

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

COMMENTARY NUMBER 383
Dollar, Deficit and Downgrade Crises, July Employment and M3

August 8, 2011

Dollar Debasement Accelerates Dangerously

U.S. Rating Downgrade Will Have Unhappy Ripple Effects

QE3 Likely Will Be Indicated This Week

Payroll and Unemployment Improvements Were Not Statistically Meaningful

July Unemployment Rates: 9.1% (U.3), 16.1% (U.6), 22.7% (SGS)

Broad Money Supply Increased in July

PLEASE NOTE: The next regular Commentary is scheduled for Friday, August 12th. It will cover July 2011 retail sales and June trade balance reporting. Special Commentaries will be published, as appropriate, in response to unusual market or economic circumstances.

—Best to all, John Williams

SPECIAL COMMENTARY

Global Confidence in U.S. Dollar Crumbles at Accelerating Pace. As this *Commentary* goes to press in the early trading hours of Monday, August 8th, well in advance of the opening of the U.S. Markets, U.S. stock futures have opened sharply lower and gold prices sharply higher. While those movements seem reasonable, given the events of the last several days and couple weeks, governments, central banks and the global equivalents of the President's Working Group on Financial Markets all are poised to "stabilize" global markets, propping stocks, supporting the U.S. dollar against other currencies and to do their best at suppressing gold prices. Irrespective of the success, or lack of same, by both the overt and covert interventionists in what should be highly volatile Monday markets, a week from now, a month from now, the U.S. dollar most likely will be sharply weaker than it is today against currencies such as the Swiss franc, Australian dollar and the Canadian dollar, as well as against gold and silver.

In the wake of the erosion of global confidence in the U.S. dollar caused by the Fed's second-round of quantitative easing (QE2) in late 2010, the dollar lost its traditional safe-haven stratus. As turmoil erupted in the Middle East and North Africa earlier this year, safe-haven money flowed into the Swiss franc and gold. The flight was out of the dollar, with the U.S. currency dropping to new historic lows against the stronger Western currencies and gold.

Lack of confidence in the U.S. dollar has been pushed to a new and more dangerous nadir in the last two weeks. Dollar selling has been exacerbated by the contentious and virtually meaningless debt deal negotiated by the President and Congress, by Standard & Poor's downgrading the rating on U.S. Treasuries to "AA+" from "AAA," and by mounting market recognition of the ongoing U.S. economic and systemic-solvency crises. Pending still is the Fed's move to QE3.

The dollar's back is close to being broken. Despite near-term interventions and extreme volatility, the heavy dollar selling that follows will be highly inflationary, and the broad inflation and economic outlooks discussed in the [*Hyperinflation Special Report \(2011\)*](#) continue to unfold and are unchanged.

Deficit-Cutting Deal Was a Complete Disaster. The extraordinarily contentious negotiation process involving the President and the Congress accomplished little other than focusing global attention on the U.S. government's untenable fiscal circumstances and lack of political stability. Not only did the elected leaders of the U.S. government demonstrate the lack of any political will whatsoever to address the longer-range solvency issues of the United States, but also they trumpeted their lack of concern to the rest of the world, thumbing their noses at the near- and long-term interests of both the American public and those investors who have been buying the U.S. Treasuries used to fund the exploding U.S. fiscal deficit.

In turn, the global markets offered their opinion on the deficit-reduction/debt-ceiling-increase deal with heavy stock and U.S. dollar selling, along with heavy gold buying.

The process also invited a rating downgrade by S&P, with Moody's and Fitch appearing to back off earlier threats of downgrade. Pressures by the administration and major clients of the rating agencies had to be extreme. The package put forth by the government certainly was not of much substance. It is hard to imagine that it could have satisfied any rating agency that really was looking to base a rating on that

package. The deficit “cuts” all were tied to slowing the pace of already-planned, unsustainable spending increases.

