

John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

Issue Number 45

August 13, 2008

Dollar Rally Should Prove Short-Lived -- Underlying Fundamentals Deteriorating

Extraordinarily High Systemic Risks -- Depositors Moving to Cash?

U.S. Treasuries at Risk of Downgrade?

Economic Activity Tumbles as Inflation Intensifies

GDP Revisions Suggest Shadow of Protracted Recession

OVERVIEW -- OPENING COMMENTS

The Best of Times or the Worst of Times?

Despite orchestrated media and market hype to the contrary, there has been absolutely no positive shift in underlying fundamentals driving the still-unfolding economic, financial-market and systemic-stability crises. The U.S. dollar's recent sharp gains reflect instead uncertainties tied to the outbreak of war in the Caucasus, with the greenback taking on a traditional flight-to-safety role. The dollar's strength also reflects some spinmeistering and jawboning by central banks, along with possible, if not probable, supportive covert intervention. Not reflecting any change in real-world conditions, the dollar's happy gains should prove to be fleeting. Related

heavy selling of oil and gold, also have not been driven by fundamental changes. Oil markets are volatile by nature and, despite recent sharp swings, prices remain highly inflationary at current levels. The markets and financial system remain vulnerable to the least surprise and are highly unstable. The inflationary recession

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continues to intensify, and gold remains the best long-term hedge against all the real risks facing investors and the system.

U.S Dollar Fundamentals Remain Horrible.

(The following section is excerpted from or expands upon recent Congressional Testimony.)

The relative value of a nation's currency is a measure not only of its trade position, but also of global capital flows that mirror how the rest of the world views that nation's economic strength, financial-system integrity and political stability.

In terms of underlying fundamentals that drive, or act as surrogates for concerns that drive relative currency values, the U.S. dollar's portfolio could not be much worse. Not one of the fundamentals has shifted recently in favor of the dollar, despite spinmeistering and jawboning efforts to the contrary. Against major trading partners, consider the United States' relative positions:

- **Trade Balance (Negative):** Despite recently reported narrowing of the monthly trade deficit, the U.S. trade shortfall remains unprecedented in its relative global magnitude.
- **Economic Activity (Negative):** U.S. business conditions are deteriorating, with the economy clearly in a recession in all but formal declaration of same. Even against contracting economies abroad, the current U.S. economy is relatively weaker.
- **Inflation (Negative):** U.S. inflation has risen sharply, with the CPI-U up 5.0% year-to-year as of June; broad money growth is highest since 1971; double-digit inflation is possible by early 2009.
- **Fiscal Discipline (Negative):** The U.S. federal budget deficit is deteriorating rapidly, due to the recession, with its unfunded obligations placing the government in a state of practical long-term bankruptcy.

- **Interest Rates (Negative):** U.S. interest rates are low, relative to the rest of the world, with Federal Reserve policy perceived to be on hold per current market expectations.
- **Political/Systemic Stability (Negative):** The President's approval rating (currently low) is a fair indicator of currency trends; the banking crisis is an increasing negative.

Marketing the Rigged Good News. If one believed the orchestrated financial media, the U.S. dollar has turned fundamentally to the upside, because the U.S. economy has dodged a recession as the rest of the global economy seems to be falling into one. Hence, the argument goes, the U.S. economy is the place to park your money. Such is absurdly nonsensical and shows some of the dangers inherent in relying on poor-quality, politically-manipulated GDP statistics.

In reality, the U.S. economy is tumbling in a deep recession. Given the dominant size of the U.S. economy and related global consumption, U.S. recessions usually trigger global recessions. What is missing from the gimmicked conventional wisdom is that the U.S. economy is contracting more rapidly than as seen in downturns in the rest of the world.

Central Bankers and Finance Ministers Lie.

Back three or four decades -- in the era of fixed exchange rates -- one could be sure a currency revaluation was pending, whenever a central bank began denying same. Such is the nature of crisis management by central bankers and finance ministers; they have to deny market moving events until the last moment or until they are ready to act.

Something of a reverse gambit is in play at present, where Federal Reserve officials keep hinting at a needed increase in interest rates, but no rate increase follows. Jean-Claude Trichet, president of the European Central Bank (ECB) recently warned of economic weakness in the

eurozone, implying a rate cut, but such followed an action where rates were held constant. If the Fed raised rates and/or the ECB lowered rates, such a fundamental shift would bolster the dollar. Neither central bank, however, is looking to change policy as hinted, so the comments drifted into the realm of jawboning, and the spin doctors in the financial markets wove stories supportive of the greenback. Impact from same was not fundamental, only fleeting fluff.

There recently was a comment out of the U.S. Treasury, however, that had a strong enough odor about it to bring back memories of the currency revaluation days.

Federal Deficit Explosion and a U.S. Treasuries Downgrade? Per a July 31st Associated Press article by Martin Crutsinger (*Administration: US bond rating safe despite deficit*), "The Bush administration expressed confidence Wednesday that the United States would be able to maintain its top-notch credit rating even as the government scrambles to find new ways of expanding debt sales to cope with soaring budget deficits."

Competent Treasury officials never would discuss such a topic, unless it was felt that some market reassurance was needed and that indeed there was some threat of a downgrade. Something may be afoot in terms of rating U.S. Treasuries from a perspective outside the U.S. dollar. Usually there would be no impaired sovereign rating from the perspective of its domestic currency, since the country in question always has the ability to print money in order to meet its obligations, as advocated by Mr. Bernanke.

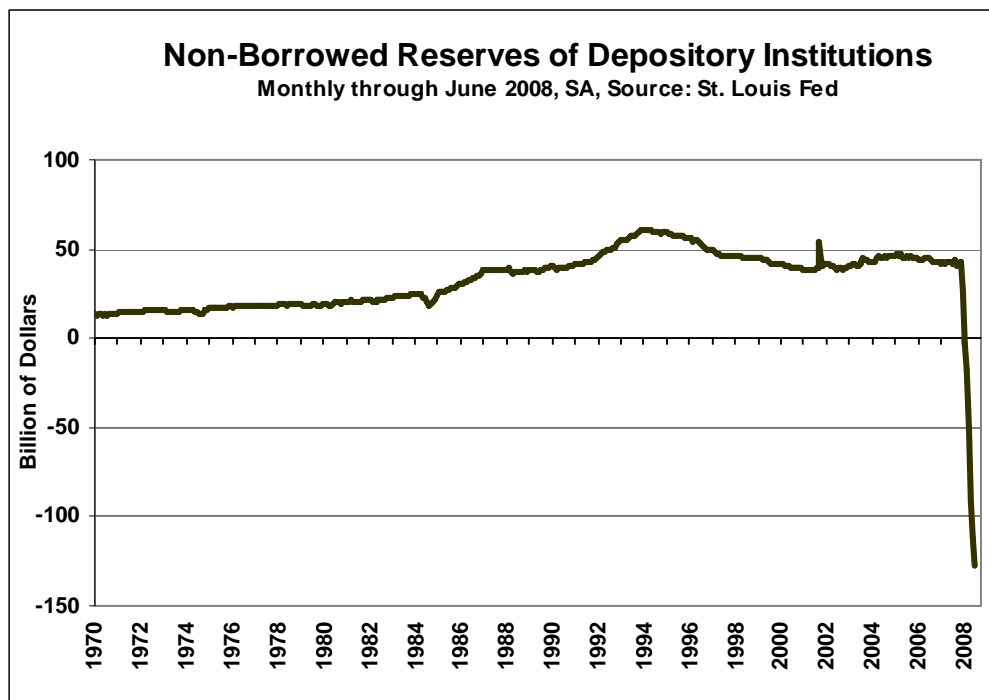
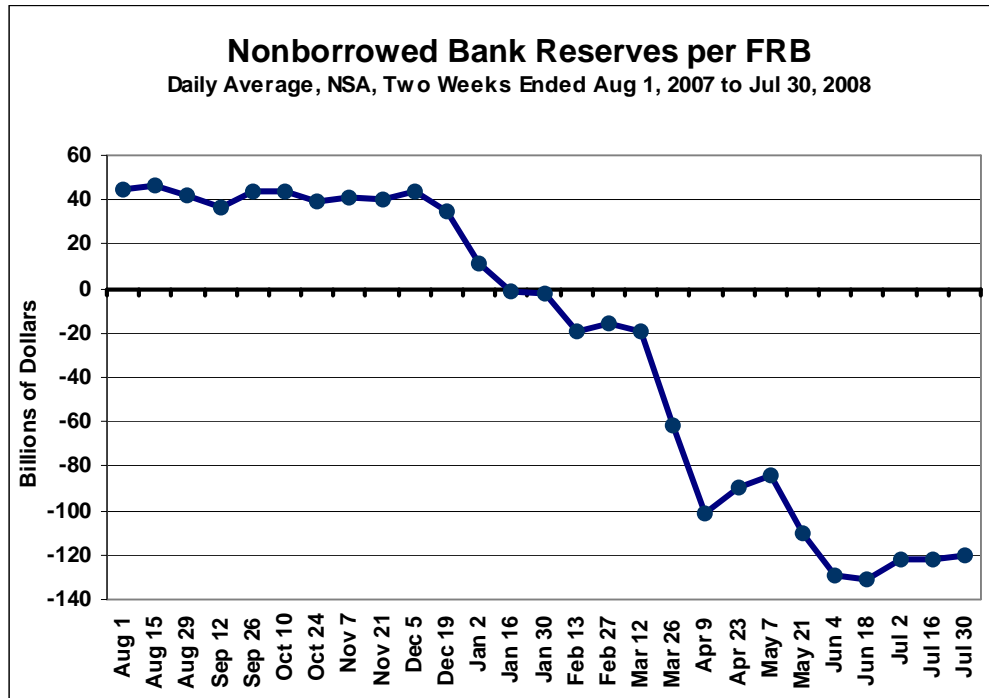
The comments followed revised budget deficit estimates that suggest a 2008 shortfall in excess of \$400 billion and a 2009 shortfall in excess of \$500, if war funding were counted fully. Such also followed the Congress raising the federal debt limit to \$10.5 trillion, allowing for the next trillion dollars of debt to be taken on from current levels.

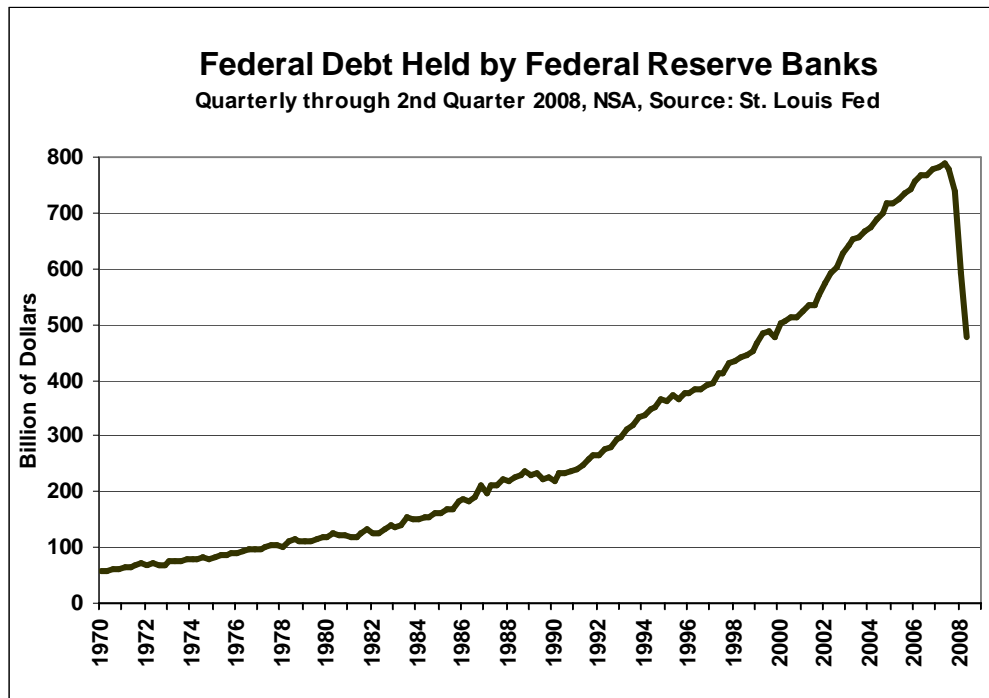
The recession and systemic banking solvency crisis (FDIC expenses) have been spiking federal spending and reducing tax revenues. None of this is good fundamental news for the U.S. dollar.

Ongoing Banking Crisis and Monetary Abnormalities. One question raised by several subscribers in terms of the August 3rd *Money Supply Special Report* was that if Fed Chairman Bernanke can dodge deflation as claimed, by creating new money and debasing the currency, then why did Japan not follow similar policies in order to avoid its deflation?

Ben Bernanke's explanation of Japan's circumstance, in his 2002 speech on avoiding deflation, is in line with mine, specifically that Japan did not want to debase its currency (much as Germany does not want to see the euro debased at present). It was a policy option, not a physical limitation on the government's ability to create money and inflation. One cannot necessarily impute the long-term willingness of the U.S. to debase its currency system to more fiscally conservative sovereign states.

