

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

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**To view all of the Newsletter, please visit <http://www.shadowstats.com/article/315>**

## **REPORTING PERSPECTIVE**

### **The Big Three Market Movers**

While most underlying economic fundamentals have deteriorated in recent reporting, certain key headline statistics -- specifically employment, GDP and CPI -- increasingly have tended toward showing market-pacifying results, suggestive of some political/financial-market oriented manipulation. The case for manipulation is explored in the Reporting/Market Focus section.

While the surprise jump in the May unemployment rate may have rattled market complacency, happy-numbers remain likely for the big three market-moving reports in the near-term. Mr. Bernanke still needs a stable U.S. currency, particularly under the circumstances of his fragile bailout of the domestic financial system, while the Administration's political needs remain great. With financial circumstances threatening national security, almost anything is possible in the arena of data and market manipulations. Data manipulation remains an extremely inexpensive and effective policy tool.

Absent manipulations, and against market expectations that remain well removed from reality, most near-term economic reporting should tend to surprise the markets on the downside, while most inflation reporting should surprise expectations on the upside.

**Employment/Unemployment** -- As discussed in this month's Reporting/Market Focus on manipulation and the June 2nd and 6th *Flash Updates*, the pattern of impossible biases being built into the headline payroll employment changes continued with the May report. Instead of the headline jobs loss of 49,000, which was at or better than consensus, consistent application of seasonal-adjustment factors would have generated results showing a monthly jobs loss of about 134,000. The implication here is of intensifying political manipulation of the data, where the cumulative 12-month-rolling upside headline bias increased from 517,000 in April to 595,000 in May.

The reported fifth consecutive decline in monthly payrolls, as of May, indicated a recession in place, with annual payroll growth on the brink of turning negative (see Opening Comments and related graph). The sharp upturn in unemployment also was consistent with a contracting economy. Still, as has become the standard pattern -- with fairly predictable gimmicks -- the weakness in the jobs report was understated, even beyond the apparent manipulation of seasonal factors.

The reported surge in the unemployment rate from 5.0% in April to 5.5% in May was suspect. While it could reflect some catch-up, and it likely does represent a deteriorating circumstance, it also encompasses the month that schools start to let out for the summer. The BLS does not have a strong track record in seasonally-adjusting for the school year. For example, in the payroll survey, May seasonally-adjusted employment jobs rose by 12,000 in the month, a number that should be flat if appropriately adjusted. If the reported unemployment rate surge in the household survey is a seasonal-factor artifact, such should become obvious in something of an offsetting decline in the unemployment rate in the June report.

**Payroll Survey.** The Bureau of Labor Statistics (BLS) reported a statistically-insignificant, seasonally-adjusted jobs loss of 49,000 (64,000 net of revisions) +/- 129,000 for May 2008, following a revised 28,000 (previously 20,000) jobs loss in April. Annual growth in total nonfarm payrolls slowed further to a recessionary 0.08% in May, from 0.29% April.

**Birth-Death/Bias Factor Adjustment.** One element continuing to add upside pressure to the numbers was the monthly bias factor (birth-death model), which never was designed to handle the downside pressures from a recession. The May 2008 bias was a net addition of 217,000 jobs (up from the prior May's 174,000 upside bias), following a net addition of 257,000 jobs in April 2008. The May add-factor mindlessly continued to spike construction jobs (up by 42,000) and financial activities jobs (up by 9,000),

irrespective of ongoing anecdotal evidence of trouble in those areas.

**Seasonal-Factor Gimmicks.** As mentioned above (see the Reporting/Market Focus section on manipulation for detailed background), year-to-year growth should be virtually identical in both the seasonally-adjusted and unadjusted series, and applying the unadjusted annual change to the seasonally-adjusted year-ago numbers for April and May suggests that the seasonally-adjusted month-to-month change should have been a contraction of 134,000, instead of 49,000. This reporting gimmick is made possible by the "recalculation" each month of the monthly seasonal factors ("concurrent" seasonal adjustment). If the process were honest, the suggested differences would go in both directions. Instead, the differences almost always (11 out of the last 12 months) suggest that the seasonal factors are being used to overstate the current month's headline payroll change, and the upside bias is increasing.

**Household Survey.** The usually statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including those of multiple job holders), showed household employment fell by 285,000 in May, after a 362,000 increase in April.

