued month-to-month contraction, and the household survey should show a rebound in the unemployment rate. Nonetheless, given the political season and ongoing financial-market crisis, March reporting, again, simply will be brought in as desired by the Administration.

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

The GDP's fourth-quarter implicit price deflator (inflation measure) rose at an annualized rate of 2.67%, revised upward from the "advance" estimate of 2.56%, versus a 1.04% rate in the third quarter. In contrast, annualized CPI inflation rose to 4.07% in the fourth quarter from 1.87% in the third quarter. Such suggests understated inflation was used to overstate the fourth-quarter GDP estimate. Artificially-low inflation, when used in deflating the GDP, results in an overstatement of the inflation-adjusted GDP growth.

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.

With the numbers too thin to generate alternate GDP measures at this time, the BEA will publish, with the next release, 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.

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 (March 27): Based on underlying fundamentals, the "final" estimate revision of annualized quarterly real GDP growth for the fourth quarter should show an actual quarterly contraction, but such is highly unlikely in an election year. The best bet is for the revised growth rate to remain in positive territory, little changed from the latest estimate.

Consumer Price Index (CPI) -- As discussed in the March 14th *Flash Update*, the BLS reported that the seasonally-adjusted February CPI-U (I.6) was "virtually unchanged" with a gain of 0.03% (up 0.29% unadjusted) +/- 0.12%, versus an increase of 0.39% (0.50% unadjusted) in January. February's annual CPI inflation eased to 4.03% from January's 4.28%. Such a result was not believable in a world of rapidly rising food and energy prices. Per Department of Energy price reports, gasoline rose by 0.5% in February, instead of dropping 0.6% as reported by the BLS. The difference in that number alone would have had reported CPI rising by the consensus expectation of 0.3%.

Year-to-year annual inflation would resume its upturn in March 2008 reporting, dependent on the seasonally-adjusted monthly gain exceeding the 0.46% monthly increase seen in March 2007. The difference would directly add to or subtract from February's annual inflation rate of 4.03%.

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 3.69% in February, down from 3.91% in January. Recent revisions to this series are discussed and graphed in the Opening Comments section.

Adjusted to pre-Clinton (1990) methodology (I.7), annual CPI growth was about 7.3% in February, down from 7.6% in January. The SGS-Alternate Consumer Inflation Measure (I.8), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was roughly 11.6% in February versus 11.8% in January. 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 (April 16): Monthly March CPI inflation should rise sharply, if the depressed energy and food prices reported in February are allowed to show anything close to a realistic catch-up. If seasonally-adjusted monthly CPI inflation for March 2008 exceeds 0.46%, 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 was seen in the February report, still is of high risk given the deteriorating systemic conditions and the Fed's having abandoned any pretext of trying to contain inflation. While some upside movement in core inflation had started to surface in January reporting, all these numbers now may be held hostage to the Fed's need to show that inflation is not a problem and hence does not need to be contained.

Other Troubled Key Series

Federal Deficit -- As discussed in the March 13th *Flash Update*, the officially gimmicked federal deficit deepened significantly in February 2008, to $175 .6 billion for the month, versus $120.0 billion the year before. For the second month, the deterioration in annual monthly comparisons reflected plunging tax receipts as well as surging outlays. That put the rolling 12-month deficit through February 2008 at $263.9 billion versus $192.7 billion in February 2007. Where the annual "improvement" in the deficit at fiscal year-end 2007 (September 30th) stood at $85.4 billion, the differential now has turned into a net deterioration of $55.6 billion.

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 $9.358 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. As of January 31, 2008, the gross federal debt stood at $9.238 trillion, up $9 billion for the month, but it was up by $620 billion from January 2007, which in turn was up by $511 billion from January 2006.

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.

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 deficit the 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. On a smoothed basis for the 17 weeks ended March 8th, annual growth rose to 6.4%, up from 5.9% in the 17 weeks ended February 2nd. 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 (such as Martin Luther King's Birthday and Presidents' Day). 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 -- February's seasonally-adjusted monthly real earnings rose by 0.3%, thanks to the unbelievably low 0.0% inflation reported for the month. Such followed an unrevised 0.5% monthly drop in January and a 0.1% decline in December. Annual change in February narrowed to a 0.8% contraction, following a 1.4% fall in January and a 1.0% drop in December.

