

John Williams'

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REPORTING PERSPECTIVE

The Big Three Market Movers

Underlying economic fundamentals continue in freefall, but some bottom-bouncing is inevitable. In a desperate effort to boost consumer and investor confidence, Wall Street, the Administration and the Federal Reserve already are talking up the softening of the downturn, with little if any evidence of such in hand. Given unusual reporting and revisions in recent months (see the Reporting/Market Focus), the numbers gaming at the moment seems to have shifted from scaring the public into backing stimulus/ bailouts to upping month-to-month economic results as an aid to developing recovery hype.

I still contend that any near-term bottom-bouncing does not necessarily mean looming economic recovery, but rather some bottom-bouncing as the broad economy hits a low-activity plateau, before rolling down hill again -- albeit with occasional bumps -- in a further downleg of a multiple-dip recession/depression.

Happier economic news also is needed by Messrs. Bernanke and Geithner in an effort to support a stable or relatively strong U.S. dollar in the still-deepening systemic solvency crisis. Such also requires contained inflation numbers. With the financial crisis remaining a threat to national

security, almost anything remains possible in the arena of data and market manipulations. Data manipulation is an extremely inexpensive and effective policy tool, but its use presumably depends to a certain degree on perceived financial-market vulnerability.

Absent manipulation, and against market expectations that have softened some, recently, most near-term economic reporting still should tend to surprise the markets on the downside. With inflation expectations having tanked along with oil prices, going forward, inflation reporting should begin to surprise expectations on the upside.

Employment/Unemployment -- As discussed in the April 3rd *Flash Update*, and as explored and graphed in the Opening Comments section, payrolls continued to sink monthly, quarterly and annually, in line with an unfolding depression. Also, as separately explored in the Reporting/Market Focus, the government's payroll reporting is, at best, seriously flawed. It underreports jobs losses meaningfully, as demonstrated in patterns of revisions and in the Concurrent Seasonal Factor Bias (CSFB).

The reported March jobs loss of 663,000 again was close to consensus expectations, but, as has been common in recent releases, major downward revisions to prior reporting helped to mute the current headline jobs loss significantly. Net of revisions, the March jobs loss would have been 749,000. Net of the CSFB, the loss would have been 750,000, in line with my estimate in the March 29th *Flash Update*.

Payroll Survey. The BLS reported a statistically-significant, seasonally-adjusted jobs loss of 663,000 (down 749,000 net of revisions) +/- 129,000 (95% confidence interval) for March 2009, following an unrevised 651,000 jobs loss in February, but January's jobs loss was revised from 655,000 to 741,000. Annual contraction (unadjusted) in total nonfarm payrolls continued to deepen, down 3.56% in March, versus a revised 3.10% (was 3.12%) in February. The annual decline in March was the deepest since July 1958. The seasonally-adjusted series also continued contracting year-to-year, down by 3.48% in March versus a revised 3.08% (was 3.02%) contraction in February.

Concurrent Seasonal Factor Bias. The pattern of impossible biases being built into the headline monthly payroll employment continued with March 2009 reporting (see the opening section above, the current Reporting/Market Focus. Instead of the headline jobs loss of 663,000, consistent application of seasonal-adjustment factors -- net of what I call the concurrent seasonal factor bias -- would have shown a more-severe monthly jobs loss of about 750,000. This upside reporting bias has been seen in 11 of the last 12 months, with a rolling 12-month total upside headline-number bias of 1,345,000. A worksheet on this is available upon request.

Birth-Death/Bias Factor Adjustment. An element that helped to soften the reported March jobs loss was the monthly upside bias factor (birth-death model). Never designed to handle the downside pressures from a recession, the model adds a fairly consistent upside bias to the payroll

levels each year, averaging about 60,000 jobs per month, assuming the BLS adequately is seasonally adjusting for same. The upside adjustment to unadjusted March 2009 payrolls was 114,000, versus 134,000 in February.

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 multiple job holders), showed March employment down by 861,000, where February had been down by 351,000.

The March 2009 seasonally-adjusted U.3 unemployment rate showed still another statistically-significant increase, to 8.54% +/- 0.23%, from 8.08% in February. Unadjusted U.3 rose to 9.0% in March from 8.9% in February. The broader March U.6 unemployment rate jumped to an adjusted 15.6% (16.2% unadjusted) from 14.8% (16.0% unadjusted) in February.

During the Clinton Administration, "discouraged workers" -- those who had given up looking for a job because there were no jobs to be had -- were redefined so as to be counted only if they had been "discouraged" for less than a year. This time qualification defined away the bulk of the discouraged workers. Adding them back into the total unemployed, unemployment in line with common experience, as estimated by the SGS-Alternate Unemployment Measure, rose to about 19.8% in March, from 19.1% in February.