Along those lines, as seen in the accompanying graphs, the still-unfolding systemic banking solvency crisis has not been getting better. If anything, indications from recent money supply reporting suggest the crisis may be in a stage of renewed deterioration. Shown in the first two graphs, Federal Reserve lending to banks is holding at record levels, and the Fed just recently liberalized its lending policies, again. The third graph shows the level of U.S. Treasuries being held by Federal Reserve banks. The decline in Treasuries has been offset by holdings of illiquid securitized instruments that are being used as collateral by banks borrowing from the Fed. The problem remains that those assets (declining Treasuries and increasing, illiquid securitized instruments) remain the formal backing for the U.S. currency issued as Federal Reserve Notes.





The cost to the system of a full bailout is surging money growth and higher inflation. As discussed in the money supply section, however, annual growth in M3 is slowing some, albeit still at very high levels, while annual growth in the narrow M1 measure (basically currency and checking accounts) has been surging. Funds appear to be shifting from the large-deposit accounts to cash, suggesting mounting depositor nervousness and a possible trigger for a new round of systemic liquidity creation by the Fed.

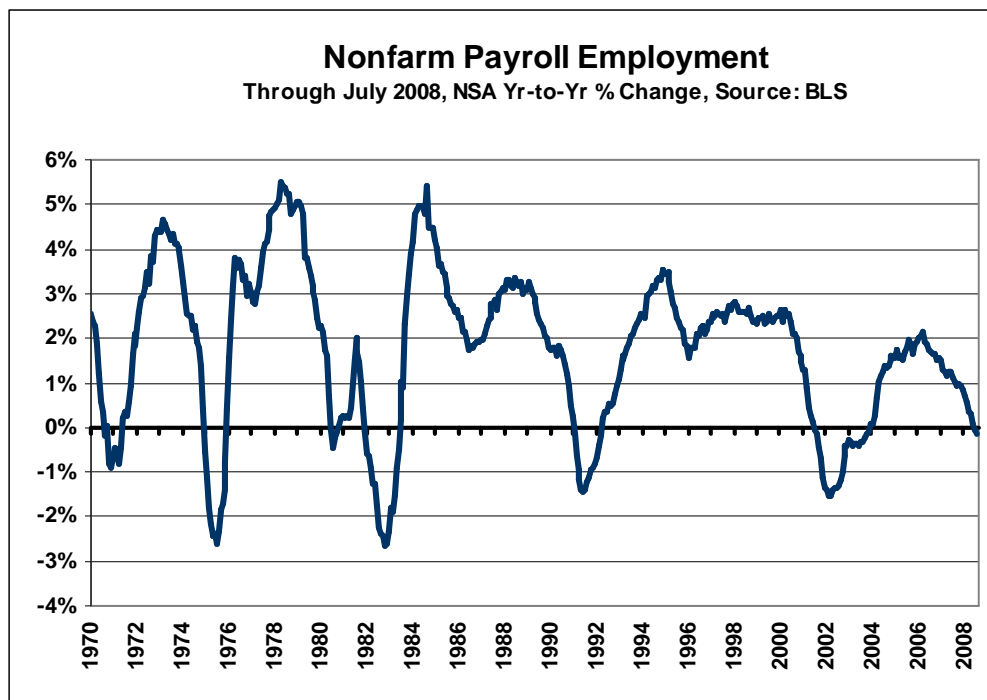
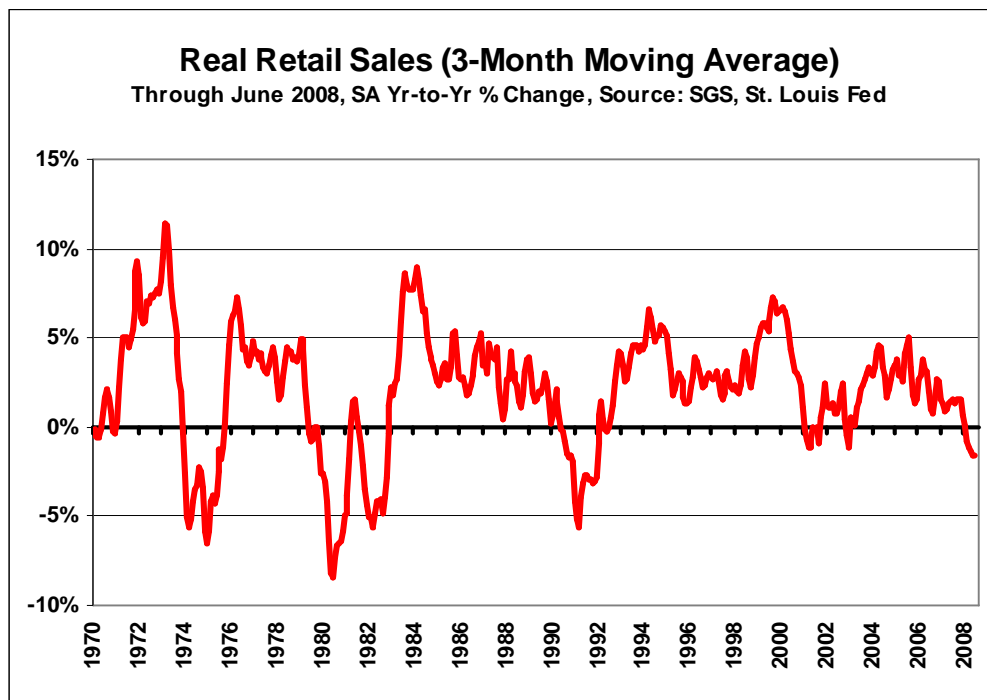
There is no good fundamental news here for the U.S. dollar.

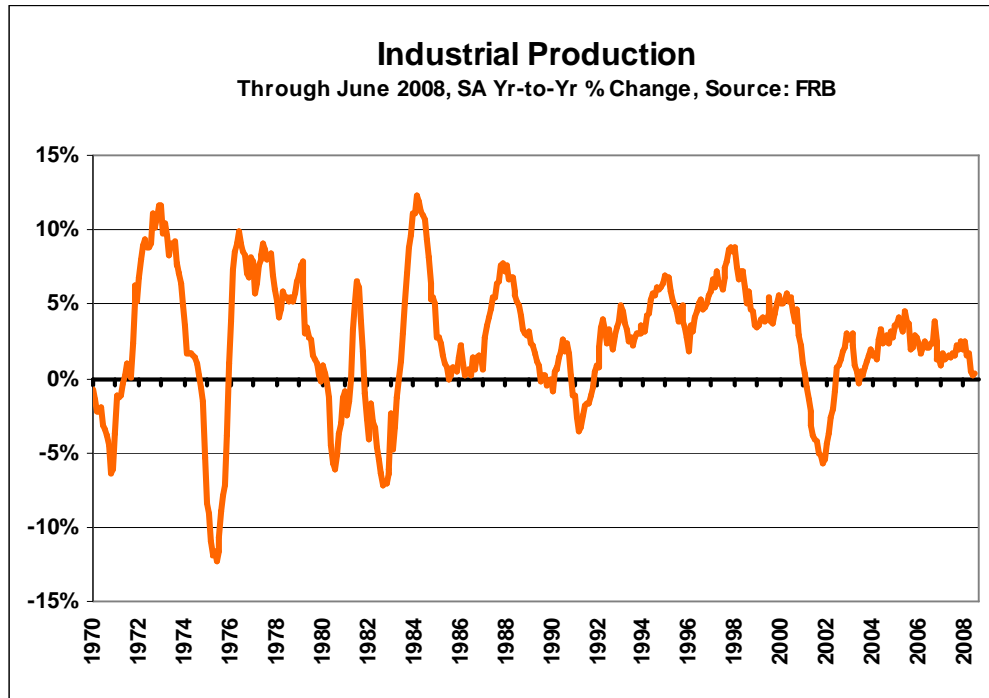
Except for GDP, Broad Economic Reporting Shows the U.S. Economy in Recession. With the

exception of GDP, and possibly its underlying trade deficit support, every economic indicator discussed in the Reporting Perspective is showing a recession in place, with further deterioration signaled by the better leading indicators through the balance of 2008.

As discussed in the Reporting/Market Focus, even the GDP annual revisions started to move into a pattern that allows for a recession having begun sometime in fourth-quarter 2006.

Shown in the following graphs are three of the broader, more important series that never have shown the displayed current annual growth patterns outside of recession.





Quarterly contractions (often multiple, consecutive ones) and annual contractions now seen in real "inflation-adjusted" retail sales, nonfarm payrolls, industrial production, housing starts and new orders for durable goods generally are not seen outside of formal recessions.

The current recession eventually should be recognized as the second downleg of a structural recession that began back in 2000. Its formal recognition, however, likely will not be announced by the National Bureau of Economic Research (NBER), official arbiter of same, until sometime after the November election.

As discussed in the April 8th *Hyperinflation Special Report*, the current inflationary recession eventually should evolve into an inflationary depression and then into a hyperinflationary great depression.

There remains no positive fundamental news for the U.S. dollar here.

Inflation Intensification Belies Benign "Core" Estimates. Annual CPI and PPI inflation rates jumped sharply in June and should be higher again in July. With annual June CPI at a 17-year high of 5.0%, however, a serious question has to be raised about so-called "core" inflation that is net of changes in food and energy prices. While the latest data show some catch-up of accounting for energy inflation in the aggregate CPI, nothing has been catching up in the core numbers.

Core inflation has not been increasing, despite a couple of years of rising oil prices that gradually have permeated the broad economic system. Even with formal energy costs removed from the accounting, inflation impact should be seen in goods and services that consume energy, get transported or involve petroleum based materials ranging from a variety of chemicals and plastics to pharmaceuticals and fertilizers. With the core numbers used for ulterior motives of the Federal Reserve (proof of contained inflation), the lack of increase in core inflation not only is unbelievable, it also reeks of official massaging and

gimmicking. This area will be explored further in an upcoming Reporting/Market Focus.

In any event, there is no positive fundamental news for the U.S. dollar here.

Volatile and Unstable Markets. As discussed in the Markets Perspective, the broad outlook is unchanged for eventual sharp sell-offs in U.S. equities and the U.S. dollar, eventual sharp rallies in gold and silver, and eventual spikes in long-term interest rates. At present, the financial markets are extremely volatile and sensitive, and much of recent trading activity has not been rationale, rather egged on by manipulative central banks or by Wall Street spinning poor-quality economic data out of the government.

Given the intensifying inflationary recession and the ongoing banking solvency crisis, there is no likely long-term happy result on the horizon for the U.S. equity and credit markets, or for the U.S. dollar. Gold and silver, however, should see eventual new long-term gains from the same factors that will pummel the other markets.

In terms of annual perspective, despite all the market gimmicks and machinations and heavy selling of gold, gold still is up sharply from the year before, while the major equity indices still are down over the same period.

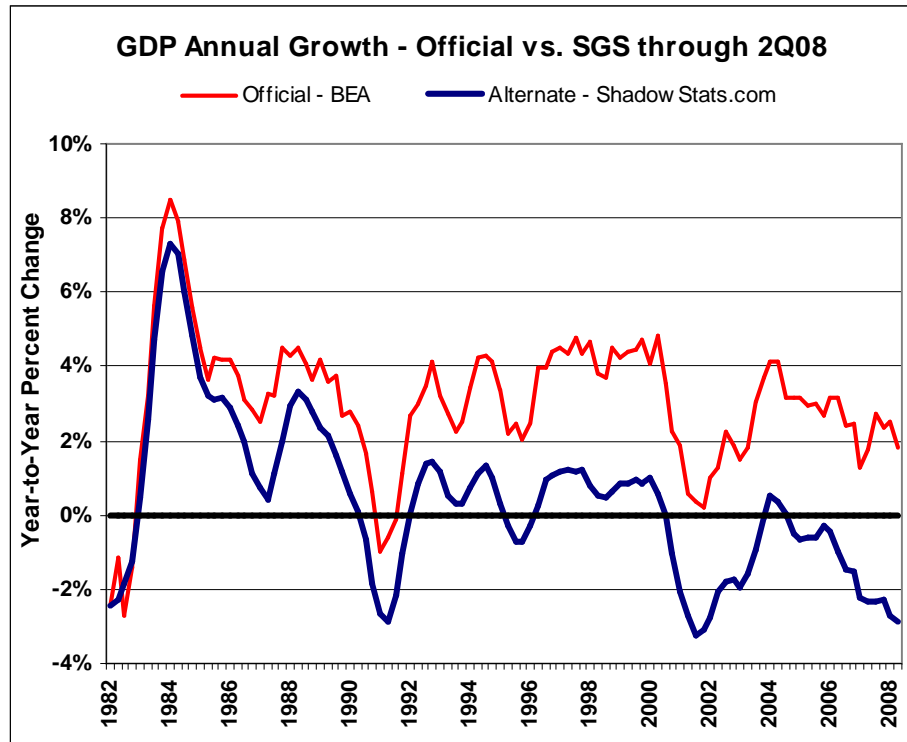
PLEASE NOTE: A "General background note" provides a broad background paragraph on certain series or concepts. Where the language used in past and subsequent newsletters usually has been or will be identical, month-after-month, any text changes in these sections will be highlighted in bold italics upon first usage. This is designed so that regular readers may avoid re-reading material they have seen before, but where they will have the material available for reference, if so desired.

