

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

**COMMENTARY NUMBER 537**  
**Gold Price and Market Instabilities**

**June 30, 2013**

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**Central Banks Dumping U.S. Treasuries at Fastest Pace Since 2011 Budget Crisis**

**Market Turmoil Reflects Shifting Sentiments and Systemic Distortions**

**Underlying Fundamentals for Gold and Silver Remain Extremely Strong**

**Gold Remains the Most-Solid Hedge  
Against Looming Dollar and Inflation Crises**

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*PLEASE NOTE: This short missive is in response to unusual developments in the financial markets. The next regular Commentary is scheduled for Wednesday, July 3rd, covering estimates of the May trade balance and of May construction spending and the annual benchmark revision. A subsequent Commentary on July 5th will cover June 2013 employment and unemployment.*

*Best wishes to all — John Williams*

## OPENING COMMENTS AND EXECUTIVE SUMMARY

**Gold and Silver Selling Has Not Been Fundamental.** Central banks were dumping U.S. Treasuries last week at a record pace (see *Central-Bank Bond Selling* section), yet, contrary to cash moving into gold, which commonly is seen in such circumstances, the rout in gold prices continued. Equity, credit and currency markets also have been unstable, but not of the magnitude seen with the precious metals. Global sentiments are shifting; something is afoot, and it likely is not good news for the broad financial system and markets. Whatever is unfolding could involve liquidity issues within certain markets, corporations, financial institutions and/or countries. It also could involve central bank efforts to pummel the precious metals. There already has been extensive jawboning aimed at pushing gold and silver prices much lower.

What has not happened here is a negative shift in the basic fundamentals that pushed gold and silver prices higher in recent years. There have been some misperceptions that briefly held sway over the markets, such as recent hype of imminent Fed tightening or “tapering” (see [Commentary No. 535](#) and [Commentary No. 536](#), in particular). These issues have been discussed broadly in numerous recent missives, particularly [No. 527: Special Commentary](#) and also [Commentary No. 516](#) and [Commentary No. 517](#), included here by reference. Once whatever underlies the current systemic turmoil breaks to the surface, look for the fundamentals supporting gold prices to regain dominance in the factors driving the market for the monetary precious metals.

**Federal Reserve Paper Dollars per Troy Ounce of Gold**  
Monthly Average Price of Gold in USD to June 2013 (ShadowStats.com, Kitco)



