

Issue Number 36

October 29, 2007

---

**Inflation Indicators Surge While Recession Signals Mount**

**Anticipated Fed Easing Pummels Real-World Markets**

**Dollar Tanks, Oil and Gold Soar and Funding Crisis Continues**

---

**OVERVIEW -- OPENING COMMENTS**

**Wall Street's Pollyannas Ignore Darkening Fundamentals**

With all-time high oil prices topping \$90 per barrel, with the U.S. dollar indices at record lows and under selling pressure, and with the SGS-Ongoing M3 annual growth at a 36-year high of 14.7%, the near-term inflation outlook is turning about as bleak as it gets. On the economic front, annual growth in new orders for durable goods, housing and employment all are generating new, or confirming prior, recession signals. This is despite overstatement of some recent economic activity in the employment data apparently aimed at removing some pressures on the Fed to ease. Nevertheless, the markets are expecting a quarter-point fed funds rate cut on Wednesday. The Federal Open Market Committee (FOMC) most likely will follow market expectations, in that it has had some hand in setting the consensus outlook, and the U.S. central bank likely will look to be as non-disruptive to the markets as possible. Even so, current expectations already are roiling the currency markets. Any rate cut beyond consensus could

prove particularly disruptive for the U.S. dollar. At some point -- and that point may have been reached -- Fed easing will become counterproductive, pummeling domestic U.S. liquidity. Where Wall Street, Administration and Fed efforts appear to be concentrated on continued artificial propping of equity prices, a dollar-induced liquidity crunch would hit both the equity markets and the credit markets hard. Despite increasing volatility in this unsettled environment, the stock market has held up remarkably well, so far. Gold and dollar prices already are at levels that risk inviting short-lived central bank interventions.

