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

Number 50

April 20, 2009

Worst Still Ahead for Economy and Solvency Crisis

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

Do Not Mistake Declining Living Standards for Deflation

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

Greenback's Credibility Cracks as Fed Accelerates Dollar Debasement

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OVERVIEW -- OPENING COMMENTS

"Glimmers of Hope" Are Just Hype

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PLEASE NOTE: *A* ***"General background note"*** *provides a broad background paragraph or section on certain series or concepts that is used in more than one SGS newsletter. Where language used in a past newsletter is repeated in subsequent newsletters (or used repetitively month-after-month), any text changes in such a section are highlighted in italics upon first usage. This is done so that regular readers may avoid re-reading material they have seen before, but where they will have the material available for reference, if so desired.*

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

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

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

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

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

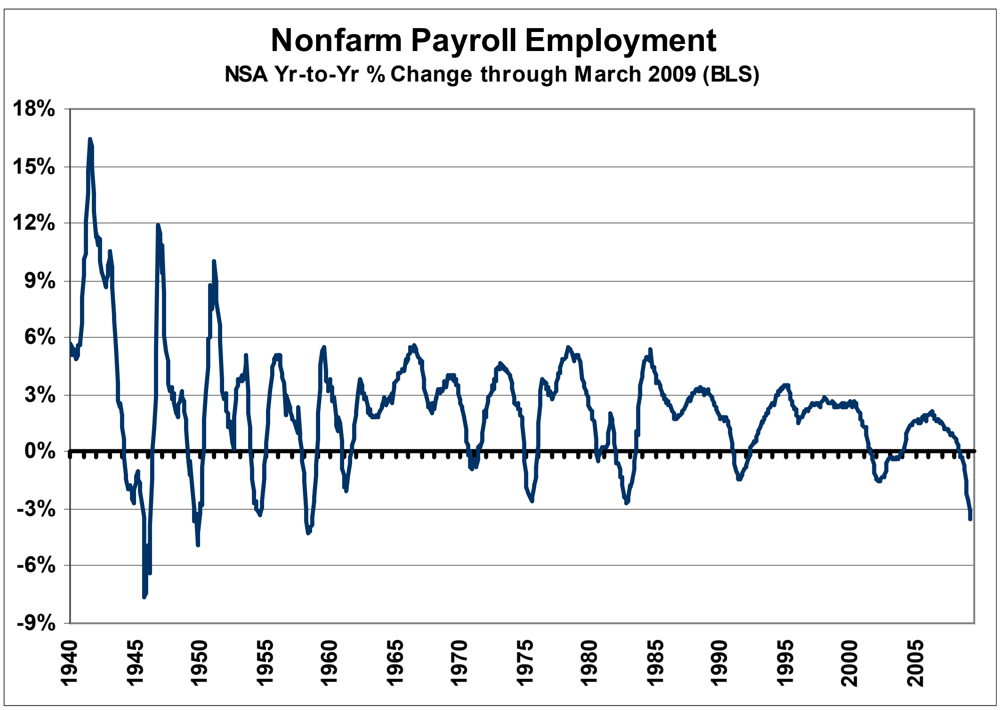
The current recession, however, began before the solvency/liquidity issues came to a head and was itself instrumental in triggering the systemic liquidity crisis. The systemic liquidity crisis, in turn, has severely exacerbated the economic contraction. Neither President Obama's stimulus package nor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

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

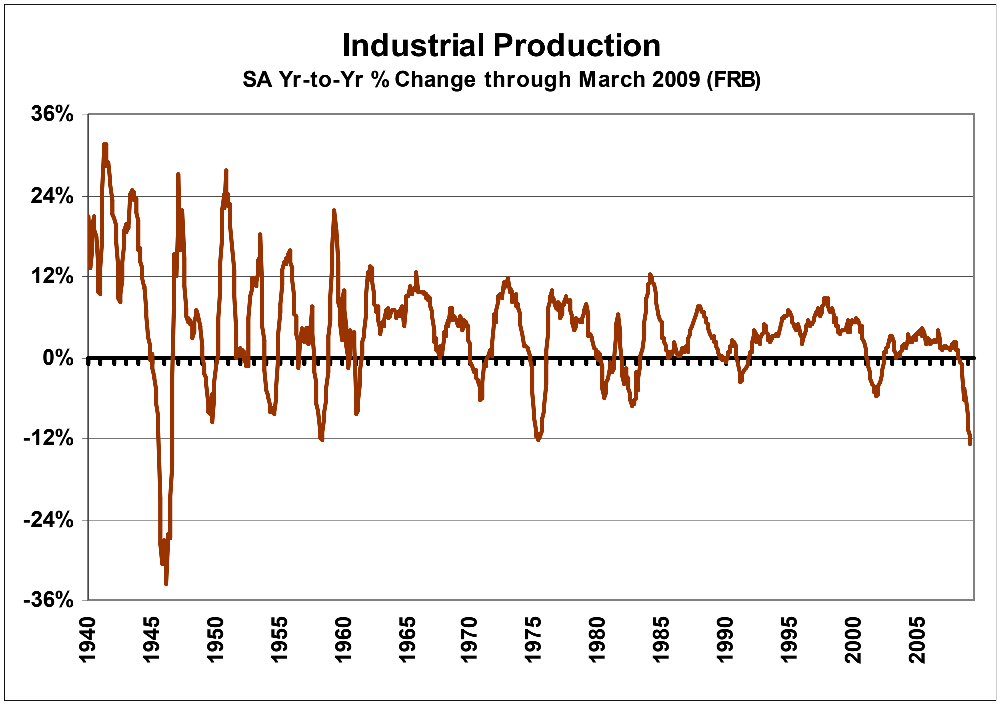
Historical Comparisons Close in on Pre-World War II. Despite temporary hype to the contrary, the U.S. economy has continued in freefall. In the accompanying graphs, payroll employment, industrial production, retail sales and housing starts plots have been extended back through 1940, where available,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

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

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



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

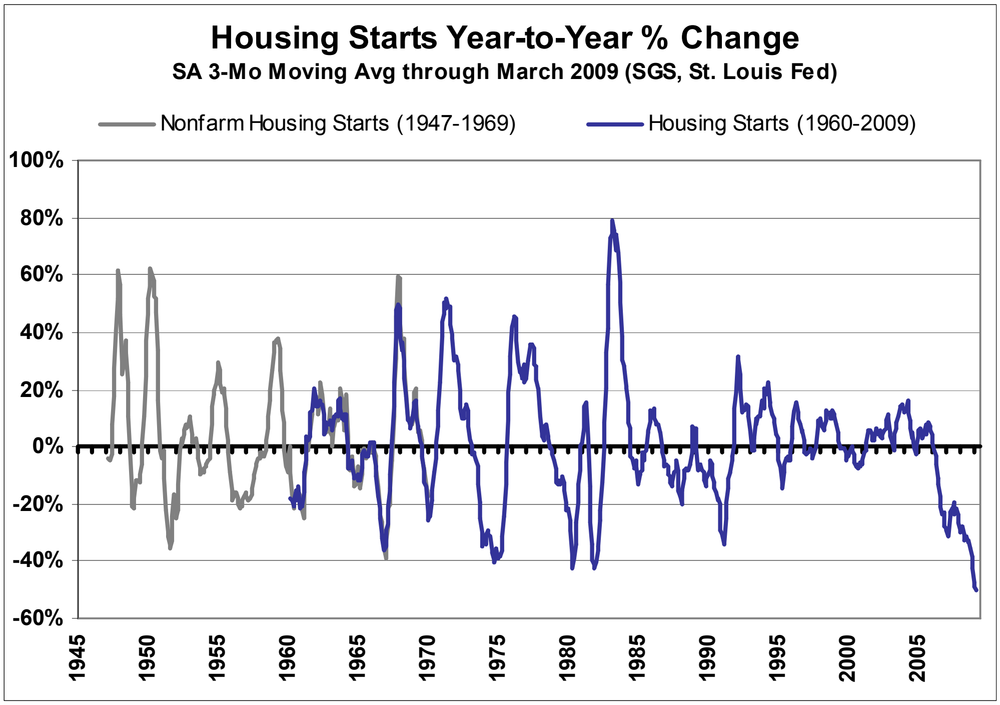


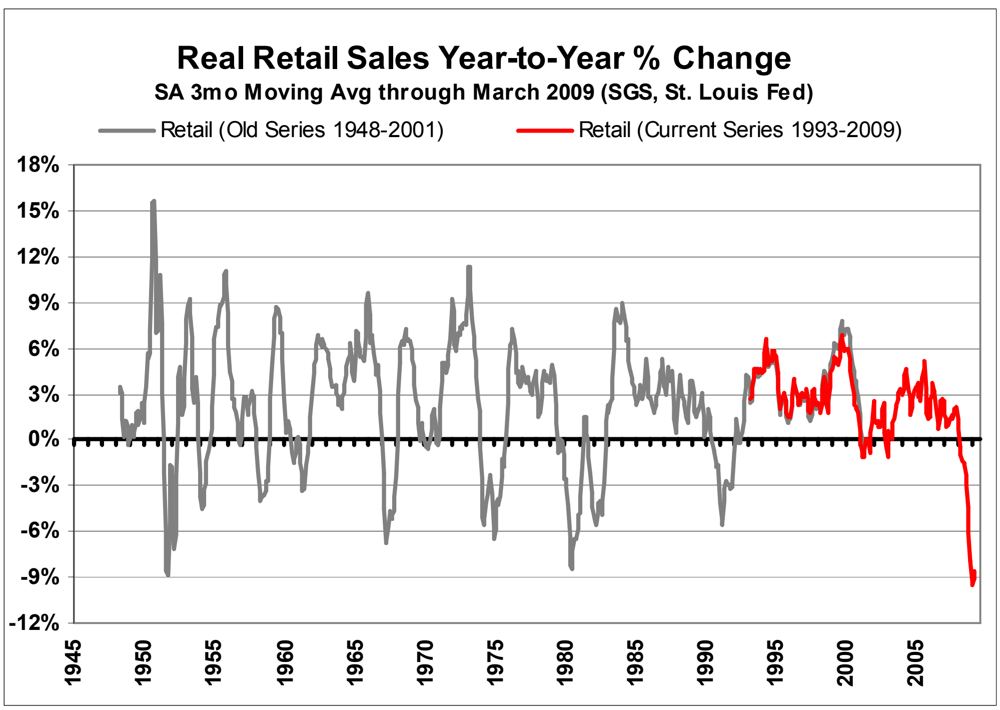
The plots on housing starts and retail sales series include both current the prior historical series, which tend to go back to the end of World War II. Despite series redefinitions, year-to-year change varies little between the old and new versions, allowing for a longer-term historical perspective.