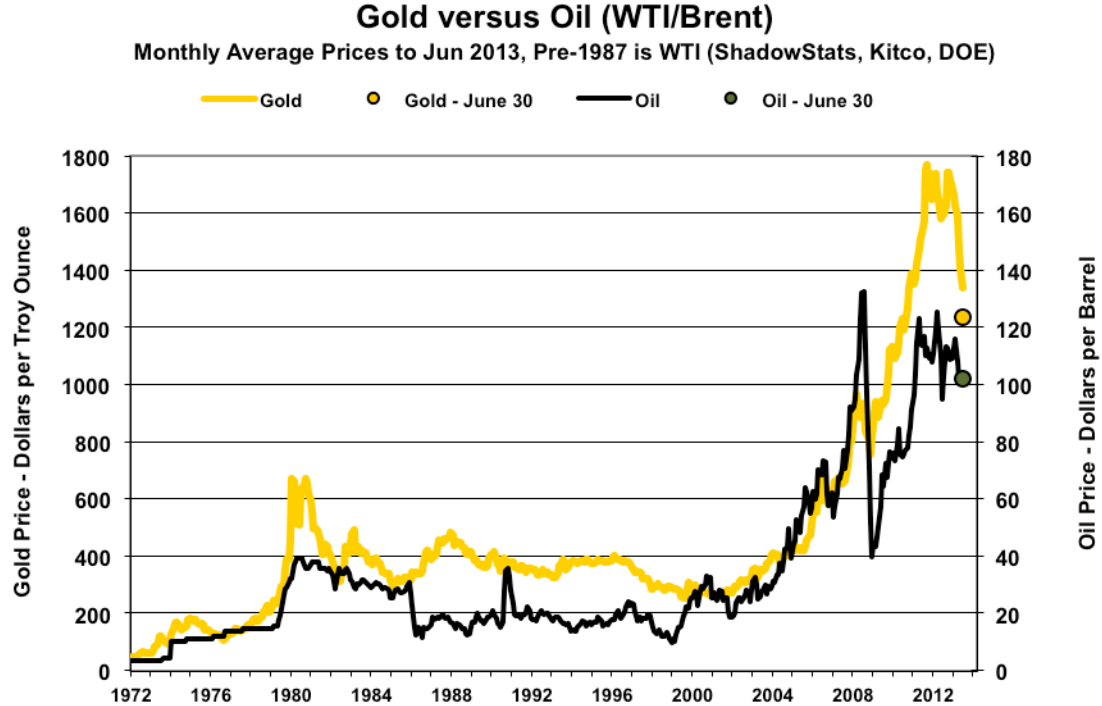
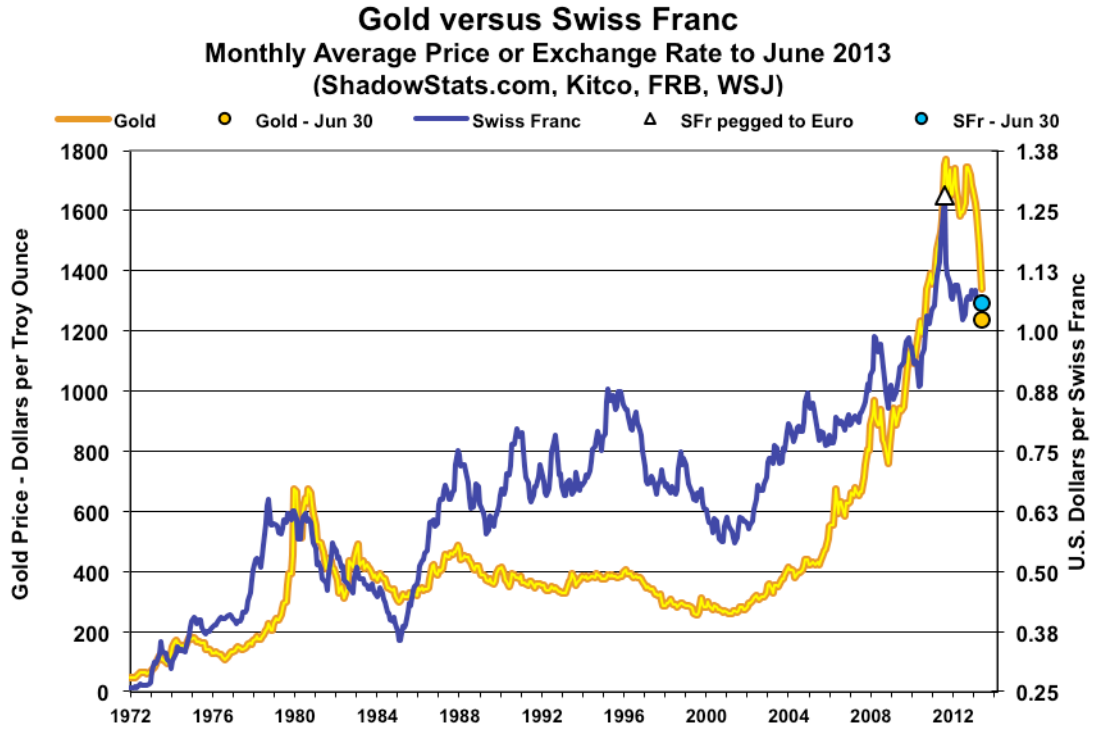
In particular, the longer-range solvency issues of the United States, including the budget deficit and the debt ceiling, are likely to come to ahead in early September. As the economy slows anew, talk of the Fed reversing QE3 should shift to anticipating increased accommodation. These issues, again, are discussed in [No 527: Special Commentary](#) and in [Hyperinflation 2012](#).

The London afternoon fix on Friday (June 28th) broke below \$1,200 per troy ounce, at \$1,192.00. By the close in New York, however, gold was up to \$1,235.30 bid (Kitco), closing out a week of extreme price gyrations. The New York closing prices for June 30th are used in the accompanying graphs.



If the recent selling in gold and silver, as seen in the preceding graph, were fundamental, those same fundamentals should be driving parallel sell-offs in oil and the Swiss franc. As seen in next two graphs, that is not happening.