---

**OVERVIEW -- OPENING COMMENTS..... 1**

**MARKETS PERSPECTIVE ..... 8**

**REPORTING PERSPECTIVE ..... 13**

*The Big Three Market Movers ..... 13*

*Other Troubled Key Series ..... 15*

*Better-Quality Numbers ..... 18*

**Reporting/Market Focus ..... 22**

---

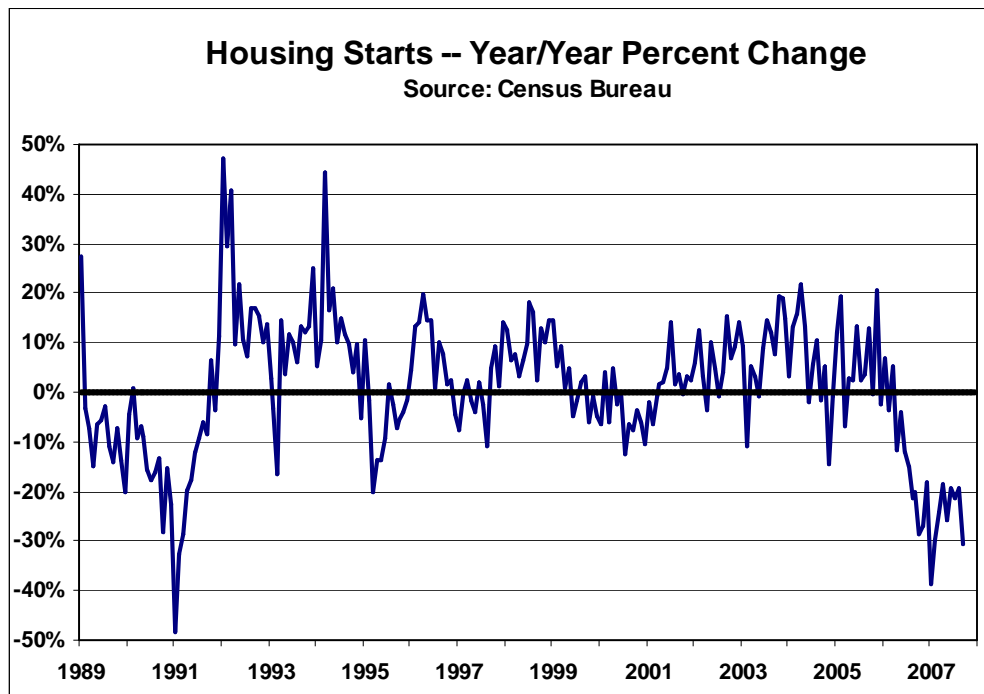
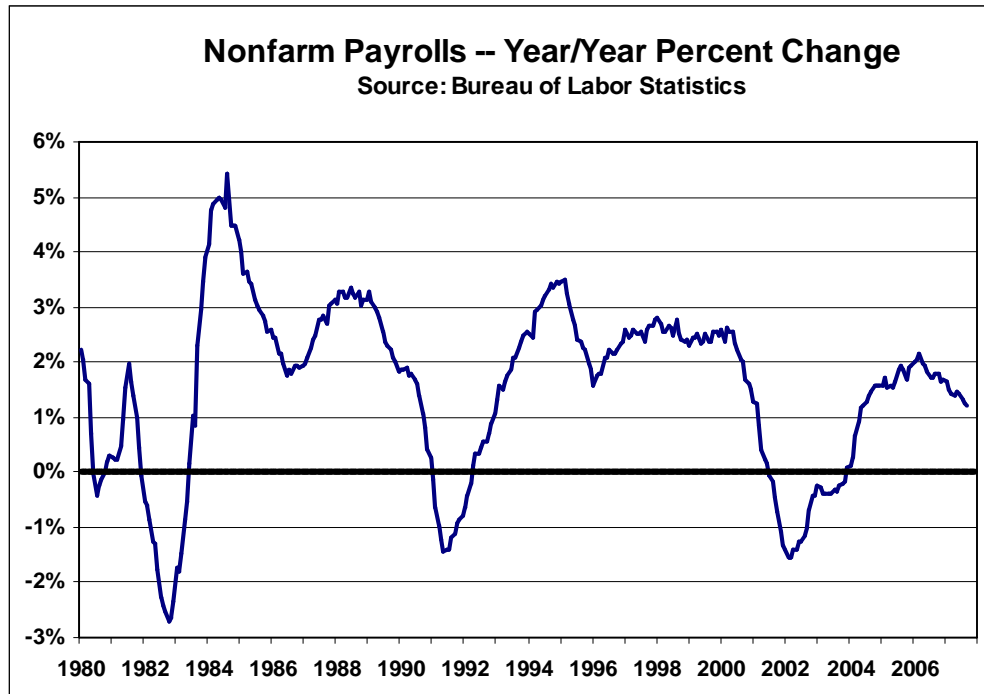
A week ago last Friday -- the 20th anniversary of the 1987 stock market crash -- I had a leisurely shoe shine at the BART (subway) station in San Francisco's financial district. As I received one of the better shoe shines of my life, the bootblack regaled me with stories of his stock market exploits. As shoe enhancement progressed, a former stockbroker and homeless acquaintance of the bootblack interrupted us, bemoaning the news that the Dow was down by 200 (it closed down 367 for the day). The circumstance brought to mind the tales of how both Joseph Kennedy and Bernard Baruch had decided to get out of the stock market before the 1929 crash, based on their bootblack, Patrick Bologna, giving stock tips. Kenneth Fisher's 100 Minds That Made The Market quoted Baruch as explaining, "When beggars and shoeshine boys, barbers and beauticians can tell you how to get rich it is time to remind yourself that there is no more dangerous illusion than the belief that one can get something for nothing."