The May 2008 seasonally-adjusted U.3 unemployment rate showed a statistically-significant increase to 5.49% +/- 0.23% from 4.95% in April. Unadjusted, U.3 increased to 5.2% in May versus 4.8% in April. The broader U.6 unemployment rate rose to an adjusted 9.7% (9.4% unadjusted) in May, versus 9.2% (8.9% unadjusted) in April. Adjusted for the bulk of the "discouraged workers" defined away during the Clinton Administration, actual unemployment, as estimated by the SGS-Alternate Unemployment measure, rose to 13.7% in May from 13.1% in April (see the Alternate Reality section).

**Employment Environment.** The employment deterioration in May ran in the right direction, but

still shy of reality, per trends indicated by some of the better-quality employment-environment indicators: April help-wanted advertising remained at an historic low, new claims for unemployment insurance have surged sharply in terms of annual growth, and a recession-level employment reading was seen once again for the May manufacturing purchasing managers surveys, while the May nonmanufacturing survey employment measure dropped once more into recession territory.

**Next Release** (July 3): Based on ongoing deterioration in underlying economic activity, the June payroll survey should show continued month-to-month contraction, with annual growth turning negative, while the household survey should show a continued rise in the unemployment rate (barring an offset to a poor-quality May number). The numbers, however, simply can be brought in at whatever level is desired by the Administration or the Federal Reserve, and ongoing risk of political distortion remains high.

**Gross Domestic Product (GDP)** -- As suggested last month, and as discussed in the Reporting/Market Focus, both the "advance" and "preliminary" estimates of first-quarter 2008 GDP appeared to be heavily politicized, showing growth rather than contraction and running contrary to the indications of better-quality underlying indicators.

Reflecting the unbelievably sharp decline in March oil imports, as discussed in the May 12th *Flash Update*, the Bureau of Economic Analysis (BEA) reported the "preliminary" estimate revision of annualized real (inflation-adjusted) growth rate for first-quarter GDP at 0.90% (previously 0.60%) +/- 3%, which remained statistically indistinguishable from a meaningful contraction. The new growth rate compared with the 0.58% growth estimate for fourth-quarter 2007, and the 4.91% economic boom reported in the third quarter. Annual growth for the first quarter was revised to 2.53% (previously 2.46%),

versus 2.46% in the fourth quarter and 2.84% in the third quarter.

The GDP's first-quarter implicit price deflator (inflation measure) rose at an annualized rate of 2.57%, previously 2.58%, against 2.41% in the fourth quarter and a 1.03% rate in the third quarter.

The "preliminary" estimate report included first estimates of official GDP-like measures for first-quarter 2008, including Gross National Product (GNP), where GDP is GNP net of trade in factor income (interest and dividend payments), and Gross Domestic Income (GDI), which is the theoretical income-side equivalent to the GDP's consumption-side measure.

Annualized real quarter-to-quarter GNP in the first quarter was reported up by 1.08%, versus 1.87% in the fourth quarter and a 5.81% increase in the third quarter. Year-to-year first-quarter growth was 3.17% versus 3.07% in the fourth quarter.

Close to showing an outright recession, however, annualized real quarter-to-quarter GDI in the first quarter gained just 0.33%, following a revised annualized contraction of 0.19% (previously 0.98%) in the fourth quarter, and a 1.2% increase in the third quarter. Year-to-year growth slowed to 1.08% in the first quarter, versus 1.29% (previously 1.09%) in the fourth quarter. With the statistical discrepancy widening to \$132.9 billion in the first quarter from \$112.1 billion in the fourth quarter, the distortions here are consistent with the massaged data apparent in the more widely followed GDP number, as discussed in Reporting/Market Focus.

Adjusting for methodological distortions built into GDP reporting over time, the SGS-Alternate GDP measure suggests that economic reality is much weaker than officially reported. A first-quarter year-to-year contraction of roughly 2.7% would have been more in line with underlying fundamentals, past methodologies and the ongoing recession (see the graph in the Alternate

Realities section of the Opening Comments). Such reflects some bottom-bouncing with the annual contraction a little deeper than the SGS-Alternate GDP third- and fourth- quarter estimates.

*General background note:* Although the GDP report is the government's broadest estimate of U.S. economic activity, it is also the least meaningful and most heavily massaged of all major government economic series. Published by the BEA, it primarily has become a tool for economic propaganda.

**Next Release** (June 26): The "final" estimate revision of first-quarter GDP should be little more than statistical noise. The upcoming "flexible" quasi-benchmark/annual revision to historical data on July 27th, however, could be of considerable significance, as will be discussed in the next newsletter.