Irrespective of the sharp decline in the price of gold, physical gold—held for the long term—remains the primary hedge against the U.S. dollar debasement ahead. Yet, it has to be in place, and it has to be held through the developing crises—irrespective of short-term market volatility—in order to provide the desired asset protection. Whether gold is purchased at \$250, \$2,500 or \$25,000 per ounce, it preserves the purchasing power of the dollars invested. Someone looking to take profits at \$100,000 an ounce is missing what has happened. Those “profits” are just the preserved purchasing power of the invested dollars. Another way of assessing that is to consider the implied proportionate amount of dollar purchasing power lost with those dollars that were not invested in the hard assets (see [Commentary No. 516, Hyperinflation 2012](#)).



**Central-Bank Bond Selling.** As of June 26, 2013, the Federal Reserve reported holding \$2.934 trillion of marketable U.S. Treasury securities in custody for foreign official and international accounts, primarily central banks. That level was down by \$32.4 billion from the week before, suggesting the largest net weekly sales of foreign, central-bank held Treasury securities since before the 2007 mortgage-backed-securities (MBS) crisis.

The June 26th four-week decline of \$42.4 billion in central-bank Treasury holdings had been approached or exceeded three times since early-2007. First at \$46.9 billion in the four weeks through August 28, 2007 (the breaking of the MBS crisis), then at \$32.8 billion in the four weeks ended September 28, 2011 (the August/September 2011 budget deficit fiasco, U.S. credit downgrade). The third time was tied to the ongoing budget-deficit and debt-ceiling crises at the end of 2011, with four-week (ended January 4, 2012) net sales of \$67.0 billion. In each of those historical circumstances, gold prices rallied and the U.S. dollar generally tended to weaken, coincident with or following the periods of heavy central-bank selling of Treasury securities.

With the Fed buying Treasury securities at a slower pace than the foreign-central banks were selling, in the last week, the difference likely was a factor in the recent upturn in longer-term interest rates.

***Fed Has Monetized 85.7% of Net Issuance of Gross Federal Debt Issuance with QE3.*** Separately, the Federal Reserve's own holdings of Treasury securities increased by \$9.7 billion in the week-ended June 26th. That brought the total Fed holdings of Treasury securities to \$1.928 trillion, where the net increase under QE3 of \$268.3 billion accounts for 85.7% of the Treasury's net issuance of gross federal debt coincident with expanded QE3, which began early in 2013.

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## HYPERINFLATION WATCH

**Hyperinflation Outlook—Unchanged Summary.** *[This summary has not been revised from prior Commentary No. 536 of June 26th].* The comments here are intended as background material for new subscribers and for those looking for a brief summary of the broad outlook of the economic, systemic and inflation crises that face the United States in the year or so ahead.

**Background Material.** [No. 527: Special Commentary](#) (May 2013) supplemented [No. 485: Special Commentary](#) (November 2012), reviewing shifting market sentiment on a variety of issues affecting the U.S. dollar and prices of precious metals. *No. 485*, in turn, updated [Hyperinflation 2012](#) (January 2012)—the base document for the hyperinflation story—and the broad outlook for the economy and inflation, as well as for systemic-stability and the U.S. dollar. Of some use, here, also is the [Public Comment on Inflation](#).

These are the primary articles outlining current conditions and the background to the hyperinflation forecast, and they are suggested reading for subscribers who have not seen them and/or for those who otherwise are trying to understand the basics of the hyperinflation outlook. The fundamentals have not changed in recent years, other than events keep moving towards the circumstance of a domestic U.S. hyperinflation by the end of 2014. Nonetheless, the next, fully-updated hyperinflation report is planned for the near future.

***Beginning to Approach the End Game.*** Nothing is normal: not the economy, not the financial system, not the financial markets and not the political system. The financial system still remains in the throes and aftershocks of the 2008 panic and near-systemic collapse, and from the ongoing responses to same by the Federal Reserve and federal government. Further panic is possible and hyperinflation remains inevitable.

Typical of an approaching, major turning point in the domestic- and global-market perceptions, bouts of extreme volatility and instability have been seen with increasing frequency in the financial markets, including equities, currencies and the monetary precious metals (gold and silver). Consensus market expectations on the economy and Federal Reserve policy also have been in increasing flux. The FOMC and Federal Reserve Chairman Ben Bernanke have put forth a plan for reducing and eventually ending quantitative easing in the form of QE3. The tapering or cessation of QE3 is contingent upon the U.S. economy performing in line with overly-optimistic economic projections provided by the Fed. Initially, market reaction pummeled stocks, bonds and gold.