Employment Environment. The continued significant deterioration in March's employment environment broadly was in line with deterioration in the better-quality employment-environment indicators, which not only led the March report, but also are leading indicators to the April report:

February newspaper help-wanted advertising was down by a record 44.6% year-to-year change on a three-month moving average basis. Similar, deepening annual fall-offs were seen in the nascent online help-wanted advertising measures.

New claims for unemployment insurance have continued to surge, with the 17-week moving average up by 73.7% as of April 11th (the highest since the 1975 recession).

Employment readings continued in the deepest recession territory for the February and March manufacturing and non-manufacturing purchasing managers surveys.

Next Release (May 8): With continuing deterioration in underlying economic activity, the March payroll survey should plunge again, by more than 700,000 jobs, along with a further spike in the unemployment rate. Odds favor actual reporting that is somewhat more positive than whatever the consensus outlook is the week before the release.

Gross Domestic Product (GDP) -- As discussed in the March 26th *Flash Update*, the Bureau of Economic Analysis' (BEA) "final" estimate revision of real (inflation-adjusted) annualized growth in the fourth-quarter 2008 GDP was little more than statistical noise. The revised decline of 6.34% +/- 3% (95% confidence interval) was little changed from the "preliminary" estimate of 6.25%, but deeper than the initial "advance" estimate of a 3.80% contraction. Such was against a 0.51% downturn reported in the third quarter. In terms of year-to-year change, the fourth quarter contraction now stands at 0.84%, versus the "preliminary" 0.82% and "advance" 0.18% contractions, and versus the third quarter's annual gain of 0.75%.

The fourth-quarter GDP inflation rate (GDP deflator) revised minimally to 0.61% from 0.51%, accounting for the minor downward revision to the real GDP change. The nominal (not-adjusted-for-inflation) GDP, was unrevised in aggregate. The "advance" fourth-quarter deflator estimate was a 0.26% contraction, versus an indicated annualized third-quarter inflation rate of 3.88%.

Based on earlier reporting methodologies and removal of some reporting gimmicks, the SGS-

Alternate GDP estimate for the fourth quarter remains an annual (not annualized) contraction of roughly 4.1% versus a 3.3% contraction in the third quarter, against official respective estimates of a 0.8% decline and 0.7% gain. Against reporting of underlying economic series, the annualized quarterly contraction likely was in excess of 7% for the fourth quarter, but the latest revised 6.3% estimate remains the closest to reality reported by the BEA in a long time (see the Alternate Realities section of the Opening Comments). Nonetheless, GDP reporting remains virtually worthless and is little more than political propaganda.

GDI Shows Greater Economic Weakness Than GDP: The BEA's GDP-like measures for fourth-quarter 2008; 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 income-side equivalent of the GDP's consumption estimate; were estimated for the first time in the "final" fourth-quarter report.

Annualized real GNP growth for fourth-quarter 2008 was reported as a 5.49% contraction, down from a 0.17% contraction in the third quarter. Year-to-change also contracted, down 0.93%, following a 0.83% gain in the third-quarter.

With a widening discrepancy versus GDP, the theoretically-equivalent GDI showed a real fourth-quarter annualized contraction of 7.54%, following a 0.86% contraction in the third quarter. Such was the fifth quarter-to-quarter contraction in real GDI in the last eight quarters of reporting. Year-to-change was a contraction of 2.10%, following a 0.36% contraction in the third-quarter. The latest GDI data reflect several quarters of revisions.

Major GDP Benchmark Revision Scheduled. The Bureau of Economic Analysis (BEA) plans a grand benchmark revision in late-July, including the introduction of new methodologies. The

pending changes will be assessed as details become available. What remains likely is that recent economic history -- as reflected in the GDP -- should appear to have been relatively weaker than initially published. Minimally, the new data should reflect quarterly GDP contractions that go back to at least first-quarter 2008, consistent with the National Bureau of Economic Research's timing of the current recession.

Next Release (April 29): Underlying economic fundamentals suggest that the "advance" estimate of first-quarter 2009 GDP should show a deeper annualized contraction than estimated for the fourth quarter (see Opening Comments). Regardless, actual reporting should come in close to consensus estimates of the week before the release.