**Consumer Price Index (CPI)** -- As discussed in the May 14th *Flash Update*, energy costs in the CPI again were unchanged, despite soaring oil and gasoline prices. The excuse was in the seasonal adjustments. Where seasonal factors have been suppressing the reporting of gasoline price increases, there should be a period of catch-up, since the raw CPI numbers do not get revised, and the monthly seasonal factors are not recalculated every month, as they are with the payroll numbers. As discussed in the Reporting/Market Focus, the month of turnaround in gasoline seasonal factors will be in June, per the reporting of my friend John Crudele of *The New York Post*.

Nonetheless, the continued increases in oil and gasoline prices have been far beyond any normal seasonal patterns. Becoming ever more distant from common experience, the Bureau of Labor Statistics (BLS) reported that the seasonally-adjusted April CPI-U (I.6) gained just 0.21% (0.61% unadjusted) +/- 0.12% for the month, versus the 0.34% (0.87% unadjusted) gain reported in March. April's annual CPI inflation

softened minimally to 3.94% from March's 3.98%.

Year-to-year annual inflation would resume its upturn in May 2008 reporting, dependent on the seasonally-adjusted monthly gain exceeding the 0.46% monthly increase seen in May 2007. The difference would directly add to or subtract from April's annual inflation rate of 3.94%.

Annual inflation for the Chain Weighted CPI-U (C-CPI-U) (I.5) -- the fully substitution-based series that increasingly gets touted by CPI opponents and inflation apologists as the replacement for the CPI-U -- was 3.45% in April, down from 3.55% in March.

Adjusted to pre-Clinton (1990) methodology (I.7), annual CPI growth held at 7.3% in April, while the SGS-Alternate Consumer Inflation Measure (I.8), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was at roughly 11.5%, versus 11.6% in March. The alternate numbers are not adjusted for near-term manipulations of the data. The eight levels of annual inflation, I.1 to I.8, are detailed in the table in the Alternate Realities section, along with the graph of SGS-Alternate Consumer Inflation.

**Next Release** (June 13): Monthly May CPI inflation should rise sharply based on surging energy costs -- well beyond any normal seasonal variation -- but the Fed's feeble tertiary (after meeting banking solvency and Wall Street needs) "fight" against inflation may necessitate continued masking of rapidly deteriorating price conditions. If seasonally-adjusted monthly CPI inflation for May exceeds 0.46%, which it should, then annual CPI inflation will increase by the difference. Where underlying fundamentals favor an upside surprise to market expectations, targeted manipulation, as has been seen recently, remains of very high risk.

## Other Troubled Key Series

**Federal Deficit** -- The rolling 12-month deficit through April 2008 stood at \$234.2 billion versus \$144.9 billion in April 2007, compared with the rolling 12-month deficit through March 2008 of \$215.8 billion versus \$203.7 billion in March 2007.

Viewing the change in gross federal debt bypasses several of the regular reporting manipulations and is a better indicator of actual net cash outlays by the federal government than is the official, gimmicked deficit reporting. Gross federal debt stood at \$9.389 trillion at the end of May 2008, up \$11 billion for the month and up \$560 billion from May 2007, which in turn was up \$472 billion from May 2006. As of the end of April 2008, gross federal debt stood at \$9.378 trillion, down \$60 billion for the month, but up \$537 billion from April 2007, which in turn was up \$485 billion from April 2006. Gross federal debt stood at \$9.438 trillion at the end of March 2008, up \$80 billion for the month and up \$588 billion from March 2007, which in turn was up \$479 billion from March 2006.

There is substantial evidence developing of weaker than anticipated tax collections at both the federal and state levels, due to the deepening recession. The Federal Reserve (Flow of Funds June 2008) estimates that total federal, state and local government receipts fell at seasonally-adjusted annualized rate of 0.22% in first-quarter 2008 from fourth-quarter 2007. While the Fed's numbers are of questionable quality, there are negative implications here both for the federal deficit and for U.S. Treasury funding needs.

*General background note:* The federal government's fiscal 2007 (year-ended September 30th) official accounting-gimmicked deficit narrowed to \$162.8 billion from \$248.2 billion in 2006. For fiscal year-end 2007, the gross federal debt stood at \$9.007 trillion, up by \$500 billion from 2006, which was up \$574 billion from 2005. As discussed in the December 2007 SGS

Newsletter's Reporting/Market Focus, the GAAP-based deficit for fiscal-year 2007 topped \$4 trillion, which remains my best estimate at this time.