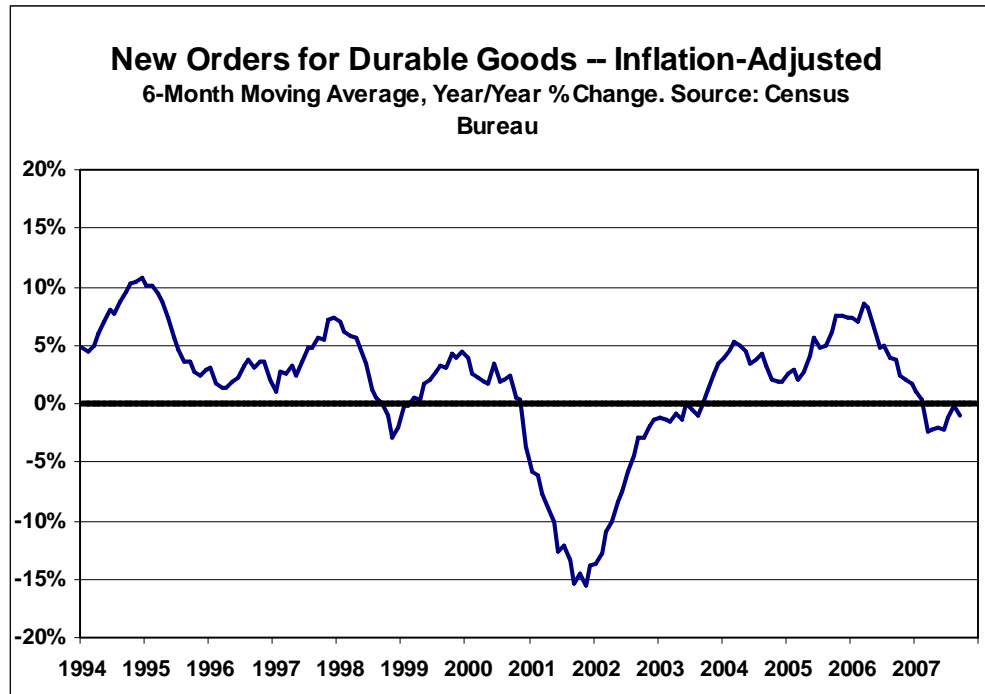
As discussed in this month's Reporting/Market Focus, liquidity crises of various forms, in combination with structural economic changes, have been the most common contributing triggers for U.S. economic contractions since the founding of the Republic. As was also seen at the onset of the Great Depression, today's still-unrecognized recession was not caused by current liquidity disruptions, only exacerbated by them.

Although the recent hemorrhaging of commercial paper outstanding appears to have been stabilized, the funding problems within the system still are surfacing, to wit, the Fed appears ready to meet market demands for another rate cut. As the recession deepens, the problems with structured financial instruments will extend far beyond the issues with problem mortgages.

**Enhanced Recession Signals.** Three economic series are highlighted this month in terms of their historical relationships to recessions. Despite the often discussed reporting problems with payroll employment, the official data are showing annual growth that always has been followed by a recession. As shown in the accompanying graph, every time annual growth has slowed to 1.2% a recession has followed. The September 2007 annual growth slowed to that level, last seen (when growth was slowing) in February 2001, the month before the official onset of the 2001 recession. The graph also suggests that the recovery from that downturn was the weakest since the first-leg of the double-dip recession in the early-1980s, and back then they did not have the bias factor (birth-death model). I'll contend that what the United States currently is experiencing is the second-leg of a double-dip recession that began in 2000,

Annual growth in housing starts has been signaling recession for some time, but given the heavy press surrounding the housing market and mortgage problems, the graph is repeated and updated here, showing year-to-year change on a monthly basis. Looking at the monthly data, as opposed to the three-month moving average published a couple of months back, highlights the sharp move shown in September reporting. Current growth patterns remain the weakest seen since the 1990/1991 recession.





Then there is the new orders for durable goods series, which took an 8.4% hit on an annual basis for September. This monthly series is highly volatile and best viewed on a six-month moving average basis.

With annual growth adjusted for inflation (official CPI-U is used as opposed to the even more useless GDP component deflator), annual change for the series has been negative since the beginning of the year. Such is consistent with a recessionary environment. Where the current series is not fully consistent over time, similar relationships with recessions were evident in earlier versions of the durable goods orders series.

In other reporting over last month, retail sales and the improvement in the trade deficit were overstated, industrial production slowed in revision, the purchasing managers surveys slowed, consumer confidence sank and help-wanted advertising bottom bounced. Most upcoming series, shy of any data massaging, should tend to come in on the low side of market expectations.

**Inflation Surge Looms.** Oil is the single most important commodity in terms of its potential impact on broad inflation. It permeates economic activity. The price of oil is notoriously volatile and making new highs as we go to press. Irrespective of any near-term pull backs, oil prices are high enough to start spiking full (as opposed to "core") inflation measures over the next several months. Oil price increases of the last couple of years still are working their way fully into the economy.

Some of the oil-driven inflation effects will be seen quickly, and the timing is poor for CPI reporting. As with the September CPI-U, which saw annual inflation jump to 2.8% from 2.0% in August, due partially to a CPI contraction in September 2006, October 2007 will see a further spike against a continued period of CPI contraction one year ago. The surge in PPI likely will continue in October, as well,

Also promising higher inflation is broad money growth, with the SGS-Ongoing M3 annual growth estimated at a 36-year high 14.7%. Added pricing pressure will come from the weakening dollar. On a more positive note, the fiscal 2007 cash-based federal deficit was reported at \$162.8 billion, down from \$248.2 billion in 2006. Those numbers, however, are gimmicked, and the Treasury's financial statements due out in December will tell a much darker story, using generally accepted accounting principles.