Consumer Price Index (CPI) -- As discussed in the April 15th *Flash Update*, despite oil prices rebounding from recent lows, "declining" monthly energy prices pushed the March CPI-U into its first formal deflation (year-to-year decline) since August 1955. As measured by the monthly average spot price of West Texas Intermediate, crude oil prices rose by 22.5% in the month of March 2009, a pace faster than the 10.7% monthly gain seen in March 2008. Energy prices in the March CPI-U, however, reportedly dropped on a monthly basis by a seasonally-adjusted 3.0% (down 0.7% unadjusted). Part of the inflation hit was due to seasonal adjustments that largely are ignored by inflation purists (the Bureau of Labor Statistics itself reports the CPI-U, upfront, on a not-seasonally-adjusted basis, both in terms of monthly and annual inflation).

Barring a new, extreme collapse in oil prices, the current consumer price deflation -- like the sporadic annual deflation seen in the late 1940s and 1950s -- should be brief and shallow, unlike the catastrophically long and deep deflation of the Great Depression. As a significant aside, if inflation today were calculated the way it was back in 1955, the March 2009, CPI-U annual inflation rate likely would have topped 7% (see

the Alternate Reality section in the Opening Comments). As also discussed in the Opening Comments, the Federal Reserve's efforts at debasing the U.S. dollar are likely to succeed, damaging the greenback's value against other currencies, spiking oil prices and boosting domestic consumer price inflation.

CPI-U. The BLS reported that the seasonally-adjusted March CPI-U (I.3) declined by 0.14% (up by 0.24% unadjusted) +/- 0.12% (95% confidence interval not seasonally adjusted) for the month, versus a 0.39% (0.50% unadjusted) gain in February. Year-to-year inflation (unadjusted) in March turned negative, down by 0.38% +/- 0.20% (95% confidence interval), versus a 0.24% gain in February. For those interested in exploring the various facets of official CPI-U reporting, I continue to refer you to CPIwatch.com, a site prepared by one of my SGS colleagues.

Annual inflation would increase or decrease in April 2009 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.15% monthly increase seen in April 2008. The difference in growth would directly add to or subtract from March's annual inflation rate of negative 0.38%. With upside pressure on oil prices, annual CPI-U should be near its trough for the current cycle, although another month or two of minor official deflation now appears likely.

CPI-W. The BLS reported that the narrower, seasonally-adjusted March CPI-W (CPI for Urban Wage Earners and Clerical Workers) (I.4) declined by 0.14% (gained 0.25% unadjusted), following a 0.44% (0.49% unadjusted) gain in February. Year-to-year inflation declined by 0.92% in March, following a 0.26% decline in February.

C-CPI-U. Year-to-year or annual inflation for the Chain Weighted CPI-U (I.6) -- the fully substitution-based series that increasingly gets touted by CPI opponents and inflation apologists

as the replacement for the CPI-U -- fell by 0.81% in March, versus a decline of 0.26% in February.

Alternate Consumer Inflation Measures.

Adjusted to pre-Clinton (1990) methodology (I.9), annual CPI growth eased to roughly 2.9%, versus 3.6% in February, while the SGS-Alternate Consumer Inflation Measure (I.10), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to roughly 7.3% (7.25% for those using the extra digit), versus 7.7% in February, and has been updated on the Alternate Data tab at www.shadowstats.com. The alternate numbers are not adjusted for any near-term manipulations of the data.

The SGS-Alternate Consumer Inflation Measure adjusts on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made the BLS. Over the decades, the BLS has altered the meaning of the CPI from being a measure of the cost of living needed to maintain a constant standard of living,

to something that no longer reflects the constant-standard-of-living concept. Roughly five percentage points of the additive SGS adjustment reflect the BLS's formal estimate of the impact of methodological changes; roughly two percentage points reflect changes by the BLS, where impact has not been formally published by the BLS.

Next Release (May 15): The April CPI likely will show a small increase for the month, due partially to some uptick in gasoline prices, but minimal annual deflation likely will continue.

Annual inflation would increase or decrease in April 2009 reporting, dependent on the seasonally-adjusted monthly change, versus the 0.15% monthly increase seen in April 2008. The difference in growth would directly add to or subtract from March's annual inflation rate of negative 0.38%.

Longer-range impact from likely renewed dollar weakness, a likely upswing in oil prices and rising broad money growth should tend to generate some upside CPI surprises in later 2009 and into 2010.

Other Troubled Key Series

Federal Deficit. Fiscal conditions continued deteriorating in the latest reporting, with the twelve-month rolling deficit through March 2009 rising to \$1,098.8 billion, from February's \$954.8 billion, from January's \$934.8 billion, which was up from December's \$833.2 billion, November's \$701.3 billion, October's \$635.1 billion and September's \$454.8 billion. In contrast, the 12-month rolling deficit through March 2008 was \$217.1 billion.

