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Worst Still Ahead for Economy and Solvency Crisis

Faulty Data, Government/Fed Obfuscation Are No Basis for Rebuilding Confidence

Do Not Mistake Declining Living Standards for Deflation

Resurgent Inflation Likely to Be Triggered by U.S. Dollar Weakness

Greenback's Credibility Cracks as Fed Accelerates Dollar Debasement

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Section One of Four

OVERVIEW -- OPENING COMMENTS

"Glimmers of Hope" Are Just Hype

The U.S. economy remains in a deepening depression that will prove to be particularly protracted and unresponsive to traditional stimuli. A few indications of possible bottom-bouncing at a temporary plateau of low business generally were flawed. Deteriorating patterns of year-to-year contraction in key economic series have continued, setting post-World War II lows. Despite all efforts by the Fed and Treasury to debase the U.S. dollar, broad money growth has stalled anew, suggesting an intensifying solvency crisis, with new or expanded Fed actions likely. Broad money growth should pick up, however, with escalating Fed monetization of Treasury debt. Although the U.S. dollar generally has held its recent relative strength in the currency markets, global investors increasingly will shun the greenback, and intense dollar weakness eventually will push dollar-based prices such as oil much higher, igniting consumer inflation that ultimately will feed into a U.S. hyperinflation.

The financial markets remain in extreme flux, unstable and dangerous, with high volatility, tremendous gimmicking and likely at least sporadic government-coordinated market manipulations. Accordingly, over the short-term, almost anything is possible in the markets. Over the long haul, the general outlook is unchanged: a hyperinflationary great depression, much lower stock prices (in inflation-adjusted terms), much higher interest rates, severe dollar selling against most major currencies, and much higher prices for precious metals, particularly gold and silver.

Recent, intermittent strong stock market rallies are reminiscent of strong rallies seen in stocks during the general stock market sell-off of 1929 to 1932. The four largest-ever percentage daily gains in the Dow Jones Industrial Average were seen in that period. Equity values, however, worked their way lower by an aggregate 89.2% from the September 3, 1929 peak (DJIA 381.17) to the July 8, 1932 low (DJIA 41.22), only to recover the 1929 peak in 1954, some 25-years later (source: dowjonesindexes.com).

Anything But the Truth. When the government decides to rig numbers in an effort to create a rosier consensus outlook, or when it moves to hide uncomfortable information from the public on a problem, odds favor the underlying reality being much worse than the public or markets perceive. Indeed, the Administration, Fed and Wall Street are attempting to sell the concept that the worst of the economic and solvency crises has passed, but evidence runs quite to the contrary, as shown in the monetary and better economic data. The worst likely still is ahead.

On the economic numbers front, unusual revisions to prior-period reporting in series such as nonfarm payrolls and retail sales suggest serious reporting flaws in key data. The revisions here are suspect, where they have tended to be all in the same direction (recent retail sales excepted) and have been regularly of magnitudes that exceeded published 90% and 95% confidence intervals of statistical significance. Where prior-period downward revisions provide a relative boost to the latest reporting, these unusual patterns have helped the monthly headline numbers for the series, which in turn generally have been happy news for the stock market. Separately, unusual seasonal-adjustment patterns have enabled part of the revision gimmicking, at least in terms of the payroll data (see details in the Reporting/Market Focus).

Also, the latest reporting of monetary aggregates by the Fed (see Money Supply section in the Reporting Perspective) showed unusually large downside revisions to recent estimates of M2 and other M3 components. While the patterns of broad money supply growth still tell the same story, questions on the quality of Fed data are raised anew. With the Fed's broad oversight of the banking and financial system, one might expect reasonably meaningful and stable data from the U.S. central bank on the U.S. banking system, but such has been sorely lacking for years, as evidenced by the poor quality of quarterly flow-of-funds data published by the Fed. With the current unusual revisions (unusual in terms of magnitude and pattern), one might wonder if there is some gaming afoot to contain reported annual growth rates in the broader money measures, given the expanded monetization of Treasury debt and with annual growth in the monetary base back over 100%.

As to information on the systemic solvency crisis, the Federal Reserve and U.S. Treasury have refused to disclose details as to where certain banking bailout/liquefaction funds have gone. Then, there is the "stress" testing being applied to banks. It would be a shock to find that the results of these analyses (at least those to be released eventually to the public) adequately measured the solvency risks to the banking system, with the downside economic case beginning to look more like the consensus outlook than a risk scenario.

Even so, Bloomberg reported (April 10th): "The U.S. Federal Reserve has told Goldman Sachs Group Inc., Citigroup Inc. and other banks to keep mum on the results of 'stress tests' that will gauge their ability to weather the recession, people familiar with the matter said." Subsequent to that, there has been a flurry of public comment and activity promising "transparency" on the stress tests, although there seem to be significant issues as to how the results can be released within the context of the new rosy scenario fable being crafted by Washington/Wall Street.

Also, accounting standards have been shifted to allow banks effectively to guesstimate and book the "economic fair-value" of otherwise illiquid and impaired assets on their balance sheets, rather than to mark-to-market, reflecting values estimated at what would have been obtained in a forced liquidation or actual sale. The resulting inflation in banking balance sheets already is being hyped in the markets, without there being any real change in the underlying financial conditions of the banking industry.

At work here are efforts to rebuild consumer confidence and investor confidence. While these generally are admirable and necessary goals, it would be much healthier for the system if the confidence rebuilding were based on underlying reality, as opposed to fantasies woven by Administration, Federal Reserve and Wall Street spinmeisters. Eventually, the fantasies will unwind, and consumer and investor confidence will take a renewed battering, worse than otherwise would have been seen or necessary.

Deepening Structural Depression Will Be Protracted. As discussed in further detail in *Shadow Government Statistics Newsletters Nos. 47, 48* and *49* (incorporated here by reference), the U.S. economy has entered a long-term structural recession, which rapidly is deepening into a depression (see definitions below). The current depression may be subject to multiple dips, and it is not subject to an easy or quick fix. It is deep enough to absorb the recent stimulus package without the economy breaking above water.

The stimuli put forth by the government and Fed do little to address the structural issues, and thus should have only limited positive impact on economic activity. The government and Fed's actions, however, do offer the promise of much higher inflation. Such, in conjunction specifically with recent Fed moves to accelerate monetization of Treasury debt, and calls among major central banks to replace the U.S. dollar as the global reserve currency, significantly increase the risk of triggering a near-term U.S. hyperinflation as soon as late-2009 or early in 2010. A hyperinflation already was inevitable in the next five years -- before the current systemic solvency crisis -- based on extreme pre-crisis U.S. fiscal abuses. My best estimate on U.S. hyperinflation timing remains in the period from late-2009 to 2014. That outlook will be reviewed and detailed in a pending update and expansion the SGS *Hyperinflation Special Report* of April 8, 2008.

The structural nature of the downturn is tied to the loss of high paying domestic production or technical jobs in recent decades to offshore competition, or where jobs were moved offshore, with a result that U.S. household income has not kept up with inflation. If the consumer's disposable income cannot grow faster than inflation, then neither can economic activity, shy of temporary debt expansion or savings liquidation, which have been stretched to their limits (see the "general background note" below for expanded detail).