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

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

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





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

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

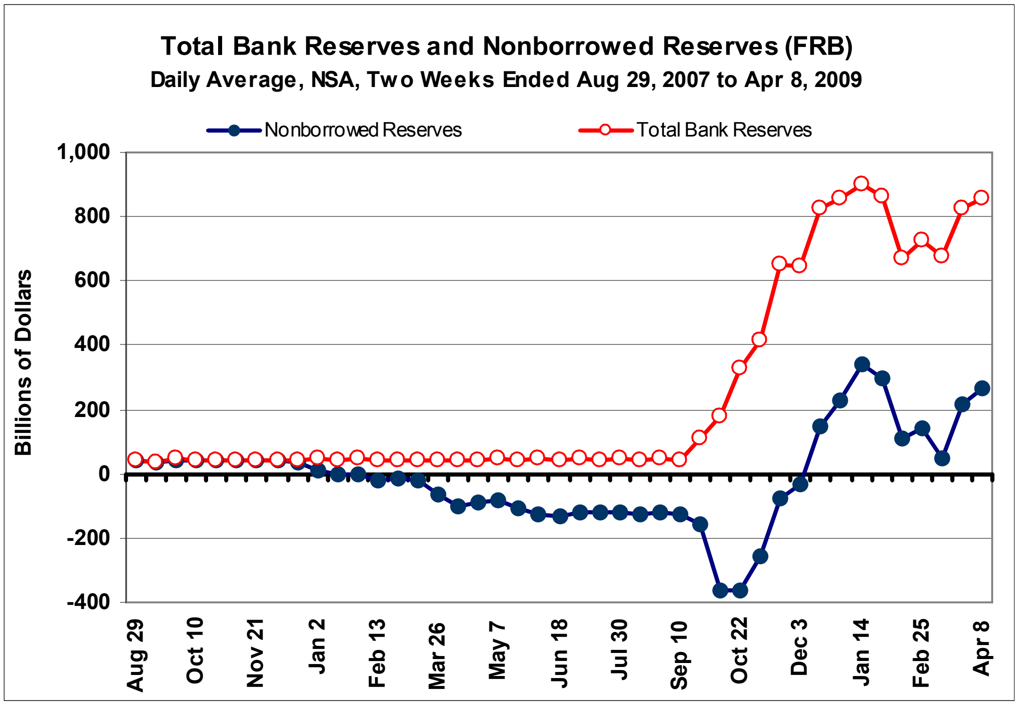
In the current cycle, inflation-adjusted retail sales (seasonally-adjusted, three-month moving average) have declined peak-to-trough by 10.4%, and industrial production has dropped 13.3%. Accordingly, both those series are in depression territory.

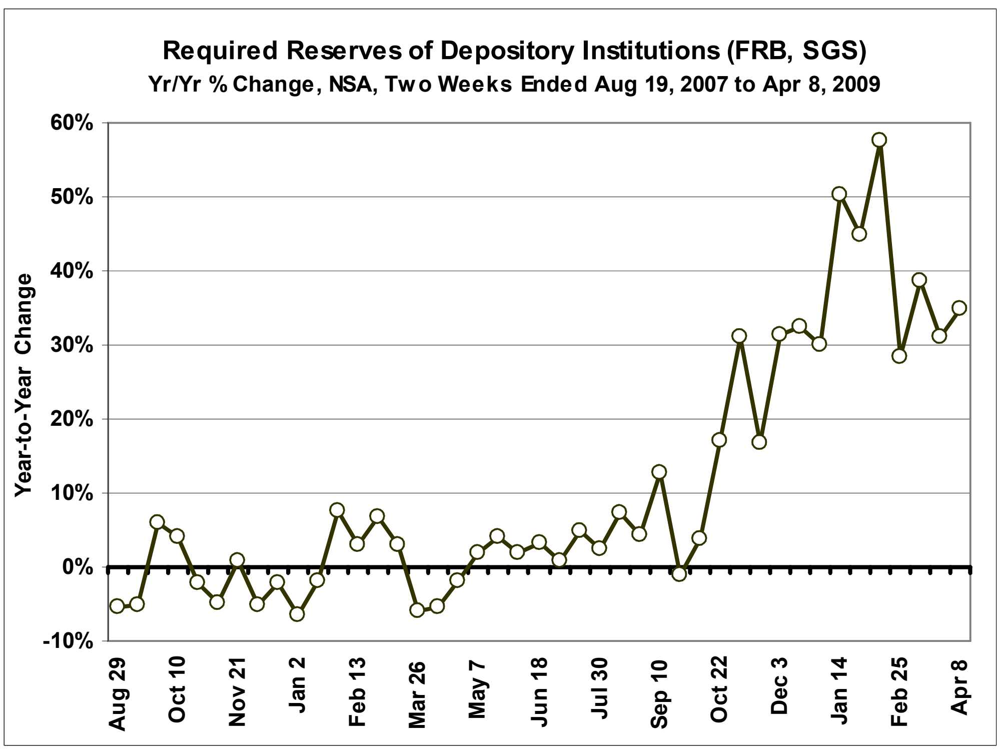
New orders for durable goods (seasonally-adjusted, three-month moving average) have declined peak-to-trough by 25.4%, breaking into the range of a great depression. The real contraction would be greater, if there were an adequate inflation series for deflating durable goods. For housing starts (seasonally-adjusted,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

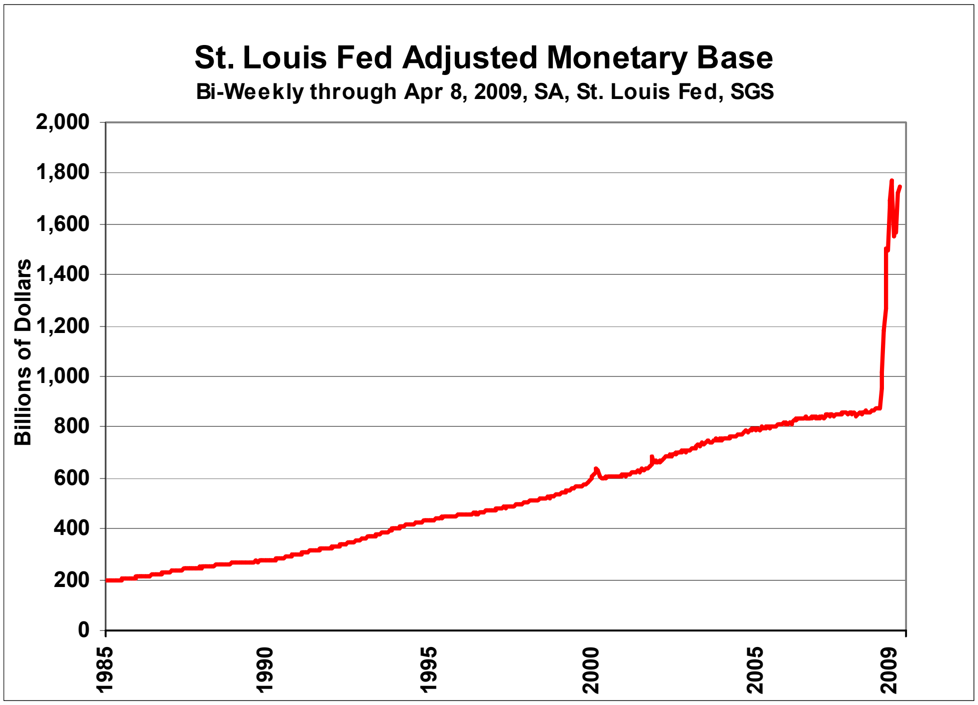
Some Bottom-Bouncing Remains Likely, But Not Yet. As discussed in the various sections related to the indicators mentioned below, reporting in the last month or so has generated some possible signals of bottom-bouncing, where tumbling business activity begins to bounce along a low-level plateau of activity.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