Further, the deficit projections are based on assumptions of ongoing positive economic growth, not a double-dip recession that would reduce tax revenues to below planned levels. The difference is that with a contracting economy, the real deficits (and borrowing needs) would be worse than they had been estimated initially before the cuts were put in place.

Downgrading the “AAA” Benchmark. Given the extreme political and business pressures countering the move, S&P’s downgrade of the U.S. sovereign debt rating was courageous, but also disruptive and dangerous for the system. Consider that some holders of U.S. Treasuries will be forced to sell them. Consider that a number of Treasury Securities holders simply will want to sell them. Consider that there are issues that could lead to downgrades of some business entities that currently have “AAA” ratings that are higher than their sovereign state, or companies that get will be downgraded because of their heavy holdings of Treasuries.

While these factors all are negatives for the U.S. dollar, the U.S. dollar losing its global reserve currency status could break the dollar’s back. How can the world’s reserve currency—the benchmark for the “riskless” rating of “AAA”—not be rated “AAA?” Not surprisingly, China already is raising the alarm.

Double-Dip Spooks the Markets. Despite stock-market hype, one economic report does not make or break the substance of an economic cycle, and the U.S. economy has been in the process of rolling into a double-dip recession for some time. Some in the markets were rattled by a sharp decline in the manufacturing and services surveys published by the purchasing managers (ISM). As discussed previously (see the [Hyperinflation Special Report \(2011\)](#) for example), the ISM surveys have been warped by terrible distortions to their seasonal factors as a direct result of the extraordinary length and depth of the economic downturn. The July ISM numbers indeed were weaker, but they also reflected some catch up from previous overstatement.

July Employment and Unemployment. Last Friday’s (August 5th) report on July labor conditions surprised the financial markets on the upside, but the numbers were meaningless as to any improvement, with no suggestion of the double-dip disappearing, as some analysts in the markets have hyped.

The headline July payroll employment number showed a gain of 117,000, up from a revised 46,000 (previously an 18,000) gain reported in June. Beyond the normal reporting distortions discussed in the *Reporting Detail* section, however, the Bureau of Labor Statistics (BLS) estimates a 95% confidence around the headline number of 129,000. To be considered statistically meaningful, the jobs gain or loss has to break 129,000 in a given month. With the July estimate, the confidence interval included not only the consensus estimate, but also it allowed for an outright contraction in the number.

The same was true with the headline unemployment for July, which narrowed to 9.1% from 9.2% in June, with a 95% confidence interval of +/- 0.2%.

QE3 Symptomatic of Failing System. The Federal Reserve likely will intensify the current dollar crisis, deliberately, with QE3 likely to be announced after Tuesday’s (August 9th) FOMC meeting. Yes, the economy and the system are that weak, meeting the Fed Chairman’s pre-stated qualifications. With U.S. Treasuries facing some likely selling pressure as a result of the downgrade, and with looming Treasury

auctions likely to face weak demand in the post-debt ceiling crisis environment, QE3 would provide an excuse for expanded Fed monetization of Treasury debt.

Faced with a flight from the U.S. dollar that was making the Swiss National Bank uncomfortable with the strength of the Swiss franc, the SNB lowered interest rates. In normal times, the Fed correspondingly would raise rates to strengthen the dollar. Yet, if the Fed raised rates now, it likely would crash the stock market. In modern decades, the Fed has demonstrated a preference to stimulating U.S. equity values as opposed to strengthening the dollar. Mr. Greenspan abandon the dollar to save stocks in 1987, Mr. Bernanke did the same with QE1, QE2, and he likely will continue doing so with QE3.