Debt expansion has been used in recent decades to fuel U.S. economic growth and to mask the growing structural limitations with consumer income. Given the recent credit market problems, debt expansion no longer can fuel economic expansion, either from the standpoint of consumers, or to an increasing extent from the standpoint of businesses. The only sector of the economy expanding its debt significantly is the federal government. While government borrowing from the public is not inflationary, government borrowing from the Fed is extremely inflationary. Therein lies the problem for ongoing federal debt expansion. With willing purchasers of U.S. Treasuries beginning to dry up, the Federal Reserve stands as a lender of last resort, monetizing federal debt (and other instruments) at an accelerating pace, limited only by its ability to print money and by the eventual costs from the resulting inflation

PLEASE NOTE: *A* ***"General background note"*** *provides a broad background paragraph or section on certain series or concepts that is used in more than one SGS newsletter. Where language used in a past newsletter is repeated in subsequent newsletters (or used repetitively month-after-month), any text changes in such a section are highlighted in italics upon first usage. This is done 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.*

Structural Economic Issues. *General background note (balance of this immediate section):* Direct impact of this circumstance [loss of high-paying production/technical jobs] has been seen in deteriorating U.S. household income, net of taxes and inflation. Using the government's numbers, real (inflation-adjusted) average weekly earnings (Bureau of Labor Statistics) in *March 2009* were down *15%* from the October 1972 high. Average weekly earnings never regained their pre-1973/1975 recession high. Partially as a result, households that once tended to have one breadwinner, now tend to have multiple breadwinners, out of necessity. Even so, the latest poverty survey published by the Census Bureau showed that real household income (average and median) in 2007 still had not regained its pre-2001 recession highs.

The numbers are much worse if the SGS-Alternate Consumer Inflation estimates are used for deflating the income measures. The SGS measure is an attempt to reflect the rate of inflation inherent in maintaining a constant standard of living, as reflected in earlier CPI reporting methodologies. In the real world, average household income has not kept up with the cost of maintaining a constant standard of living, and that shortfall has been met in recent decades, at least partially, by consumers taking on increasing levels of debt.

Indeed, without growth in inflation-adjusted income, real economic growth cannot be sustained, other than through temporary measures such as debt expansion. Aware of this circumstance, former Federal Reserve Chairman Alan Greenspan *et al* did their best to keep the economy growing in recent decades by encouraging unsustainable debt growth, with a resultant economic growth effectively borrowed from the future. The current downturn is akin to something of a payback period.

What I refer to as the "debt standard" was created during the Franklin Roosevelt Administration as replacement for the gold standard. Its expansion through the decades has led to excessive use of debt by government, industry and individuals. In recent years, creative derivative and structured financial instruments have allowed for even greater leverage, building debt excess upon debt excess.

Now, as the debt excesses begin to implode, the federal government, and unusually large segments of local and state governments and the commercial and private sector, face financial distress and possible insolvency. Fallout has been seen in the rapidly intensifying economic contraction.

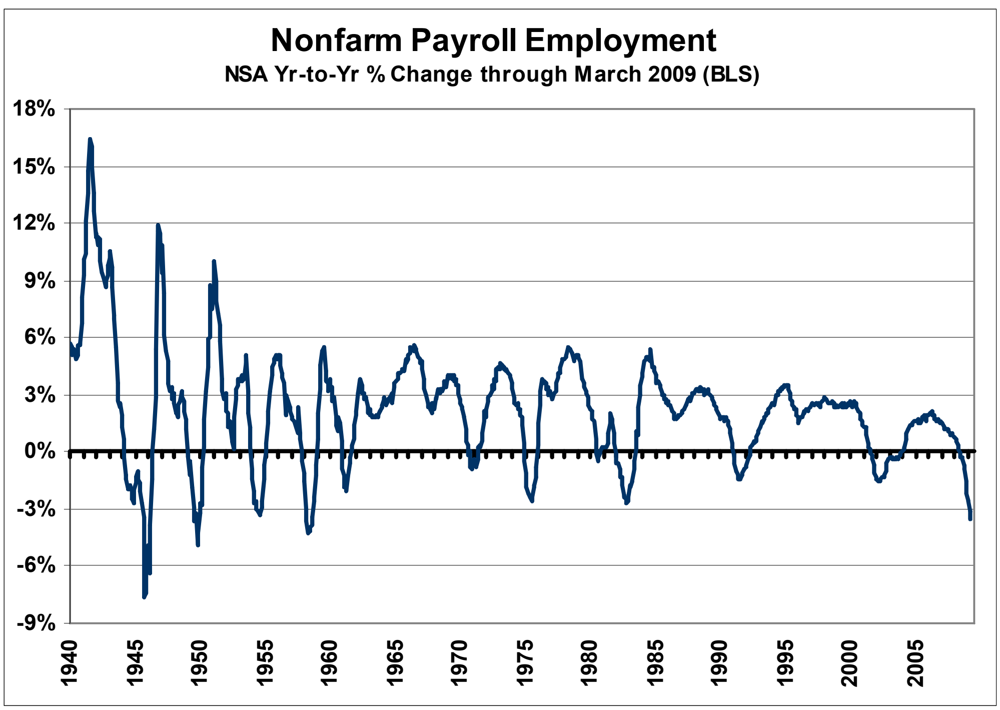
The current recession, however, began before the solvency/liquidity issues came to a head and was itself instrumental in triggering the systemic liquidity crisis. The systemic liquidity crisis, in turn, has severely exacerbated the economic contraction. Neither President Obama's stimulus package nor Messrs. Geithner and Bernanke's still-evolving systemic bailout program will turn the economy fundamentally or provide any lasting prop for the equity market. What these packages do promise is an ongoing effort to maintain a functioning system of depository institutions, and

higher -- much higher -- inflation.
End of general background note.

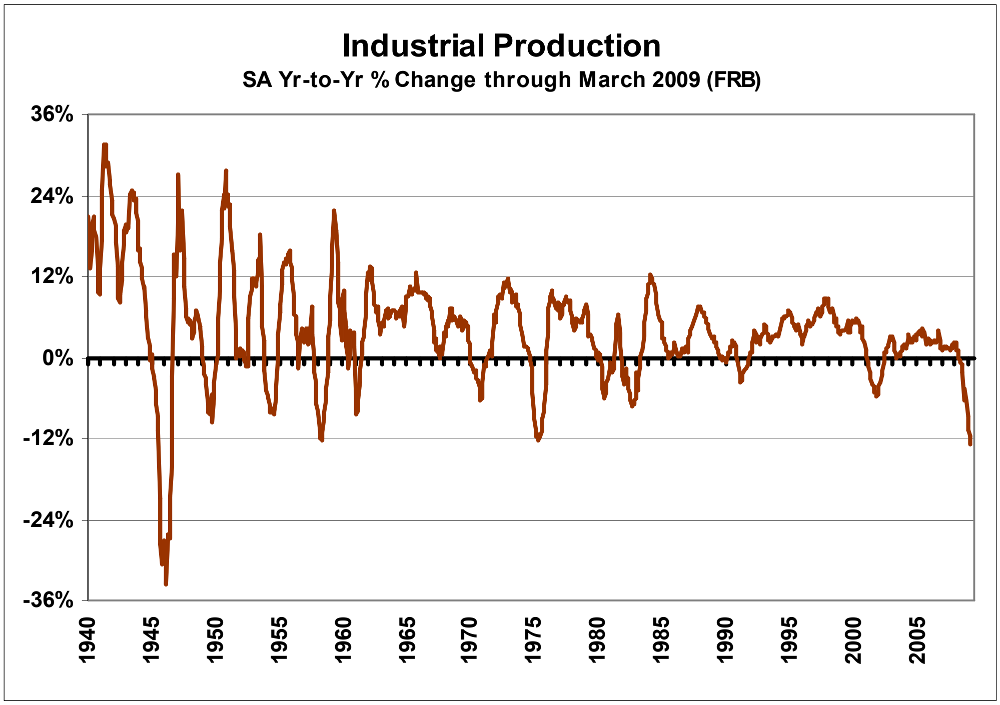
Historical Comparisons Close in on Pre-World War II. Despite temporary hype to the contrary, the U.S. economy has continued in freefall. In the accompanying graphs, payroll employment, industrial production, retail sales and housing starts plots have been extended back through 1940, where available, or otherwise back to the earliest point published for related historical series. While several recent reports have suggested the potential of some bottom-bouncing in the economy at a low-level plateau of business activity, the reported monthly gains were not meaningful (see later Bottom-Bouncing section).