*General background note:* The Bush Administration projects a gimmicked deficit of \$410 billion for fiscal 2008, up from \$163 billion in 2007. With no allowance for recession in the assumptions underlying the deficit the projections (the Administration forecasts real 2008 GDP growth at 2.7%), the final 2008 numbers should be much worse than the current Administration estimates. While GDP growth estimates can be gimmicked, incoming tax receipts (based on consistently applied tax policies) remain an independent estimate of underlying economic reality and have started to reflect the economy's mounting problems.

**Initial Claims for Unemployment Insurance** -- The trend in annual growth has continued to deteriorate at an accelerating pace. On a smoothed basis for the 17 weeks ended May 31st, annual growth rose to 14.9%, up from 9.9% in the 17 weeks ended April 17th. A rising growth trend in new claims is an economic negative.

*General background note:* More often than not, week-to-week volatility of the seasonally-adjusted weekly claims numbers is due to the Labor Department's efforts to seasonally adjust these numbers around holiday periods (*such as Memorial Day*). The Labor Department has demonstrated an inability to do such adjusting successfully. When the new claims series is viewed in terms of the year-to-year change in the 17-week (four-month) moving average, however, such generally is a fair indicator of current economic activity.

**Real Average Weekly Earnings** -- April's seasonally-adjusted monthly real earnings fell by 0.5%, following a revised 0.3% (was 0.2%) increase in March. Annual change in April



deepened to a 1.0% contraction, from March's revised 0.9% (previously 1.0%) contraction.

*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 shows the average worker to be under severe financial stress in an ongoing structural recession (see the *Hyperinflation Special Report* of April 8, 2008).

**Retail Sales** -- As discussed and graphed in the Opening Comments, and as detailed in the May 14th *Flash Update*, real (inflation-adjusted) retail sales again showed a deepening recession, with the year-to-year real change in the three-month moving average version showing an intensifying contraction. With real monthly change in ongoing decline, reporting patterns here are consistent with a second quarter contraction for the series.

The Census Bureau reported seasonally-adjusted April retail sales declined by 0.19% (down 0.86% net of benchmark revisions) +/- 0.6% (95% confidence interval), following a 0.20% increase in the re-benchmarked monthly March data. On a year-to-year basis, April retail sales rose 2.03% versus a revised 2.03% (previously 1.97%) in March. The real (inflation-adjusted) monthly change continued negative (down 0.4%), as did the real annual change (down 1.8%).

**Core Retail Sales.** Consistent with the Federal Reserve's predilection for ignoring food and energy prices, "core" retail sales -- retail sales net of grocery store and gasoline station revenues -- were down by 0.3% in April, versus a 0.1% decline in March, against the official aggregate loss of 0.2% in April and gain of 0.2% in March. "Core" retail sales remained negative year-to-year, down 0.3% for April, following a 0.6% loss in March.

The benchmark revisions and core analysis, however, also show that revamped data reflected

higher food and energy inflation than previously reported. Where the aggregate April number showed a 0.2% contraction, which was a 0.9% decline net of revisions, the core decline of 0.3% was a decline of 4.2% net of revisions.

**Next Release** (June 12): Underlying fundamentals suggest ongoing weakness and a likely much weaker than expected showing for May retail sales. While expectations are for a strong gain of roughly 0.6%, any strength seen there should be due to inflation, not to rising consumer demand. The monthly and annual changes again should remain underwater, after inflation adjustment, consistent with an ongoing recession.

**Industrial Production** -- Seasonally-adjusted industrial production plunged by 0.7% in April, as reported by the Federal Reserve, following a revised 0.2% (previously 0.3%) increase in March. April's year-to-year growth ground to a halt, at just 0.2%, down sharply from March's 1.4%. The series should turn negative year-to-year in the next reporting or two, providing the first monthly annual contraction of this recession.

The seasonally-adjusted first-quarter 2008 production reading contracted at an annualized 0.2% versus the fourth quarter. With production just holding even in May and June, the annualized quarter-to-quarter contraction for the second quarter would be about 3.2%. Legitimate GDP reporting would tend to follow the growth patterns of the quarterly production data.

**Next Release** (June 17): The May production numbers should continue a pattern of ongoing monthly contractions, with the erratic but generally slowing annual growth a fair bet to turn negative. Such would be consistent with the manufacturing contractions still signaled by the purchasing managers survey, and with a second-quarter quarterly production contraction, suggestive of a second-quarter GDP contraction.