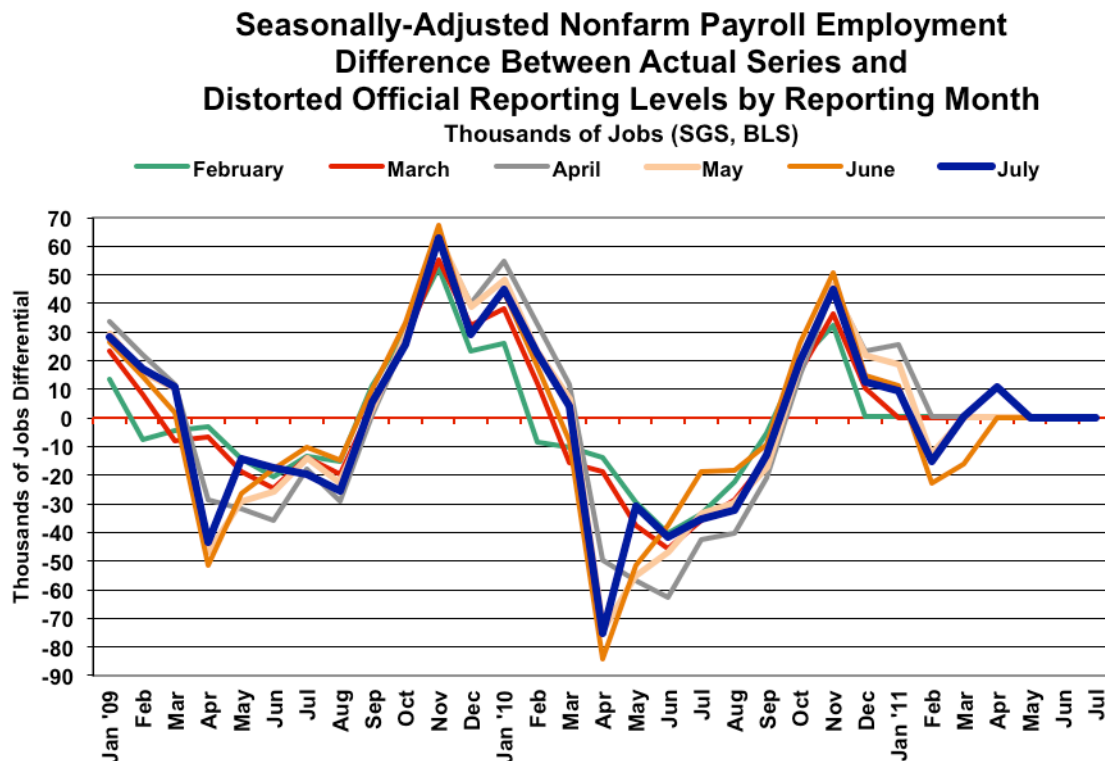
SGS Ongoing-M3 Estimate for July Likely Showed Some Pick Up. The preliminary estimate for the SGS Ongoing-M3 Estimate for July 2011 (published in the [Alternate Data](#) section), showed year-to-year growth of about 2.6%, up from 2.3% in June and 2.2% in May. Prior history on key elements were revised by the Federal Reserve Board during the last month, with June's annual growth coming in initially at about 2.0%. Seasonally-adjusted month-to-month change in M3 had stalled in June at roughly plus 0.1%, but it appears to be on the rise again, up about 0.5% in July, with declines in large time deposits and institutional money funds largely offsetting an increase in M2. The estimated month-to-month M3 changes, however, remain less reliable than the estimates of annual growth.

An early estimate on M2 for July shows year-to-year growth of 7.9% in July, versus 6.0% in June. Month-to-month M2 growth is estimated at roughly 2.0% in July, versus 1.0% in June. The early estimate on M1 for July shows year-to-year growth of 15.2% in July, versus 13.0% in June. Month-to-month M1 growth is estimated at roughly 2.2% in July, versus 0.8% in June

REPORTING DETAIL

EMPLOYMENT AND UNEMPLOYMENT (JULY 2011)

Constant Recalculation of Payroll Seasonal Factors Help to Boost June Upside Revision. As discussed in prior writings (see the *Hyperinflation Report*, for example), seasonal-factor estimation for most economic series has been distorted severely by the extreme depth and duration of the economic contraction. These distortions are exacerbated for payroll employment data based on the BLS's monthly seasonal-factor re-estimations and lack of full reporting.