In recent reporting, most key series now have been reported with the worst year-to-year declines since the Great Depression, ignoring the extreme special-circumstance distortions placed on system and the economy by World War II. The exception is nonfarm payroll employment, which was down year-to-year by 3.56% as of March 2009, the weakest showing since July 1958 and the effects of a steel strike.

If the current pace of monthly jobs loss holds above 600,000 for the next three months -- a fair bet -- then the annual percentage decline in payrolls will exceed all but 1949 as of May 2009, and it will be the worst since the shutdown of war production at the end of World War II, as of the reporting for June 2009.



For March 2009, industrial production -- the other series plotted back through 1940 -- showed its greatest year-to-year decline for any month since the shutdown of war production at the end of World War II. March 2009 production was down 12.8% from the year before.

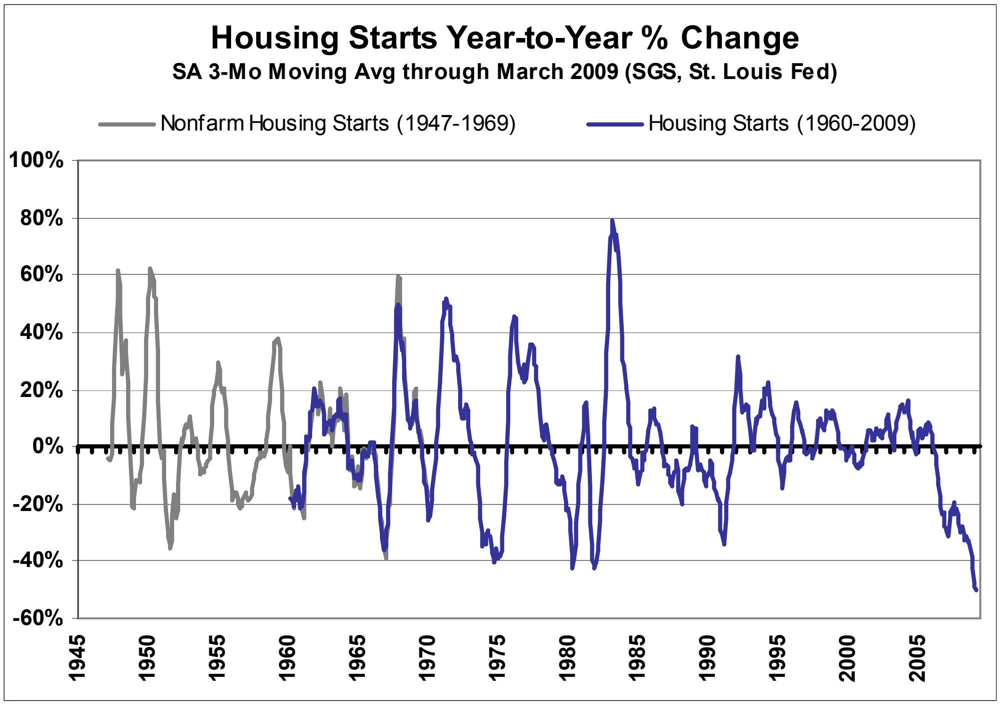


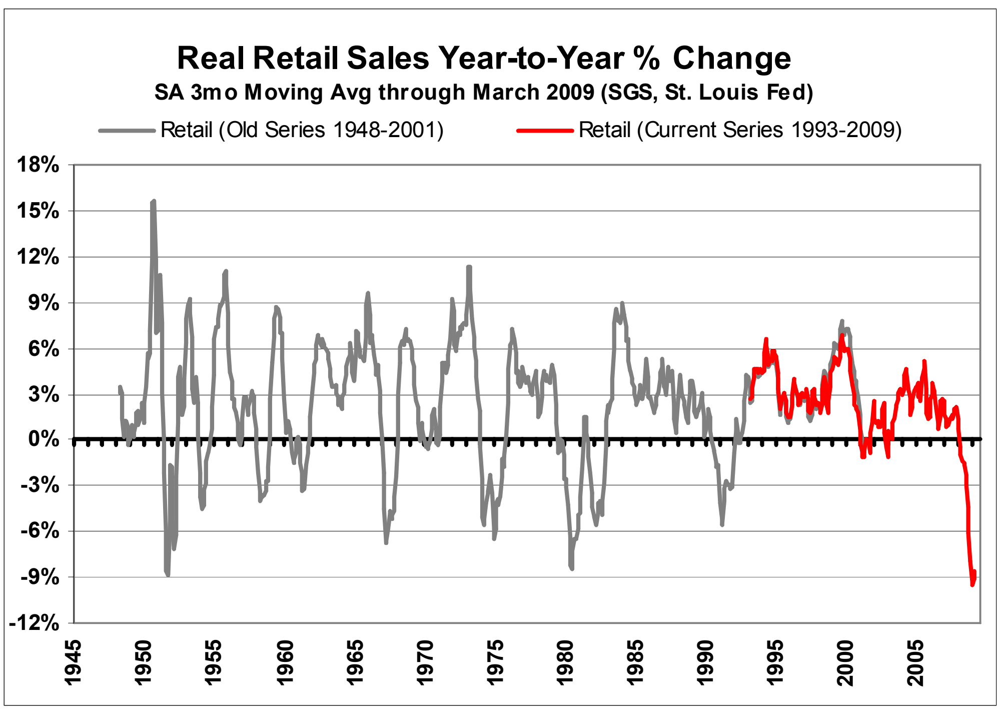
The plots on housing starts and retail sales series include both current the prior historical series, which tend to go back to the end of World War II. Despite series redefinitions, year-to-year change varies little between the old and new versions, allowing for a longer-term historical perspective.

In both the housing starts and retail sales graphs, year-to-year change in the three-month moving average is used in order to soften reporting volatility in the monthly series. In both the housing and retail series, annual growth in the current cycle has hit historic lows and, very likely, the lowest levels seen since the Great Depression, outside of the World War II systemic upheaval.

First-Quarter GDP Contraction Should Deepen. In terms of annualized growth, key indicators suggest the inflation-adjusted GDP decline in the first quarter should be worse than the fourth-quarter's 6.3% loss. Given the heavily politicized nature of GDP reporting, though, such a result is far from certain.

Consider that seasonally-adjusted nonfarm payrolls contracted by an annualized 5.9% in the first quarter versus a 3.7% contraction in the fourth. Aside from any gimmicking issues, the nonfarm payrolls series is the broadest coincident indicator of domestic economic activity that has any basis in actual surveying. Seasonally-adjusted industrial production contracted at an annualized 20.0% pace in the first quarter, versus a 12.7% drop in the fourth. In earlier times, industrial production was used as a surrogate for broad economic reporting.





Housing starts (seasonally-adjusted, three-month moving average) fell at an annualized 60.5% in the first quarter, versus a 67.7% contraction in the fourth. Only inflation-adjusted retail sales (seasonally-adjusted, three-month moving average) showed a large narrowing in contraction, with sales down an annualized 2.5% in the first quarter, versus an 18.8% drop in the fourth. The retail sales result, however, was of suspect reporting (see the Reporting/Market Focus).

Depths of Contraction Breach Depression and Great Depression Definitional Barriers. Furthermore in terms of peak-to-trough contraction, definitional barriers have been broken by key series. By SGS definition, a depression is a peak-to-trough contraction in inflation-adjusted GDP (broad economic activity) in excess of 10%; a great depression is a peak-to-trough contraction in excess of 25%. Even as reported with official GDP, a depression is probable in the current downturn. A great depression, however, likely will evolve primarily as a result of the inevitable hyperinflation, where normal commerce simply would cease to function.