Underlying economic reality remains much weaker than Fed projections. As actual economic conditions gain broader recognition, market sentiment should shift quickly towards no imminent end to QE3, and then to expansion of QE3. The markets and the Fed are stuck with underlying economic reality, and, eventually, they will have to recognize same. Business activity remains in continued and deepening trouble, and the Federal Reserve—despite currency-market platitudes to the contrary—is locked into quantitative easing by persistent problems now well beyond its control. Specifically, banking-system solvency and liquidity remain the primary concerns for the Fed, driving the quantitative easing. Economic issues are secondary concerns for the Fed; they are used as political cover for QE3. That cover will continue for as long as the Fed needs it.

At the same time, rapidly deteriorating expectations for domestic political stability reflect widening government scandals, in addition to the dominant global-financial-market concern of there being no viable prospect of those controlling the U.S. government addressing the long-range sovereign-solvency issues of the United States government. All these factors, in combination, show the end game to be nearing.

The most visible and vulnerable financial element to suffer early in this crisis likely will be the U.S. dollar in the currency markets (all dollar references here are to the U.S. dollar, unless otherwise stated). Heavy dollar selling should evolve into massive dumping of the dollar and dollar-denominated paper assets. Dollar-based commodity prices, such as oil, should soar, accelerating the pace of domestic inflation. In turn, that circumstance likely will trigger some removal of the U.S. dollar from its present global-reserve-currency status, which would further exacerbate the currency and inflation problems tied to the dollar.

This still-forming great financial tempest has cleared the horizon; its impact on the United States and those living in a dollar-based world will dominate and overtake the continuing economic and systemic-solvency crises of the last eight years. The issues that never were resolved in the 2008 panic and its aftermath are about to be exacerbated. Based on the precedents established in 2008, likely reactions from



the government and the Fed would be to throw increasingly worthless money at the intensifying crises. Attempts to save the system all have inflationary implications. A domestic hyperinflationary environment should evolve from something akin to these crises before the end of next year (2014). The shifting underlying fundamentals are discussed in [No. 527: Special Commentary](#); some of potential breaking crises will be expanded upon in the next revision to the hyperinflation report.

***Still Living with the 2008 Crisis.*** There never was an actual recovery following the economic downturn that began in 2006 and collapsed into 2008 and 2009. What followed was a protracted period of business stagnation that began to turn down anew in second- and third-quarter 2012 (see new detail in [Commentary No. 530](#)). The official recovery seen in GDP has been a statistical illusion generated by the use of understated inflation in calculating key economic series (see [No. 527: Special Commentary](#), [Commentary No. 528](#) and [Public Comment on Inflation](#)). Nonetheless, given the nature of official reporting, the renewed downturn likely will gain recognition as the second-dip in a double- or multiple-dip recession.

What continues to unfold in the systemic and economic crises is just an ongoing part of the 2008 turmoil. All the extraordinary actions and interventions bought a little time, but they did not resolve the various crises. That the crises continue can be seen in deteriorating economic activity and in the ongoing panicked actions by the Federal Reserve, where it still proactively is monetizing U.S. Treasury debt at a pace suggestive of a Treasury that is unable to borrow otherwise.

Before and since the mid-April rout in gold prices, there had and has been mounting hype about the Fed potentially pulling back on its “easing” and a coincident Wall Street push to talk-down gold prices. As discussed in [No. 527: Special Commentary](#), those factors appeared to be little more than platitudes to the Fed’s critics and intensified jawboning to support the U.S. dollar and to soften gold, in advance of the still-festered crises in the federal-budget and debt-ceiling negotiations. Despite orchestrated public calls for “prudence” by the Fed, and Mr. Bernanke’s press conference following the June 19th FOMC meeting, the underlying and deteriorating financial-system and economic instabilities have self-trapped the Fed into an expanding-liquidity or easing role that likely will not be escaped until the ultimate demise of the U.S. dollar.

Further complicating the circumstance for the U.S. currency is the increasing tendency of major U.S. trading partners to move away from using the dollar in international trade, such as seen most recently in the developing relationship between France and China (see [No. 527: Special Commentary](#)).