Alternate Realities. This section updates the Shadow Government Statistics (SGS) alternate

measures of official 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 second-quarter 2008 GDP growth reflects the "advance" estimate, with many of the methodological gimmicks of recent decades removed. The alternate second-quarter inflation-adjusted annual growth rate (year-to-year, as opposed to the popularly-touted annualized quarter-to-quarter rate) for GDP was a decline of roughly 2.9% versus the official year-to-year gain of 1.8%. The official annualized real growth rate for the quarter was 1.9%. While the quarterly growth number is popularly followed, its significant inaccuracies are expanded to the fourth-power in reporting. The alternate measure, once again, safely would have shown a quarterly contraction. The graph and data postings have been updated for the July 31, 2008 annual revisions to GDP.

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.

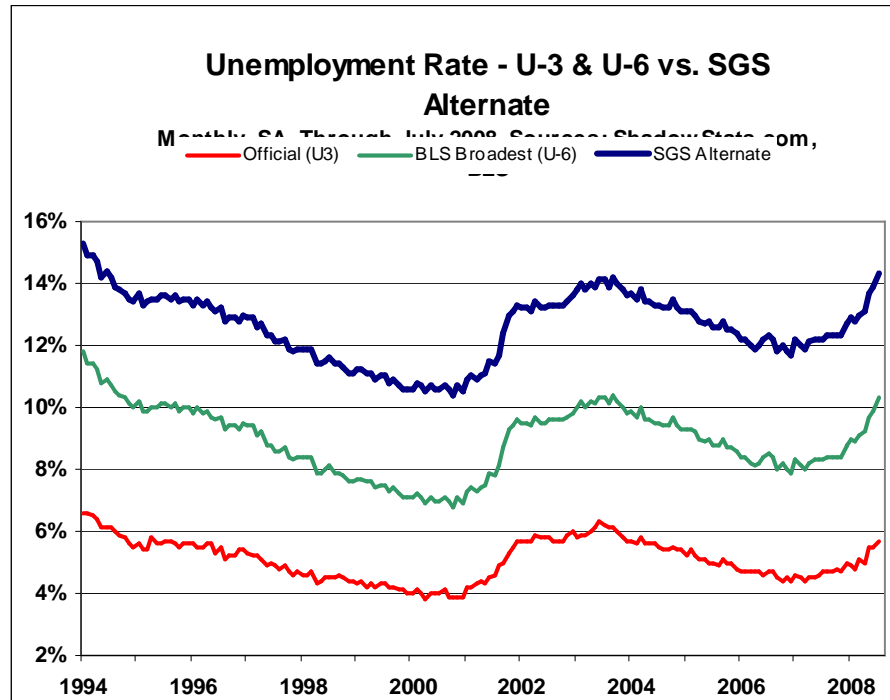


Unemployment Rate. Shown are two official seasonally-adjusted unemployment measures, U.3 and U.6, and the SGS-Alternate Unemployment Measure. All three measures moved sharply higher, again, in July, in response to rapidly deteriorating labor-market conditions, standing respectively at 5.7%, 10.3% and 14.3%, up from 5.5%, 9.9% and 13.9% in June.

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 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. It is planned to take the alternate series further back in time.

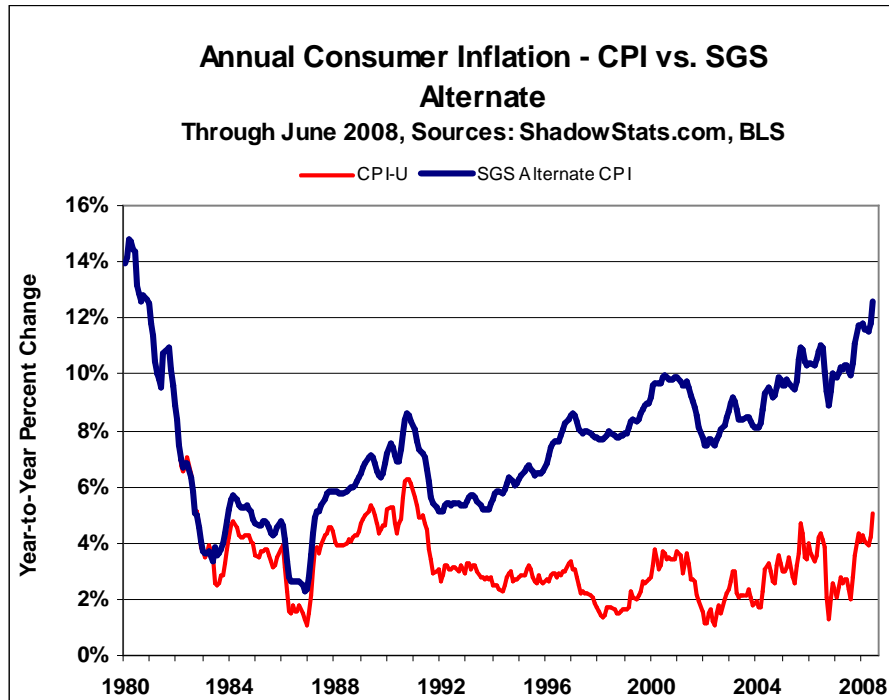


CPI. July's annual non-core inflation rates spiked, while core inflation was little changed. The PCE measures were revised upwards as part of the annual revisions to the national income accounts. Annual inflation rates should continue rising well into 2009, with mounting inflationary pressures reflecting the increasing impact of energy-cost damages to the general economy, combined with pressures from a weakened dollar and extremely high monetary growth.

Outright data manipulation appears to be an ongoing issue. Recent food and oil-related price pressures still have been reflected only minimally in current reporting, and that increasingly has caused some in the financial media to question the accuracy of official inflation reporting. The effect is particularly noticeable in the lack of pass-

through energy inflation to the so-called "core" numbers.

General background note: Historical data on both the official and SGS-Alternate CPI series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate CPI numbers tend to show significantly higher inflation over time, generally reflecting the reversal of hedonic adjustments, geometric weighting and the use of a more traditional approach to measuring housing costs, measures all consistent with the reporting methodology in place as of 1980. Available as a separate tab at the SGS homepage www.shadowstats.com is the SGS Inflation Calculator that calculates the impact of inflation between any two months, 1913 to date, based on both the official CPI-U and the SGS-Alternate CPI series.



Eight Levels of Consumer Inflation
Annual Inflation for March to June 2008

		2008			
Measure		Mar	Apr	May	Jun
I.1	Core PCE Deflator (r)	2.2%	2.2%	2.2%	2.3%
I.2	Core Chained-CPI-U	2.1%	2.0%	2.0%	2.1%
I.3	Core CPI-U	2.4%	2.3%	2.3%	2.4%
I.4	PCE Deflator (r)	3.4%	3.4%	3.5%	4.1%
I.5	Chained-CPI-U	3.6%	3.5%	3.6%	4.2%
I.6	CPI-U	4.0%	3.9%	4.2%	5.0%
I.7	Pre-Clinton CPI-U	7.3%	7.3%	7.5%	8.3%
I.8	SGS Alternate Consumer Inflation	11.6%	11.5%	11.8%	12.6%

(r) Revised, including annual revisions published August 4, 2008.

Notes: I.1 to I.3 reflect the core inflation rates, respectively, of the substitution-based personal consumption expenditure (PCE) deflator, the Chained-CPI-U and the geometrically-weighted CPI-U. I.4 to I.6 are the same measures with energy and food inflation included. The CPI-U (I.6) is the measure popularly followed by the financial press, when the media are not hyping core inflation. I.7 is the CPI-U with the effects of geometric weighting (Pre-Clinton Era as estimated by SGS) reversed. This is the top series in the CPI graph on the SGS home page www.shadowstats.com. I.8 reflects the SGS Alternate Consumer Inflation measure, which reverses the methodological gimmicks of the last 25 years or so, plus an adjustment for the portion of Clinton-Era geometric weighting that is not otherwise accounted for in BLS historic bookkeeping.

MARKETS PERSPECTIVE

As shown in the accompanying tables, market movements recently have turned sharply in favor of the U.S. dollar and against oil and gold prices, with bouts of extreme volatility. This pattern should prove

Closing Financial-Market Indicators as of Second-Quarter 2008

<i>Indicator</i>	<i>2nd-Quarter 2008</i>				<i>1st-Quarter 2008</i>			<i>Year-End 2007</i>	
	<i>Level</i>	<i>Qtr/Qtr</i>	<i>YTD</i>	<i>Yr/Yr</i>	<i>Level</i>	<i>YTD (Qtr/Qtr)</i>	<i>Yr/Yr</i>	<i>Level</i>	<i>Yr/Yr</i>
Equity Market									
DJIA	11,350.01	-7.44%	-14.44%	-15.35%	12,262.89	-7.55%	-0.74%	13,264.82	6.43%
S&P 500	1,280.00	-3.23%	-12.83%	-14.86%	1,322.70	-9.92%	-6.91%	1,468.36	3.53%
DJ Wilshire 5000	13,073.54	-1.94%	-11.78%	-14.05%	13,332.00	-10.44%	-7.48%	14,819.60	3.94%
NASDAQ Comp	2,292.98	0.69%	-13.55%	-11.92%	2,279.10	-14.07%	-5.89%	2,652.28	9.81%
Credit Market (1)									
Fed Funds Target	2.00%	-25bp	-225bp	-325bp	2.25%	-200bp	-300bp	4.25%	-100bp
3-Mo T-Bill	1.90%	52bp	-146bp	-292bp	1.38%	-118bp	-366bp	3.36%	-166bp
2-Yr T-Note	2.63%	101bp	-42bp	-224bp	1.62%	-143bp	-296bp	3.05%	-177bp
5-Yr T-Note	3.34%	88bp	-11bp	-158bp	2.46%	-99bp	-208bp	3.45%	-125bp
10-Yr T-Note	3.99%	54bp	-5bp	-104bp	3.45%	-59bp	-120bp	4.04%	-67bp
30-Yr T-Bond	4.53%	23bp	8bp	-59bp	4.30%	-15bp	-54bp	4.45%	-36bp
Oil (2) US\$ per Barrel									
West Texas Int.	140.00	37.81%	45.82%	98.04%	101.59	5.81%	54.20%	96.01	57.24%
Currencies/Dollar Indices (3) US\$/Unit									
Pound Sterling	1.9906	0.26%	0.32%	-0.58%	1.9855	0.06%	0.72%	1.9843	1.31%
Euro	1.5748	-0.36%	7.84%	16.48%	1.5805	8.23%	18.18%	1.4603	10.65%
Swiss Franc	0.9802	-2.76%	11.05%	19.98%	1.0080	14.20%	22.23%	0.8827	7.64%
Yen	0.0094	-5.95%	5.22%	16.13%	0.0100	11.88%	17.74%	0.0090	6.54%
Canadian Dollar	0.9818	0.88%	-2.98%	4.41%	0.9732	-3.83%	13.34%	1.0120	17.92%
Australian Dollar	0.9562	4.71%	8.96%	12.61%	0.9132	4.06%	12.71%	0.8776	11.31%
Weighted Currency Units/US\$ (Jan. 1985 = 100)									
Financial (FWD)	44.91	0.45%	-4.97%	-9.34%	44.71	-5.40%	-10.62%	47.26	-7.64%
Change US\$/FX	--	-0.45%	5.23%	10.31%	--	5.70%	11.88%	--	8.27%
Trade (TWD)	51.06	0.93%	-3.15%	-9.79%	50.59	-4.04%	-12.70%	52.72	-10.00%
Change US\$/FX	--	-0.92%	3.25%	10.85%	--	4.21%	14.55%	--	10.01%
Precious Metals (4) US\$ per Troy Ounce									
Gold	930.25	-0.35%	11.57%	43.01%	933.50	11.96%	38.97%	833.75	31.92%
Silver	17.65	-1.89%	19.58%	40.75%	17.99	21.88%	34.76%	14.76	14.41%

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

to be short-lived, given the general deterioration that continues in the underlying factors driving the equities and the U.S. dollar, and the strengthening fundamentals driving the precious metals. The newsletter is being put to bed with Friday's (August 8th) closing prices. As we go to press on Wednesday, though, stocks and gold are somewhat weaker and the dollar is somewhat stronger than indicated in the accompanying table.

The various markets are as dangerous and unstable as I can remember, with minor surprises purportedly triggering heavy price movements in everything from oil to stocks. With plenty of "surprises" in the works (most of them negative for equities and the U.S. dollar), near-term activity is unusually dangerous to try to predict, but I would hazard a guess that bulk of dollar buying and oil and gold selling has passed. That said, extreme volatility in those markets easily can continue for while.

The "surprises" lie in upcoming economic reporting and breaking news that will tend to confirm the nature of the intensifying inflationary recession and the still-unfolding systemic liquidity and banking-solvency crises.

Irrespective of ongoing market volatility in the days and weeks ahead, what is discussed below is based on the underlying fundamentals and from a longer term perspective. The markets eventually tend to catch up with the fundamentals.