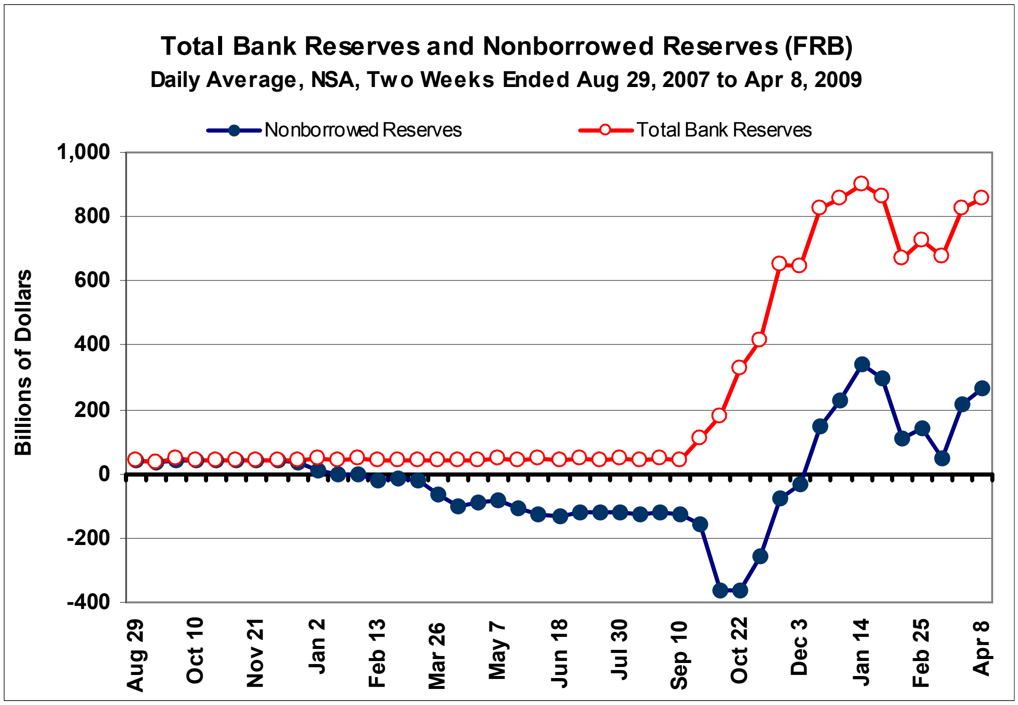
In the current cycle, inflation-adjusted retail sales (seasonally-adjusted, three-month moving average) have declined peak-to-trough by 10.4%, and industrial production has dropped 13.3%. Accordingly, both those series are in depression territory.

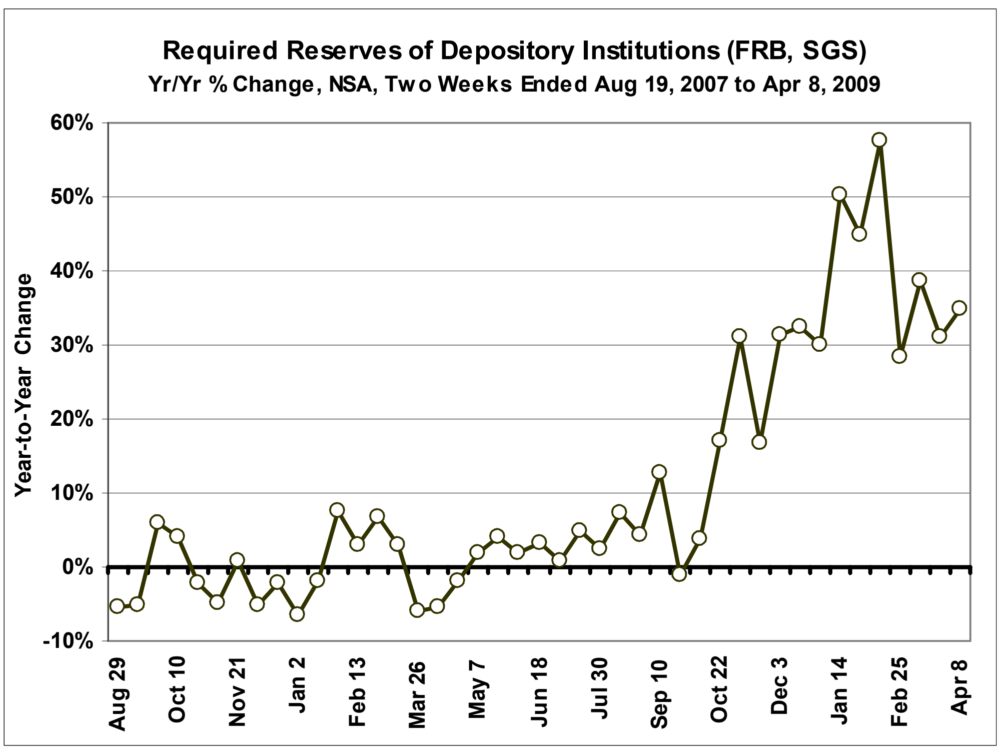
New orders for durable goods (seasonally-adjusted, three-month moving average) have declined peak-to-trough by 25.4%, breaking into the range of a great depression. The real contraction would be greater, if there were an adequate inflation series for deflating durable goods. For housing starts (seasonally-adjusted, three-month moving average), the peak-to-trough decline has hit 75.5%. Both series here are in great-depression territory.

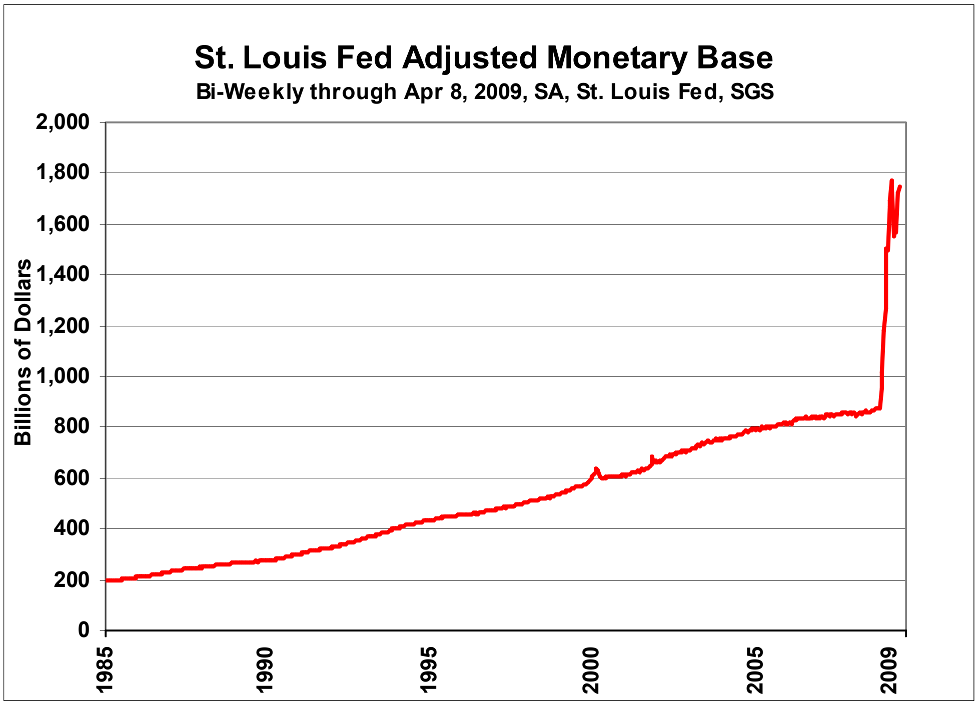
Some Bottom-Bouncing Remains Likely, But Not Yet. As discussed in the various sections related to the indicators mentioned below, reporting in the last month or so has generated some possible signals of bottom-bouncing, where tumbling business activity begins to bounce along a low-level plateau of activity. Such usually happens in protracted and severe downturns, but it has not happened in the current circumstance, yet. When it does, it likely will serve as a just a temporary pause in the current ongoing business freefall, as part of the formation of multiple-dip recession/depression.