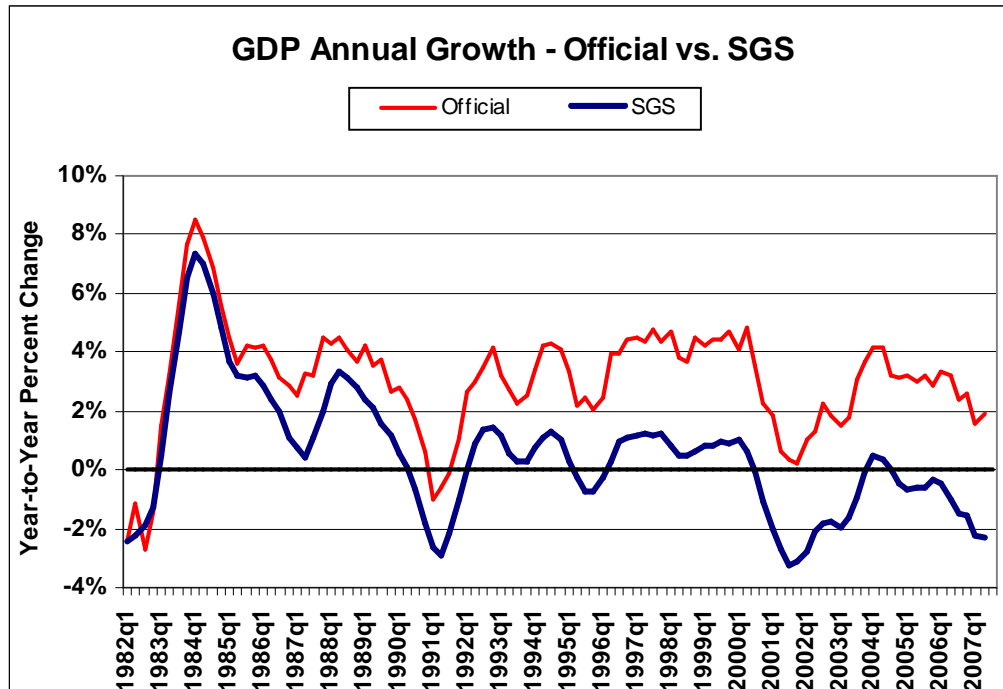
*PLEASE NOTE: A "General background note" provides a broad background paragraph on certain series or concepts. Where the language used in past and subsequent newsletters usually has been or will be identical, month-after-month, any text changes in these sections will be highlighted in bold italics upon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

*General background note:* The U.S. economy is in a protracted and deepening structural recession that will prove to be the second leg of a double-dip recession, which began in 2000/2001. The current downleg was signaled in mid-2005 by a series of leading indicators used for that purpose by SGS. With neither traditional fiscal nor monetary stimulus available to help turn economic activity, the current circumstance is likely to evolve into a hyperinflationary depression (see December 2006 SGS).

**Market Turmoil Continues.** With the ongoing liquidity crisis and rising oil prices, U.S. dollar selling has intensified and the price of gold has rallied. Despite any near-term violent swings in oil or gold prices, those general broad upside trends likely will persist over the longer term. Treasury yields generally have softened, due primarily to flight-to-safety issues, while the equity markets have seen increased volatility and vulnerability to negative surprises. Eventually, dollar selling will create a domestic U.S. liquidity crisis that should impact the credit and equity markets negatively. If the Fed eases, as expected, or more than expected, such should contribute to the pressures on the greenback.

**Alternate Realities.** *General background note:* This section updates the Shadow Government Statistics (SGS) alternate measures of official CPI and GDP 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 post-World War II CPI and the pre-Reagan-Era GDP. The methodologies for the series are discussed in the August 2006 SGS (see Archives page at [www.shadowstats.com](http://www.shadowstats.com)).

**GDP.** The alternate second-quarter GDP growth reflects the "final" estimate revision, with many of the methodological gimmicks of recent decades removed. The alternate second-quarter inflation-adjusted annual growth rate (year-to-year, as opposed to the popularly-touted annualized quarter-to-quarter rate) for GDP was a decline of roughly 2.3% versus the official year-to-year gain of 1.9%.