While the BLS recalculates the monthly seasonal factors each month for payroll employment, going back a number of years, it only publishes revised data for the last two months of reporting (May and June 2011 with the July 2011 report). Shown in the preceding graph, the latest “concurrent” seasonal factor changes again upped June and July of 2010 (with implied stronger seasonals for the June and July 2011 reporting). With just two months of prior reporting shown as revised, the changes pre-May 2011 were not published by the BLS, so as to avoid “confusing” people who use the data.

As discussed repeatedly in recent employment *Commentaries*, meaningful seasonal-adjustments tend to be stable over time, without wild fluctuations every time the seasonals are re-estimated. This is true particularly for series like payroll employment and retail sales, where the seasonal factors are concurrent—recalculated each month for the current month’s raw data. If the payroll seasonals were stable, the lines in the preceding graph would be flat and coincident. Instead, the variations intensify with each successive month. The monthly recalculations of seasonally-adjusted payroll levels show irregular revisions, with monthly swings now of plus or minus 90,000 jobs shifting over time. To the extent the numbers affect current reporting, the differences are enough potentially to alter financial-market perceptions and reactions.

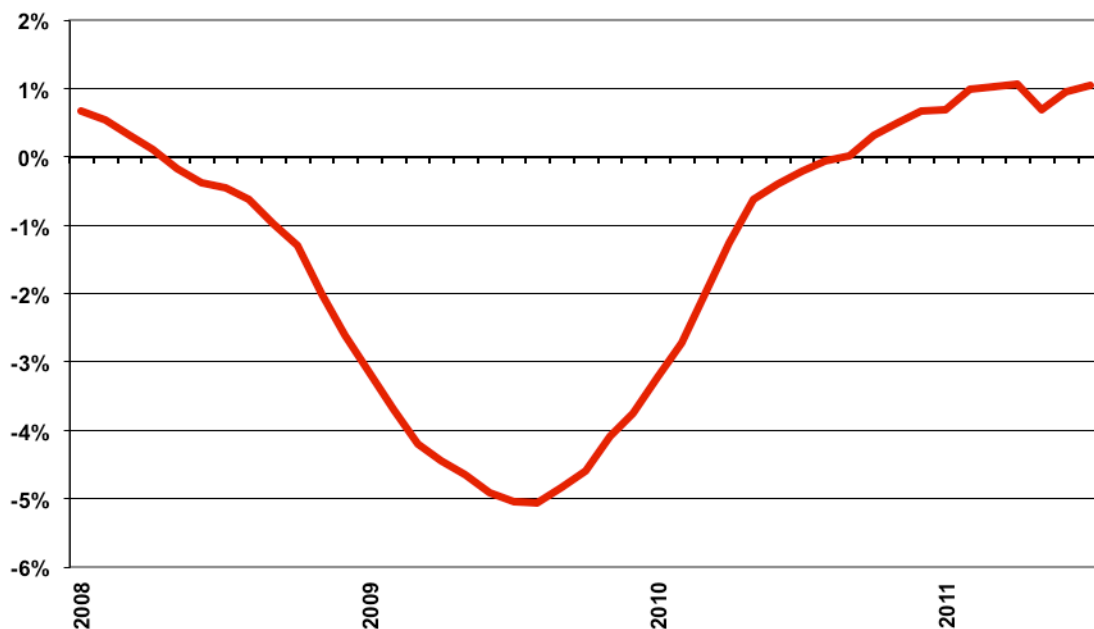
The big issue remains that the month-to-month seasonally-adjusted payroll data have become increasingly worthless, with reporting errors likely now well beyond the official 95% confidence interval of +/- 129,000 jobs in the reported monthly payroll change. Yet the media and the markets tout the data as meaningful, usually without question or qualification.