Fiscal stresses are going to be severe in the next several years, given the Obama Administration's budget and economic stimulus package boosts to government outlays, and given the sharp hit on tax

receipts from the severe and deepening recession. The 2009 official budget deficit easily should top \$2 trillion, with commensurate funding in excess of that required by the U.S. Treasury.

The official 2008 federal deficit was \$454.8 billion, against a \$161.8 billion deficit in 2007. These are the officially-gimmicked numbers (counting Social Security revenues, but not liabilities, not fully counting the costs of the Iraq War, etc.), using a variation on cash-based accounting, not GAAP reporting. The 2008 GAAP-based deficit (counting unfunded Social Security and Medicare liabilities, etc.), using accrual accounting, was \$5.1 trillion, up from \$1.2

trillion (\$4 trillion-plus, using consistent annual assumptions and accounting) in 2007. The 2009 GAAP-Based deficit likely will top \$8 trillion (nearly half of annual U.S. GDP).

Viewing the change in the level of gross federal debt bypasses several of the regular reporting manipulations of the government's financial results 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 \$11.127 trillion at March 31, 2009, up by \$250 billion for the month, and up by \$1.689 trillion from March 2008, which in turn was up by \$588 billion from March 2007. Gross federal debt stood at \$10.877 trillion at February 28, 2009, up by \$245 billion for the month, and up by \$1.519 trillion from February 2008, which in turn was up by \$580 billion from February 2007.

As of the end of September 2008, the close of the government's fiscal year, gross federal debt stood at \$10.025 trillion, up \$379 billion for the month and up by \$1.017 trillion from September 2007, which in turn was up \$501 billion from September 2006.

Initial Claims for Unemployment Insurance --

The ongoing rapid rise in initial claims for unemployment insurance continued to reflect the severe deterioration in labor market conditions, where a rising growth trend in new claims is an economic negative. On a smoothed basis for the 17 weeks ended April 11th, annual growth hit 73.7%, its highest level since the 1975 recession (the 1980s double-dip recession's peak growth was 59.4%; historical peak growth [March 1975] was 78.8%). The latest growth was up from 69.6% as of the 17 weeks ended March 14th, and up from 55.4% in the 17 weeks ended February 14th. A year ago (April 12, 2008) claims were up 10.0%.

An "unexpected" decline in weekly claims recently was touted as evidence for an economic rebound. Such is nonsense. 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 Good Friday and Easter in the current circumstance. 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 -- Contained primarily by declining hours, versus higher wages and declining inflation, March's seasonally-adjusted monthly real earnings were unchanged for the month, following 0.2% monthly declines in February and January. Annual growth in March was 2.5%, versus 2.6% in February and 3.2% in January. Recent positive annual growth has been due to the collapse in gasoline prices in latter 2008.

General background note: Gyration in the poor quality of reported CPI growth account for most month-to-month volatility in this series. Adjusting for the major upside biases built into the CPI-W inflation measure used in deflating the average weekly earnings, annual change in this series still shows the average worker to be under severe financial stress in a *deepening structural recession/depression* (see *Opening Comments*).

Retail Sales -- As discussed and graphed in the *Opening Comments* and as discussed in the April 14th and 15th *Flash Updates*, March retail sales continued to show annual growth patterns that, other than for recent months, are the weakest seen in post-World II history. Recent revisions show suspect patterns, as discussed in the *Reporting/Market Focus*. The entire series will be recast in a benchmark revision on April 30th.

As reported by the Census Bureau, seasonally-adjusted March retail sales fell by 1.14% (down 0.70% net of revisions) +/- 0.6% (95% confidence interval). Such followed a revised 0.30% monthly gain (previously a 0.11% contraction) in February. On a year-to-year basis, March retail sales fell by

9.41%, versus a revised 7.89% (previously 8.58%) plunge in February. By a wide historical margin, the three-month moving average of the nominal (not-adjusted for inflation) year-to-year contraction continued the worst levels of post-World War II reporting.

Core Retail Sales. Consistent with the Federal Reserve's predilection for ignoring food and energy prices when "core" inflation is lower than full inflation, "core" retail sales -- retail sales net of grocery store and gasoline station revenues -- fell by 1.35% (down 1.02% net of revisions) in March, following a revised 0.11% gain (previously a 0.31% drop) in February. Those numbers contrasted with the official aggregate decrease of 1.14% in March and a revised 0.30% gain in February. On an annual basis, March core retail sales fell by 7.00%, versus a revised 5.25% (was 6.54%) decline in February.

Real Retail Sales. Inflation- and seasonally-adjusted March retail sales fell by 1.01% (down 1.14% before inflation adjustment), versus a February decline of 0.09% (a 0.30% gain before inflation adjustment). Year-to-year, March real retail sales fell by 9.01% (9.41% before inflation adjustment) versus a 7.95% (7.89% before inflation adjustment) decline in February. The annual real change here continued to be skewed by unusual patterns in the seasonally-adjusted CPI-U used in deflating the series.