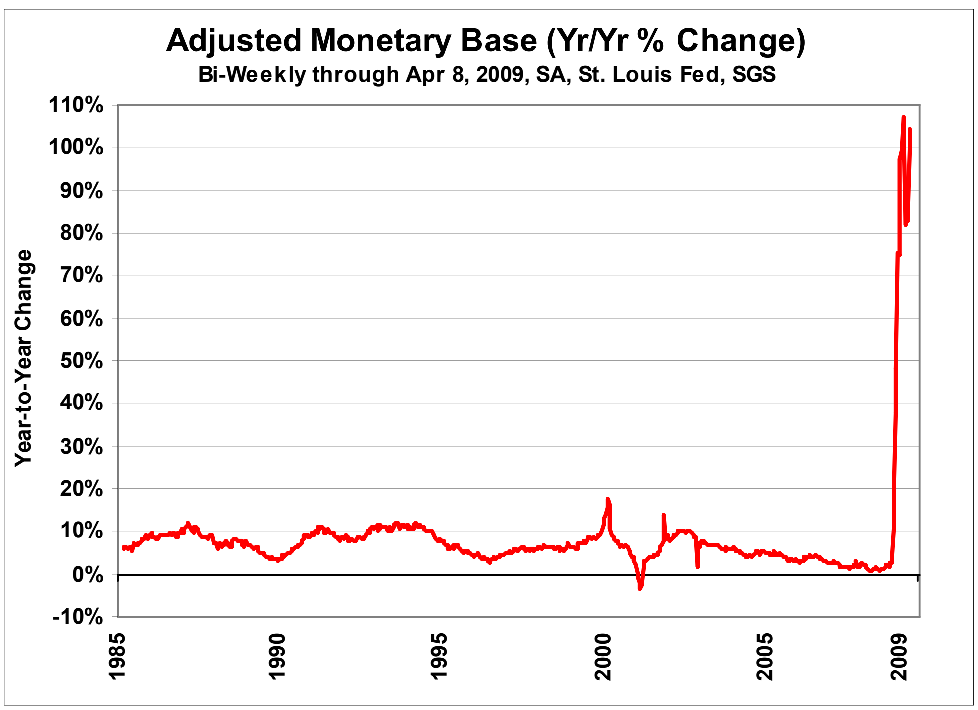
In terms of the recent grasping at straws by spinmeisters on Wall Street, at the Fed and in the Administration, most monthly gains simply were not statistically meaningful (housing data, new orders for durable goods, new claims for unemployment insurance, early-month consumer sentiment), while annual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

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

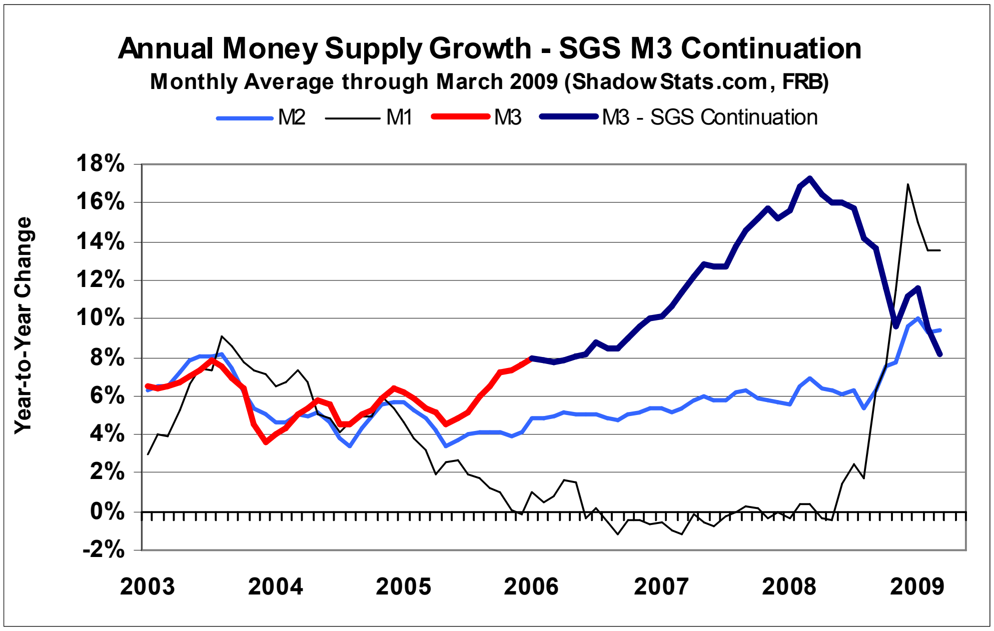

Total Bank Reserves and Nonborrowed Reserves (FRB)
Daily Average, NSA, Two Weeks Ended Aug 29, 2007 to Apr 8, 2009
Nonborrowed Reserves
Total Bank Reserves
Billions of Dollars
1,000
800
600
400
200
0
-200
-400
Aug 29
Oct 10
Nov 21
Jan 2
Feb 13
Mar 26
May 7
Jun 18
Jul 30
Sep 10
Oct 22
Dec 3
Jan 14
Feb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


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





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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

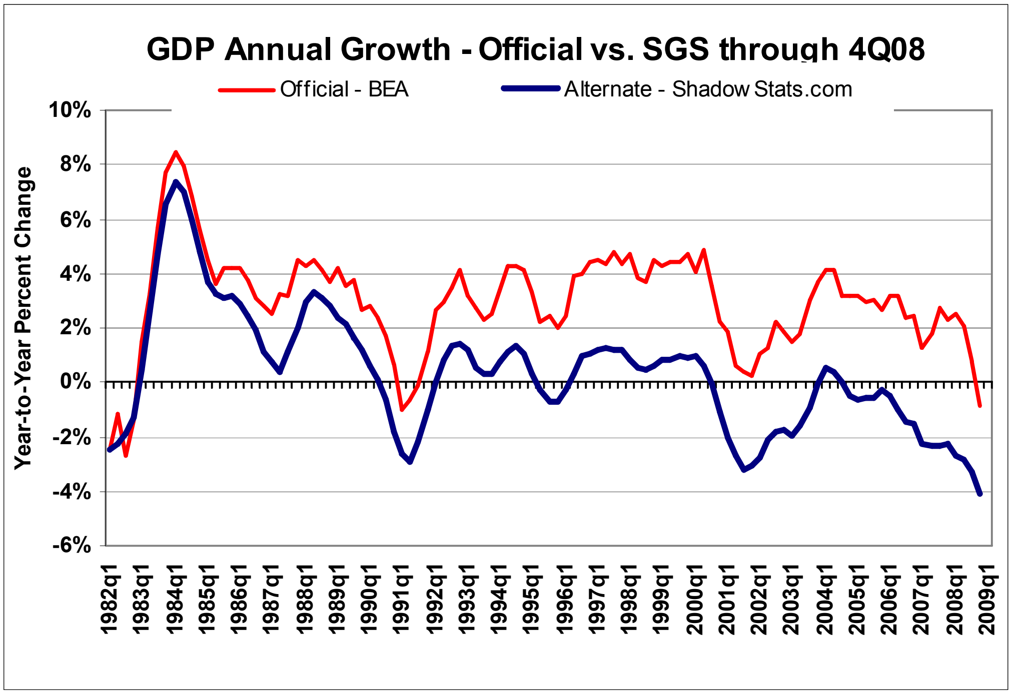
A Penny for All Your Debts and Obligations. I recently received a framed sampling of Zimbabwe (formerly Rhodesia) currency from my son as a birthday present. Zimbabwe has been through a number of years of high inflation and hyperinflation, and through three devaluations, where excess zeros repeatedly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

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

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

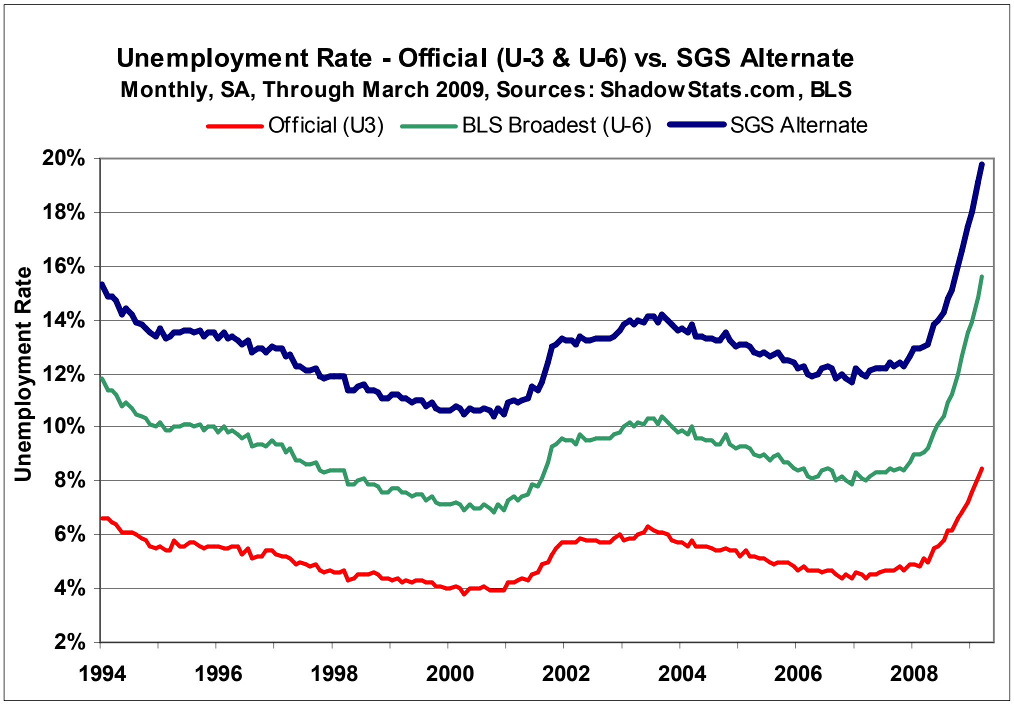
What helped enable the evolution of the Zimbabwe monetary excesses over the years, while still having something of a functioning economy, was the back-up of a well functioning black market in U.S. currency. The United States has no such backup, however, with implications for a more rapid and disruptive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

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



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

General background note: Historical data on both the official and SGS-Alternate GDP series are available for download on the Alternate Data page of www.shadowstats.com. The Alternate GDP numbers tend to show deeper and more protracted recessions than have been reported formally or reflected in related official reporting. Nonetheless, the patterns shown in the alternate data are broadly consistent with the payroll employment and industrial production series, which are major indicators used by the National Bureau of Economic Research in determining the official timing of U.S. business cycles.