At such time as the markets reclaim some sanity, I would expect to see: intense selling of the U.S. dollar, with the greenback hitting new historic lows; heavy buying of oil and gold, with eventual new highs to be made (gold is the best bet there); heavy selling of equities that will make the unfolding bear market one of the worst in history. With fiscal conditions deteriorating rapidly, intense dollar selling

Closing Financial-Market Indicators of August 8, 2008

<i>Indicator</i>	<i>3rd-Quarter-to-Date 2008</i>			
	<i>Level</i>	<i>QTD</i>	<i>YTD</i>	<i>Yr/Yr</i>
<i>Equity Market</i>				
DJIA	11,734.32	3.39%	-11.54%	-14.08%
S&P 500	1,296.32	1.28%	-11.72%	-13.43%
DJ Wilshire 5000	13,197.13	0.95%	-11.78%	-10.95%
NASDAQ Comp	2,414.10	5.28%	-8.98%	-7.61%
<i>Credit Market (1)</i>				
Fed Funds Target	2.00%	0bp	-225bp	-325bp
3-Mo T-Bill	1.70%	-20bp	-166bp	-325bp
2-Yr T-Note	2.51%	-12bp	-54bp	-213bp
5-Yr T-Note	3.21%	-3bp	-14bp	-148bp
10-Yr T-Note	3.94%	-5bp	-10bp	-90bp
30-Yr T-Bond	4.55%	2bp	10bp	-46bp
<i>Oil (2) per Barrel</i>				
West Texas Int.	115.20	-17.71%	19.99%	59.60%
<i>Currencies/Dollar Indices (3) US\$/Unit</i>				
Pound Sterling	1.9193	-3.58%	-3.28%	-5.77%
Euro	1.5047	-4.45%	3.04%	8.97%
Swiss Franc	0.9258	-5.55%	4.88%	10.06%
Yen	0.0091	-3.56%	-3.56%	8.78%
Canadian Dollar	0.9366	-4.60%	-7.45%	-1.69%
Australian Dollar	0.8915	-6.77%	4.34%	1.58%
<i>Weighted Currency Units/US\$ (Jan. 1985 = 100)</i>				
Financial (FWD)	47.05	4.77%	-0.44%	-3.05%
Change US\$/FX	--	-4.55%	0.45%	3.15%
Trade (TWD)	53.37	4.92%	1.23%	-3.84%
Change US\$/FX	--	-4.33%	-1.22%	3.99%
<i>Precious Metals (4) US\$ per Troy Ounce</i>				
Gold	852.50	-8.39%	2.25%	26.20%
Silver	15.76	-10.71%	6.85%	20.95%

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

will help to boost long-term Treasury yields, particularly as foreign investors move to dump their dollar-denominated holdings.

U.S. Equities -- With the markets highly vulnerable and irrational, I look only to reemphasize the underlying fundamentals. A severe and protracted inflationary recession is not good for equities, despite any inflation play. Slowing business activity and higher costs (particularly where a company is slow to raise its prices) should hit earnings. Heavy dollar selling eventually should drain liquidity from the equity and credit markets, hitting both stock and bond prices. Higher market interest rates -- irrespective of likely near-term rate inaction by the Fed -- generally act as an inhibitor to stock market exuberance.

General background note: I *still* contend that stocks already have turned down into what will prove to be a particularly protracted and savage bear market (see the *Hyperinflation Special Report*). As equities catch-up with the underlying economic, financial and systemic fundamentals, the downside adjustments to stock prices should be quite large over some years, eventually rivaling the 90% decline in equities seen in the 1929 crash and ensuing four years. The decline might have to be measured in real terms, as a hyperinflation eventually will kick in, with the Fed moving to liquefy the system and monetize federal debt. Stocks do tend to follow inflation, since revenues and earnings get denominated in inflated dollars. Hence with a hyperinflation, a DJIA of 100,000 or 100,000,000 could be expected, but such still would be well below today's levels, adjusted for inflation.

U.S. Credit Market -- The Fed keeps jawboning the dollar with various officials suggesting the interest rates may have to move higher, but the Fed's primary mission and concern at the moment is maintaining systemic solvency and liquidity. All other issues, including defense of the U.S. dollar, fighting inflation and stimulating the economy, are secondary, unless panicked selling

of the U.S. currency threatens to collapse systemic liquidity, and that is real possibility. In a true dollar panic, the Fed may well be pushing rates significantly higher in an effort to provide some fundamental defense of the dollar.

At present, however, the forced investment in U.S. Treasuries of unwanted dollars held outside the United States continues to keep Treasury yields artificially low. The entire yield curve now is negative in real (inflation-adjusted) terms, a circumstance that tends to increase money velocity and overall inflation pressures.

Market yields for U.S. Treasuries, nonetheless, still should be facing upside pressures, shy of short-lived flights to safety, thanks to rapidly deteriorating federal fiscal conditions (meaning significant new Treasury issuance), rapidly mounting inflationary pressures, rapid money growth and a soon-to-be-seen flight from the dollar that evolves into a flight-to-safety outside the dollar. The longer range outlook continues for long-term Treasury yields to back up by several hundred basis points, approaching a more-normal spread in long-term Treasuries over inflation. With a normal spread and annual inflation at 5.0%, the yield on the 30-year Treasury bond should be over 8.0%, not around the current 4.5%.

U.S. Dollar -- As discussed in the Opening Comments, aside from some traditional flight-to-safety in the greenback due to uncertainties surrounding the Caucasus war, none of the underlying fundamentals have shifted in support of the dollar. At work have been central bank jawboning and spinmeistering, and likely significant, covert, central-bank intervention in support of the dollar.

With all of the preceding factors being short-lived, by nature, the long-term outlook for the dollar remains for a massive sell-off, with flight from the dollar eventually evolving into a flight to safety outside the dollar. Contrary to market hype, the underlying fundamentals -- those factors that determine the long range outlook for the

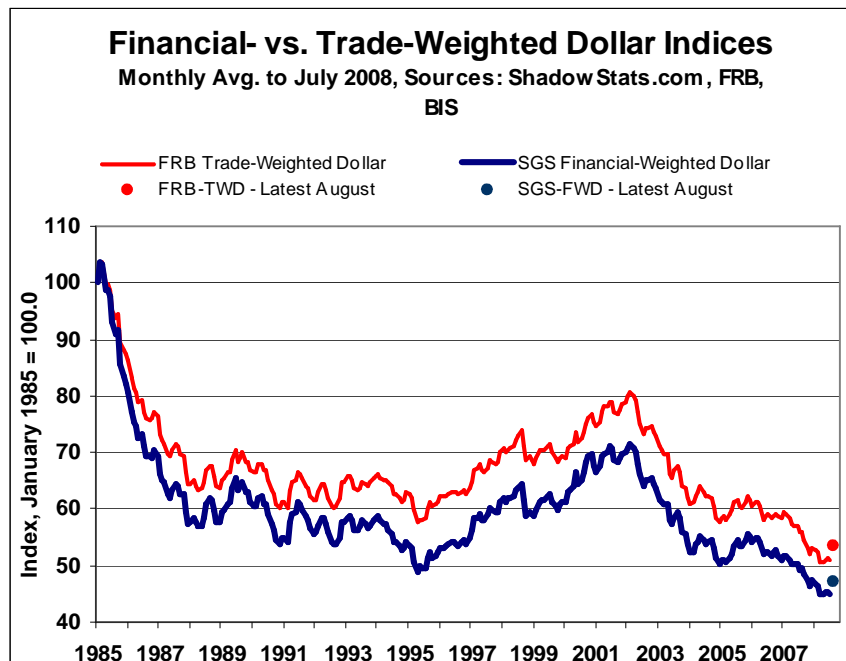
greenback -- still remain abysmal and are deteriorating.

The U.S. dollar's portfolio of underlying fundamentals could not be worse. Relative to major trading partners, the U.S. economy is much weaker; interest rates are lower and anticipated possibly to go lower still on a relative basis (i.e., foreign rates rising); inflation is higher; rising federal deficit and relative trade-balance conditions are horrendous; and relative political/systemic concerns are high, with the President's and Congress's approval ratings bottom-bouncing at all-time lows. Neither presumptive presidential candidate (pocketbook issues favor a win for the Democrats) has any prospects of turning the economy.

General background note: Beyond renewed capitulation by the Federal Reserve to the solvency/funding crisis, the proximal trigger for a full dollar panic could come from a bad economic

statistic, political missteps by the Administration, negative trade or market developments outside the United States, or a terrorist attack or expansion of U.S. military activity in the Middle-East or South America. When the trigger is pulled, what likely will be broad selling pressure will turn to an outright panicked dumping of the greenback, which should overwhelm any short-lived central bank intervention and roil the domestic financial markets. Generally, the greater the magnitude of the dollar selling, the greater will be the ultimate inflation pressure and liquidity squeeze in the U.S. capital markets, on top of an otherwise deteriorating systemic crisis.

As shown in the accompanying graph, the U.S. dollar notched lower in July versus June, but it has rallied strongly since, particularly in the last week or two. The latest data points shown for the financial- and trade-weighted indices are as of Friday, August 8th.



General background note: Historical data on both dollar series are available for download on the Alternate Data page of www.shadowstats.com. See the July 2005 SGS Newsletter for methodology.

U.S. Dollar Indices. The Shadow Government Statistics' Financial-Weighted U.S. Dollar Index (FWD) is based on dollar exchange rates weighted for respective global currency trading volumes. For July 2008 the monthly FWD fell by 0.90%, after gaining 0.45% in June. The July 2008 average index level of 44.92 (base month of January 1985 = 100.00) was down by 8.80% from July 2007, while June 2008 was down 9.84% from the year before. As of August 8th, the FWD had rebounded to 47.05.

Also falling in July was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The July 2008 average declined by 0.70% from June, which, in turn, was up by 0.95% from May. The July 2008 index level of 51.03 (base month of January 1985 = 100.00) was down 8.50% year-to-year, versus a 9.51% annual decline in June. As of August 8th, the TWD closed at 53.37.

Gold and Silver -- Like the buying in the U.S. dollar, the heavy selling pressure on precious metals and the extreme volatility in gold and silver prices have been driven by extraordinary jawboning and market spin, along with likely covert central-bank intervention that was used, minimally, to help turn the market back at the time of the Bear Stearns crisis. The gimmicks have been coordinated with, and heavily overlap, the machinations related to dollar and oil price manipulations. Other than some legitimate, short-term profit taking, the underlying fundamentals for gold silver remain strong, and even have increased in strength in the last several months, as both the systemic crisis and inflationary pressures have intensified.

From its record-high London afternoon fix of \$1,011.25 per troy ounce on March 17, 2008, gold closed below \$820, yesterday (August 12th). Despite all the market gimmicks, in terms of annual perspective, gold still is up sharply from the year before, while the major equity indices are down over the same period. The long-term outlook for gold remains extremely bullish, with

recovery to \$1,000-plus levels and higher likely sooner, rather than later, given the continuing, extraordinary strength of the underlying fundamentals (inflation, monetary and fiscal policy, political instabilities).

For July (based on Kitco.com), the monthly average London gold afternoon fix was \$939.77 per troy ounce, versus \$889.49 in June. Silver averaged \$18.03 per troy ounce in July, up from \$16.97 in June. Respective closing prices on August 8th were \$852.50 and \$15.76 per troy ounce.