The pace of annualized decline in the inflation-adjusted retail series narrowed sharply in first-quarter 2009 to 2.5%, from 18.78% in the fourth quarter.

On a three-month moving-average basis, the March and February annual real declines were 8.58% and 9.07%, respectively. Along with the declines of the last several months, the March annual decline in the moving-average remains was at the low for the two historical retail series of the post-World War II era.

Next Releases (April 30, May 13): Prior history will be revised in a benchmark revision on April 30th. The usual pattern is that previously reported retail sales will be revised lower. April retail sales should continue showing a pattern of deepening annual contraction, though there may be some month-to-month "bottom-bouncing" as the series appears to have been targeted for happier reporting.

Industrial Production -- As discussed and graphed in the Opening Comments and detailed in the April 15th *Flash Update*, industrial production plunged as measured monthly, quarterly and annually. Incorporating an annual benchmark revision, which showed weaker historical production growth than previously reported, the Federal Reserve reported that seasonally-adjusted March industrial production fell by 1.5% (down 2.3% net of revisions [pre-benchmark]) for the month, after a revised 1.5% (previously [pre-benchmark] 1.4%) decline in February. The year-to-year decline in March deepened to a contraction of 12.8%, the weakest showing since war-time production was shut down after World War II. Such followed February's 11.8% (previously [pre-benchmark] 11.2%) drop.

Consistent with the still-deepening recession/depression, first-quarter 2009 production showed an annualized quarterly contraction of 20.0%, following and 12.7% contraction in the fourth quarter. A depression is defined (SGS) as a recession where the peak-to-trough economic contraction exceeds 10%, a level exceeded not only by current year-to-year contraction, but also in annualized terms by both fourth-quarter 2008 and first-quarter 2009 industrial production.

Next Release (May 15): April production should continue to show sharply deepening year-to-year decline, although some monthly bottom-bouncing at a low-activity plateau is possible in the next several reports, as needed by Wall Street.

New Orders for Durable Goods -- As discussed in the *Flash Update* of March 25th, the regularly-

volatile new orders for durable goods reportedly rose by 3.4% month-to-month in February, as reported by the Census Bureau. Given the high volatility of the series, such a seasonally-adjusted monthly increase is of little significance, particularly where most of the gain was due to downside prior period revisions. Net of revisions, the February orders rose by 1.1%. January's previously reported monthly contraction of 5.2% revised to a contraction of 7.3%. The same pattern of revisions was seen in the prior release.

More importantly, before any accounting for inflation, February's new orders were down by 28.9% from February 2008, setting a record annual decline for the current series, which goes back to 1992 (the reading is the worst of the current downturn). January's annual decline was revised to 27.9% (previously 26.4%). Adjusted for inflation the series would have shown even sharper contractions.

The widely followed new orders for nondefense capital goods rose by 7.4%, again heavily distorted by prior-period revisions. Net of revisions, February orders rose by just 0.4%. In January, orders fell by a revised 8.9% (previously down by 2.7%). Year-to-year, February orders were down by 35.5%, following a revised 35.4% (was 31.4%) in January.

General background note: Durable goods orders lost its status as a solid leading economic indicator when the semi-conductor industry stopped reporting new orders in 2002.

Trade Balance -- As discussed in the April 9th *Flash Update*, the February trade data suggested that the U.S. downturn was worse than the economic contraction in the rest of the world. To the extent the Bureau of Economic Analysis/Census Bureau report of a sharp narrowing in the February U.S. trade deficit can be believed, it suggested that U.S. demand (reflected in imports) is slowing faster than demand in the rest of the world (reflected in exports). On a seasonally-adjusted basis, U.S. monthly purchases

from the rest of the world (imports) fell by 5.1% in February, while U.S. sales to the rest of the world (exports) actually increased by 1.6%.

As reported, the seasonally-adjusted February deficit narrowed to \$26.0 billion from a revised \$36.2 billion (was \$36.0 billion) in January. Even as officially adjusted for inflation, the deficit improved, with the January and February levels suggesting that the net export account in gross domestic product will make a net positive contribution in the upcoming "advance" estimate of first-quarter GDP.

The price of imported oil appears to have bottomed. The February's price was reported at \$39.22 per barrel for the month, down from January's \$39.81. The recent upturn in oil prices should widen the trade deficit anew in the months ahead.

Erratic reporting in the trade data, particularly tied to oil imports, leaves these numbers highly suspect. Distortions of paperwork flows through the Customs Service can generate meaningful distortions in the monthly reporting.