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

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

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

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

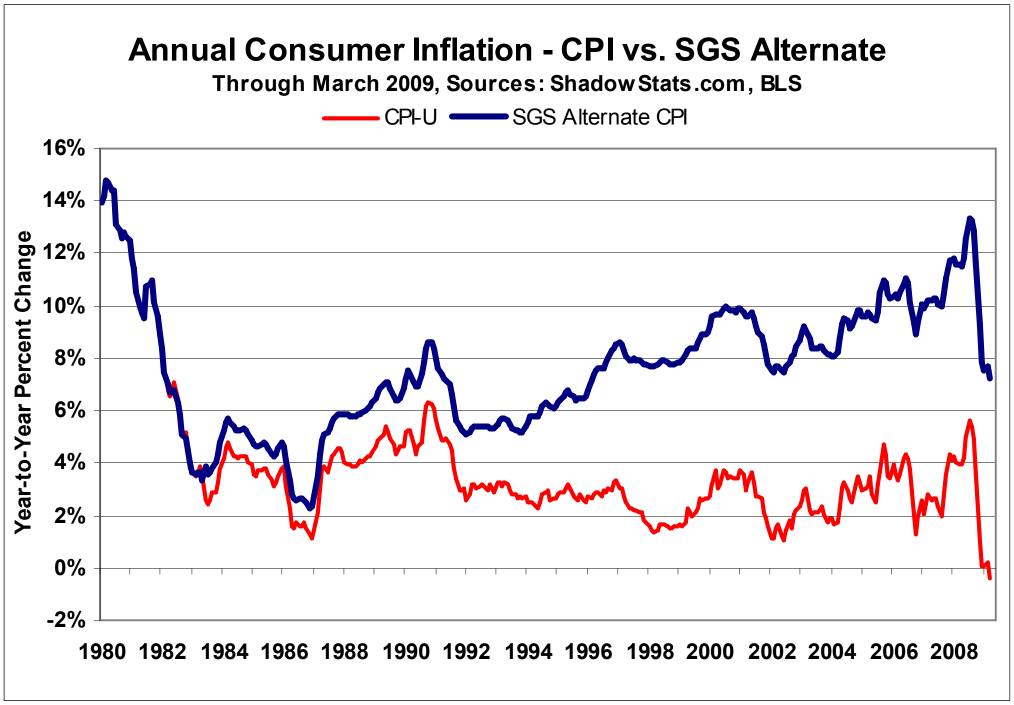
General background note: U.3 is the popularly followed unemployment rate published by the Bureau of Labor Statistics (BLS), while U.6 is the broadest unemployment measure published by the BLS. U.6 is defined as total unemployed, plus all marginally attached workers, plus total employed part time for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

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

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

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

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



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

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

Sources: SGS, BLS (Bureau of Labor Statistics), BEA (Bureau of Economic Analysis).
Notes: (r) Revised. I.1 to I.4 reflect the core inflation rates, respectively, of the substitution-based personal consumption expenditure (PCE) deflator, the substitution-based Chained-CPI-U, and the geometrically-weighted CPI-U and CPI-W. I.5 to I.8 are the same measures, as standardly reported, with energy and food inflation included. The CPI-U (I.7) "all urban consumers" is the measure popularly followed by the financial press, when the media are not hyping core inflation. The CPI-W (I.8) "urban wage earners and clerical workers is a narrower measure, more heavily weighted in basics such as gasoline, and used in calculating cost-of-living adjustments for items such as Social Security Payments. I.9 is the CPI-U with the effects of geometric weighting (Pre-Clinton Era as estimated by SGS) reversed. This is the top series in the CPI graph on the SGS home page www.shadowstats.com. I.10 reflects the SGS Alternate Consumer Inflation measure, which reverses the methodological gimmicks of the last 25 years or so, plus an adjustment for the portion of Clinton-Era geometric weighting that is not otherwise accounted for in BLS historic bookkeeping.

MARKETS PERSPECTIVE

The three best bets I can offer are: (1) The U.S. economy does not face imminent recovery. (2) The U.S. dollar faces an extreme sell-off against most major currencies. (3) The U.S. economy will see double-

Closing Financial-Market Indicators at April 17, 2009

Indicator	*2nd-Qtr-to-Date 2009*			*1st-Qtr 2009*			*Year-End 2008*	
	Level	*YTD*	*Yr/Yr*	*Level*	*YTD*	*Yr/Yr*	*Level*	*Yr/Yr*
Equity Market (1)								
DJIA	**8,131.33**	-7.35%	-35.57%	**7,608.92**	-13.30%	-37.95%	**8,776.39**	-33.84%
S&P 500	**869.60**	-3.73%	-35.48%	**797.87**	-11.67%	-39.68%	**903.25**	-38.49%
DJ Wilshire 5000	**8,889.25**	-2.18%	-36.32%	**8,001.90**	-11.94%	-39.98%	**9,087.17**	-38.68%
NASDAQ Comp	**1,673.07**	6.09%	-28.58%	**1,528.59**	-3.07%	-32.93%	**1,577.03**	-40.54%
Credit Market (2)								
Fed Funds (3)	**0.00%**	0bp	-225bp	**0.00%**	0bp	-225bp	**0.00%**	-425bp
3-Mo T-Bill	**0.14%**	3bp	-109bp	**0.21%**	10bp	-117bp	**0.11%**	-325bp
2-Yr T-Note	**0.99%**	23bp	-114bp	**0.81%**	5bp	-81bp	**0.76%**	-229bp
5-Yr T-Note	**1.91%**	36bp	-99bp	**1.67%**	12bp	-79bp	**1.55%**	-190bp
10-Yr T-Note	**2.98%**	73bp	-77bp	**2.71%**	46bp	-74bp	**2.25%**	-179bp
30-Yr T-Bond	**3.79%**	110bp	-75bp	**3.56%**	87bp	-74bp	**2.69%**	-176bp
Oil (4) *US$ per Barrel*								
West Texas Int.	**50.33**	1.35%	-56.18%	**49.66**	11.35%	-51.12%	**44.60**	-53.55%
Currencies/Dollar Indices (5) *US$/Unit*								
Pound Sterling	**1.4784**	1.13%	-25.74%	**1.4300**	-2.18%	-27.32%	**1.4619**	-26.33%
Euro	**1.3026**	-6.42%	-18.30%	**1.3261**	-4.73%	-16.10%	**1.3919**	-4.68%
Swiss Franc	**0.8566**	-8.57%	-14.13%	**0.8776**	-6.33%	-12.94%	**0.9369**	6.14%
Yen	**0.0101**	-8.52%	2.99%	**0.0101**	-8.43%	0.71%	**0.0110**	23.04%
Canadian Dollar	**0.8230**	0.73%	-16.82%	**0.7933**	-2.90%	-17.87%	**0.8170**	-19.27%
Australian Dollar	**0.7210**	3.25%	-23.05%	**0.6925**	-0.83%	-24.17%	**0.6983**	-20.43%
Weighted Currency Units/US$ (Jan. 1985 = 100)								
Financial (FWD)	**54.05**	2.97%	21.41%	**54.95**	4.04%	22.14%	**52.49**	11.07%
Change US$/FX	**--**	-2.89%	-17.63%	**--**	-3.88%	-18.13%	**--**	-9.96%
Trade (TWD)	**59.35**	3.85%	17.80%	**59.89**	4.79%	18.38%	**57.15**	8.40%
Change US$/FX	**--**	-3.71%	-15.11%	**--**	-4.58%	-15.53%	**--**	-7.75%
Precious Metals (6) *US$ per Troy Ounce*								
Gold	**870.50**	0.09%	-7.98%	**916.50**	5.38%	-1.82%	**869.75**	4.32%
Silver	**11.98**	11.03%	-35.45%	**13.11**	21.50%	-27.13%	**10.79**	-26.90%

bp: Basis point or 0.01%. (1) *Wall Street Journal,* dowjonesindexes.com. (2) Treasuries are constant-maturity yield, U.S. Treasury. (3) Current Fed Funds target is 0.00% to 0.25%. (4) Department of Energy. (5) Shadow Government Statistics, *Wall Street Journal,* Federal Reserve Board (see Dollar Index Section for definitions). (6) London fix (afternoon for gold), Kitco.com.

digit inflation driven by factors other than economic demand; a circumstance that eventually will evolve into hyperinflation. None of these factors is happy for the traditional equity and credit markets. The timing on the economy is ongoing. Despite intermittent hype and occasional bottom-bouncing, the better-quality economic reporting will show ongoing recession/depression and a likely grudging recognition of same by Wall Street. Timing on the dollar and inflation remain open, but the moves are just a matter of time, with implications so severe for the system that they hard to ignore. The markets remain unstable and extremely dangerous.