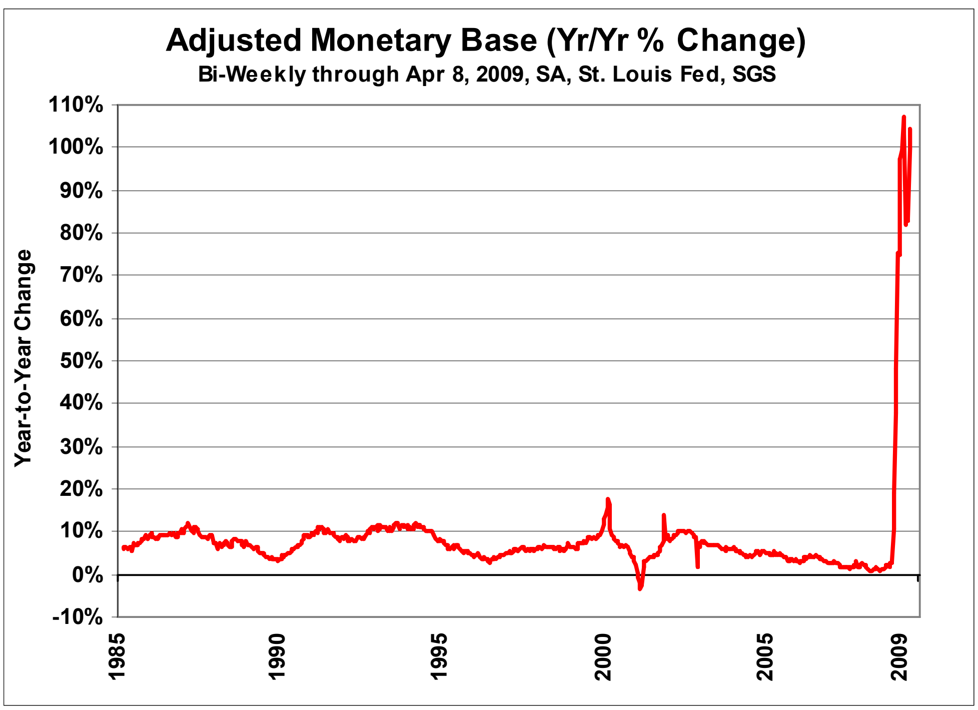
In terms of the recent grasping at straws by spinmeisters on Wall Street, at the Fed and in the Administration, most monthly gains simply were not statistically meaningful (housing data, new orders for durable goods, new claims for unemployment insurance, early-month consumer sentiment), while annual growth continued in significant deterioration. Some had unusual seasonal-factor distortions (retail sales). Subsequent reporting in certain series also has reversed the market-stirring prior gains (housing, retail sales). Again, these series are discussed in their regular sections in the Reporting Perspective.

Broad Money Supply Has Failed, So Far, to Respond to Continued Boom in Monetary Base. The latest release of bank reserves data showed the annual growth in the St. Louis Fed's Adjusted Monetary Base rebounding to 105.5% in the two weeks ended April 8th, up from 99.5% in the prior two-week period, reflecting the intensified systemic liquefaction efforts by the Fed, following the March FOMC meeting. Such was up from its recent trough of 81.9% in the two weeks ended February 11th but still was shy of the record 107.2% seen in the two weeks ended January 14th. The bulk of volatility in the series has been due to variations in excess reserves. The monetary base (basically currency plus bank reserves) is the Fed's primary tool for targeting growth in the money supply.

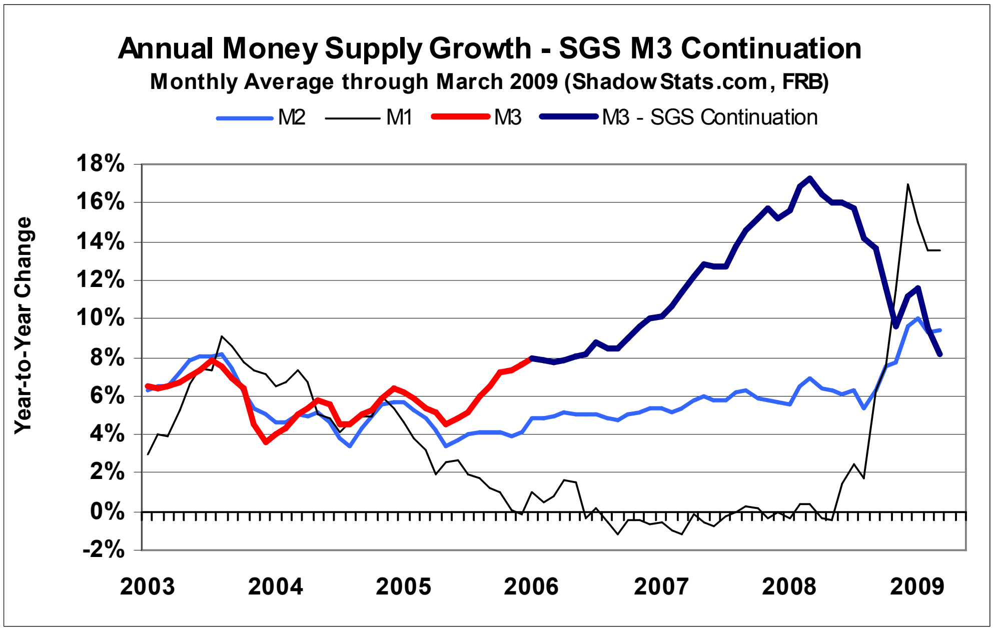

Total Bank Reserves and Nonborrowed Reserves (FRB)
Daily Average, NSA, Two Weeks Ended Aug 29, 2007 to Apr 8, 2009
Nonborrowed Reserves
Total Bank Reserves
Billions of Dollars
1,000
800
600
400
200
0
-200
-400
Aug 29
Oct 10
Nov 21
Jan 2
Feb 13
Mar 26
May 7
Jun 18
Jul 30
Sep 10
Oct 22
Dec 3
Jan 14
Feb 25
Apr 8


Required Reserves of Depository Institutions (FRB, SGS)
Yr/Yr % Change, NSA, Two Weeks Ended Aug 19, 2007 to Apr 8, 2009
Year-to-Year Change
60%
50%
40%
30%
20%
10%
0%
-10%
Aug 29
Oct 10
Nov 21
Jan 2
Feb 13
Mar 26
May 7
Jun 18
Jul 30
Sep 10
Oct 22
Dec 3
Jan 14
Feb 25
Apr 8





Of continued significance to the broader money measures, annual growth in required reserves (seasonally-unadjusted) rose to 34.8%, up from 31.2% in the prior two weeks. Such remained shy of the record 57.6% annual growth reported for the two weeks ended February 11th. Aside from higher growth seen recently, though, the current growth remained in record-high post-World War II territory. It suggests ongoing growth in depository accounts. The preceding four graphs were updated for the latest detail in terms of bank reserves and the monetary base.



Stalling Broad Money Growth Suggests Pressures on Fed for Expanded Action. Despite the U.S. Treasury's plan for subsidizing an arrangement with private investors to purchase so-called "toxic assets" from banks' balance sheets, the approach likely will not have much positive impact on the systemic solvency crisis. Assuming that the assets were sold at a realistic value, the selling banks would have to recognize actual losses, instead of enjoying fantasy value enabled by the recent revamping of accounting rules. The Fed's extreme liquefaction of the U.S. financial system has not had its desired effects, yet, either.