**New Orders for Durable Goods** -- As discussed in the May 29th *Flash Update*, the highly volatile new orders for durable goods put in another

recessionary performance in April. New orders fell by a seasonally-adjusted 0.5% decline (a gain of 1.0% net of revisions), following an unrevised monthly March decline of 0.3%. On a year-to-year basis, April's new orders fell by 1.7% versus a revised annual decline of 3.2% (previously a 4.2% drop) in March. Smoothed using a six-month moving average, annual growth (net of inflation) remained negative and generating an ongoing recession signal.

The closely followed nondefense capital goods new orders fell by 1.4% in April, reversing the 1.4% (previously 1.5%) gain seen in March. April's year-to-year change was a decline of 4.7%, following a revised 4.8% (previously 3.3%) drop in March.

*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 May 12th *Flash Update*, the March trade deficit improved enough, due to reported declining oil imports, to account for the bulk of the upside revision in the preliminary estimate of second-quarter GDP.

The seasonally-adjusted monthly trade deficit for March was reported to have narrowed to \$58.2 billion, from a revised \$61.7 billion (previously \$62.3 billion). These data remained far from reliable and may have undergone some massaging in support of the likely rigged GDP numbers.

At least two factors appeared unusual in the data. First were the prior month's revisions, which were unusually large from a carryover standpoint. Carryover reflects irregularities in paperwork flows out of the ports to the Commerce Department. Carryover games were used in an outright manipulation of the trade numbers back in 1987 and 1988, in a successful effort to affect U.S. dollar trading (see the Primer Series on [www.shadowstats.com](http://www.shadowstats.com)). Second were oil imports. Although the average price of imported oil rose

from a reported \$84.76 per barrel in February to \$89.85 in March, the average number of barrels per day imported in March 2008 was 8.986 million, down from 10.460 million in March 2007, where January and February 2008 daily volumes were up from 2007. Such suggests that there may be significant carryover problems in the works.

The upcoming report holds the potential for significant revisions to prior data, where benchmark revisions should recast any known carryover problems.

**Next Release** (June 10 with annual revisions): This newsletter was written before the trade data release, but it will be posted after same. Details will follow in the next *Flash Update*. Underlying reality (including sharply rising oil prices) favors a sharp deterioration in the monthly April trade deficit, along with significant, negative revisions to recent trade deficit history, but the government can play games with this series as long as it wants to play them. Given the potential impact of the series on otherwise shaky currency markets and on GDP reporting, realistic numbers still may not be seen for some time come.

**Consumer Confidence** -- Consistent with slowing consumer activity evident in housing and retail sales, May's major consumer confidence numbers plummeted both month-to-month and year-to-year.

The Conference Board's May Consumer Confidence plunged by 8.9% month-to-month, and by 47.3% year-to-year, showing the lowest level and deepest annual contraction seen since the 1990/1991 recession. Such followed a 4.7% monthly decline and 40.9% annual decline in April reporting.

The Reuters/University of Michigan Sentiment measure fell by 4.5% month-to-month in May to its lowest level since 1980, and it collapsed to an annual contraction of 32.3%, the steepest annual downturn in the history of the series. These

numbers compared with a 9.9% monthly plunge in April, and an annual decline of 28.1% in April.

These lagging, not leading, indicators tend to reflect the tone of the popular financial media and are fully consistent with an ongoing and severe inflationary recession.

*General background note:* The Conference Board measure is seasonally adjusted, which can provide occasional, but significant distortion. The adjustment does not make much sense and is of suspect purpose, given that the Conference Board does not release the unadjusted number. The 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 commercial borrowing continued to show mixed pressures from the banking system's solvency crisis. The intensifying decline in annual growth for commercial paper outstanding has been offset partially by growth in commercial and industrial bank loans. Consumer credit numbers continue to show fairly consistent, soft annual-growth levels.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth was reported at 6.0% in April, against 5.8% in March and against 5.9% (previously 5.8%) in February.

As reported by the Fed (Flow of Funds June 2008), home equity loan growth slowed from a year-to-year 6.1% growth rate in the fourth quarter to 4.9% in the first-quarter. The data, which are of questionable quality, show the seasonally adjusted annualized rate of growth in home equity loans slowed from \$92.4 billion in third-quarter 2007, to \$42.8 billion in the fourth quarter, to an outright contraction of \$7.3 billion in first-quarter 2008.

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 or eventual contraction in consumer debt remains an ongoing constraint on economic activity.

Annual growth in commercial borrowing varied sharply, once again. Annual change in May commercial paper outstanding showed a 17.2% contraction, versus a 13.9% contraction in April and a 10.5% contraction in March. In contrast, annual growth in April commercial and industrial loans rose by 21.0%, versus 21.0% in March and 20.3% in February. The relative instability in commercial paper is ongoing, with resultant credit difficulties continuing to inhibit broad business activity and continuing to disrupt banking system stability.