General background note: I continue to argue that investors should be looking at the long-term and at preserving their wealth and assets in what eventually will become a hyperinflationary great depression. With severe economic, inflation and currency displacements ahead in the United States, those who can ride out the turmoil eventually should see tremendous investment opportunities. As to preserving capital and assets for someone in a U.S. dollar-denominated environment, holding some assets in physical gold (and some silver), and holding some assets outside the dollar (i.e. the Swiss franc, Canadian dollar) in high-quality, liquid assets, remain the best long-range hedges against all the real risks facing investors and the system.

Again, this is for the long haul. Short-term conditions still can show extreme volatility in the U.S. dollar and precious metals, as seen in the last year. Putting aside risks of political instabilities tied to the economic turmoil or any short-term liquidity concerns, real estate also remains a prime long-term hedge against the severe currency debasement that lies ahead.

With the ongoing crises in systemic solvency and in a severely contracting economy with *pending* inflation problems, the long-term outlook holds: U.S. equities will continue to suffer in a severe bear market; long-term U.S. Treasury yields will spike in response to inflation, eventual dollar dumping and mounting Treasury borrowing needs against a market with weakening demand; selling will intensify against the U.S. dollar, evolving into dollar dumping and dumping of dollar-denominated assets. Precious metals, particularly gold, will rally against mounting monetary and inflation pressures (and likely higher oil prices from a weakening dollar), weakness in the dollar, and as safe-haven hedges against increasing systemic and global political instability. *(End of general background note.)*

U.S. Equities -- Despite recent strong rallies -- somewhat reminiscent of the strong rallies seen during the broad stock market decline in 1929 to 1932 -- equities generally remain in a savage bear market, off their all-time highs of last October. Downside potential remains in the range of a peak-to-trough contraction in the vicinity of 90%, as seen in the 1929 to 1932 period (see note below). This outlook remains over the longer term, and is in the context of ongoing extreme volatility, including likely intervening sharp rallies.

The recession rapidly is turning to depression, with no end in sight foe the downturn. The Fed's dollar debasement program likely will intensify selling of the U.S. dollar and dollar-denominated paper assets. The result either will be a liquidity squeeze as the U.S. markets move to absorb the dollar-denominated paper, or, more likely, the Fed will heavily monetize the dumped dollar assets, accelerating the move to a hyperinflation. None of this is good for the real value of stocks.

General background note: Equities have begun to catch-up with the underlying economic, financial and systemic fundamentals, but the aggregate downside adjustments to stock prices still should be quite large over a number of years, eventually rivaling the total 90% decline in equities seen in the 1929 crash and ensuing three years. The current decline might have to be measured in real terms, however, 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 (see the *Hyperinflation Special Report* of April 8, 2008).

U.S. Credit Market -- With the targeted fed funds rate at 0.00% to 0.25% and with the Fed buying longer-term Treasuries, the market is heavily rigged, with downside potential on controlled yields. Eventually, rapid inflation and dollar dumping will spike U.S. interest rates, assuming regular market forces remained in play. Further boosting yields would be rapidly mounting concerns as to U.S. government solvency.

General background note: If inflation rises strongly in the year ahead, as I expect (*but before hitting hyperinflationary levels*), it would tend to support double-digit long-term yields, again, assuming normal market forces are allowed to play out.

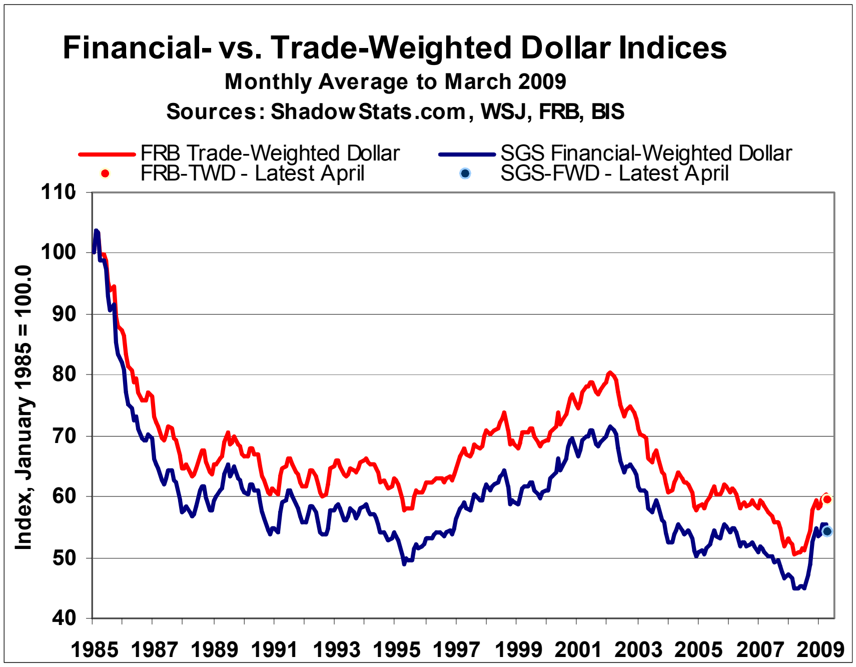
U.S. Dollar -- Developments of recent weeks have included an accelerating pace of U.S. dollar debasement, along with increasingly public complaints from major trading partners as to U.S. excesses in doing same. Central bankers have a pretty good sense of what lies ahead for the U.S. currency, and no one can be particularly happy with heavy holdings of the greenback, particularly China.

Weakening global demand for U.S. Treasuries already has surfaced. In a related area, any demand on the U.S. to issue its debt denominated in something other than dollars would place severe strains on the U.S. dollar as well as on the United States' sovereign credit rating. In like manner, any efforts to replace the U.S. dollar as the world's reserve currency would be met by heavy dollar selling.

General background note: 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. The U.S. dollar's portfolio of underlying fundamentals generally could not be much worse. Relative to major trading partners, the U.S. economy is much weaker; interest rates are lower; inflation has been and *again* will be higher; fiscal and monetary conditions are worse in the extreme; relative trade-balance conditions *still* are horrendous; and relative political/systemic concerns are high, *with mounting disgruntlement among major U.S. trading partners as to the outlook for the dollar and its status as the world's reserve currency.*

General background note: The proximal trigger for a full dollar panic already may be in place, given the Fed and Treasury's responses to the ongoing systemic solvency crisis. Otherwise it could come from a particularly bad economic statistic, political missteps by the Administration *(i.e. a Treasury Secretary contemplating changing the U.S. dollar's reserve status)*, negative trade or market developments outside the United States, or a terrorist attack or expansion of U.S. military activity. When the trigger is pulled, what likely will be broad selling pressure will turn into an outright panicked dumping of the greenback, which should overwhelm any short-lived central bank intervention and roil the domestic financial markets, further. 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 ongoing systemic and intensifying economic crisis.

As shown in the accompanying graph, the strength in the U.S. dollar -- since the market distortions and interventions following the Bear Stearns crisis -- generally has continued amidst ongoing volatility. The financial- and trade-weighted indices rose in both February and March, but they have softened slightly as of the U.S. market close on April 17th.



Please Note: As of January 1, 2009, the Federal Reserve ceased publishing its daily noon exchange rates on a timely basis. Where the daily rate or monthly average for a currency or index used in the newsletter or indices has been based on Federal Reserve reporting, such will continue when possible. Otherwise, the exchange rate or index will be based on daily rates published in the Wall Street Journal. *When full Federal Reserve data are available, the monthly indices will be updated to reflect same in the regular postings on the Alternate Data tab at www.shadowstats.com.*

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 March 2009 the FWD gained 0.1% for the month after a 2.6% increase in February. The March 2009 monthly average index level of 55.33 (base month of January 1985 = 100.00) was up by 20.5% from March 2008, down from February's 23.3% annual gain. As of April 17th, the FWD stood at 54.05.

Also increasing in March 2009 was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The March average rose by 0.9% for the month, following a 2.6% increase in February. The March 2009 index level of 60.33 (base month of January 1985 = 100.00) was up by 17.1% from March 2008, versus an annual 19.2% increase in February. As of April 17th, the TWD closed at 59.35.

The differences in the two series can be accounted for largely by the much heavier weighting of the Canadian dollar in the TWD series.

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.

Gold and Silver -- Despite recent some softness, gold and silver have received occasional support from sporadic selling of the U.S. dollar, as well as increasing safe-haven flight in response to accelerated attempts at official debasing of the greenback. Physical holdings of gold and silver remain the best long-term hedges against all the craziness that will be unfolding in the U.S. markets in the year or two ahead. In the short-term, however, extreme price volatility continues as a fair risk, as seen during the last year.

Falling from its all-time high London afternoon fix of $1,011.25 per troy ounce on March 17, 2008, amidst extreme volatility, gold hit a subsequent bottom of $712.50 in October. It closed April 17th at $870.50. In like manner, silver plunged from its March 17, 2008 high of $20.92 per troy ounce, hitting a subsequent low close of to $8.88 in October. It closed on April 17th at $11.98.