Inflation-Adjusted Historic Gold and Silver Highs. Outside of the current period's March 17th high of \$1,011.25, the earlier all-time high of \$850.00 (London afternoon fix, per kitco.com) of January 21, 1980 still has not been hit in terms of inflation-adjusted dollars. Based on inflation through June 2008, the 1980 gold price peak would be \$2,390 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be \$6,690 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

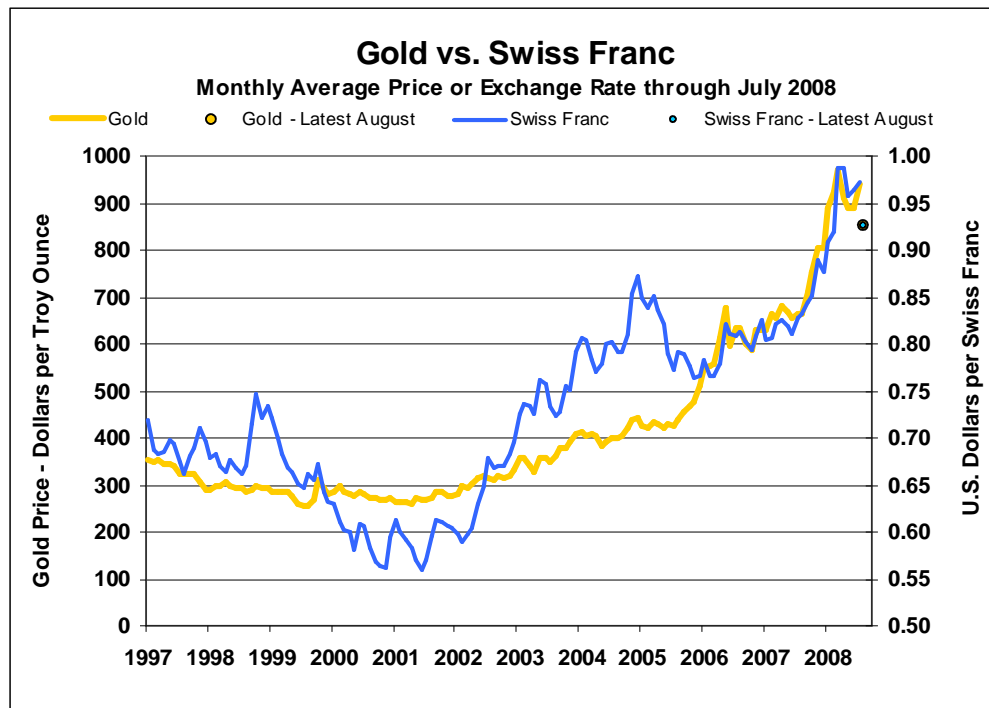
In like manner, the all-time high price for silver in January 1980 of \$49.45 (London afternoon fix, per silver institute.org) has not been hit since, including in terms of inflation-adjusted dollars. Based on inflation through June 2008, the 1980 silver price peak would be \$139 per troy ounce, based on not-seasonally-adjusted=CPI-adjusted dollars, and would be \$389 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

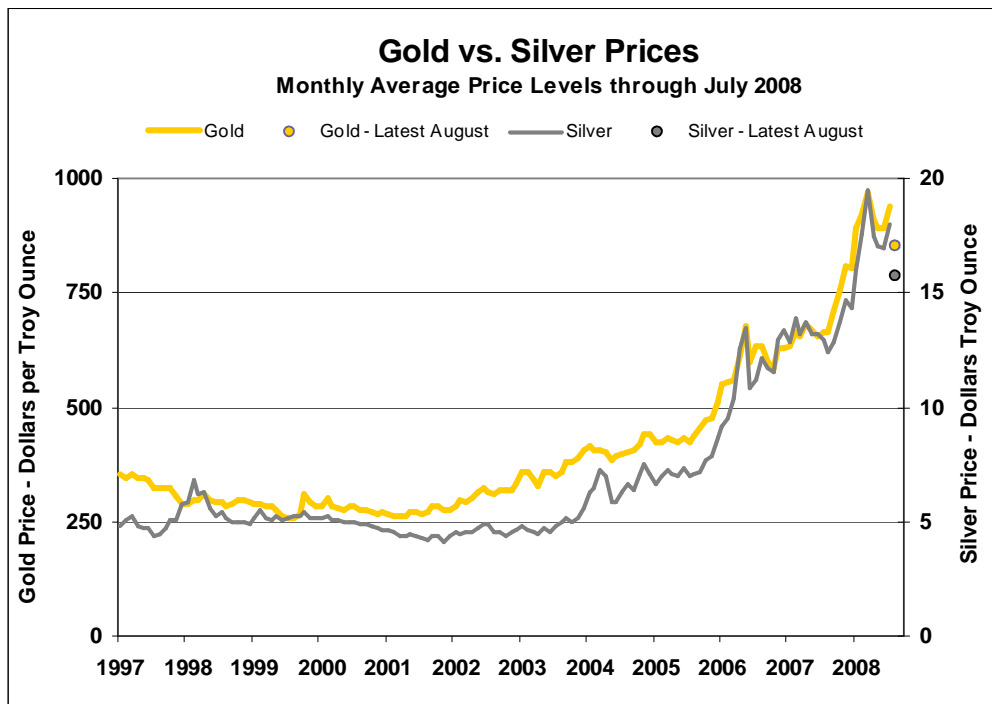
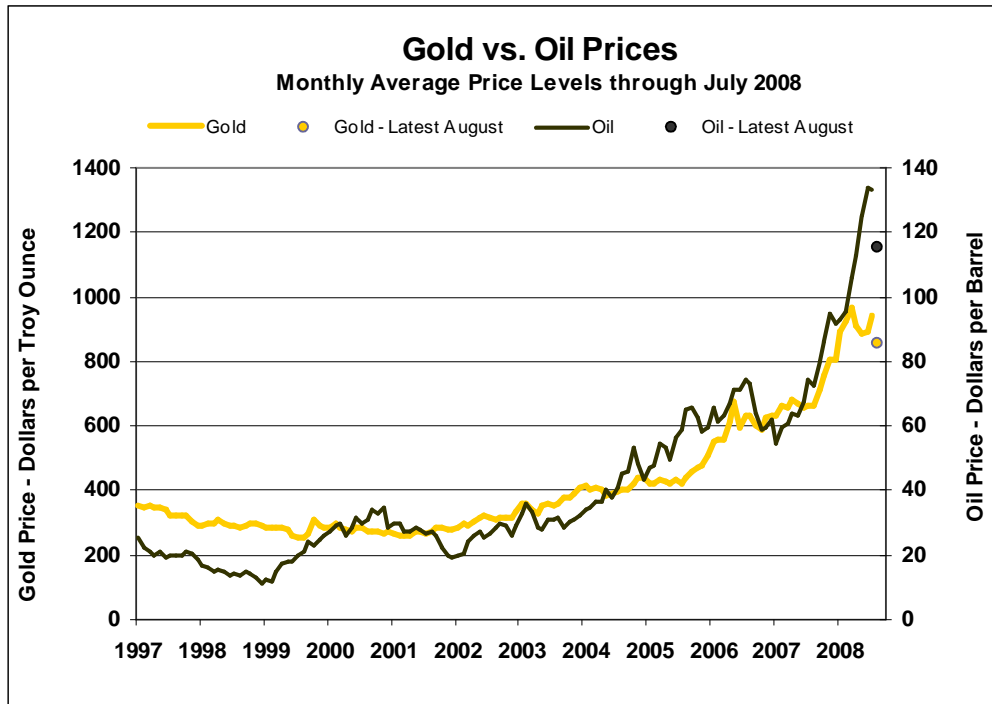
General background note: Near-term gold price volatility likely will continue and could be significant. Upside price pressures from mounting inflation, a weakening dollar and increasing global political, financial and systemic instabilities, face offsets with bouts of profit taking and with intensified overt and covert central bank interventions in the gold and currency markets, aimed at propping the greenback. Despite any central-bank machinations or intervention, the

upside potential for the precious metals remains explosive.

General background note: As discussed in the *Hyperinflation Special Report (April 2008)*, the eventual collapse of the U.S. dollar -- the world's reserve currency -- will force the creation of a new international currency system. Gold likely will be structured into any replacement system, in an effort by those organizing the new currency structure to gain public acceptance.

The updated gold versus oil and Swiss franc graphs and the new gold versus silver graph show the July monthly average price levels, as well as added points for closing prices on August 8th, with gold at \$852.50, silver at \$15.76, oil at \$115.20 and the Fed's published noon buying rate for the Swiss franc at \$0.9258. All four measures should trade significantly higher in the months ahead, eventually breaking highs seen otherwise during the last six months.





REPORTING PERSPECTIVE

The Big Three Market Movers

Most underlying economic fundamentals have continued to deteriorate in recent reporting, yet, key headline statistics -- specifically employment, GDP and elements of the CPI -- increasingly have shown market-pacifying results, which is highly suggestive of political/financial-market oriented manipulation.

The surging second-quarter GDP growth, better-than-expected July payroll numbers, and "core" inflation that somehow keeps dodging the permeating effects of higher oil prices, are numbers that only a mother (Hank Paulson or Ben Bernanke) could love and believe in.

Messrs. Bernanke and Paulson need a stable U.S. currency, particularly under the circumstances of the increasingly vulnerable and fragile bailout of the domestic banking/financial system. The Administration's political needs remain great, and with financial circumstances threatening national security, almost anything remains possible in the arena of data and market manipulations. Data manipulation remains an extremely inexpensive and effective policy tool. As discussed in the Opening Comments, the tool has been used with significant, albeit short-lived impact in support of the greenback.

Absent manipulations, and against market expectations that have moved once again far away 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. Watch out, though, for the key headline numbers, at least until after the November election.

Employment/Unemployment -- As discussed in the August 1st *Flash Update* and graphed in the Opening Comments, signs of a purported economic boom did not show up in the July employment report. In particular, year-to-year change in the July 2008 payrolls showed a second month of a deepening contraction in the unadjusted numbers, an event never seen outside of a recession. The reported seventh consecutive decline in monthly payrolls also continued to show a recession in place, as likely will be recognized eventually (post-election) by the National Bureau of Economic Research (NBER), official arbiter of recessions. The continued deterioration in the unemployment rate -- particularly the surge in the broadest official unemployment measure (U.6) -- also signaled intensifying business difficulties.

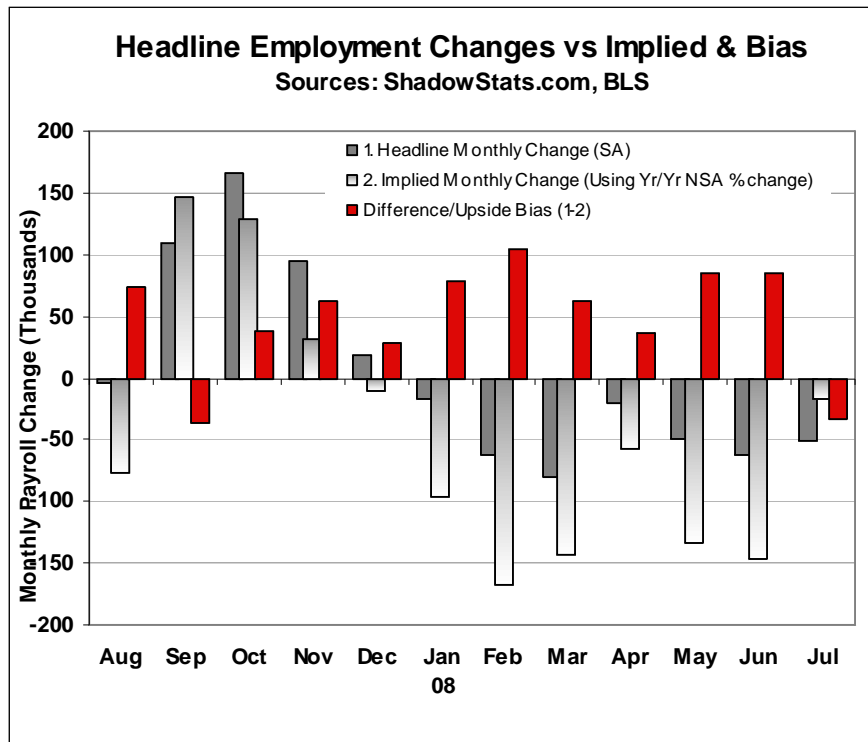
Payroll Survey. The Bureau of Labor Statistics (BLS) reported a statistically-insignificant, seasonally-adjusted jobs loss of 51,000 (down 25,000 net of revisions) +/- 129,000 for July, following a revised 51,000 (previously 62,000) jobs loss in June. Annual change (unadjusted) in total nonfarm payrolls was negative, down 0.13% in July versus a revised 0.07% (was 0.12%) decline in June (see the graph and discussion in the Opening Comments section). The seasonally-adjusted series also turned negative year-to-year, down 0.05% in July, versus a 0.14% gain in June.

Concurrent Seasonal Factor Bias. The pattern of impossible biases (see the Reporting/Market Focus in the prior *SGS Newsletter*) being built into the headline payroll employment changes reversed with the July reporting. Instead of the headline

jobs loss of 51,000, consistent application of seasonal-adjustment factors -- net of what we are calling the concurrent seasonal adjustment bias -- would have shown a less-severe monthly jobs loss of about 17,000.

The reversal of the pattern seen previously in 11 out of 12 months of reporting was subsequent to a

request from within the BLS for my calculations (the worksheet is available to anyone upon request). We have not received nor have we requested a comment on these numbers from the BLS.



Nonetheless, unusual revision patterns still were seen in the July report, where the unadjusted June payroll number was revised upward by 70,000, but that only translated into a 26,000 upward revision to the adjusted numbers. While such raised the level of the previously reported payroll employment, it resulted in a relatively weaker base against which the June to July adjusted change was calculated.

The deterioration in July's employment environment continued in line with, but still shy of reality, per trends indicated by the better-quality

employment-environment indicators: June help-wanted advertising bottom-bounced near the prior month's historic low; new claims for unemployment insurance continued to surge sharply in terms of annual growth; and a recession-level employment reading was seen in both the June manufacturing and nonmanufacturing purchasing managers survey (leading indicators of July employment). The just-released July surveys showed the manufacturing employment component moving into positive territory, but the nonmanufacturing employment measure held in contraction territory. In

combination, these factors suggest that an ongoing jobs loss running in excess of 100,000 jobs per month would be closer to reality than the officially-reported changes (see the respective sections).

Since the employment and unemployment indicators tend to be coincident markers of broad economic activity, weaknesses in these numbers are signaling an ongoing recession in place.

Birth-Death/Bias Factor Adjustment. Another element that usually adds upside pressure to the monthly payroll numbers but was muted in July was the monthly bias factor (birth-death model). Never designed to handle the downside pressures from a recession, the model added a 4,000 jobs bias to July 2008 (versus the prior July's 3,000 upside bias), following a net upside bias of 177,000 jobs in June 2008.