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

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

The Census Bureau reported seasonally-adjusted February retail sales down by 0.56% (down 0.71% net of revisions) +/- 0.6% (95% confidence interval), following a revised 0.43% (previously a 0.33%) gain in January. On a year-to-year basis, February retail sales rose 2.58% versus a revised 4.00% (was 3.85%) in January. Both the monthly and annual changes reflected deepening contractions, net of inflation.

***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 -- fell by 0.55% (a decline of 0.76% net of revisions) for the month of February, after increasing by a revised 0.15% (previously 0.11%) in January. The decline in gasoline and food prices suggested by the retail sales report was confirmed in the February CPI report, but the numbers are not credible as discussed in the CPI section.

Next Release (April 14): Underlying fundamentals suggest ongoing weakness and a likely weaker than expected showing for March retail sales. The annual change should continue underwater after inflation adjustment, consistent with an ongoing recession. Going forward, inflation-adjusted monthly and annual contractions should be quite regular.

Industrial Production -- Seasonally-adjusted January industrial production rose by 0.1% (plus 0.2% net of revisions), following a 0.1% gain (previously unchanged) in December. Year-to-year change rose to a 2.2% gain in January, up from 1.7% (previously1.6%) in December.

Next Release (March 17): Look for historical benchmark revisions on March 28th to show weaker than previously reported growth. The February production numbers are expected to start declining, in line with the purchasing managers survey's manufacturing indicators and with continued real (inflation-adjusted) weakness in new orders for durable goods. Such is reasonable. Monthly contractions in this series should become regular, with the erratic but generally slowing annual growth eventually turning negative.

New Orders for Durable Goods -- The usually volatile durable goods orders fell by a seasonally-adjusted 5.3% (down by 6.1% net of revisions) in January, following a revised 4.4% (previously by 5.2%) increase in December. On a year-to-year basis, January's new orders rose by 3.0% versus 4.2% (previously 5.0%) in December. Smoothed using a six-month moving average, annual growth (net of inflation) remained negative and an ongoing recession signal.

The closely followed nondefense capital goods new orders fell by 8.1% (8.0% net of revisions), after rising by 5.5% (previously 5.4%) in December. January's year-to-year change was an increase of 14.7%, following a 7.7% increase in December.

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 -- This series appears to be under increasing manipulation with a resulting understatement as to the scope of the trade deficit in goods and services. In particular, the services trade numbers, which largely are guesstimates, have been used to mute partially the deficit reported in goods trading. Oil prices and related trade volume also continue to be understated. The annual numbers for 2007 are reviewed in the Reporting/Market Focus.

That said, the seasonally-adjusted January trade deficit was reported at $58.2 billion, somewhat wider than the revised December deficit of $57.9 billion, but December was revised downward from $58.8 billion. Those numbers should help keep the "final" estimate of fourth-quarter GDP growth above water.

Reflecting "improved" estimates of the services sector, the overall deficit for 2007 was revised to $708.5 billion from the prior month's estimate of $711.6 billion, narrowed from the reported 2006 deficit of $758.5 billion. The recasting of monthly seasonal adjustments threw the monthly distribution of the 2007 deficit more heavily into the early months of the year, which, fortuitously, again will help the upcoming "final" estimate of fourth-quarter GDP growth.

The value of imported oil still appears to be seriously understated in terms of pricing. The average imported price for oil rose to $84.09 per barrel in January, up from $82.76 in December and $79.65 in November.

Next Release (April 10): Underlying reality still favors sharp deterioration in the monthly February trade deficit, but the government can play games with this series as long as it wants to play them. Given the impact of the series on the currency markets and on GDP reporting, realistic numbers may not be seen for some time come.

Consumer Confidence -- February consumer confidence numbers tumbled both in terms of monthly and annual change. For February 2008, the Conference Board Confidence measure plunged by 14.1% for the month, after falling by 3.6% (previously 3.0%) in January. February's year-to-year change was down by 32.6%, sinking from January's 20.8% annual decline.