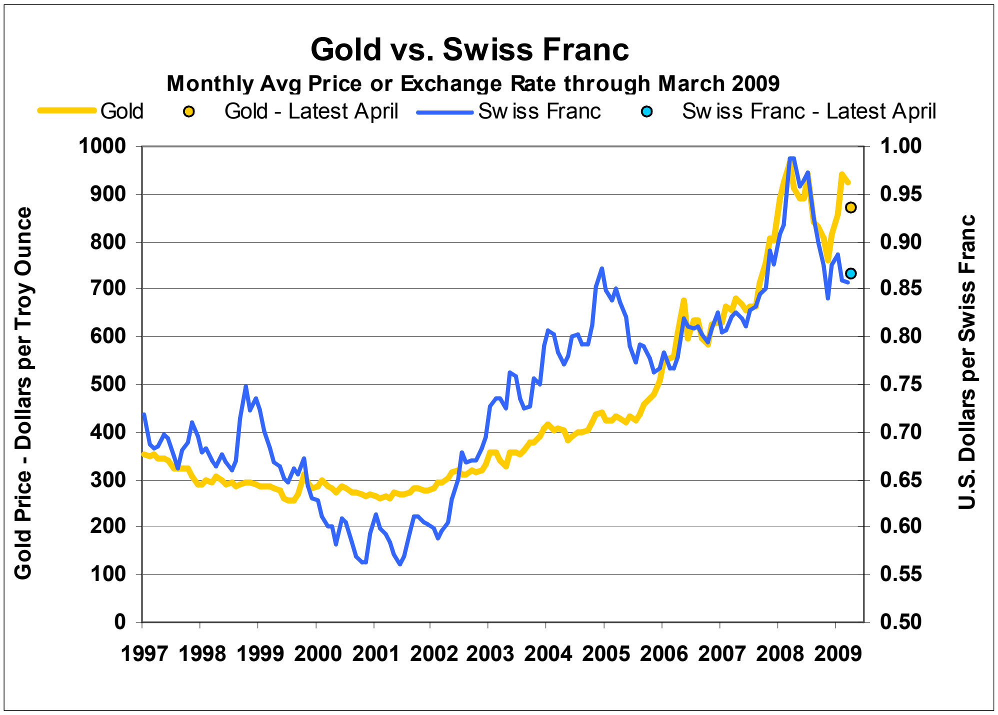
For March 2009 (per Kitco.com for both and silver prices), the monthly average London gold afternoon fix was $924.27 per troy ounce, down from $943.16 in February. Silver averaged $13.12 per troy ounce in March, down from $13.41 in February.

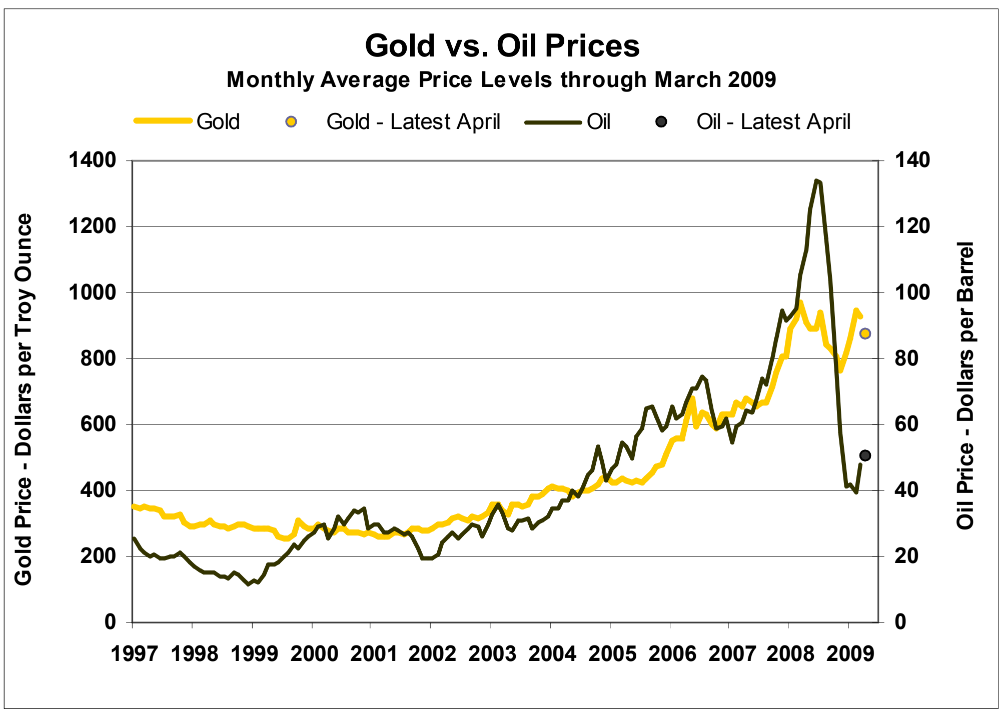
Inflation-Adjusted Historic Gold and Silver Highs. Even with the March 17, 2008 historic high of $1,011.25, the prior all-time high of $850.00 (London afternoon fix, per kitco.com) of January 21, 1980 still has not been hit in terms of inflation-adjusted dollars. Based on inflation through March 2009, the 1980 gold price peak would be $2,324 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be $6,906 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 March 2009, the 1980 silver price peak would be $135 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be $402 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

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, Swiss franc and silver graphs show March monthly average price levels, as well as added points for closing prices at April 17th, with gold at $870.50, silver at $11.98, oil at $50.33 and the *Wall Street Journal's* closing rate for the Swiss franc at $0.8566. As current market distortions subside, all four measures should trade significantly higher in the year ahead, eventually breaking the highs seen otherwise during 2008.


Gold vs. Swiss Franc
Monthly Avg Price or Exchange Rate through March 2009
Gold
Gold - Latest April
Sw iss Franc
Sw iss Franc - Latest April
Gold Price - Dollars per Troy Ounce
U.S. Dollars per Swiss Franc
1000
900
800
700
600
500
400
300
200
100
0
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009


Gold vs. Oil Prices
Monthly Average Price Levels through March 2009
Gold
Gold - Latest April
Oil
Oil - Latest April
Gold Price - Dollars per Troy Ounce
Oil Price - Dollars per Barrel
1400
1200
1000
800
600
400
200
0
140
120
100
80
60
40
20
0
1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009


Gold vs. Silver Prices
Monthly Average Price Levels through March 2009
Gold
Gold - Latest April
Silver
Silver - Latest April
Gold Price - Dollars per Troy Ounce
Silver Price - Dollars per Troy Ounce
1000
750
500
250
0
20
15
10
5
0
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009

REPORTING PERSPECTIVE

The Big Three Market Movers

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

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

Happier economic news also is needed by Messrs. Bernanke and Geithner in an effort to support a stable or relatively strong U.S. dollar in the still-deepening systemic solvency crisis. Such also requires contained inflation numbers. With the financial crisis remaining a threat to national security, almost anything remains possible in the arena of data and market manipulations. Data manipulation is an extremely inexpensive and effective policy tool, but its use presumably depends to a certain degree on perceived financial-market vulnerability.

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

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

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

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

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

Birth-Death/Bias Factor Adjustment. An element that helped to soften the reported March jobs loss was the monthly upside bias factor (birth-death model). Never designed to handle the downside pressures from a recession, the model adds a fairly consistent upside bias to the payroll levels each year, averaging about 60,000 jobs per month, assuming the BLS adequately is seasonally adjusting for same. The upside adjustment to unadjusted March 2009 payrolls was 114,000, versus 134,000 in February.

Household Survey. The usually statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including multiple job holders), showed March employment down by 861,000, where February had been down by 351,000.

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

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

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

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

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

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

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

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

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

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

GDI Shows Greater Economic Weakness Than GDP: The BEA's GDP-like measures for fourth-quarter 2008; Gross National Product (GNP), where GDP is GNP net of trade in factor income (interest and dividend payments); and Gross Domestic Income (GDI), which is the income-side equivalent of the GDP's consumption estimate; were estimated for the first time in the "final" fourth-quarter report.

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

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

Major GDP Benchmark Revision Scheduled. The Bureau of Economic Analysis (BEA) plans a grand benchmark revision in late-July, including the introduction of new methodologies. The pending changes will be assessed as details become available. What remains likely is that recent economic history -- as reflected in the GDP -- should appear to have been relatively weaker than initially published. Minimally, the new data should reflect quarterly GDP contractions that go back to at least first-quarter 2008, consistent with the National Bureau of Economic Research's timing of the current recession.

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

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

Barring a new, extreme collapse in oil prices, the current consumer price deflation -- like the sporadic annual deflation seen in the late 1940s and 1950s -- should be brief and shallow, unlike the catastrophically long and deep deflation of the Great Depression. As a significant aside, if inflation today were calculated the way it was back in 1955, the March 2009, CPI-U annual inflation rate likely would have topped 7% (see the Alternate Reality section in the Opening Comments). As also discussed in the Opening Comments, the Federal Reserve's efforts at debasing the U.S. dollar are likely to succeed, damaging the greenback's value against other currencies, spiking oil prices and boosting domestic consumer price inflation.

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

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

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

C-CPI-U. Year-to-year or annual inflation for the Chain Weighted CPI-U (I.6) -- the fully substitution-based series that increasingly gets touted by CPI opponents and inflation apologists as the replacement for the CPI-U -- fell by 0.81% in March, versus a decline of 0.26% in February.