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 household employment fell by 72,000 in July, following a 155,000 decline in June.

The July 2008 seasonally-adjusted U.3 unemployment rate showed a statistically-insignificant increase to 5.68% +/- 0.23% from 5.50% in June. Unadjusted, U.3 increased to 6.0% in July, versus 5.7% in June. The broader U.6 unemployment rate jumped to an adjusted 10.3% (10.8% unadjusted) in July versus 9.9% (10.3% unadjusted) in June. Refigured 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 14.3% in July, from 13.9% in June (see the Alternate Realities section in the Opening Comments).

Next Release (September 5): Based on continuing deterioration in underlying economic activity, the August payroll survey should show deepening

month-to-month and annual contractions, while the household survey should show a further rise in the unemployment rate (barring political massaging). The unfortunate reality remains, however, that these numbers can be brought in at whatever level is desired by the Administration or the Federal Reserve, and risk of political distortion remains extremely high.

Gross Domestic Product (GDP) -- This issue's Reporting/Market Focus examines the recently published annual revisions to the national income accounts, which showed -- as has become traditional -- that previously reported GDP growth was not quite as strong as initially indicated. In fact, given the new reporting patterns, the current recession tentatively has started to appear as having begun in fourth-quarter 2006, but recognition of such remains at least a year away -- probably longer -- dependent on the eventual grand-scale benchmark revision to the GDP data that remains long overdue.

As to the current reporting, only the political hacks in the Administration and the spinmeisters on Wall Street could profess to believe the surging GDP activity claimed for second-quarter 2008. As discussed in the July 31st *Flash Update*, despite sharp quarterly contractions in employment, industrial production, new orders, real retail sales and residential construction, among other series, the second-quarter 2008 GDP was reported as booming (net of inventory reductions, the inflation-adjusted economy expanded at an above-average annualized 3.9% rate).

With fourth-quarter 2007 revised into a 0.17% contraction (previously a gain of 0.58%), the official story now likely will go along the lines that the economy dipped a little in the fourth quarter -- not enough to be called a recession -- and has been in recovery ever since. Such is an absurdity, given the reporting of better quality surveys discussed in the Opening Comments and extremely strong anecdotal evidence to the contrary, but the reporting will enable the pushing

off of any recession recognition until after November.

Key to the unbelievable report was the use of artificially low inflation in deflating the GDP. In theory, the GDP is first estimated in nominal, or not-inflation-adjusted, terms, and then deflated using the GDP's implicit price deflator (IPD). The IPD inflation was at an incredibly-low annualized 1.11% for the quarter, down from 2.56% in the first quarter, and at a 10-year *low* (lowest since second-quarter 1998). The lower the IPD used, the stronger will be the inflation-adjusted growth. In contrast, on a parallel calculation basis, CPI inflation was 5.04%. Outside of 6.34% in third-quarter 2005, that was a 17-year *high* quarterly inflation rate (highest since 6.97% in fourth-quarter 1990). There is enough room in the price-adjustment gimmicks for there to have been a meaningful contraction in second-quarter GDP.

In the context of the mildly weaker historical GDP -- an overall downward revision of 0.5% spread over three years -- the Bureau of Economic Analysis (BEA) reported that the "advance" estimate of annualized, seasonally-adjusted real (inflation-adjusted) growth rate for the second-quarter GDP was 1.89% (down 0.02% net of revisions) +/- 3%, up from a revised 0.87% (previously 0.96%) in the first quarter. Year-to-year annual change in second-quarter GDP fell to 1.82% from a revised 2.54% (previously 2.55%) in the first quarter.

In inflation-adjusted dollars, the reported annualized improvement in the trade deficit (\$66.8 billion) -- though highly questionable -- more than accounted for the reported annualized quarterly growth of \$54.6 billion to bring total real GDP to \$11,700.6 billion. Such, in turn, largely was offset by a net liquidation of business inventories (\$52.0). That means that the rest of the economy: personal consumption (plus \$31.4 billion), fixed investment (minus \$10.8 billion), and government (plus \$17.2 billion), accounted for \$39.8 billion (or \$37.8 billion) of the growth -- if only the numbers added up. Due to the quirks of GDP

deflation methodology, the underlying GDP categories total \$190.4 billion more (a "residual") than the officially-reported GDP.

The BEA's GDP-like measures for second-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, were not estimated in the "advance" reporting, since the BEA did not have enough information to guesstimate them meaningfully (the BEA also did not have enough information to guesstimate the GDP). The results of the related benchmark revisions, however, are examined in the Reporting/Market Focus.

Adjusting for methodological distortions and gimmicks built into GDP reporting over time, the SGS-Alternate GDP measure suggests that economic reality was much weaker than officially reported. A second-quarter year-to-year contraction of roughly 2.9% 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 somewhat greater than the SGS-Alternate GDP first-quarter estimate of a 2.7% annual decline.

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 (August 28): The "preliminary" estimate revision of second-quarter GDP growth could see significant upward revision, thanks to the "improvement" in the June trade deficit and the May revision, reported subsequent to the "advance" estimate of GDP growth. The nature of the current economic and systemic financial crises

argues for continued fluff and for positive GDP reporting until after the November election.

Consumer Price Index (CPI) -- As discussed in the July 16th *Flash Update*, consumer inflation surged to a 17-year high annual rate of 5.0% in June, as measured by the CPI-U all-urban-consumers measure. Even worse, for the narrower CPI-W -- targeted at the wage-earners category where gasoline takes a bigger proportionate bite out of spending -- annual inflation jumped to 5.6%. The measure used for making the annual cost of living adjustments to Social Security payments is the CPI-W, and the 2009 adjustment that will be based on the July to September 2008 period now is a good bet to top 5%, more than double last year's 2.3% adjustment for 2008.

Where annual SGS-Alternate M3 growth has stalled at around 15.4% in July, such still is highly inflationary, and likely new liquidity moves by the Fed/Treasury should spike annual growth further in the months ahead. In conjunction with high oil prices (still above \$100 per barrel) and a volatile dollar that still is down year-to-year and likely headed much lower, the rapid money expansion still suggests double-digit inflation -- as officially reported in the CPI -- into early 2009.

CPI-U. The Bureau of Labor Statistics (BLS) reported that the seasonally-adjusted June CPI-U (I.6) gained 1.06% (1.01% unadjusted) +/- 0.12% for the month, versus the 0.65% (0.84% unadjusted) gain in May. Year-to-year or annual inflation in June jumped to 5.02% from 4.18% in May. Annual inflation will continue its upturn in July 2008 reporting, dependent on the seasonally-adjusted monthly gain exceeding the 0.22% monthly increase seen in July 2007, which appears highly likely. The difference would directly add to or subtract from June's annual inflation rate of 5.02%.

The adjusted monthly inflation gain reflected negligible catch-up from the underreporting of

energy-related inflation in recent months; such should intensify some in the next report. The lack of significant pick-up in the gimmicked concept of "core" inflation remains beyond belief and is addressed in the Opening Comments.

C-CPI-U. Annual inflation for the Chain Weighted 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 -- jumped to 4.24% in June, up from 3.62% in May.

Alternate Consumer Inflation Measures.

Adjusted to pre-Clinton (1990) methodology (I.7), annual CPI growth rose to roughly 8.3% in June from 7.5% in May, while the SGS-Alternate Consumer Inflation Measure (I.8), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, rose to a 27-year high of roughly 12.6% in June, up from 11.8% in May. The alternate numbers are not adjusted for any 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 (August 14): Annual July CPI inflation should rise sharply, again, based on still higher energy costs. Despite the recent plunge in oil prices, average gasoline prices rose slightly (0.2%) in July, which, in combination with seasonal factors that should boost gasoline inflation to the upside, means a fair shot of the seasonally-adjust monthly CPI-U gain coming in near or above the consensus expectations of roughly 0.4% (per briefing.com). Any seasonally-adjusted monthly increase exceeding the 0.22% monthly gain seen in July 2007 would directly add to June's annual inflation rate of 5.02%. Where underlying fundamentals favor an upside surprise to market expectations, targeted manipulation remains of very high risk.

Other Troubled Key Series

Federal Deficit -- As discussed in the Opening Comments, the fiscal condition of the U.S. government is in a state of rapid deterioration, due to surging government outlays and otherwise uncontained spending in conjunction with recession-strangled tax revenues. Excluding significant war costs in its July 28th mid-session review, the Office of Management and Budget estimated that the fiscal-year 2008 (year-ended September 30, 2008) budget deficit would total \$389 (previously \$410) billion dollars, up from \$162 billion in 2007, and that the deficit for fiscal-year 2009 would hit \$482 billion. Where the 2009 deficit was projected at \$407 billion back in February, the forecast change was based on softer economic projections -- but not on a recession.

Yet, evidence continues to mount of weaker-than-anticipated tax collections at both the federal and state levels, due to the deepening recession. For the first ten months of fiscal 2008, federal receipts are down 0.3% from the same period in 2007. As noted in the prior newsletter, the Federal Reserve (Flow of Funds June 2008) estimated 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 state and federal conditions and for U.S. Treasury funding needs.

With no allowance for recession in the assumptions underlying the deficit the projections, the final 2008 numbers should be somewhat worse than currently estimated, while the 2009 deficit estimate should see significant further deterioration. Where 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.

The rolling 12-month deficit through July 2008 stood at \$365.5 billion versus \$165.8 billion in July 2007, compared with the rolling 12-month deficit through June 2008 of \$309.2 billion versus \$162.7 billion in June 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 \$9.585 trillion at the end of July 2008, up \$93 billion for the month and up \$653 billion from July 2007, which in turn was up \$488 billion from July 2006. As of the end of June 2008, gross federal debt stood at \$9.492 trillion, up \$103 billion for the month, and up \$624 billion from June 2007, which in turn was up \$448 billion from June 2006.

The federal government's fiscal 2007 official, accounting-gimmicked deficit narrowed to \$162 billion from \$248 billion in 2006. Yet 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 still remains my best estimate.

Initial Claims for Unemployment Insurance --

The ongoing deterioration in the trend of annual change has intensified in recent weeks. On a smoothed basis for the 17 weeks ended August 2nd, annual growth soared to 22.9%, from 18.8% in the 17 weeks ended June 28th and from 14.9%

in the 17 weeks ended May 31st. 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 Labor 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 -- Reflecting catch-up in seasonally-adjusted CPI-W inflation, June's seasonally-adjusted monthly real earnings fell by 0.9%, following a 0.7% decline May and a 0.1% drop in April. Annual change in June tumbled to a 2.4% contraction, following a 1.1% decline in May and a 0.7% year-to-year fall in April.

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 today's (August 13th) and July 15th's *Flash Updates*, retail sales have continued to signal a deepening recession, with ongoing real (inflation-adjusted) contractions on a monthly, quarterly and annual basis. The Census Bureau reported that monthly seasonally-adjusted July retail sales fell by 0.12% (up 0.11% net of revisions) +/- 0.6% (95% confidence interval), following a revised 0.35% (previously 0.07%) increase in June. On a year-to-year basis, July retail sales rose by 2.63%,

following a revised June gain of 3.35% (previously 3.04%). In terms of real growth, however, both the monthly and annual rates of change continued in contraction, given the likely reporting of tomorrow's July 2008 CPI-U estimate. Despite the positive impact of tax-rebate checks, real second-quarter retail sales contracted for the fourth consecutive quarter, and the July data are setting the pattern for a fifth such consecutive contraction.

Core Retail Sales. Consistent with the Federal Reserve's predilection for ignoring food and energy prices, "core" retail sales -- retail sales net of grocery store and gasoline station revenues -- fell by 0.33% (up 0.03% net of revisions) in July versus a revised 0.27% (was 0.68%) decline in June, against the official aggregate drop of 0.12% in July and the revised 0.35% gain in June. It is important to note that the physical volume of gasoline consumption has started to decline in response to high gasoline prices, so the inflation-adjusted retail sales number should take a bigger hit than seen in the "core" rate. On an annual basis, July "core" retail sales fell by 0.53% versus a revised June increase of 0.44%, previously a 0.09% contraction.

Next Release (September 12): With the tax rebate checks out of the way, underlying fundamentals suggest ongoing severe weakness, with a fair downside risk for August retail sales growth against what likely will be an overly optimistic consensus forecast. Any gains should continue to be due to inflation -- not to increased consumer purchasing power -- with sharp contractions likely continuing in the monthly and annual growth rates.

Industrial Production -- As discussed in the July 16th *Flash Update* and as graphed in the Opening Comments, June industrial production continued to signal a contracting economy. As reported by the Federal Reserve, monthly seasonally-adjusted June industrial production rose by 0.5% (0.7% net of revisions that stretched back over six months). Such followed an unrevised 0.2% decline in May.

The monthly gain was attributed to surging auto production following the end of a strike.

Despite the revisions erasing the annualized 0.1% quarterly contraction previously reported for the fourth quarter (now up by 0.5%), the second quarter was reported with a sharp, annualized 3.1% contraction, common to recessions. Year-to-year growth was 0.3% in June, up from a revised 0.2% gain (was a 0.1% contraction) in May. Year-to-year change in the second quarter dropped sharply to 0.3% from 1.8% in the first quarter.