The University of Michigan Sentiment measure also plunged, down by 9.7% for the month of February, following January's monthly gain of 3.8%. February's year-to-year decline also deepened, down by 22.5% in February versus a 19.1% decline in December. 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 Michigan survey is unadjusted. How does one seasonally-adjust peoples' attitudes? Also, beware the mid-month Consumer Sentiment release from the University of Michigan. Its sampling base is so small as to be virtually valueless in terms of statistical significance.

Short-Term Credit Measures -- Patterns of annual growth in commercial borrowing continue to reflect pressures from the financial system's solvency crisis, with the declining annual growth for commercial paper outstanding being offset partially by growth in commercial and industrial bank loans. Consumer credit numbers continue to show softness in annual growth, against downwardly revised annual growth rates.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth was reported at 4.5% in January, against 4.1% (previously 5.5%) in December and against 5.1% (previously 5.6%) in November. 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.

The 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-founds accounting for the banking system and, to a certain extent, are an exacerbating factor in the current solvency crisis.

Commercial borrowing growth varied sharply, again. Annual change in February commercial paper outstanding showed a 9.1% contraction, versus a 6.2% contraction in January and a 10.1% annual decline in December. In contrast, annual growth in January commercial and industrial loans rose by 20.6%, versus 20.1% in December, and against 19.1% in November. The relative instability in commercial paper continues, though somewhat abated, with resultant credit difficulties placing a major dent in broad business activity and continuing to disrupt banking system stability.

Producer Price Index (PPI) -- The seasonally-adjusted January finished goods PPI rose by 1.0% (0.8% unadjusted) following a revised 0.3% decline (previously down by 0.1% and down by 0.4% unadjusted) in December. The December revision reflected recalculations of the monthly seasonal factors and reweighting of components, which tended to throw more reported inflation back into the first half of 2007.

Annual PPI inflation for January rose to 7.4% from 6.3% in December. Seasonally-adjusted intermediate and crude goods rose by 1.4% and 2.5% respectively, after easing by 0.2% and rising by 1.1% (previously 1.0%) in December.

Next Release (March 18): Given what appears to have been a deliberate understatement of the February CPI, one has to favor a downside "surprise" in the February PPI, against market expectations of around 0.3%. Nonetheless, 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. As with the CPI, the core PPI inflation rate still is long overdue for a meaningfully upside move, but such still may be further delayed by the ongoing financial-market needs of the battered Federal Reserve.

Better-Quality Numbers

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

Economic Indicators

Purchasing Managers Survey: Manufacturing New Orders -- As discussed in the January SGS Reporting/Market Focus, the Institute for Supply Management (ISM) impaired slightly the quality of its composite indices in last month's reweightings of the composite indices components.

As currently published, the February 2008 manufacturing fell into recession territory, dropping below 50.0 to 48.3, versus 50.7 in January. 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 February new orders index remained in contraction, at 49.1, down from 49.5 in January. 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 February new orders index fell by 9.5%, following a 3.8% decline in January. 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, the new orders measure breached its fail-safe point in mid-2005, generating a signal of pending recession.

Also of significance, the manufacturing employment component moved deeper into recession territory at 46.0 in February, down from 47.1 in January.

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 February services composite index remained below 50.0, at 49.3, which was up from 44.6 in January.

Both the services employment and prices paid components, however, have some meaning. Covering the real estate and banking industries, among others, the February employment component remained in contraction territory at 46.9, up from to 43.9 in January. The prices paid component is covered in the Inflation Indicators.

Help-Wanted Advertising Index (HWA) -- The Conference Board's seasonally-adjusted January help-wanted advertising index fell to 21, from 22 in December, tying the historic low reported in November 2007. Year-to-year change was down 32.3% in January, versus 33.3% in December, with the annual growth in the three-month moving average dropping to 31.2% from a 22.6% decline in December. Despite some of the historic weakness in the series 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 still is indicative of a severe deepening in an ongoing recession.

Where the 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 slowed meaningfully in January and February.