The Fed’s recent and ongoing liquidity actions themselves suggest a signal of deepening problems in the financial system. Mr. Bernanke admits that the Fed can do little to stimulate the economy, but it can create systemic liquidity and inflation. Accordingly, the Fed’s continuing easing moves appear to have been primarily an effort to prop-up the banking system and also to provide back-up liquidity to the U.S. Treasury, under the political cover of a “weakening economy.” Mounting signs of intensifying domestic banking-system stress are seen in softening annual growth in the broad money supply, despite a soaring pace of annual growth in the monetary base, and in global banking-system stress that followed the crisis in Cyprus and continuing, related aftershocks.

***Still Living with the U.S. Government’s Fiscal Crisis.*** Again, as covered in [No. 527: Special Commentary](#), the U.S. Treasury is in the process of going through extraordinary accounting gimmicks, at present, in order to avoid exceeding the federal-debt ceiling. Early-September appears to be the deadline for resolving the issues tied to the debt ceiling, including—in theory—significant budget-deficit cuts.

Both Houses of Congress recently put forth outlines of ten-year budget proposals that still are shy on detail. The ten-year plan by the Republican-controlled House proposes to balance the cash-based deficit as well as to address issues related to unfunded liabilities. The plan put forth by the Democrat-controlled Senate does not look to balance the cash-based deficit. Given continued political contentiousness and the use of unrealistically positive economic assumptions to help the budget projections along, little but gimmicked numbers and further smoke-and-mirrors are likely to come out of upcoming negotiations. There still appears to be no chance of a forthcoming, substantive agreement on balancing the federal deficit.

Indeed, ongoing and deepening economic woes assure that the usual budget forecasts—based on overly-optimistic economic projections—will fall far short of fiscal balance and propriety. Chances also remain nil for the government fully addressing the GAAP-based deficit that hit \$6.6 trillion in 2012, let alone balancing the popularly-followed, official cash-based accounting deficit that was \$1.1 trillion in 2012 (see [No. 500: Special Commentary](#)).

Efforts at delaying meaningful fiscal action, including briefly postponing conflict over the Treasury's debt ceiling, bought the politicians in Washington minimal time in the global financial markets, but the time has run out and patience in the global markets is near exhaustion. The continuing unwillingness and political inability of the current government to address seriously the longer-range U.S. sovereign-solvency issues, only pushes along the regular unfolding of events that eventually will trigger a domestic hyperinflation, as discussed in [Commentary No. 491](#).

***U.S. Dollar Remains Proximal Hyperinflation Trigger.*** The unfolding fiscal catastrophe, in combination with the Fed's direct monetization of Treasury debt, eventually (more likely sooner rather than later) will savage the U.S. dollar's exchange rate, boosting oil and gasoline prices, and boosting money supply growth and domestic U.S. inflation. Relative market tranquility has given way to mounting instabilities, and severe market turmoil likely looms, despite the tactics of delay by the politicians and ongoing obfuscation by the Federal Reserve.

This should become increasingly evident as the disgruntled global markets begin to move sustainably against the U.S. dollar. As discussed earlier, a dollar-selling panic is likely this year—still of reasonably high risk in the next month or so—with its effects and aftershocks setting hyperinflation into action in 2014. Gold remains the primary and long-range hedge against the upcoming debasement of the U.S. dollar, irrespective of any near-term price gyrations in the gold market.

The rise in the price of gold in recent years was fundamental. The intermittent panicked selling of gold has not been. With the underlying fundamentals of ongoing dollar-debasement in place, the upside potential for gold, in dollar terms, is limited only by its inverse relationship to the purchasing power of the U.S. dollar (eventually headed effectively to zero). Again, physical gold—held for the longer term—remains as a store of wealth, the primary hedge against the loss of U.S. dollar purchasing power.



## WEEK AHEAD

**Weaker Economic and Stronger Inflation Data Are Likely for June and Beyond.** *[Except for the revised underlined details on the upcoming release of June employment and unemployment, the text in the Week Ahead section is unchanged from the prior Commentary.]* In the context of mixed, but generally weak May economic reporting, the data into June and beyond likely will disappoint a still overly-optimistic consensus view of the broad economy. Separately, with energy-inflation related seasonal-adjustment factors swinging to the plus-side in June, higher inflation reporting is likely in the months ahead.

Going forward, reflecting the still-likely negative impact on the U.S. dollar in the currency markets from continuing QE3 and the still-festering fiscal crisis/debt-ceiling debacle, reporting in the ensuing months and year ahead generally should reflect much higher-than-expected inflation (see [No. 527: Special Commentary](#)).