**Producer Price Index (PPI)** -- As discussed in the May 22nd *Flash Update*, consistent with increasing irregularities in the reporting of the government's most popular economic series (CPI, GDP and employment), the seasonally-adjusted producer price index (PPI) increased by 0.2% (0.7% unadjusted) for the month of April, 6.5% year-to-year, per the Bureau of Labor Statistics (BLS). Such followed 1.1% (1.9% unadjusted) monthly and 6.9% annual increases in the March reading. Incredibly, April food prices reportedly were unchanged and energy prices declined by 0.2%.

Minimally, the unbelievable numbers were distorted by poor-quality seasonal adjustments, which eventually should reverse (if not revise away). As with the CPI data, however, the actual increases in food and energy prices are far more than can be accounted for by regular seasonal variations, suggesting that other factors -- tied perhaps to political or financial-market needs of



the Administration and/or Federal Reserve -- could be at work.

**Next Release** (June 17): Given what appears to have been continued deliberate understatements of the monthly CPI and PPI inflation rates (see the Reporting/Market Focus), the PPI may be subject to further understatement, or it could face

a catch-up rebound in May. Underlying reality of higher inflation eventually should prevail.

Allowing for the ongoing regularly random volatility of the monthly price variations, PPI inflation reporting over the next six-to-nine months generally should favor upside surprises in official results, thanks to the broad-based impact of higher oil prices.

### 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 May 2008 manufacturing index remained in recession territory for the fourth month, notching higher to 49.6 from 48.6 in April. While the Institute for Supply Management (ISM) uses an index reading of 41.1 (in its recently reformulated index) as the break point between recession in the broad economy and expansion, a reading below 50.0 means a contracting manufacturing sector. The 50.0 mark works out still as a solid broad recession signal in my analyses that are unfettered by reliance on GDP data for a recession signal.

The various components of the ISM composite indices are diffusion indices, which are calculated as the percent of positive responses from the ISM survey plus one-half of the neutral or unchanged responses. Hence, a reading below 50.0 indicates a contracting series.

The May new orders index showed continuing contraction (meaning it stayed below 50.0), rising

to 49.7 from 46.5 in April. The new orders index has been in actual contraction now 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 May new orders index fell by 15.2%, following a 13.9% decline in April.

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 of significance, the manufacturing employment component remained in recession territory at 45.5 in May, versus 45.4 in April.

**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 May services composite index remained above 50.0, at 51.7, versus 52.0 in April.

Both the services employment and prices paid components, however, have some meaning.

Covering the real estate and banking industries, among others, the May employment component fell into contraction territory at 48.7, again, down from 50.8 in April. The soaring prices paid component for both indices is covered in the Inflation Indicators.

**Help-Wanted Advertising Index (HWA) (Newspapers and On-Line)** -- The Conference Board's seasonally-adjusted April help-wanted advertising index held at its record low of 19, as seen in March, the lowest reading since the index was first calculated at the end of President Harry Truman's term in office.

The unchanged monthly April reading was down by 34.5% year-to-year, also the same as in March. The annual change in the three-month moving average as of May was a 33.7% contraction, versus a 31.9% contraction in March. Despite some of the historic weakness in the series being due to the loss of newspaper business to the Internet, the HWA remains a solid leading indicator to the broad economy and to the monthly employment report. It continues to signal severe deepening in an ongoing recession.

Where the HWA series does not include a measure of on-line advertising, recent indices developed to measure Internet activity have serious definitional problems and still are too young to be meaningful indicators. That said, the Conference Board has reported that annual growth in its nascent on-line measure of help-wanted advertising has continued to contract on a year-to-year basis in April and May, following the first year-to-year decline of the series in March (the series was started in May 2006). On a year-to-year basis, total on-line help-wanted advertising decline by 13.2% in May, after dropping by 16.4% in April, per the Conference Board.

**Housing Starts** -- The regularly-volatile, seasonally-adjusted housing starts measure rose by a statistically insignificant 8.2% +/- 17% (95% confidence interval) for the month of April, but fell by 30.6% year-to-year, according to the

Census Bureau. Such followed the annual benchmark revisions to the series, with the March numbers now showing 13.8% (previously 11.9%) monthly, and 36.1% (previously 36.5%) annual declines. The annualized first-quarter 2008 decline was 32.8%, while -- assuming May and June reporting held at April levels -- the annualized second-quarter decline would narrow to 3.8%, still consistent with a second-quarter GDP contraction.