Housing Starts -- The housing numbers have started to bottom-bounce, with January's seasonally-adjusted housing starts up by 0.8% (up 0.6% net of revisions) +/- 10% (95% confidence interval), following a 14.8% (revised from 14.2%) plunge in December starts. January's level was down by 27.9% year-to-year, well shy of the 48.6% annual decline seen at the trough of the 1990/1991 recession.

Still signaling housing industry problems, January building permits were down 3.0% (down by 1.9% net of revisions) for the month, down 33.1% year-to-year, while new home sales fell 2.8% for the month and 33.9% for the year. January existing home sales eased by 0.4% for the month and were down 23.4% year-to-year.

Inflation Indicators

Money Supply -- As graphed and as discussed more extensively in the Opening Comments, the estimate for annual growth in the SGS-Ongoing M3 is a record-high 16.9%, up from 15.5% in January. The current reading tops the prior high growth rate of 16.4% seen in June of 1971, and has ominous implications for a surge in monetary inflation.

For February 2008, annual change for monthly M1 was virtually no change, after a 0.6% decline in January. February M2 annual growth surged to 6.9% from 5.8% in January.

With the caveats expressed below on the following table, here are the monthly-average levels for M3:

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

Feb 06	10.303	Sep 06	10.855	Apr 07	11.727(r)	Nov 07	12.835(r)
Mar	10.362	Oct	10.990	May	11.868	Dec	12.927(r)
Apr	10.429	Nov	11.102	Jun	11.932(r)	Jan 08	13.069(r)
May	10.502	Dec	11.227	Jul	12.012	Feb	13.357(p)
Jun	10.562	Jan 07	11.315	Aug	12.224		
Jul	10.643	Feb	11.430	Sep	12.419(r)		
Aug	10.746	Mar	11.565(r)	Oct	12.660(r)		

(r)Revised (based on Federal Reserve revisions 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 February 2008 prices paid indices remained strong in the purchasing managers composite surveys. The indices reflect upside inflation pressures from a variety of factors, including high oil prices, and continue to signal broad inflation problems ahead.

On the manufacturing side, the February price index eased to 75.5 from 76.0 in January. On a three-month moving average basis, though, February's 37.6% year-to-year gain was slightly stronger than January's 37.3%. 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 February prices diffusion index came in at 67.9, down from 70.7 in January. On a three-month moving-average basis, February’s annual gain was 24.5%, versus 26.9% in January.

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 – After fluctuating shy of the $100 per barrel mark for months, the price of oil now is trading comfortably on the upside of that old psychological price barrier. For February 2008, the monthly-average West Texas Intermediate spot price (St. Louis Fed) rose 2.6% to $95.35 from January's $92.95, setting a new all-time monthly-average high. Against last year's average, February's level was up by 60.9%, compared with January's 70.3%. These levels of growth continue to signal ongoing disastrous news is in the offing for official CPI, PPI and GDP annual inflation reporting.

As of Friday, March 14th, West Texas Intermediate closed at $110.21 per barrel, spot, just shy of the prior day's record high $110.33. Oil price movement remains highly volatile, but generally should trend higher and set new record highs in the months ahead, despite a U.S. 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 will trigger debilitating U.S. inflation. Regardless of any near-term price swings, meaningful upside risks to oil prices remain in place, from the still-unfolding dollar catastrophe and ongoing OPEC actions and rumblings, as well as from ever-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.