The inconsistency differences in the graph were calculated based on the raw data and the seasonal-adjustment program available to the public on the BLS Web site. Using the BLS data, we have calculated the seasonally-adjusted numbers as the BLS should be showing them, as of the current reporting, and the differences between official reporting and the consistent seasonally-adjusted series.

Payroll Survey Detail. The BLS reported a statistically-insignificant, seasonally-adjusted July 2011 month-to-month jobs gain of 117,000 (a jobs gain of 173,000 jobs before prior-period revisions) +/- 129,000 (95% confidence interval). June payrolls showed a revised 46,000 (previously 18,000) gain.

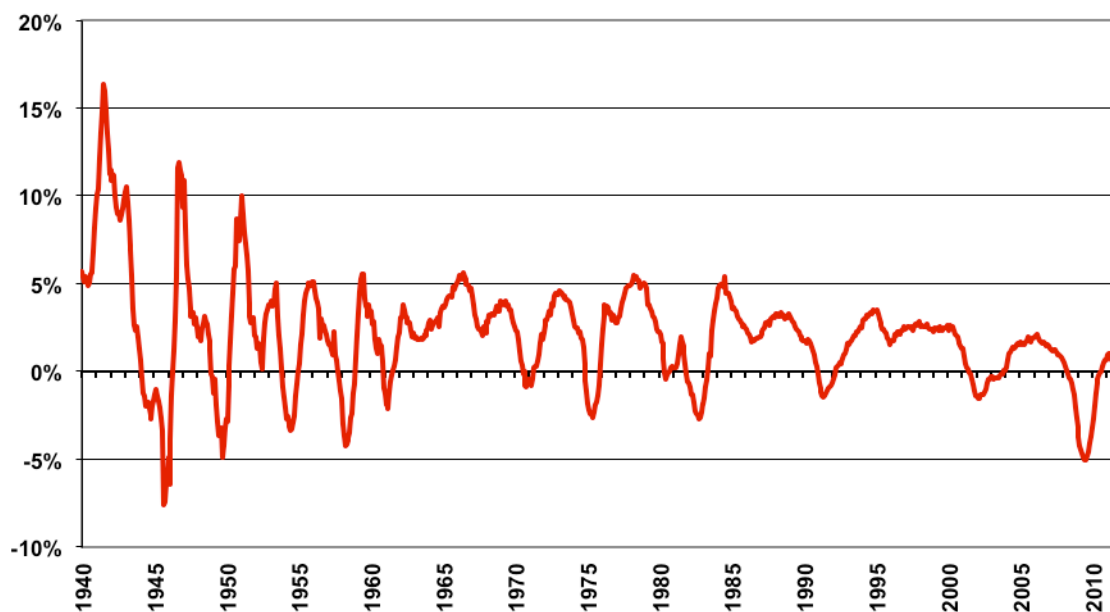
In terms of year-to-year change, the unadjusted July 2011 growth rate was at 1.04%, versus the revised 0.95% (previously 0.89%) annual growth reported in June. Although the graphs of long-term year-to-year unadjusted payroll change had shown a recent rising trend in annual growth, which primarily reflected the still-protracted bottom-bouncing in the payroll series, that pattern had flattened out in the last several months and now has begun to soften, as shown in the first graph following of the near-term detail in year-to-year change. These numbers still reflect some short-lived distortions as a result of the year-ago hiring surge and full layoffs of temporary census workers.

Nonfarm Payroll Employment
NSA Yr-to-Yr % Change through July 2011 (BLS)