Despite short-lived market excitement over a small monthly gain in April new home sales, the broad picture could not be much worse. Rebased with annual benchmark revisions, seasonally-adjusted April new home sales rose by 3.3% (unchanged net of revisions) +/- 14% (95% confidence interval), which was not statistically distinguishable from a contraction. The April gain followed a revised 11.0% (previously 8.5%) plunge in March. On a year-to-year basis, however, April new home sales fell at an accelerating annual pace of 42.0%, following a revised 38.2% (previously 36.6%) annual plunge in March.

Increasingly reflecting the impact of foreclosures, existing home sales in April eased by 1.0% (0.8% net of revisions), after a revised 1.8% (previously 2.0%) drop in March. Year-to-year sales fell by 17.5% in April, versus a 19.1% (previously 19.3%) decline in March.

### ***Inflation Indicators***

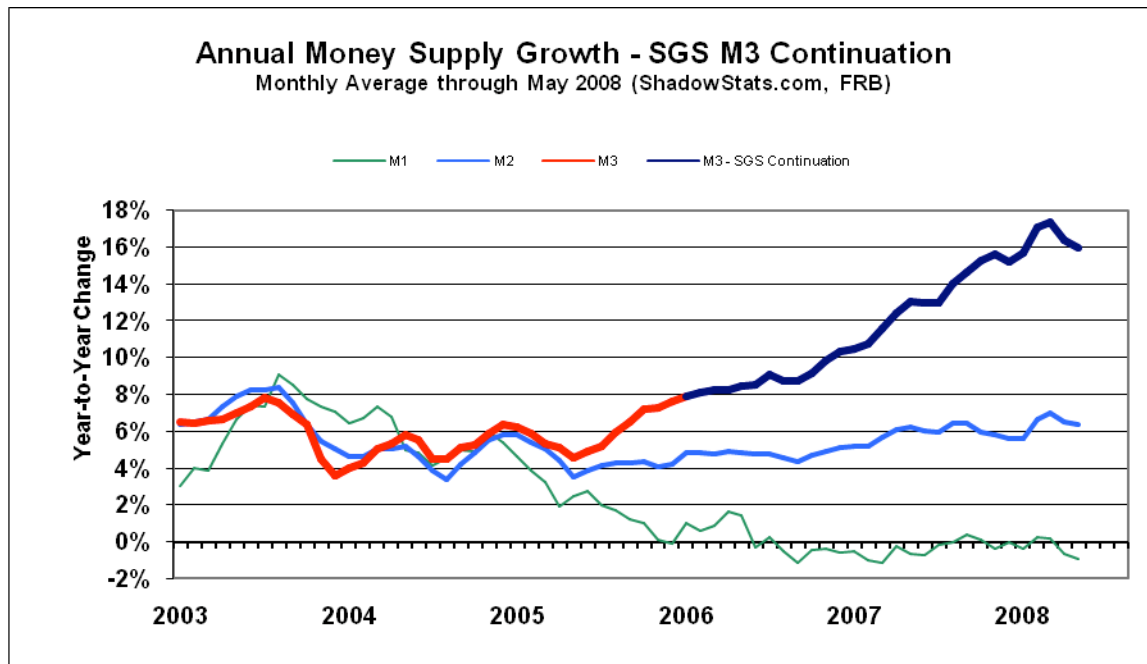
**Money Supply** -- Annual growth in the seasonally-adjusted SGS-Ongoing M3 is estimated at 16.0% (based on 26 of 31 days of data) in May, down from 16.4% in April and a record-high 17.4% in March. The sharp slowing in growth during April appears to have been tied to intensifying problems in the banking system that were relieved, at least partially, by the Fed's expansion of its Term Auction Facility (TAF) lending. As the auction results began to have their impact, the weekly surge in reported M3

components resumed, but not early enough to generate higher annual growth for the monthly average.

Outside of the last several months, the prior historic high of 16.4% was seen in June of 1971, two months before President Nixon closed the gold window and imposed wage and price controls. The May growth is just shy of the 1971

high, and still promises significant upside inflation pressure in second-half 2008.

For May 2008, annual change for monthly M1 was estimated at an annual contraction of 0.9%, versus a 0.7% contraction in April and gain of 0.2% in March. May M2 annual growth appeared to be near 6.4% in May, versus 6.5% in April and 7.0% in March.