Next Release (August 15): The July production numbers should resume a pattern of ongoing monthly contractions, against expectations of a flat monthly performance. The erratic but generally slowing annual growth rate is a fair bet to turn negative, again. Such would be consistent with the manufacturing contractions still signaled regularly by the purchasing managers survey (before recent re-formulation).

New Orders for Durable Goods -- As discussed in the July 30th *Flash Update* and in the Opening Comments, durable goods orders sank, again, year-to-year. The regularly-volatile new orders for durable goods series was reported by the Census Bureau as up by 0.8% (0.8% net of revisions) for the month of June on a seasonally-adjusted basis. Such followed an upwardly revised 0.1% (previously unchanged) monthly gain in May. Minor fluctuations in monthly growth for this high-volatility series are meaningless, especially against consensus estimates, except for the occasional overreaction hyped in the equity markets, as followed the June release.

Of significance, however, was that the series contracted on a year-to-year basis (before any adjustment for inflation) for the fourth straight month: down 0.8% March, down 3.8% April, down 1.4% May, down 1.1% June. Where the series also contracted year-to-year in the second quarter, it also showed the third consecutive

quarter-to-quarter contraction, an event not seen historically outside of recessions.

The closely followed nondefense capital goods new orders fell by 3.2% in June, following a revised 0.2% (previously 0.4%) gain in May. June's year-to-year change turned to a decline of 6.2%, following a revised 1.3% (previously 0.4%) gain in May.

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 -- The Bureau of Economic Analysis and the Census Bureau reported a continued and largely unbelievable reduction in the monthly June trade deficit. The number was strong enough to place fair odds on a strong upward revision to already-overstated second-quarter GDP growth.

The seasonally-adjusted monthly trade deficit for June was reported to have decreased to \$56.8 billion from a revised \$59.2 (previously \$59.8 billion) in May. The data appear unreliable, with unusual paperwork flows from the ports likely distorting current reporting.

The reported average unit price for imported oil rose in June to \$117.13 per barrel, from \$106.28 in May. Yet, and the average barrels per day reported as imported for June plunged by 7.5% year-to-year. While U.S. oil imports may be softening, along with oil consumption, there are indications of some underreporting of oil imports in the trade data, versus statistics otherwise available through the U.S. Department of Energy. More will follow on this in a later newsletter.

Next Release (September 11): Images of underlying reality are not strong in this increasingly damaged series. Given their use as a prop to GDP reporting, questionable trade data are likely to continue through the November election. Accordingly, the July and August numbers

(needed for the third-quarter GDP estimate just before the election) are likely to show a continued narrowing of the deficit, despite any anecdotal evidence to the contrary.

Consumer Confidence -- As discussed in the July 30th *Flash Update*, the ongoing weakness evident in consumer housing and retail sales activity is consistent with the historic annual plunges being reported in the June and July consumer confidence measures.

The Conference Board's Consumer Confidence measure gained 1.8% in July (versus down 12.2% in June) and the Reuters/University of Michigan's Consumer Sentiment measure rose by 8.5% in July (versus down 5.7% in June). Similar monthly patterns were seen last year, however, and greater significance was evident in the pattern of annual change.

Consumer Confidence in July fell by the largest annual amount in the history of the series, down by 53.6% year-to-year, breaking the prior month's record annual contraction of 51.7%. July Consumer Sentiment fell by 32.3% year-to-year, the steepest annual contraction shy of June's record 33.9% drop. 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 started to slow markedly,

intensifying recession pressures and highlighting ongoing difficulties the Federal Reserve is having in stabilizing solvency issues in the U.S. banking system. The intensifying decline in annual growth for commercial paper outstanding has continued to deepen as growth in commercial and industrial bank loans has slowed.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth was reported at 5.6% in June, a notch higher than the 5.5% reported in May, but down sharply from 6.0% in April and from 5.8% in March.

General background note: 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 and eventual contraction in consumer debt remains an ongoing constraint on economic activity.

Annual growth in commercial borrowing varied sharply, but growth patterns have started dropping in tandem for both commercial paper and commercial and industrial loans. Annual change in July commercial paper outstanding showed a 20.8% contraction, deepening from contractions of 19.0% in June, 17.2% in May and 13.9% in April.

While annual growth in June commercial and industrial loans rose by a still healthy 18.7%, such has slowed from growth of 19.9% in May, 21.2%

in April and 21.6% in March. The instability in commercial paper is ongoing. With the relative offset in commercial and industrial loans stalling, resultant credit difficulties increasingly will inhibit broad business activity.

Producer Price Index (PPI) -- As discussed in the July 15th *Flash Update*, the seasonally-adjusted June producer price index (PPI) increased by 1.8% (1.6% unadjusted) for the month, up minimally from May's 1.4% (1.6% unadjusted), and above consensus forecasts. Annual inflation for June jumped to 9.2% from May's 7.2% rate, per the Bureau of Labor Statistics (BLS).

Both food and energy inflation continued to appear to be understated, meaningfully, while the monthly "core" inflation rate remained at the unbelievably low monthly rate of 0.2%, as discussed in the Opening Comments.

On a monthly basis, seasonally-adjusted June intermediate goods rose by 2.1% (2.9% May), crude goods gained 3.7% (6.7% May). Year-to-year inflation, remained excessive, but still shy of a real world that had seen a near-doubling in oil prices year-to-year, with June intermediate goods up by 14.5% (12.6% May) and with crude goods up by 45.5% (41.5% May). Crude energy materials rose by a modest 72.1%.

Next Release (August 19th): Given what appears to be ongoing deliberate understatements of the monthly CPI and PPI inflation rates (see Opening Comments), the PPI likely will be subject to further understatement in July. Allowing for the ongoing regularly random volatility of the monthly price variations, PPI inflation reporting over the next six-to-nine months, however, generally should favor upside surprises in official results, thanks in particular 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 -- But for the reformulation of the purchasing managers manufacturing index (PMI) back in January, the June and July index readings both would have remained below 50.0, signaling a contracting manufacturing sector and a recession. The Institute for Supply Management (ISM) reweighted its key index so that the PMI 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 PMI. Fortunately, however, the more meaningful components of the index were not affected by the efforts to match the flawed government data.

The July PMI eased to the borderline growth-contraction reading of 50.0, from 50.2 in June and the May reading of 49.6, which had been the fourth consecutive monthly recession reading. While the 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 July orders index showed continuing contraction (holding below 50.0), falling to 45.0 from 49.6 in June and from 49.7 in May. The new orders have been in actual contraction 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 July new orders index fell by 17.1%, following respective June and May declines of 16.8% and 15.2%.

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 bounced to 51.9 in July, up from 43.7 in June and 45.5 in May.

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 July services composite index notched higher to 49.5, from 48.2 in June, but down from 51.7 in May.

Both the services employment and prices paid components, however, have some meaning. Covering the real estate and banking industries, among others, the July employment component remained below 50.0, at 47.1, up from 43.8 in June, but down from 48.7 in May. The extremely high prices paid component for both indices is covered in the Inflation Indicators.

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

Based on such a request, the seasonally-adjusted June help-wanted advertising index notched higher to 18 in June, up from 17 in May. The May reading had been the lowest level seen since the index was first calculated at the end of President Harry Truman's term in office.

The June reading was down by 30.0% year-to-year, versus a 37.0% decline in May. The annual change in the three-month moving average as of June was a 35.4% contraction, versus a 36.5% contraction in May. Despite some of the historic weakness in the series being due to the loss of newspaper business 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.

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 contracted on a year-to-year basis in each month from April through July 2008. Such likely is not a good sign

for national employment or for broad economic activity.

Housing Starts -- As discussed in the July 22nd *Flash Update*, the consistency of the government's residential construction measures been compromised. The Census Bureau's June reporting of building permits and housing starts was seriously distorted by changes in New York City construction codes that triggered a surge in reported activity that was little more than renewed paperwork.

Where seasonally-adjusted June housing starts was reported up by 9.1% for the month, such would appear to have been a contraction net of the New York City activity. May's monthly change revised to a 0.4% decline from an initial report of a 1.8% drop. Annual change likewise was distorted, down 26.9% versus May's revised 35.7% decline. I am working on a temporary adjustment to the series so to as allow for more-meaningful, period-to-period comparisons, which should be in place for the next newsletter.

In home sales data, the seasonally-adjusted June new home sales fell by 0.6% (up by 3.5% net of revisions) +/- 14% (95% confidence interval), which was not statistically distinguishable from a contraction. The June gain followed a revised 1.3% (previously 2.5%) monthly decline in May. On a year-to-year basis, however, June new home sales dropped by 33.2%, following a revised 37.8% (previously 40.3%) annual plunge in May.

Increasingly reflecting the impact of foreclosures, existing home sales in June fell by 2.6%, after a 2.0% gain in May. Year-to-year sales fell by 15.5% in June, following a 15.9% decline in May.

Net of increasing stress in the reporting of the data, the housing market remains in a severe and protracted recession.

Inflation Indicators

Money Supply -- See the August 3rd *Money Supply Special Report* for a discussion of the practical measurement and analytical uses of money supply in assessing inflation prospects.

Annual growth in the seasonally-adjusted SGS-Ongoing M3 is estimated to have slowed further to 15.4% in July, following estimated annual growth of 15.8% in June, 15.9% in May, 16.4% in April and a record-high 17.4% in March. The continued slowing in annual growth in June and July (the monthly data continue to expand) appears tied to the still-intensifying problems in the banking system, and well may foreshadow near-term systemic jolts and still-further liquidity expansion by the Fed.

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. While the July's growth remains shy of 1971's high, it still promises heavy upside inflation pressure into first-half 2009.

For July 2008, annual growth for monthly M1 is estimated to have risen to 2.0% from 1.5% in June, continuing a positive swing from a 0.6% contraction in May and ending two years of flat-to-minus annual growth. July annual M2 growth notched higher to 6.2%, from 6.1% in June, but still was down from 6.4% in May. The relative pick-up in M1 growth appears to be due to funds shifting from accounts in the broader M2 and M3 measures (particularly institutional money funds and large time deposits) into M1 checking accounts and currency. Such may reflect increased wariness of the part of large depositors.

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

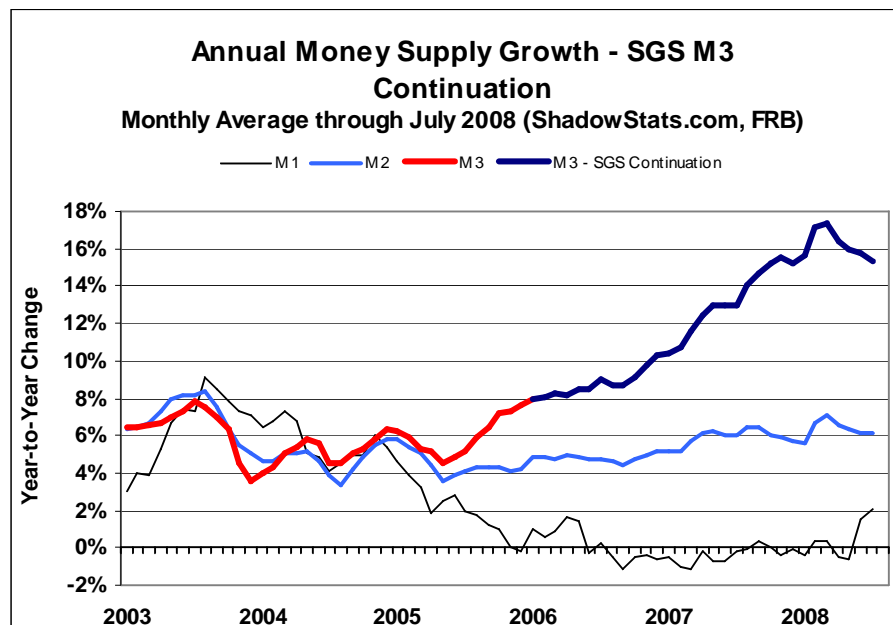
Feb 06	10.311	Oct	10.979	Jun	11.950	Feb	13.390
Mar	10.364	Nov	11.094	Jul	12.055	Mar	13.575
Apr	10.425	Dec	11.226	Aug	12.261	Apr	13.646
May	10.504	Jan 07	11.314	Sep	12.443	May	13.764
Jun	10.575	Feb	11.436	Oct	12.651	Jun	13.836
Jul	10.672	Mar	11.563	Nov	12.823	Jul (p)	13.907
Aug	10.755	Apr	11.720	Dec	12.931		
Sep	10.852	May	11.872	Jan 08	13.088		

(r) Revised, based on extensive FRB historical revisions. (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. 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 July 2008 prices paid indices remained extremely high, though off the peaks seen in June for both of 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 July price index eased to 88.5 from June's 28-year high reading of 91.5, and following May's reading of 87.0. On a three-month moving average basis, July's year-to-year gain was 30.9%, versus 24.1% in June and 21.7% in May. 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 July prices diffusion also eased, falling back to 80.8 from 84.5 in June, but up from 77.0 in May. On a three-month moving-average basis, July's annual gain was 25.5%, versus 21.0% in June and 15.5% in May.