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

The SGS-Alternate Consumer Inflation Measure adjusts on an additive basis for the cumulative impact on the annual inflation rate of various methodological changes made the BLS. Over the decades, the BLS has altered the meaning of the CPI from being a measure of the cost of living needed to maintain a constant standard of living, to something that no longer reflects the constant-standard-of-living concept. Roughly five percentage points of the additive SGS adjustment reflect the BLS's formal estimate of the impact of methodological changes; roughly two percentage points reflect changes by the BLS, where impact has not been formally published by the BLS.

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

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

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

Other Troubled Key Series

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

Fiscal stresses are going to be severe in the next several years, given the Obama Administration's budget and economic stimulus package boosts to government outlays, and given the sharp hit on tax receipts from the severe and deepening recession. The 2009 official budget deficit easily should top $2 trillion, with commensurate funding in excess of that required by the U.S. Treasury.

The official 2008 federal deficit was $454.8 billion, against a $161.8 billion deficit in 2007. These are the officially-gimmicked numbers (counting Social Security revenues, but not liabilities, not fully counting the costs of the Iraq War, etc.), using a variation on cash-based accounting, not GAAP reporting. The 2008 GAAP-based deficit (counting unfunded Social Security and Medicare liabilities, etc.), using accrual accounting, was $5.1 trillion, up from $1.2 trillion ($4 trillion-plus, using consistent annual assumptions and accounting) in 2007. The 2009 GAAP-Based deficit likely will top $8 trillion (nearly half of annual U.S. GDP).

Viewing the change in the level of gross federal debt bypasses several of the regular reporting manipulations of the government's financial results and is a better indicator of actual net cash outlays by the federal government than is the official, gimmicked deficit reporting. Gross federal debt stood at $11.127 trillion at March 31, 2009, up by $250 billion for the month, and up by $1.689 trillion from March 2008, which in turn was up by $588 billion from March 2007. Gross federal debt stood at $10.877 trillion at February 28, 2009, up by $245 billion for the month, and up by $1.519 trillion from February 2008, which in turn was up by $580 billion from February 2007.

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

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

An "unexpected" decline in weekly claims recently was touted as evidence for an economic rebound. Such is nonsense. More often than not, week-to-week volatility of the seasonally-adjusted weekly claims numbers is due to the Labor Department's efforts to seasonally adjust these numbers around holiday periods, such as Good Friday and Easter in the current circumstance. The Labor Department has demonstrated an inability to do such adjusting successfully. When the new claims series is viewed in terms of the year-to-year change in the 17-week (four-month) moving average, however, such generally is a fair indicator of current economic activity.

Real Average Weekly Earnings -- Contained primarily by declining hours, versus higher wages and declining inflation, March's seasonally-adjusted monthly real earnings were unchanged for the month, following 0.2% monthly declines in February and January. Annual growth in March was 2.5%, versus 2.6% in February and 3.2% in January. Recent positive annual growth has been due to the collapse in gasoline prices in latter 2008.

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

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

As reported by the Census Bureau, seasonally-adjusted March retail sales fell by 1.14% (down 0.70% net of revisions) +/- 0.6% (95% confidence interval). Such followed a revised 0.30% monthly gain (previously a 0.11% contraction) in February. On a year-to-year basis, March retail sales fell by 9.41%, versus a revised 7.89% (previously 8.58%) plunge in February. By a wide historical margin, the three-month moving average of the nominal (not-adjusted for inflation) year-to-year contraction continued the worst levels of post-World War II reporting.

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

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

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

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

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

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

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

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

New Orders for Durable Goods -- As discussed in the *Flash Update* of March 25th, the regularly-volatile new orders for durable goods reportedly rose by 3.4% month-to-month in February, as reported by the Census Bureau. Given the high volatility of the series, such a seasonally-adjusted monthly increase is of little significance, particularly where most of the gain was due to downside prior period revisions. Net of revisions, the February orders rose by 1.1%. January's previously reported monthly contraction of 5.2% revised to a contraction of 7.3%. The same pattern of revisions was seen in the prior release.

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

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

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

Trade Balance -- As discussed in the April 9th *Flash Update*, the February trade data suggested that the U.S. downturn was worse than the economic contraction in the rest of the world. To the extent the Bureau of Economic Analysis/Census Bureau report of a sharp narrowing in the February U.S. trade deficit can be believed, it suggested that U.S. demand (reflected in imports) is slowing faster than demand in the rest of the world (reflected in exports). On a seasonally-adjusted basis, U.S. monthly purchases from the rest of the world (imports) fell by 5.1% in February, while U.S. sales to the rest of the world (exports) actually increased by 1.6%.

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

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

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

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

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

Showing minimal bottom-bouncing near historic lows, the March consumer confidence numbers were somewhat improved, though still down sharply year-to-year. The Conference Board's March 2009 Consumer Confidence measure rose by 2.8% for the month, up from a 32.4% decline in February, which set the historic low for the series (lowest since the Lyndon Johnson Administration). Year-to-year change for the three-month moving average was a record decline of 61.4% in March, versus a 60.2% annual decline in February.

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

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

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

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

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

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

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

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

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

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

This was the fourth month of formal PPI deflation (year-to-year price decline), subsequent to a 0.4% gain reported for November. Since 1980, the finished goods PPI has shown formal deflation in 1986, 1994, 1997/1998 and 2001/2002, without the CPI-U ever following suit. As with the current circumstance, those declines and related index volatility often were tied to large swings in oil prices.

On a monthly basis, seasonally-adjusted March intermediate goods fell by 1.5% (down by 0.9% in February), and crude goods eased by 0.3% (down by 4.5% in February). The decline in year-to-year inflation continued to deepen, with March intermediate goods down 8.9% (down by 5.2% in February) and March crude goods down by 39.0% (down by 34.7% in February).

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

Better-Quality Numbers

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

Economic Indicators

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

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

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

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

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

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

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

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

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

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

The deepening annual fall-off in online help-wanted advertising (Conference Board) also continued, down 36.0% year-to-year in March, versus an annual decline of 34.3% in February. The Monster.com online survey estimated that online jobs offerings were down 29% year-to-year in March, versus a 26% decline in February.

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

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

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

In home sales data, February new home sales showed a statistically insignificant monthly gain, which got the financial markets excited. Seasonally-adjusted February new home sales rose by 4.7% (9.1% net of revisions) +/- 22% (95% confidence interval), which statistically was not much distinguishable from a monthly decline, following a revised 13.2% (was 10.2%) decline in January. On a year-to-year basis, February new home sales dropped by 41.1%, following a 48.2% decline in January.

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

Inflation Indicators

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

The series have been through massive revisions, particularly in recent months. While the general patterns of seasonally-adjusted money growth remain intact, recent annual change in the SGS-Ongoing M3 estimate is somewhat lower than it had been. That said, year-to-year growth rates as of March 2009, for M1, M2 and M3, respectively, were: 13.6% (versus 13.5% in February, 9.4% (versus 9.3% in February) and 8.1% (versus 9.5% in February). In terms of month-to-month change as of March 2009, growth rates for M1, M2 and M3, respectively, were: 0.2% (versus a 1.1% contraction in February), 0.9% (versus 0.4% in February) and unchanged (versus a 0.1% gain in February).

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

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

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

Purchasing Managers Surveys: Prices Paid Indices -- Prices paid indices in the March manufacturing and nonmanufacturing surveys were mixed, although they still continued to indicate falling prices in the aftermath of collapsing oil prices.

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

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

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

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

West Texas Intermediate (WTI) spot price closed at $50.33 per barrel on April 17th, which was up by 64.4% from its recent low close of $30.81 on December 22nd. The latest spot price, however, still is down by 65.4% since the record-high closing price of $145.66 on July 11, 2008.

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

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

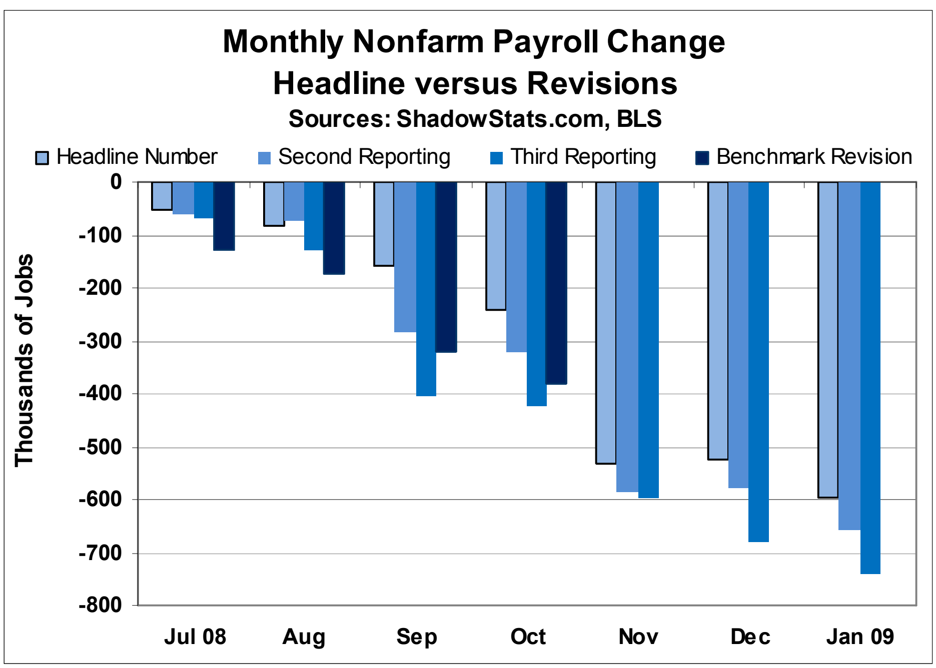
Reporting/Market Focus

Indications of Serious Error in Current Government Economic Reporting

This Reporting/Market Focus looks at headline numbers from two key economic reports -- monthly statistics that excite or roil the financial markets -- and subsequent revisions to those series that suggest, at best, serious flaws in the government's initial reporting of retail sales and nonfarm payroll employment.