Next Release (May 12): With oil prices likely having bottomed out in the trade reporting, the March trade deficit likely will reverse recent reporting trends, showing a net deterioration.

Consumer Confidence -- Consumer confidence is easily swayed by the tone of the popular media towards the state of economy and the financial markets. Given recent happy spins put on a variety of stories, some upside results in reported confidence could be expected for the March and the coming April numbers.

Showing minimal bottom-bouncing near historic lows, the March consumer confidence numbers were somewhat improved, though still down sharply year-to-year. The Conference Board's March 2009 Consumer Confidence measure rose by 2.8% for the month, up from a 32.4% decline in February, which set the historic low for the

series (lowest since the Lyndon Johnson Administration). Year-to-year change for the three-month moving average was a record decline of 61.4% in March, versus a 60.2% annual decline in February.

The Reuters/University of Michigan's Consumer Sentiment measure rose by 1.8% for the month of March, following an 8.0% decline in February. Year-to-year change in the Sentiment three-month moving average was down by 20.1% in March, versus a 21.0% decline in February.

"Recovery" talk generated by an increase in the early-April Sentiment measure was overblown, given the limited statistical significance for the series as discussed in the "general background note."

These lagging, not leading indicators confirm that the economy has been in a deepening recession.

General background note: The Conference Board measure is seasonally adjusted, which can provide occasional, but significant distortion. The adjustment does not make much sense and is of suspect purpose, given that the Conference Board does not release the unadjusted number. The Reuters/Michigan survey is unadjusted. How does one seasonally-adjust peoples' attitudes? Also, beware the mid-month Consumer Sentiment release from Reuters/University of Michigan. The sampling base is so small as to be virtually valueless in terms of statistical significance.

Short-Term Credit Measures -- Annual growth in both consumer credit and commercial borrowing has continued to deteriorate, reflecting both tight credit and increasingly impaired business conditions. Despite direct intervention as a lender in the commercial paper market, and heavy jawboning of banks to lend to credit-worthy customers, the Fed's push to stimulate both commercial and consumer lending has not turned lending growth to the upside. Such also is reflected in the slowing broad money growth.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth was reported up 1.1% in February, down from 1.8% in both January and December.

In the current environment, where inflation-adjusted growth in income is not adequate to support meaningful growth in the personal consumption component of GDP, GDP growth only can come from temporary debt expansion or savings liquidation. Accordingly, stagnating growth and monthly contractions in consumer debt are an ongoing drag on economic activity.

Annual contraction in commercial paper outstanding has varied, but generally has deteriorated, even with the Fed's involvement in the market. Commercial paper outstanding showed an 18.3% annual contraction in March, versus a 20.3% contraction February and a 16.3% contraction in January.

Annual growth in January commercial and industrial loans also has continued to slow sharply, to 4.3% in March, down from 7.1% in February and 8.4% in January. Slowing growth in commercial lending not only tends to dampen broad business activity, but also can signal a deepening economic downturn.

Producer Price Index (PPI) -- As discussed in the April 14th *Flash Update*, despite rebounding oil and gasoline prices, energy costs tanked the regularly-volatile, seasonally-adjusted producer price index (PPI). For March, the PPI fell by 1.2% (fell by 0.7% before seasonal adjustment). Such followed a 0.1% gain (0.1% unadjusted loss) month-to-month in February. The BLS data showed March's year-to-year PPI inflation contracted by 3.5%, versus a 1.3% drop in February.

This was the fourth month of formal PPI deflation (year-to-year price decline), subsequent to a 0.4% gain reported for November. Since 1980, the finished goods PPI has shown formal deflation in

1986, 1994, 1997/1998 and 2001/2002, without the CPI-U ever following suit. As with the current circumstance, those declines and related index volatility often were tied to large swings in oil prices.

On a monthly basis, seasonally-adjusted March intermediate goods fell by 1.5% (down by 0.9% in February), and crude goods eased by 0.3% (down by 4.5% in February). The decline in year-to-year inflation continued to deepen, with March intermediate goods down 8.9% (down by 5.2% in

February) and March crude goods down by 39.0% (down by 34.7% in February).

Next Release (May 14): With higher oil prices, the April PPI should see some rebound. Barring a renewed collapse in energy prices, PPI inflation reporting over the next six-to-nine months generally should favor upside surprises in official results.

Better-Quality Numbers

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

Economic Indicators

Purchasing Managers Survey: Manufacturing New Orders -- The March 2009 manufacturing purchasing managers survey continued some bottom-bouncing, with the overall index rising to 36.3 from a 35.8 in February. The composite measure held deep in recession territory.