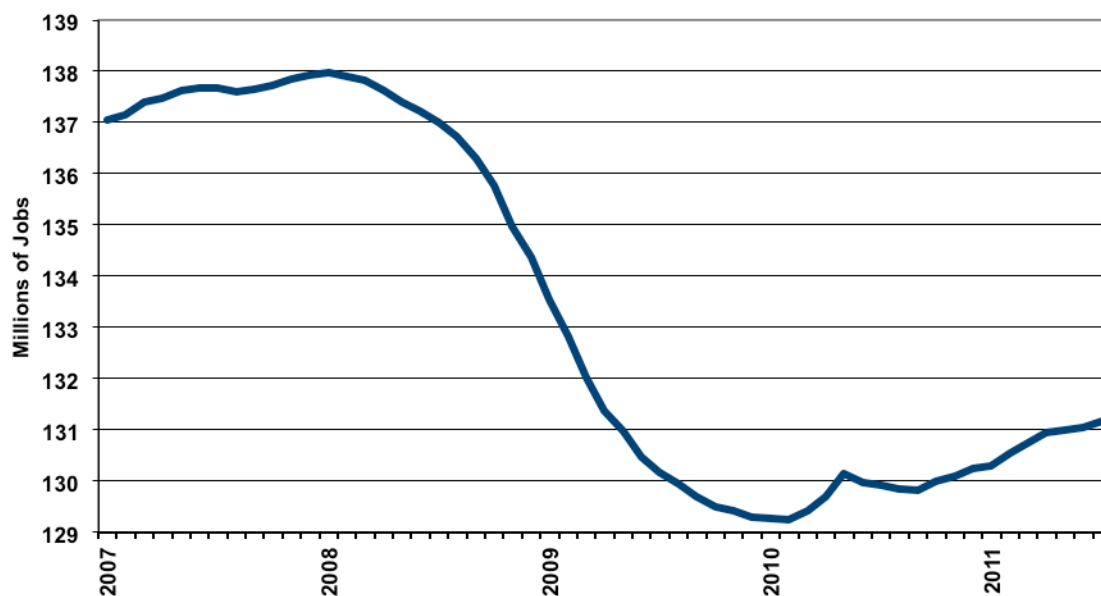


As shown in the following, longer-term graph (historical detail back to World War II), with the bottom-bouncing of recent years, current annual growth has recovered from the post-World War II record 5.06% decline in August 2009, which was the most severe annual contraction seen since the production shutdown at the end of World War II (a trough of a 7.59% annual contraction in September 1945). Disallowing the post-war shutdown as a normal business cycle, the August 2009 annual decline remains the worst since the Great Depression, yet the current level of employment is far from any recovery.

Nonfarm Payrolls
NSA Yr-to-Yr % Change through July 2011 (BLS)



Nonfarm Payroll Employment
Seasonally-Adjusted Levels through July 2011 (BLS)



In the above plot of seasonally-adjusted payroll levels (as reported by the BLS) the current level of nonfarm payrolls shows a recent flattening and certainly no recovery to pre-recession highs. The data continue to bottom-bounce along a plateau of low-level activity, with the latest payroll level still well below where it was a decade ago, even though the U.S. population has increased by more than 10% in the same period.

Birth-Death/Bias Factor Adjustment. Despite the ongoing and regular overstatement of monthly payroll employment—as evidenced by the regular and massive, annual downward benchmark revisions to the reported payroll numbers—the BLS generally has upped its monthly biases in post-benchmark reporting. For July 2011, the monthly bias used was a subtraction of 18,000 jobs, a less-negative number than the 38,000 subtraction in July 2010. In June 2011, the upside bias was 131,000. These upside biases reflect an ongoing assumption of a net positive jobs creation by new companies versus those going out of business. Such becomes a self-fulfilling system, as the upside biases boost reporting for financial-market and political needs, with relatively good headline data, while also setting up the next year's downside benchmark revisions, which traditionally are ignored by the media and the politicians.

Where the BLS cannot measure the impact of jobs loss and jobs creation from employers starting up or going out of business, on a timely basis (within at least five years, if ever), such information is estimated by the addition of a bias-factor generated by the Birth-Death Model (a model of the effects of new business creation and old business bankruptcies). The fundamental defects of the Birth-Death Model are discussed as usual in the ensuing paragraphs.