In the ongoing systemic solvency crisis, periods of slowing broad money growth appear to have signaled periods of crisis intensification. Given no signs of relief for broad money growth -- the latest weekly numbers show sharp contraction in M2 and little net change in the other published M3 components -- the Federal Reserve appears to be under intensified near-term pressure for further unusual and/or excessive actions. Those pressures for increased U.S. dollar debasement (inflation creation) recently were intensified by the reporting of formal CPI-U annual deflation in March 2009, the first such number since Dwight Eisenhower was U.S. President.

As shown in the money supply graph, and as detailed in the Money Supply section in the Reporting Perspective, year-to-year change in the seasonally-adjusted estimate SGS-Ongoing M3 has continued to soften, hitting 8.1% in March, versus 9.5% in February and a short-lived, near-term peak of 12.6% annual growth in January. The slowing growth in February was a signal for the Fed to begin monetizing longer-term debt (unexpected at the time by the markets). The Fed's effort at debasing the U.S. dollar by exploding the monetary base has yet to flow through to the broader money measures, but it will.

Little Choice But for Greater Debt Monetization. As discussed in the Federal Deficit section, the rolling 12-month federal deficit through March 2009 was $1.1 trillion, up from $0.2 trillion in March 2008. Gross federal debt as of March 31st was up by $1.7 trillion from the year before. The official deficit should top $2 trillion in the 2009 fiscal year, as outlays explode wildly and as depression-impaired tax revenues fall off sharply. As a result, U.S. Treasury funding needs in the months ahead will exceed market expectations significantly.

The timing of such funding needs is unfortunate, however, given the coincident growing reluctance of domestic and foreign investors to hold dollar-denominated U.S. Treasury instruments. Normal market forces would push Treasury yields higher, but the Fed still is trying actively to debase the U.S. dollar, to create domestic inflationary pressures. The U.S. central bank stands eagerly now as buyer of last resort for U.S. Treasuries. Such debt monetization tends to be particularly stimulative to broad money growth and is inflationary. The Treasury's cash here is provided by the Fed, not drained from the working capital of an otherwise purchasing investment community, and the funds from the Treasury usually flow through the private sector on their way to getting deposited into the banking system.

Inflation Remains the Concern: No Practical Way Out for the Fed in Reversing Dollar Debasement Actions. Mr. Bernanke is dedicated to debasing the U.S. dollar, in order to create inflation and to avoid deflation (he outlined such plans to avoid deflation while a Federal Reserve Governor in 2002). Accordingly, it seems somewhat silly for the Fed to assure the markets that its policies will not create inflation, where such actually is the intent of the policies. The assurances here presumably are that inflation will not get out of control, but control is not easily or likely had.

The latest assurances that the Fed's massive liquidity creation will not create inflation came from Federal Reserve Vice Chairman Donald L. Kohn in an April 18th speech, "Monetary Policy in the Financial Crisis:"

"Will These Policies Lead to a Future Surge in Inflation? No, and the key to preventing inflation will be reversing the programs, reducing reserves, and raising interest rates in a timely fashion. Our balance sheet has grown rapidly, the amount of reserves has skyrocketed, and announced plans imply further huge increases in Federal Reserve assets and bank reserves. Nonetheless, the size of our balance sheet will not preclude our raising interest rates when that becomes appropriate for macroeconomic stability. Many of the liquidity programs are authorized only while circumstances in the economy and financial markets are 'unusual and exigent,' and such programs will be terminated when conditions are no longer so adverse. Those programs and others have been designed to be unattractive in normal market conditions and will naturally wind down as markets improve.

"However, our newly purchased Treasury securities and MBS will not mature or be repaid for many years; the loans we are making to back the securitization market are for three years, and their nonrecourse feature could leave us with assets thereafter. But we have a number of tools we can use to absorb the resulting reserves and raise interest rates when the time comes. We can sell the Treasury and agency debt either on an outright basis or temporarily through reverse repurchase agreements, and we are developing the capability to do the same with MBS. We are paying interest on excess reserves, which we can use to help provide a floor for the federal funds rate, as it does for other central banks, even if declines in lending or open market operations are not sufficient to bring reserves down to the desired level. Finally, we are working with the Treasury to promote legislation that would further enhance our toolkit for absorbing reserves."

The problems here are at least twofold. First, any return to economic or financial-market normalcy is years off in the future. To the extent that the Fed's programs work in restoring economic and systemic normalcy, such would have to be in place and moving solidly under its own power, before the Fed would pull the plug on its various supports, potentially risking a relapse of the systemic crash. Inflation likely would have a strong footing before then.

Second, with a looming massive sell-off in the U.S. dollar, the Fed will have no market for the Treasuries it has been and will be monetizing. The Fed's eventual choices would be to dump its Treasury holdings, spiking U.S. rates and tanking the U.S. markets and economy, or to continue to monetize the growing and increasingly unwanted federal debt, further fueling inflationary pressures.

Do Not Mistake Declining Living Standards for Deflation. The popularly-followed CPI-U inflation measure just turned in its first formal deflation reading (year-to-year contraction) in 54 years. With March 2009 reflecting annual deflation of 0.4%, the SGS-Alternate Consumer Inflation measures still reflect annual inflation ranging from somewhat below 3% to roughly 7%, with the 7% being my best estimate of where current CPI reporting would be, if it were calculated using the methodologies in place as of 1955, the time of the last formal deflation reading.

In terms of official inflation reporting, the recent downturn in aggregate prices has been due largely to collapsing oil and gasoline prices. Energy prices are on the rise again, however, and they should help to bottom the annual CPI inflation measures at close to current levels. Still, the question arises as to the differences between the official and SGS measures. The biggest differences between the official CPI reporting measures and the SGS measures are whether they reflect the cost of maintaining a constant standard of living (the official CPI measure no longer do so), including hedonic adjustments for quality changes that cannot be directly measured and that have little relationship to common experience (see the SGS *Response to BLS Article on CPI Misconceptions* on www.shadowstats.com).

Hedonic quality adjustments continue to depress prices on computers, other electronic equipment, appliances, automobiles, etc., even though consumption of such items may not be strong. Consider, too, that in a recession, consumers who used to eat out once or twice a week might cut back as to frequency and/or cost of the dining facility. While such may feel like deflation to the participant, it does not reflect the cost of maintaining a constant standard of living. Such, however, would be picked up as deflationary pressure in official CPI reporting, with the pending reweighting of CPI expenditure categories.

Weakness in Debased U.S. Dollar Likely to Trigger Inflation Surge. The FOMC announced on March 18th, that, "to help improve conditions in private credit markets, the Committee decided to purchase up to $300 billion of longer-term Treasury securities over the next six months." The market did not anticipate the announcement, and such generated a quick 5% hit on the U.S. dollar in the currency and gold markets, as well as a corresponding boost in oil prices. Such offered some flavor of what lies ahead for the U.S. dollar and domestic inflation.

The efforts at U.S. dollar debasement by the Federal Reserve not only will spike broad money supply growth eventually, but also will contribute to massive selling pressure against the U.S. dollar in the currency markets. Foreshadowing the latter, comments and actions by a variety of U.S. trading partners, including China, have been critical of U.S. Treasury and Federal Reserve policies and have indicated a growing wariness among central banks of holding U.S. dollars and dollar-denominated U.S. government or quasi-U.S. government securities. China, in particular, has called for the use of expanded special drawing rights (SDR) as a mechanism for holding of currency reserves, in lieu of the U.S. dollar. Any use of a new reserve currency or surrogate in place of the U.S. dollar would generate heavy dollar selling/dumping. The U.S. Treasury Secretary even blundered briefly, suggesting he was open to a change in the U.S. dollar's reserve currency status, before reversing himself, triggering a brief bout of intense dollar selling.

Whenever investors lose confidence in the dollar, and heavy selling commences, the hit on the greenback should be massive. One subscriber likened this circumstance to what happened to the currency of the Confederate States of America, when holders of CSA money dumped it as being worthless, or having the prospects of becoming worthless in the very near term.