The Institute for Supply Management (ISM) designates a reading of 41.1 or below in its aggregate indices as signaling recession. The ISM reweighted its key in January 2008 so that the manufacturing index would better match GDP results. While the effort was well intentioned, altering the data to match the extremely overstated GDP growth rates damaged the reporting quality of the index. Fortunately, however, the more meaningful components of the index were not affected by the efforts to match the flawed

government data, although most are affected by the Commerce Department's attempts at seasonal adjustment.

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, which is the reading I use as a signal for contracting economic activity.

The March new orders index rebounded to 41.2, from 33.1 in February. New orders have been in actual contraction (below 50.0) since December 2007. Distortions from the seasonal factors calculated by the Department of Commerce can be minimized by viewing the series using year-to-year change on a three-month moving average basis. On that basis, the March new orders index fell by 25.8%, following a 38.5% decline in February.

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

Also a significant measure, the manufacturing employment component was 28.1 in March, up from February's 26.1, which was lowest reading ever recorded for the series, going back to January 1948.

Service Sector Composite Index. This series does not have much meaning related to overall business activity, since new order activity at law firms, dentists, hospitals or fast-food restaurants has little obvious relationship to broad economic activity. With that as background, the March 2009 purchasing managers non-manufacturing (or services) composite index eased to 40.8, from 41.6 in February.

Both the services employment and prices paid components, however, have some meaning. Covering the real estate and banking industries, among others, the March employment component eased to a near record-low 32.3, from 37.3 in February. The series, however, only goes back to 1997. The bottom-bouncing prices-paid components for both indices are covered in the Inflation Indicators.

Help-Wanted Advertising Index -- (Newspapers and On-Line) -- *Please Note: The Conference Board has ceased issuing Web-based press releases on its help-wanted advertising (HWA) in newspapers series, but the monthly data still are available for some undetermined period of time, upon request.*

As discussed in the March 30th and April 3rd *Flash Updates*, February newspaper help-wanted advertising (Conference Board) held at its historic low level of 12 for a third month, with year-to-year change on a three-month moving average basis down by a record 44.6%, versus a 41.6% decline in January. The record low and record decline are the weakest showings since the series was started in January 1951.

The deepening annual fall-off in online help-wanted advertising (Conference Board) also continued, down 36.0% year-to-year in March,

versus an annual decline of 34.3% in February. The Monster.com online survey estimated that online jobs offerings were down 29% year-to-year in March, versus a 26% decline in February.

Despite some of the historic weakness in the newspaper series being due to the loss of ads to the Internet, and despite its looming abandonment by the Conference Board, the HWA remains a solid leading indicator to the broad economy and to the monthly employment report. It continues to signal severe deepening in the recession and ongoing deterioration in labor-market conditions. The nascent online surveys are telling a similar story.

Housing Starts -- As discussed in the Opening Comments, and as graphed there net of the New York City paperwork distortions in June 2008 data, the Census Bureau reported that seasonally-adjusted March housing starts contracted by 10.8% (down 12.5% net of revisions) +/- 13.6% (95% confidence interval) month-to-month and by 48.4% year-to-year. Such contrasted with February's revised monthly decline of 17.2% (previously 22.2%) and annual contraction of 48.3% (previously 47.3%). The current 50.3% pace of annual contraction on a three-month moving-average basis is the deepest downturn of the post-World War II era.

Seasonally-adjusted March building permits showed a similar pattern, down 9.0% (down 6.2% net of revisions) +/- 4.8% (95% confidence interval) for the month, following February's revised 6.2% (was 3.0%) gain. Permits fell by 45.0% year-to-year in March, after an annual drop of 42.5% (previously 44.2%) in February.

In home sales data, February new home sales showed a statistically insignificant monthly gain, which got the financial markets excited. Seasonally-adjusted February new home sales rose by 4.7% (9.1% net of revisions) +/- 22% (95% confidence interval), which statistically was not much distinguishable from a monthly decline, following a revised 13.2% (was 10.2%) decline in

January. On a year-to-year basis, February new home sales dropped by 41.1%, following a 48.2% decline in January.

Existing home sales reporting is being heavily impacted and distorted by highly volatile foreclosure sales, which in turn have been affected by various programs to forestall foreclosures, as well as efforts at accelerating the bad news. Accordingly the monthly numbers, where February sales were up 5.1% for the month and down 4.6% for the year, have little meaning at the moment.