Positive assumptions—commonly built into government statistical reporting and modeling—can become self-fulfilling prophecies, with “stronger” economic data being reported as a result of happy guesstimates, or underlying assumptions of ongoing economic recovery. Indeed, historically, the Birth-Death Model biases have tended to overstate payroll employment levels—to understate employment declines—during recessions. There is a faulty underlying premise here that jobs created by start-up companies in this downturn have more than offset jobs lost by companies going out of business. So, if a company fails to report its payrolls because it has gone out of business, the BLS assumes it still has its previously-reported employees and adjusts those numbers for the trend in the company's industry.

Further, presumed additional “surplus” jobs, created by start-up firms, get added on to the payroll estimates each month as a special add-factor. These add-factors have averaged 40,000 jobs per month over the last 12 months. I still estimate this monthly bias should be negative by roughly 200,000 or so, on average. Since it is not, the BLS overestimates monthly growth in payroll employment by roughly 240,000 jobs. Much of that misreporting was not picked up in the 2010 benchmarking, and now will not be corrected until at least the 2011 benchmark revision (based on the upcoming March 2011 benchmarking) to be published in February 2012.

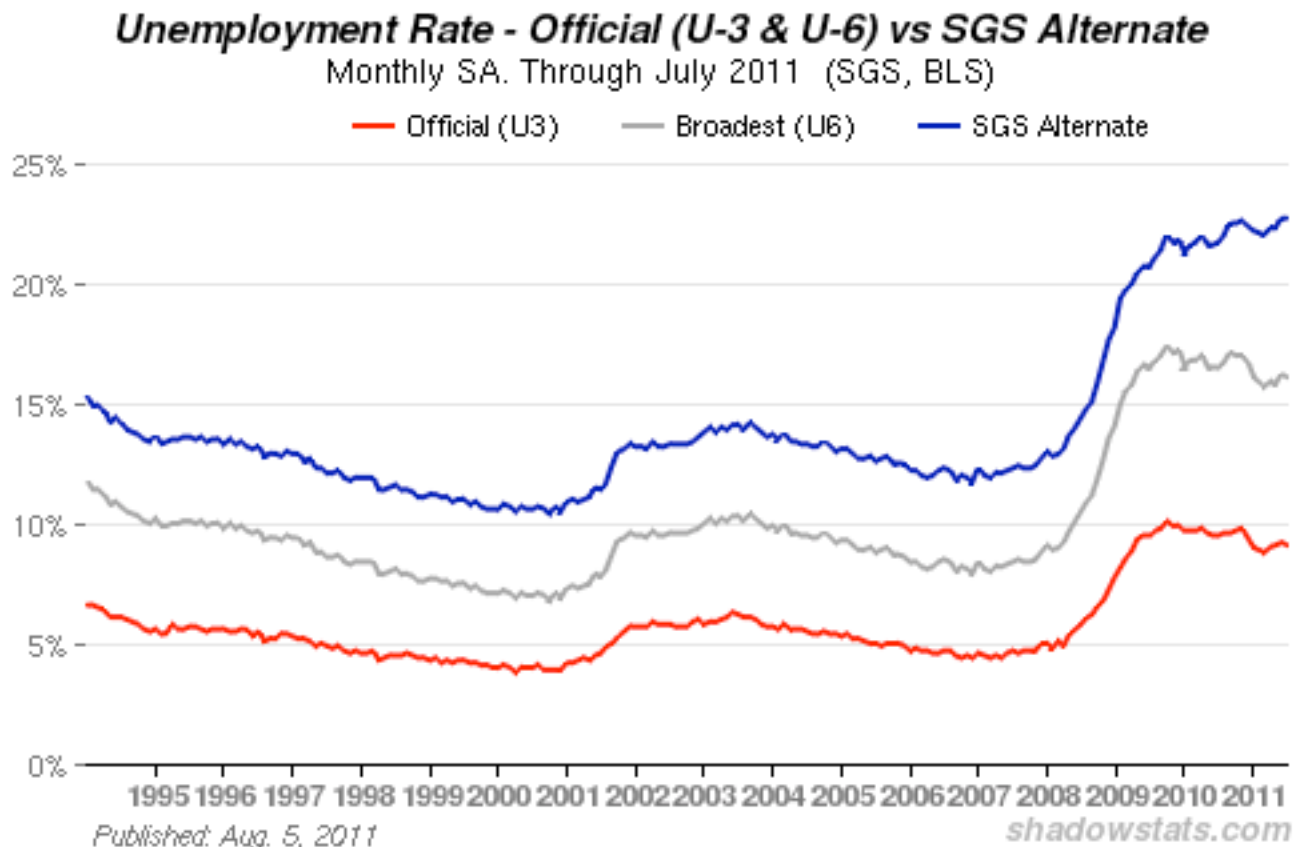
Household Survey. The usually statistically-sounder household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (counting multiple job holders more than once), showed a July 2011 employment drop of 38,000 versus June, which in turn had plunged by 455,000 in from May. Issues with seasonal factors still cloud the significance of the reported monthly levels in the adjusted headline U.3 unemployment rate and other adjusted household-survey numbers. Again, adjusted data have been moved by highly unstable seasonal factors that are artifacts of