Where expectations for economic data in the months and year ahead should tend to soften, weaker-than-expected economic results still remain likely, given the intensifying structural liquidity constraints on the consumer. Increasingly, previous estimates of economic activity should revise lower, particularly in upcoming annual benchmark revisions, as has been seen already in industrial production, new orders for durable goods, retail sales, and the trade deficit, and as likely is pending for construction spending (July 1st). The big event, though, will be the July 31st comprehensive overhaul, benchmark revision and redefinition of the GDP back to 1929. A ShadowStats estimate of the likely net shift in GDP reporting patterns (generally slower growth in recent years) will be published before that revision.

**Reporting Quality Issues and Systemic Reporting Biases.** Significant reporting-quality problems remain with most major economic series. Headline reporting issues are tied largely to systemic distortions of seasonal adjustments. The data instabilities were induced by the still-ongoing economic turmoil of the last six-to-seven years, which has been without precedent in the post-World War II era of modern economic reporting. These impaired reporting methodologies provide particularly unstable headline economic results, where concurrent seasonal adjustments are used (as with retail sales, durable goods orders, employment and unemployment data), and they have thrown into question the statistical-significance of the headline month-to-month reporting for many popular economic series.

With an increasing trend towards downside surprises in near-term economic reporting, recognition of an intensifying double-dip recession should continue to gain. Nascent concerns of a mounting inflation threat, though muted, increasingly have been rekindled by the Fed's monetary policies. Again, though, significant inflation shocks are looming in response to the fiscal crisis and a likely, severely-negative response in the global currency markets against the U.S. dollar.

The political system and Wall Street would like to see the issues disappear, and the popular media do their best to avoid publicizing unhappy economic news, putting out happy analyses on otherwise negative

numbers. Pushing the politicians and media, the financial markets and their related spinmeisters do their best to hype anything that can be given a positive spin, to avoid recognition of serious problems for as long as possible. Those imbedded, structural problems, though, have horrendous implications for the markets and for systemic stability, as discussed in [Hyperinflation 2012](#), [No. 485: Special Commentary](#) and [No. 527: Special Commentary](#).

**Construction Spending (May 2013, Annual Benchmark Revisions).** Due for release on Monday, July 1st, by the Commerce Department, May 2013 construction spending will be reported in the context of an annual benchmark revision, back to January 2011. The benchmarking likely will be to the downside.

Although expectations appear to favor a monthly gain in May month-to-month spending, the monthly change likely will not be statistically significant, and the series should continue its recent trend of month-to-month stagnation, particularly after adjustment for inflation.

**U.S. Trade Balance (May 2013).** The May trade deficit is scheduled for release on Wednesday, July 3rd, by the Census Bureau and the Bureau of Economic Analysis (BEA). Where the inflation-adjusted merchandise trade deficit in April basically was flat against reported first-quarter activity, the May report will set the tone for the net-export contribution to the initial estimate of second-quarter 2013 GDP (July 31st). Significant trade deterioration in May would be a net negative for the GDP, while significant narrowing of the deficit would boost GDP growth. Underlying fundamentals and long-term trends favor trade deterioration.

**Employment and Unemployment (June 2013).** The June labor data are due for release on Friday, July 5th, from the Bureau of Labor Statistics (BLS). Most commonly, the consensus jobs estimate settles around the trend estimate from the BLS seasonal-adjustment models. The June 2013 payroll trend number is for a 148,000 jobs gain, versus May reporting of 175,000 (see [Commentary No. 531](#)). The early consensus appears to be settling around 160,000, above the trend, but weaker than the May reporting. Separately, the markets now appear to be looking for the June unemployment rate to hold at the 7.6% headline U.3 level reported in May.

Reflecting underlying fundamental economic activity that is weaker than consensus expectations, reporting risks continue to the downside of expectations for payrolls and to the upside for the unemployment rate.

Although the unemployment rate should move higher—at least in its broader measures that include discouraged workers—there is a persistent reporting problem that has been discussed frequently with this series (see [Commentary No. 451](#) and [Commentary No. 487](#), for example). Month-to-month comparisons of the headline unemployment data cannot be made legitimately. The headline change in the unemployment rate is of no meaning, other than in misguided-media and market reactions. Specifically, all the recent historical unemployment rates are re-calculated each month as part of the concurrent-seasonal-adjustment process, but where the BLS publishes the new headline unemployment rate, it does

not publish, and it does not make available, the revised number from the month before, which would be consistent with the new number.

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