Inflation Indicators

Money Supply -- As suggested in the March 30th and April 3rd *Flash Updates*, and as discussed and graphed in the Opening Comments, after hitting a near-term trough in annual growth of around 9.6% November, broad money supply rebounded in December and January, hitting 12.6%, before faltering anew with an intensification of the systemic solvency crisis. Despite announced further Fed action to buy longer-term Treasuries -- an action unexpected by the markets, but likely in response to broader money measures not picking up obvious gain from the excessive monetary base growth -- the reaction as seen in the annual growth estimate of the SGS-Ongoing M3 has been nil. March growth slowing to roughly 8.1% from 9.5% in February, and with the latest weekly data suggesting further softening of annual growth.

The series have been through massive revisions, particularly in recent months. While the general patterns of seasonally-adjusted money growth remain intact, recent annual change in the SGS-Ongoing M3 estimate is somewhat lower than it had been. That said, year-to-year growth rates as of March 2009, for M1, M2 and M3, respectively, were: 13.6% (versus 13.5% in February, 9.4% (versus 9.3% in February) and 8.1% (versus 9.5% in February). In terms of month-to-month change as of March 2009, growth rates for M1, M2 and

M3, respectively, were: 0.2% (versus a 1.1% contraction in February), 0.9% (versus 0.4% in February) and unchanged (versus a 0.1% gain in February).

Per the Opening Comments, despite recent, extreme systemic liquefaction by the Fed, annual broad money growth has not picked-up. Broad money would be expected to rise sharply, particularly if Federal Reserve monetization of Treasury debt were to increase sharply.

Once accelerating, annual M3 growth in the months ahead easily could overtake the historic strong growth seen early in 2008. Prior to February 2008, the historic high of 16.4% had been in June of 1971, two months before President Nixon closed the gold window and imposed wage and price controls. While current growth is well shy of 1971's high, the current environment promises much stronger broad money growth in the months ahead and heavy upside inflation pressure well into 2010.

General background note: Historical annual growth data and monthly levels 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 published series can be linked to earlier historical data available from the St. Louis Fed. 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 -- Prices paid indices in the March manufacturing and nonmanufacturing surveys were mixed, although they still continued to indicate falling prices in the aftermath of collapsing oil prices.

On the manufacturing side, the March prices paid index rose to 31.0 from 29.0 in February. On a three-month moving average basis, March's year-to-year change was a collapse of 62.1% versus a 65.4% decline in February. The manufacturing price indicator is not seasonally adjusted and, therefore, is generally the better indicator of pricing activity.

On the non-manufacturing side, the seasonally-adjusted March prices diffusion index fell to 39.1, from 48.1 in February. On a three-month moving-average basis, March's annual decline was 38.9%, versus a decline of 40.5% in February.

General background note: Published by the Institute for Supply Management (ISM), the prices paid components of the purchasing managers surveys are reliable leading indicators of inflationary pressure. The measures are diffusion indices, where a reading below 50.0 indicates falling prices.

Oil Prices -- Oil prices generally have trended higher in March and April, with prices appearing to have bottomed in February. Where the recent collapse in oil prices was the primary factor behind the slowdown in reported annual CPI inflation, the bottoming of oil prices also should be accompanied by some bottoming in the annual CPI inflation rate.

West Texas Intermediate (WTI) spot price closed at \$50.33 per barrel on April 17th, which was up

by 64.4% from its recent low close of \$30.81 on December 22nd. The latest spot price, however, still is down by 65.4% since the record-high closing price of \$145.66 on July 11, 2008.

March's monthly average spot price for WTI (St. Louis Fed) was \$47.98 per barrel, up 22.3% from February's \$39.16. The March average was down 53.5% from the year before, and down 64.2% from June's \$133.93 historic-high average. For February 2009, the year-to-year change in price level was a decline of 58.9%. Higher oil prices have been reflected in an upturn in retail gasoline prices, which is continuing in April. Beyond immediate fuel costs, oil-related costs impact industries ranging from the transportation of goods and services, to material costs in the plastics, pharmaceutical, fertilizer, chemical industries, etc.

Oil prices remain highly volatile and sensitive to minor surprises. While sharp declines in U.S. and global economic activity have reduced oil demand, OPEC activities have been and likely will continue to be aimed at offsetting such, with production cuts or enforcement of same. Also adding some upside pressure to prices are intensified Middle East political tensions, and other supply and demand risks/issues. Of greatest long-term impact, however, is the U.S. dollar, where oil is denominated in same. As discussed in the Opening Comments, Mr. Bernanke's efforts at debasing the U.S. dollar likely will result in massive selling of the dollar in the currency markets. At such time as heavy dollar selling resumes -- and that is just a matter of time -- look for oil prices to spike anew, eventually moving back above the \$90 per barrel level, and significantly rekindling oil-price related inflation concerns.