the severe and extraordinarily protracted downturn in U.S. economic activity, not by the regular and stable seasonal patterns that were in place before the current economic crisis.

The July 2011 seasonally-adjusted headline (U.3) unemployment rate eased by a statistically-insignificant 0.09 percentage point to 9.09% +/- 0.23% (95% confidence interval), from 9.18% in June. Not-seasonally-adjusted, July's U.3 unemployment rate was 9.3%, the same as in June.

The July U.6 unemployment rate eased to a seasonally-adjusted 16.1%, from 16.2% in June. The unadjusted U.6 rate eased to 16.3% in July, from 16.4% in June. The broadest unemployment rate published by the BLS, U.6 includes accounting for those marginally attached to the labor force (including short-term discouraged workers) and those who are employed part-time for economic reasons (they cannot find a full-time job).

In 1994, 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 long-term discouraged workers. The remaining short-term discouraged workers (less than one year) are included in U.6.



Adding the SGS estimate of excluded long-term discouraged workers back into the total unemployed and labor force, unemployment—more in line with common experience as estimated by the SGS-Alternate Unemployment Measure—held at about 22.7% in July, the same level as in June. The SGS estimate generally is built on top of the official U.6 reporting, and tends to follow its relative monthly movements. Accordingly, it will suffer some of the current seasonal-adjustment woes afflicting the base series. See the [Alternate Data](#) tab for more detail.

As discussed in previous writings, an unemployment rate nearing 23% might raise questions in terms of a comparison with the purported peak unemployment in the Great Depression (1933) of 25%. The SGS level likely is about as bad as the peak unemployment seen in the 1973 to 1975 recession. The Great Depression unemployment rate was estimated well after the fact, with 27% of those employed working on farms. Today, less than 2% work on farms. Accordingly, for purposes of Great Depression comparison, I would look at the estimated peak nonfarm unemployment rate in 1933 of 34% to 35%.

Week Ahead. Gaining increasing recognition, though still not widely acknowledged, there is both an intensifying double-dip recession and a rapidly escalating inflation problem. Until such time as financial-market expectations fully catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the month and months ahead. Generally, previously unreported economic weakness should show up in prior-period revisions.

Trade Balance (June 2011). Due for release on Thursday, August 11th, the June 2011 monthly trade deficit likely widened in both real (inflation-adjusted) and nominal (not adjusted for inflation). A meaningful swing either way could impact the first revision to the second-quarter 2011 GDP estimate due for release August 26th. Significant trade deterioration in real terms would suggest a downside revision to the GDP estimate, and vice versa.

Retail Sales (July 2011). Due for release on Friday, August 12th, the July 2011 retail sales report is at fair risk of coming in below consensus estimates (a monthly gain of 0.5% per Breifing.com). In any event, retail sales should be flat-to-minus for the month, net of inflation effects.