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

Feb 06	10.315	Sep	10.850	Apr	11.717	Nov	12.823
Mar	10.367	Oct	10.976	May	11.868	Dec	12.932
Apr	10.425	Nov	11.093	Jun	11.947	Jan 08	13.089
May	10.501	Dec	11.226	Jul	12.053	Feb	13.389
Jun	10.573	Jan 07	11.317	Aug	12.258	Mar	13.575
Jul	10.669	Feb	11.437	Sep	12.440	Apr	13.635
Aug	10.752	Mar	11.565	Oct	12.649	May (p)	13.762

(r) Revised. (p) Preliminary.

NOTE OF CAUTION: The estimates of monthly levels best are used for comparisons with other dollar amounts, such as nominal GDP. While the estimates are based on seasonally-adjusted Federal Reserve data, great significance cannot be read into the month-to-month changes, as was the case even when the Fed published the series. The most meaningful way to view the data is in terms of year-to-year change.

*General background note:* Historical annual growth data for the money supply series, including the SGS-Ongoing M3 estimates, are available for download on the Alternate Data page of [www.shadowstats.com](http://www.shadowstats.com). See the August 2006 SGS Newsletter for methodology. The indicated M3 levels are our best estimate and are provided at specific subscriber request. Keep in mind that regular revisions in the related Fed series affect historical M3. Usually, annual growth rates hold, although levels may shift a little. We have not attempted, nor do we plan to recreate a revised historical series for an M3 monthly-average level going back in time. The purpose of the SGS series was and is to provide monthly estimates of ongoing annual M3 growth. We are comfortable with those numbers and that our estimated monthly growth rates are reasonably close to what the Fed would be reporting, if it still reported M3.

**Purchasing Managers Surveys: Prices Paid Indices** -- The May 2008 prices paid indices surged for both the purchasing managers composite surveys. The indices continued to reflect strong upside inflation pressures from a variety of factors, including high oil prices and a weaker U.S. dollar, and they continued to signal broad inflation problems ahead.

On the manufacturing side, the May price index jumped to 87.0 from 84.5 in April. On a three-month moving average basis, May's year-to-year gain was 21.7% versus 23.3% in April. 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 May prices diffusion index rose to 77.0 from 72.1 in April. On a three-month moving-average basis, May's annual gain was 15.5% versus 17.1% in April.

*General background note:* Published by the Institute for Supply Management (ISM), the

prices paid components of the purchasing managers surveys are reliable leading indicators of inflationary pressure. The measures are diffusion indices, where a reading above 50.0 indicates rising prices.

**Oil Prices** -- With oil currently more than double its price of a year ago, inflation pressures will continue accelerating for the balance of 2008. Irrespective of any near-term extreme price swings, profit-taking or central bank, government and/or cartel intervention, etc., following Friday's (June 6th) record closing spot price on West Texas Intermediate (WTI) of \$138.55 per barrel (up 110% year-to-year), the inflation damage has been done. The inflation implications already were severe when oil prices broke above the \$90 per barrel level.

Oil prices well may continue to rise in the near term and most likely will rise over the longer term, particularly as dollar weakness surfaces anew and rumors build of looming military action against Iran. If so, the financial consequences from such activity would become increasingly dire. Nonetheless, the implications for inflation and real GDP growth remain extremely ominous for the balance of 2008 and into 2009.

May's monthly average spot price for WTI (St. Louis Fed) was \$125.39 per barrel (up 76.8% year-to-year and 11.4% month-to-month), topping the record-high just set in April. For April 2008, the monthly-average WTI spot price of \$112.57 per barrel was up by 61.5% year-to-year, 6.6% month-to-month.

Despite a deepening U.S. recession and possible global recession, regardless of any near-term price swings and possibly extreme short-term price volatility, meaningful upside risks to oil prices remain in place over the longer term. In particular, pressures remain in place from the still-unfolding dollar catastrophe, ongoing OPEC involvement, increasingly volatile Middle Eastern tensions, heightened political tensions in South



America, and other supply and demand risks/issues.

Though their impact on inflation recently has been masked by questionable seasonal adjustments, the persistent and increasingly higher oil prices should resume spiking basic annual CPI inflation in the U.S. in the months ahead. Even the gimmicked "core" inflation measures -- net of changes in food and energy

prices -- should begin to rise. High oil prices continue working their way through all levels of U.S. economic activity, ranging from transportation and energy costs, to material costs in the plastics, pharmaceutical, fertilizer, chemical industries, etc. These broad inflationary pressures will remain intact despite any near-term oil price gyrations, and "core" inflation eventually should catch-up with full inflation reporting.