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 -- Extreme price volatility has been the recent norm for oil trading, but the general outlook for inflation continues to be strongly on the upside, despite any relative near-term oil-price softness. The economy still suffers from oil priced in excess of \$100 per barrel, where severe inflation damage already was ingrained in the system when oil broke above the \$90 per barrel. Implications for inflation and real GDP growth remain extremely ominous for the balance of 2008 and into 2009.

After exploding to record-level closing spot price of \$145.66 for West Texas Intermediate (WTI) on

July 11, 2008, the price of oil has plunged to the \$115 area, as we go to press just a month later. Nonetheless, I would be extremely surprised if we have seen the near-term peak in oil.

Despite heavy oil selling in late-July, July's monthly average spot price for WTI (St. Louis Fed) was \$133.44 per barrel, down just 0.4% from June's \$133.93 historic-high average, which, in turn was up by 6.8% from May's \$125.39. For July 2008, the year-to-year increase in price level was 79.9%, down from June's 98.5% and May's 97.6% annual rates of increase.

The oil market, again, is highly volatile and sensitive to minor surprises or speculation in terms of possible U.S. Gulf Coast hurricanes or potential military action against Iran by Israeli and/or U.S. forces. Despite a deepening U.S. recession and increasing indications of a global recession, and regardless of any continued 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, irrespective of near-term dollar gains. Further pressures come from ongoing OPEC needs, increasingly volatile global military and political tensions, and other supply and demand risks/issues.

Though a reversal in questionable seasonal factors has helped to resume spiking basic annual CPI inflation in the United States, energy inflation measures still remain well shy of reality. The gimmicked "core" inflation measures -- net of changes in food and energy prices -- also should be increasing, but, somehow, the oil-related costs just do not seem to get into the government's inflation reporting. This is despite high oil prices continuing to work 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.

Reporting/Market Focus

GDP Benchmark Revisions -- Weaker Historical Growth

Under normal political circumstances, the nature of the regular reporting of gross domestic product (GDP) and the broader gross national product (GNP), by the Bureau of Economic Analysis (BEA), is overstatement. This broadest of economic measures has become a tool of political propaganda over the years, particularly in the last two to three decades, although I recently heard a story concerning the 1960 presidential election from a former Department of Commerce official. He claimed that Richard Nixon blamed Democrats in his and President Eisenhower's Department of Commerce for the reporting of a rigged second-quarter 1960 GNP contraction. Nixon saw this as a direct effort by his political enemies to help elect John Kennedy, and the former official indicated that there was some substance to that claim.

As noted in Primer Series available at www.shadowstats.com, a former Department of Commerce economist told me the story of how President Lyndon Johnson would review the GNP reports before their release. If he did not like the report, he would keep sending the GNP estimates back to the Commerce Department until they got the numbers "correct."

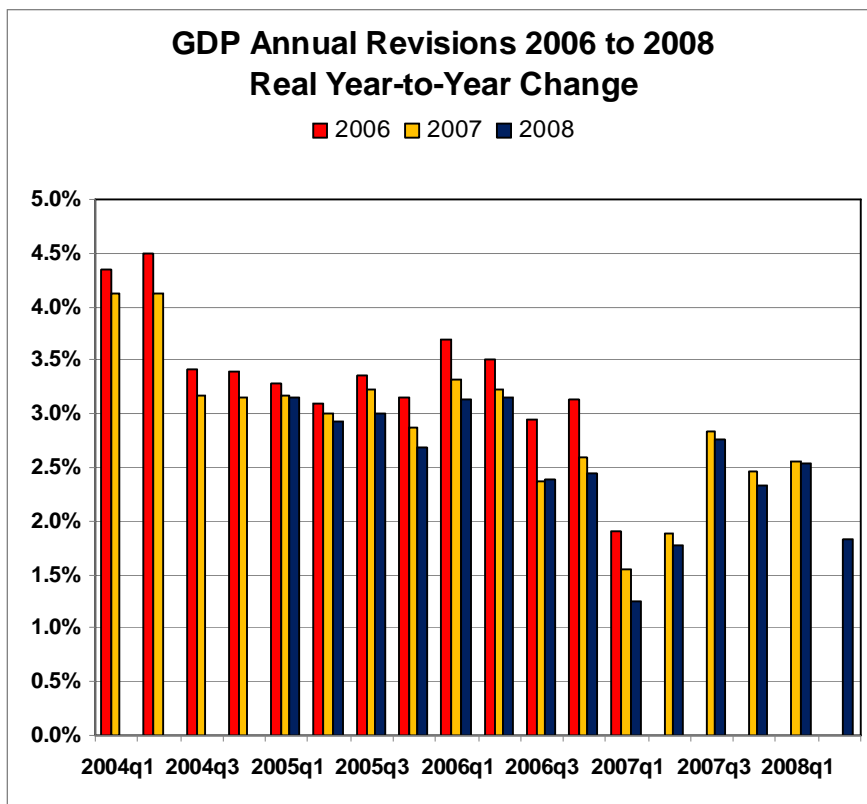
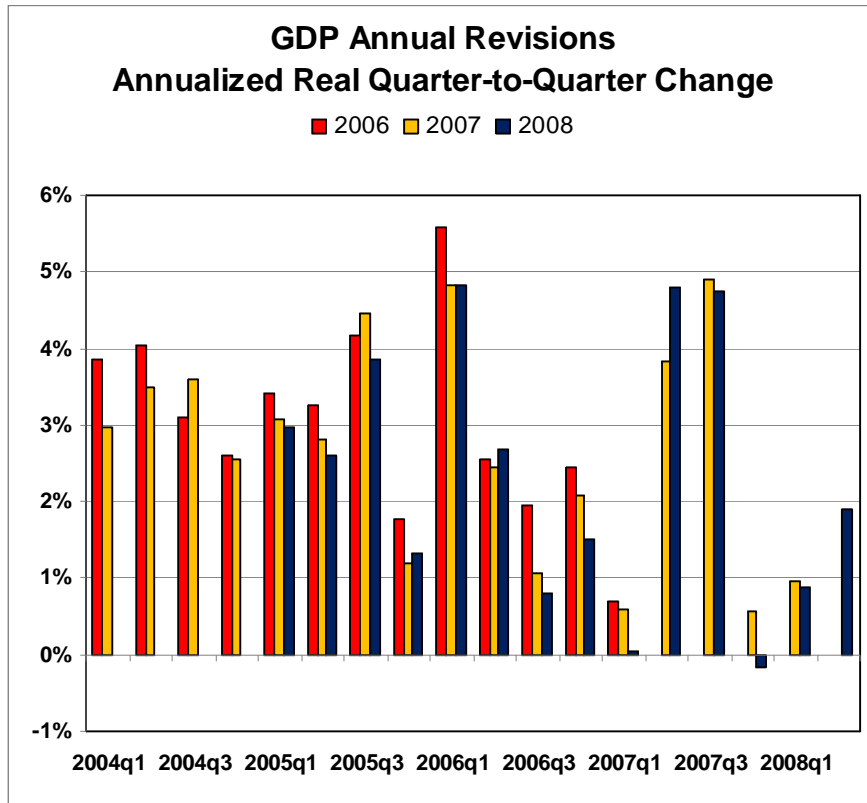
From people directly involved in the incident was story from near the end of the first Bush Administration, where an outside-the-system manipulation of the GDP was worked. A senior member of the Executive Branch approached a senior official of a large computer company and requested that reporting of computer sales to the BEA be inflated. This was done specifically to help with President Bush's reelection effort. The request was granted, and, thanks to the heavy leverage of computer deflation, reported GDP growth enjoyed an artificial spike. Nonetheless, Main Street U.S.A. rarely is fooled by statistics that vary widely from common experience, and

Mr. Bush appeared to many voters to be out of touch with reality, as he touted an economic recovery.

Most commonly, though, the GDP is given some up some upside bias in early reporting. As evidence of that, annual benchmark revisions to the series usually end up showing weaker than previously reported economic growth, and the July 31, 2008 revisions were no exception. As shown in the accompanying graphs, whether growth is on a quarter-to-quarter or year-to-year basis, revision patterns of the last several years generally have been to the downside. In the current revision, an overall downward revision of 0.5% was spread over three years, back to first-quarter 2005.

Note in the graph of comparative quarterly growth rates, and as discussed in the next section, that the revised reporting shows that first-quarter 2007 was close to no growth, that fourth-quarter 2007 now is in contraction, and that first-quarter 2008 growth remained below 1.0%. The downward revisions to growth in those quarters were dominated by upward revisions to the reported trade deficit. Increasingly, the trade deficit appears to the preferred current tool for propping the pre-election GDP reporting.

Subsequent annual and grand-scale benchmark revisions to all the data have a fair shot at eventually showing a recession in place from some point in fourth-quarter 2006 through the present. Such revised reporting will be more likely if control of the White House shifts in the upcoming election, where blame for the ongoing downturn most likely would be placed on the prior Administration. Curiously, though, the current Bush Administration never made much of an effort to blame the 2001 recession on the Clinton Administration, even though the roots for same clearly were in place back in 2000.



Official GDP-Like Measures, GDI and GNP.

The official GDP-like measures include Gross Domestic Income (GDI), which is the theoretical income-side equivalent to the GDP's consumption-side measure, and Gross National Product (GNP), where GDP is GNP net of trade in factor income (interest and dividend payments). The BEA did not publish second-quarter GDI or GNP estimates along with the "advance" second-quarter GDP estimates, because of the lack of availability of meaningful data.

GDI. As described in the July 31st BEA press release: "The statistical discrepancy is current-dollar GDP less current-dollar gross domestic income (GDI). It arises because most components of GDP and of GDI are estimated independently. GDP measures final expenditures -- the sum of consumer spending, private investment, net exports, and government spending. GDI measures the incomes earned in the production of GDP. In concept, GDP is equal to GDI. In practice, they differ because they are estimated using different source data and different methods.

"As a result of the annual revision, the statistical discrepancy as a percentage of GDP (without regard to sign) was revised from less than 0.1 percent to 0.6 percent for 2005, was revised from 0.1 percent to 1.2 percent for 2006, and was revised from 0.2 percent to 0.6 percent for 2007. For all 3 years, the revisions to the discrepancy reflected downward revisions to GDP and upward revisions to GDI."

Of some interest, the statistical discrepancy has widened in revision, instead of narrowing as might be hoped for with the introduction of more complete and presumably better data. Also, the deterioration in the statistical discrepancy has been moving consistently in a direction suggestive of relative overstatement of GDP to GDI growth since fourth-quarter 2006, the point in time from which I figure the current recession eventually will be timed.

Ignoring the nonsense of 2Q08 = 1.9%, for the moment, as currently reported, the annualized quarterly real growth rates for the GDP run as follows:

4Q06 = 1.5%, 1Q07 = 0.0%, 2Q07 = 4.8%, 3Q07 = 4.8%, 4Q07 = -0.2%, 1Q08 = 0.9%, while the annualized quarterly real growth rates for the GDI run as follows:
4Q06 = 2.2%, 1Q07 = -0.2%, 2Q07 = 3.4%, 3Q07 = 0.7%, 4Q07 = -0.8%, 1Q08 = 0.0%.

Somehow, the GDI missed the mid-2007 economic boom shown in the GDP, and is within a hair's breadth of showing a formal recession in 4Q07 and 1Q08, just shy of two consecutive quarters of contracting GDP growth. With the contraction in 1Q07 GDI, one more year's worth of revisions easily could show a recession in place that began at some point in 4Q06.

GNP. Net-debtor nations prefer expressing their economic growth in GDP instead of GNP, because the GDP does not reflect the drain on the economic activity from the net outflow of funds from the system used to service foreign investment. Aside from the effects of Treasury yields depressed artificially by the forced investment of unwanted, foreign-held U.S. dollars in U.S. Treasury instruments, the GNP numbers have appeared to be sporadically out of traditional balance with GDP, which generally should be stronger than the GNP growth estimates.

As currently reported, annualized quarterly real growth rates for the GNP run as follows:
3Q06 = 0.2%, 4Q06 = 2.0%, 1Q07 = -0.3%, 2Q07 = 4.4%, 3Q07 = 6.3%, 4Q07 = 1.3%, 1Q08 = 0.1%.

SGS-Alternate GDP. As to the estimates of SGS-Alternate GDP growth, updated materials are included in the Alternate Realities section in the Opening Comments as well as in the GDP section of the Reporting Perspective. The revised data are available on the Alternate Data tab of www.shadowstats.com.

Upcoming Reporting/Market Focus

The next Reporting/Market Focus will be determined based on factors tied to the evolving market and financial-system foci and concerns of the time.

PLEASE NOTE: The next SGS Newsletter currently is targeted for the week of September 8th, following the release of the August employment report on September 5th. Intervening Flash Updates and Alerts will be posted in response to key economic or financial-market developments.

Earlier editions of the SGS writings referenced in the text can be found on the Archives tab at www.shadowstats.com.

Occasionally, important, brief updates are communicated directly by e-mail. If you are not receiving e-mail communications from us, please let us know at johnwilliams@shadowstats.com or by using the "Contact Us" option on www.shadowstats.com.