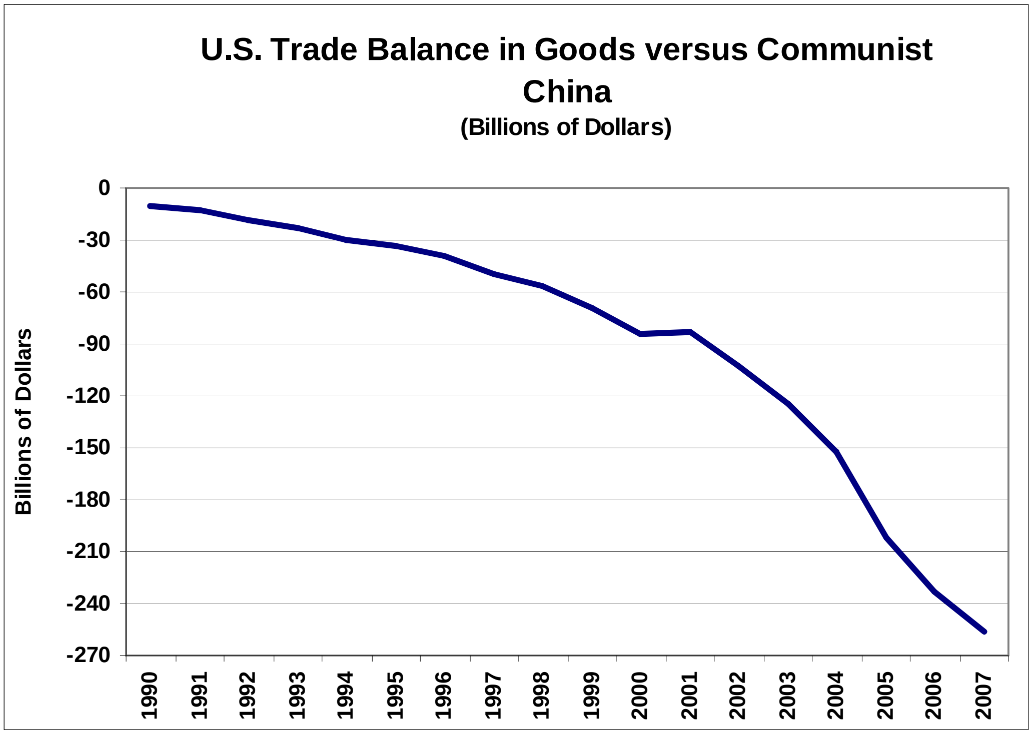
Reporting/Market Focus

Trade Deficit Woes Mount Despite Reported Improvement
Trade Deficit Has Cost Over 7 Million U.S. Jobs

The U.S. trade deficit has been in a downhill spiral since the mid-1990s, but it reportedly improved on an annual basis for 2007, per the Bureau of Economic Analysis (BEA) and the Census Bureau (Census), which share reporting of this key series. Based on the revisions included in the reporting of the January trade deficit, the 2007 deficit in goods and services narrowed to $708.5 billion from a record $758.5 billion in 2006. Such broke out as the merchandise trade deficit narrowing to $815.4 billion in 2007, from $838.3 billion in 2006, and the services sector showing a $106.9 billion surplus in 2007, up from $79.7 billion in 2006. This reporting is of extremely poor quality, but it has helped spike growth in recent GDP reporting. The deficit is reflected in the net exports account, where the trade shortfall is subtracted from GDP. Hence, a narrowing of the deficit adds to reported GDP growth.

The reporting problems are twofold. First, the services surplus is meaningless, a guesstimate added some years back to offset the deteriorating merchandise sector. While trade in services indeed needs to be counted, the BEA and Census have no way of generating meaningful data.

Second, over the last year or two, unusual reporting of oil prices and imports has understated the dollar volume of oil imports, which has had the effect of understating the trade deficit.