Heavy dollar selling, in turn, would spike the dollar-denominated prices of key commodities, such as oil. Indeed, recent dollar fluctuations have contributed to the recent upturn in oil prices. Abandonment of the U.S. dollar as a reserve currency would only exacerbate the rise in oil and other global commodity prices in dollar terms.

Oil prices spiking due to dollar debasement, instead of strong economic demand, would trigger a non-economic-demand-driven inflation in the United States. Such was seen last year, with a crashing dollar, rising oil prices and spiking domestic inflation. It is on such inflation that the Fed's dollar debasement could feed and fuel the early stages of an eventual hyperinflation.

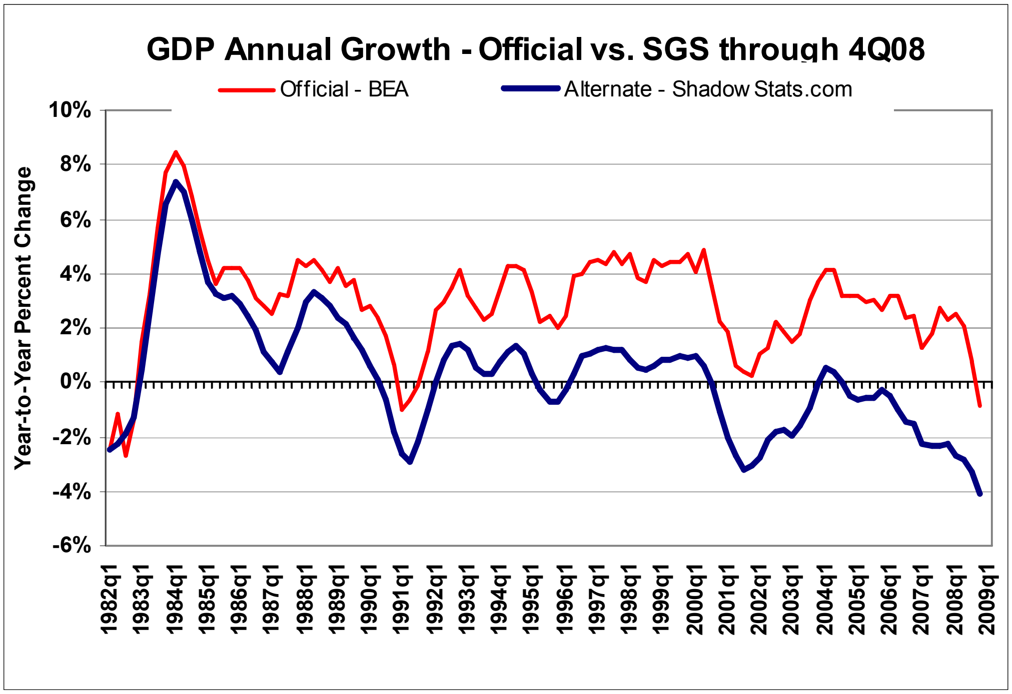
A Penny for All Your Debts and Obligations. I recently received a framed sampling of Zimbabwe (formerly Rhodesia) currency from my son as a birthday present. Zimbabwe has been through a number of years of high inflation and hyperinflation, and through three devaluations, where excess zeros repeatedly were lopped off notes as high as 100 trillion Zimbabwe dollars. My son noted that a stack of current two dollar bills equal in value to a single Zimbabwe two-dollar bill of 1978 would stretch from the Earth to the Andromeda Galaxy.

My definition of hyperinflation has been that when the largest currency note in circulation before the inflation (a $100 bill in the case of United States) becomes worth more as functional toilet paper than as currency, one has a hyperinflation. Along those lines, a subscriber recently forwarded an image of a restroom facility at a South African border station with Zimbabwe, where a sign directed that Zimbabwe dollars were not to be used as toilet paper.

The governor of the Zimbabwe Reserve Bank recently indicated he felt his actions in printing money were vindicated by the recent actions of the U.S. Federal Reserve. If the U.S. went through a hyperinflation like that of Zimbabwe's, total U.S. federal debt and obligations (over $65 trillion with unfunded liabilities) could be paid off for much less than a current penny.

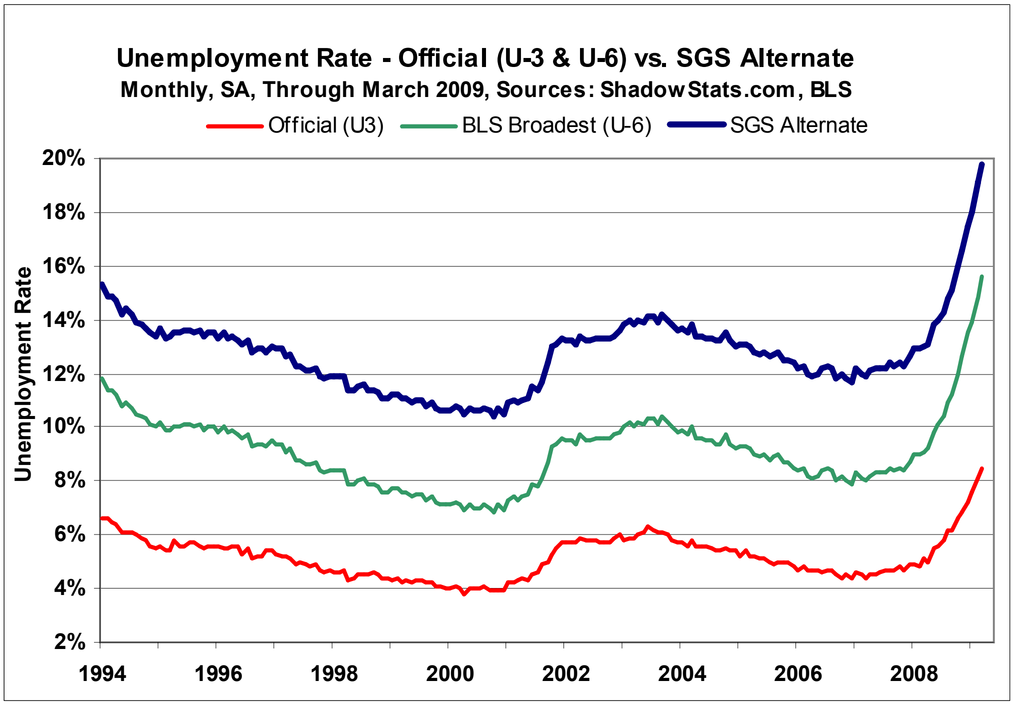
What helped enable the evolution of the Zimbabwe monetary excesses over the years, while still having something of a functioning economy, was the back-up of a well functioning black market in U.S. currency. The United States has no such backup, however, with implications for a more rapid and disruptive hyperinflation than seen in Zimbabwe, when it hits. These areas will be more fully explored in the pending update to the SGS *Hyperinflation Special Report.*

Alternate Realities. This section updates the Shadow Government Statistics (SGS) alternate measures of official GDP, unemployment and CPI reporting. When a government economic measure does not match common public experience, it has little use outside of academia or the spin-doctoring rooms of the Federal Reserve, White House and Wall Street. In these alternate measures, the effects of gimmicked methodological changes have been removed from the official series so as to reflect more accurately the common public experience, as embodied by the pre-Reagan-Era CPI and GDP and the pre-Clinton Era unemployment rate. Methodologies for the GDP and CPI series are discussed in the August 2006 SGS.



GDP. The alternate fourth-quarter 2008 GDP growth reflects the "final" estimate, with many of the methodological gimmicks of recent decades removed. The alternate fourth-quarter inflation-adjusted annual growth rate (year-to-year, as opposed to the popularly-touted annualized quarter-to-quarter rate) for GDP was a decline of roughly 4.1% versus the official year-to-year contraction of 0.8%. The official, annualized real quarter-to-quarter change stands at a 6.3% contraction. While the quarterly growth number is popularly followed, its significant inaccuracies are expanded to the fourth-power in reporting. The alternate measure safely would have shown an annualized quarterly contraction in the fourth quarter in excess of seven-percent.