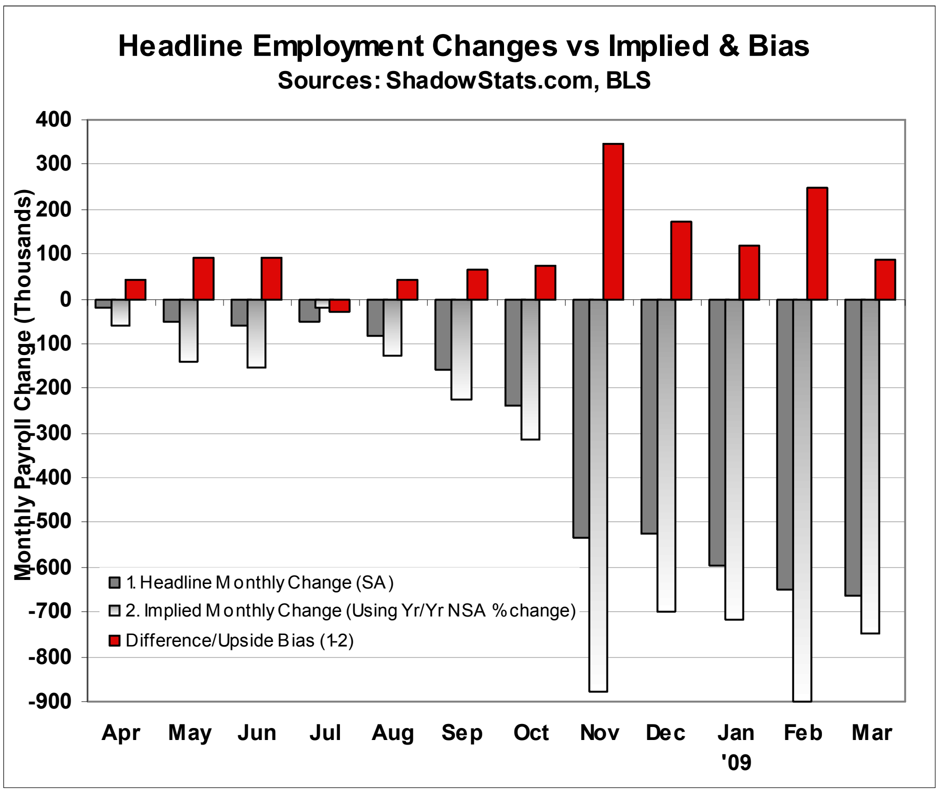
Simply put, recent monthly headline numbers have tended to be overstated, as indicated by subsequent, massive downside revisions to the prior months' reporting. I use the term "massive," because the revisions frequently are larger than those that would be suggested by the government's published 90% and 95% confidence intervals. I use the term "overstated," because the nature of the revisions usually is to revise prior reporting downward. Such has the effect of allowing stronger reporting in the current month than would have been possible based on original reporting. It also means that the prior month's headline number was overstated by the amount of the relative downward revision.

Consider nonfarm payrolls. The following graph shows the last seven months of reporting and revisions for the month-to-month seasonally-adjusted change in nonfarm payrolls.



As to total net revisions, from headline to latest (I only show those months with two months of revision in place), all displayed months have shown net downside revisions to the headline payroll number. As to statistical significance, the BLS publishes a 90% confidence interval around the headline number of +/- 107,000 jobs, and a 95% confidence interval around the headline number of +/- 129,000 jobs. In the period tracked above, net revisions in four out of seven months topped the both the 90% and 95%. The average occurrence of such large revisions at the 95% level should be about 1-in-20, instead of 11.4-in-20.

As discussed in recent newsletters, and as detailed in the Reporting/Market Focus of *SGS Newsletter No. 43* of June 10, 2008, other statistical anomalies -- tied to concurrent seasonal adjustment factors -- appear to enable these unusual revisions to the payroll series.

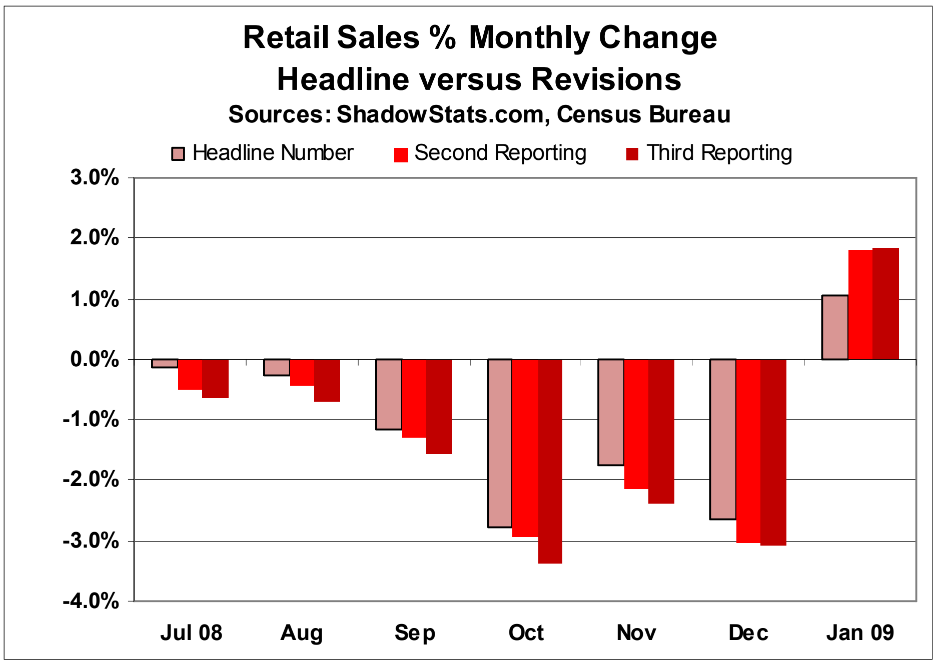


As noted earlier in the Employment/Unemployment section, the pattern of impossible biases being built into the headline monthly payroll employment continued with March 2009 reporting. Instead of the headline jobs loss of 663,000, consistent application of seasonal-adjustment factors -- net of what I call the concurrent seasonal factor bias -- would have shown a more-severe monthly jobs loss of about 750,000. As shown in the above graph, this upside reporting bias (red bar) has been seen in 11 of the last 12 months, with a rolling 12-month total upside headline-number bias of 1,345,000.

If one looks carefully at the downside revisions to the earlier payroll reporting, they often appear as a result of changing monthly seasonal-adjustment factors. Such is suggested where the revisions to the relatively hard, not-seasonally-adjusted numbers are nil, or go in the other direction of the reported seasonally-adjusted revisions. This is a circumstance that has been enabled by the BLS's "concurrent" seasonal adjustment practices, which calculate current-month and recalculate recent-month seasonal adjustments each month. In most other economic series, seasonal factors are determined in advance and are held constant for six months to a year. Over the period of a year, seasonally-adjusted and unadjusted series should be equal to each other. Instead of balancing out, however, the unusual seasonal-adjustment patterns appear to have "created" an extra 1,345,000 jobs in the headline employment during the last year.

In the bias graph, the year-to-year change in the unadjusted number is applied to recast the seasonally-adjusted number. The unadjusted annual rate of change is applied to the prior year's seasonally-adjusted number to estimate the current year's seasonally adjusted number. Where annual growth in adjusted and unadjusted series should equal each other over the period of a year (such is the nature of seasonal adjustment in a balanced redistribution of data), the patterns should show random swings month-to-month, not a consistent upside bias.

Consider now the retail sector. The following graph shows the last seven months of reporting and revisions for the month-to-month seasonally-adjusted change in "advance" retail sales.



As to net revisions, from headline to latest (I only show those months with two months of revision in place), all months but the latest have shown net downside revisions to the headline month-to-month retail sales change. As to statistical significance, the Census Bureau publishes a 90% confidence interval around the headline number of +/- 0.5%, and a 95% confidence interval around the headline number of +/- 0.6%. In the period tracked above, net revisions in four out of seven months topped the 90% limit, and three out of seven topped the 95% limit, including January 2009. The average occurrence of such large revisions at the 90% level should be about 1-in-10, instead of 5.7-in-10; at the 95% level it should be about 1-in-20, instead of 8.6-in-20.

These patterns have been seen irregularly in other key economic series, such as housing starts and new home sales, new orders for durable goods, etc. The problem may be as simple as the government not being able to survey key economic series meaningfully, on a monthly basis, during periods of rapid change, particularly in a deep recession. There also could be some very deliberate manipulation at work, particularly with the payroll numbers. Whatever the case, the government's data are not being published with the promised level of accuracy, and the markets often are being moved based on misleading data.