U.S. Trade Balance in Goods versus Communist China
(Billions of Dollars)
Billions of Dollars
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-150
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-210
-240
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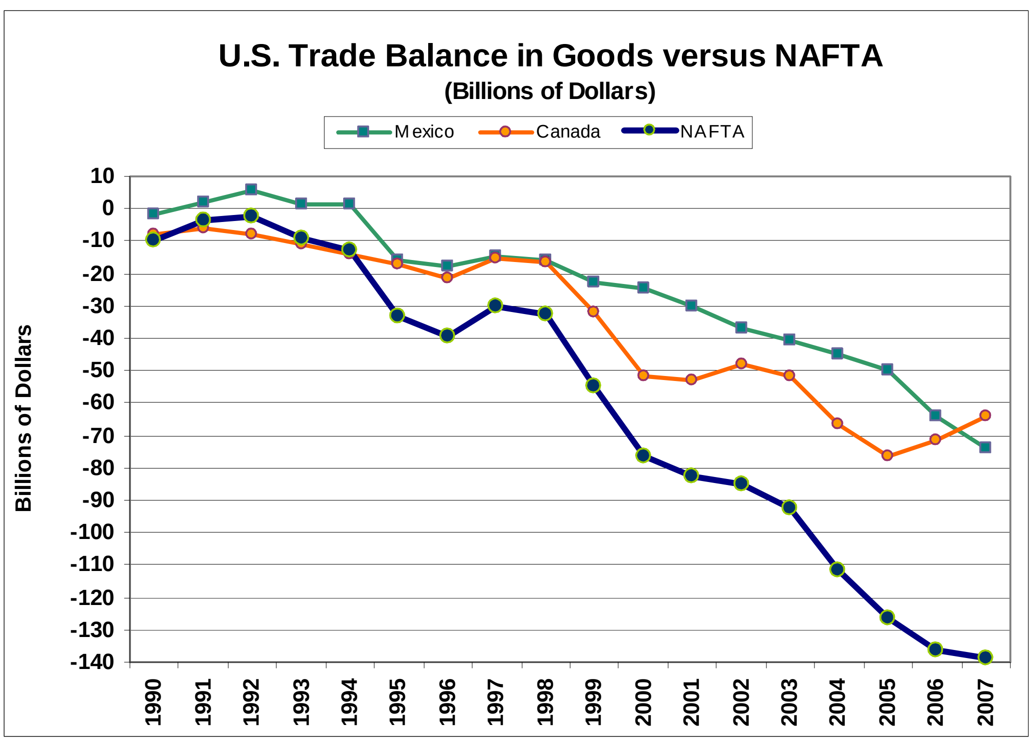
U.S. Trade Balance in Goods versus NAFTA
(Billions of Dollars)
Mexico
Canada
NAFTA
Billions of Dollars
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Such considerations aside, the annual data published with the December 2007 report show not so happy trade-balance developments with key trading partners. As shown in the accompanying graphs, Communist China remains the country with single largest surplus against the United States, with the U.S. showing a record deficit there of $256.3 billion in 2007, versus $232.6 billion in 2006.

As to NAFTA, conditions also have deteriorated, with the U.S. deficit against Mexico and Canada widening to $138.5 billion in 2007, versus $136.1 billion in 2006. All the deterioration there, however, was against Mexico, where the deficit widened to $74.3 billion from $64.3 billion. The deficit against Canada narrowed for the second year to $64.2 billion from $71.8 billion.

As discussed in previous newsletters, when countries enter into NAFTA-like trade agreements, and *none of the parties are at full employment*, the trade and manufacturing benefit will shift primarily to the country with the cheapest labor.

Given the current official estimate of nominal net exports in fourth-quarter 2007 at an annual rate of negative $711.3 billion, against nominal GDP (excluding net export accounting) of $14.795 trillion, implies that the ongoing deficit has cost over 7 million jobs, which, coincidentally, is just shy of official unemployment of 7.4 million estimated for fourth-quarter 2007. More importantly, that trade-linked number also accounts for the bulk of discouraged workers and other marginally attached workers who are not counted in the official U.3 unemployment rate. See the Alternate Realities section in the Opening Comments for further information on the unemployment measures.

Upcoming Reporting/Market Focus for March

The Reporting/Market Focus on illegal immigration's impact on the economy and economic reporting, previously scheduled for the current newsletter, has been pushed back another couple of months, so as to allow for further research. The April Reporting/Market Focus will be decided nearer to the time, based on factors that are tied to the evolving market and financial-system conditions.

NOTICE TO SUBSCRIBERS: As discussed in the March 11th Flash Update, this has become the February/March newsletter. The Hyperinflation Special Issue will follow around March 31st. The April SGS Newsletter is targeted for the week of April 14th. Flash Updates and Alerts will continue to be posted in response to key economic or financial-market developments.

Going forward, the regular SGS Newsletter will be published 11 to 12 times per year, dated when posted, and will be supplemented irregularly with Special Issues of general interest. As has been the case in recent months, the newsletter also will be supplemented regularly with increasingly frequent Flash Updates and with Alerts as needed.

PLEASE NOTE: 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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