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, which are major indicators used by the National Bureau of Economic Research in determining the official timing of U.S. business cycles.



Unemployment Rate. Shown are two official seasonally-adjusted unemployment measures, U.3 and U.6, and the SGS-Alternate Unemployment Measure. The various measures moved sharply higher again in March, reflecting continued rapid deterioration in labor-market conditions. The March rates stood respectively at 8.5%, 15.6% and 19.8%, up from 8.1%, 14.8% and 19.1% in February.

The average person has a pretty good sense as to whether or not he or she is unemployed, regardless of varying official definitions. It is to the broad, common-experience unemployment measure that the SGS-Alternate Unemployment Measure is addressed; its calculation is described below. Ask people simply if they are employed or unemployed, and the response likely would indicate an unemployment rate much closer to 19.8% than to 8.5%.

As to how the rates line up historically, the widely circulated estimate of 25% peak unemployment in 1933 of the Great Depression was guesstimated from a variety of sources as late as 1940. Unemployment was not surveyed at the time. The 1933 estimate appears to reflect what I would call a broad unemployment definition. Where roughly 28% of employment then was agricultural, the nonfarm unemployment rate was estimated at a peak of 34% in 1933. With less than 2% of current employment accounted for by agriculture, the 34% unemployment rate might be the better one to use in comparing the 1933 circumstance with today's.

Putting the SGS-Alternate Unemployment Measure into perspective, in the best of times, it would have fallen perhaps into the 8% to 9% range. Now approaching 20%, it likely is comparable to the experience in the 1973/1975 recession and still is well shy of the 34% peak reported in 1933.

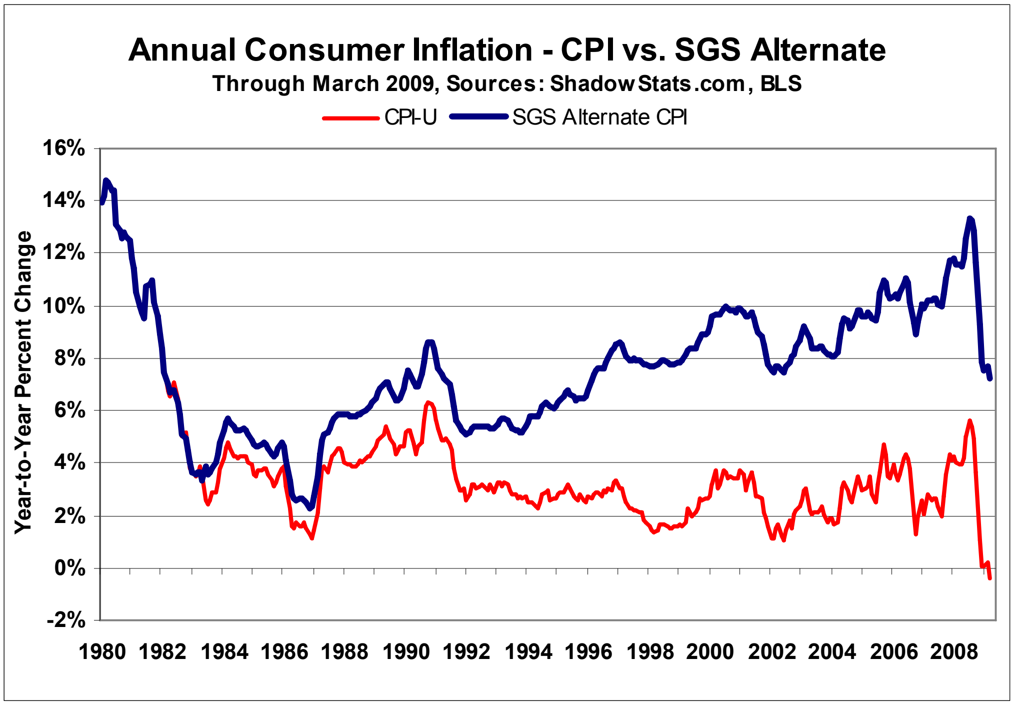
General background note: U.3 is the popularly followed unemployment rate published by the Bureau of Labor Statistics (BLS), while U.6 is the broadest unemployment measure published by the BLS. U.6 is defined as total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers. Marginally attached workers include the discouraged workers who survived redefinition during the Clinton Administration. The SGS-Alternate Unemployment Measure simply is U.6 adjusted for an estimate of the millions of *old-definition* discouraged workers defined away during the Clinton Administration -- those who had been "discouraged" for more than one year.

General background note: Historical data on both the official and SGS-Alternate unemployment series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate numbers are reported from the 1994 series redefinitions forward. *While it had been planned to take the alternate series further back in time, such appears to be impractical at the moment, given the lack of ongoing or parallel alternate data, as well as lack of good quality estimates of the impact of methodological shifts.*

CPI. Irrespective of the rebound in oil and gasoline prices, March's annual full inflation rates sank anew due to "declining" energy costs, while so-called "core" inflation held steady on an annual basis. CPI-U (I.7) turned negative, year-to-year. Curiously, the February PCE Deflator (I.5 in the accompanying table), which tends to track closely with the C-CPI-U (I.6), continued to show annual inflation holding well above the C-CPI. Such remains suggestive of conflicting issues in handling energy costs in the government's various inflation measures.

Nonetheless, with oil prices generally moving higher again, current annual inflation rates should be at or near the trough of the current cycle. Prospective stronger broad money growth and a prospective weaker U.S. dollar (higher related oil prices) threaten much higher inflation ahead this year and next.

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. *The changes made are additive, reflecting BLS estimates of the impact of the various methodological changes on the aggregate annual inflation rate.* 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.



Ten Levels of Consumer Inflation
Annual Inflation for December 2008 to March 2009

Measure		Dec	Jan 09	Feb	Mar
I.1	Core PCE Deflator (BEA) (r)	1.8%	1.7%	1.8%	n.a.
I.2	Core Chained-CPI-U (BLS) (r)	1.3%	1.2%	1.3%	1.3%
I.3	Core CPI-U (BLS)	1.8%	1.7%	1.8%	1.8%
I.4	Core CPI-W (BLS)	1.7%	1.7%	1.7%	1.8%
I.5	PCE Deflator (BEA)	0.8%	0.8%	1.0%	n.a.
I.6	Chained-CPI-U (BLS) (r)	-0.5%	-0.5%	-0.3%	-0.8%
I.7	CPI-U (BLS)	0.1%	0.0%	0.2%	-0.4%
I.8	CPI-W (BLS)	-0.5%	-0.5%	-0.3%	-0.9%
I.9	Pre-Clinton CPI-U (SGS)	3.4%	3.3%	3.6%	2.9%
I.10	SGS Alternate Consumer Inflation	7.8%	7.5%	7.7%	7.3%

Sources: SGS, BLS (Bureau of Labor Statistics), BEA (Bureau of Economic Analysis).
Notes: (r) Revised. I.1 to I.4 reflect the core inflation rates, respectively, of the substitution-based personal consumption expenditure (PCE) deflator, the substitution-based Chained-CPI-U, and the geometrically-weighted CPI-U and CPI-W. I.5 to I.8 are the same measures, as standardly reported, with energy and food inflation included. The CPI-U (I.7) "all urban consumers" is the measure popularly followed by the financial press, when the media are not hyping core inflation. The CPI-W (I.8) "urban wage earners and clerical workers is a narrower measure, more heavily weighted in basics such as gasoline, and used in calculating cost-of-living adjustments for items such as Social Security Payments. I.9 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.10 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.