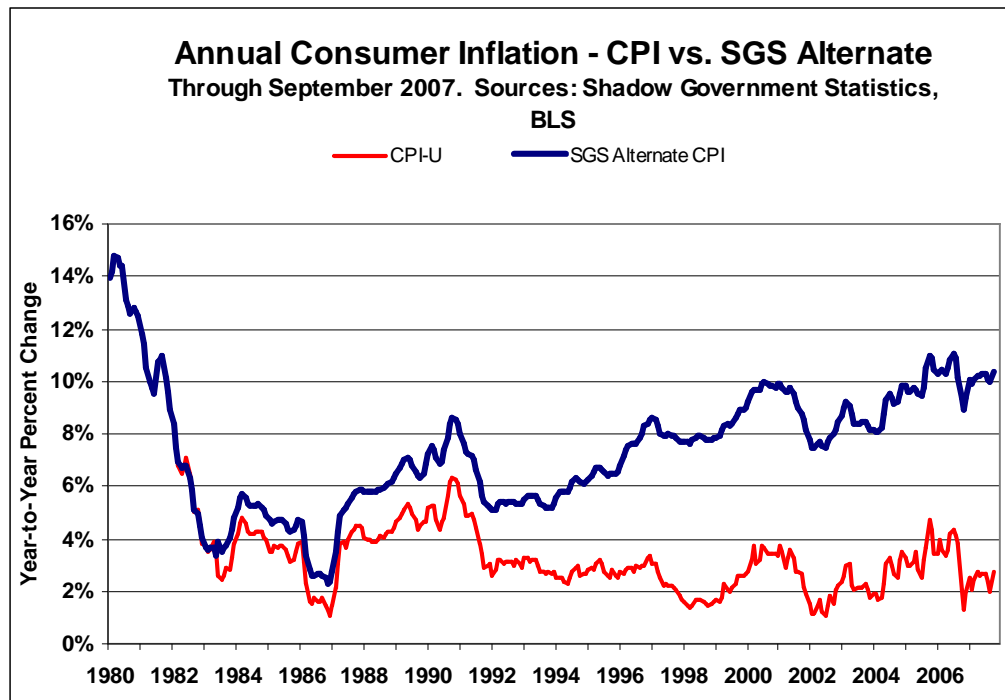
*General background note:* Historical data on both the official and SGS-Alternate GDP series are available for download on the Alternate Data page of [www.shadowstats.com](http://www.shadowstats.com). The Alternate GDP numbers tend to show deeper and more protracted recessions than have been reported 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 (as revised), which are major indicators used by the National Bureau of Economic Research in determining the official timing of U.S. business cycles (see this month's Reporting/Market Focus).

**CPI.** The annual non-core annual inflation rates spiked in September and are due to spike again October, while the so-called "core" inflation rates continue their orchestrated malingering. Food and oil-related price pressures increasingly are a problem, due primarily to supply issues, but those pressures have been avoided in much of the government's reporting of the non-core inflation, so far. Continued sharp increases in market prices, however, suggests the pick-up in reporting inflation should accelerate in the next several months.

**Eight Levels of Inflation**  
**Annual Inflation for June to September 2007**

Measure	2007			
	Jun	Jul	Aug	Sep
I.1 Core PCE Deflator	1.9%	1.9%	1.8%	n.a.
I.2 Core Chained-CPI-U	1.8%	1.8%	1.7%	1.7%
I.3 Core CPI-U	2.2%	2.2%	2.1%	2.1%
I.4 PCE Deflator	2.3%	2.1%	1.8%	n.a.
I.5 Chained-CPI-U	2.3%	2.1%	1.8%	2.3%
I.6 CPI-U	2.7%	2.4%	2.0%	2.8%
I.7 Pre-Clinton CPI-U	6.1%	5.7%	5.4%	6.1%
I.8 SGS Alternate Consumer Inflation	10.3%	10.1%	9.9%	10.4%

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



*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](http://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.

**MARKETS PERSPECTIVE**

The market instabilities that intensified in response to the systemic liquidity crisis, and the resulting Federal Reserve emergency accommodation, have continued. Fed accommodation is expected to continue in the days ahead. The systemic and economic problems, however, are structural and not fixed as simply as the markets' spinmeisters would like to believe. Fed accommodation will not resolve the current problems. Those problems will not disappear, and pressures for further easing by the Fed will be ongoing. Ongoing, that is, until either the dollar sell-off forces a reconsideration, or until Mr. Bernanke owns up to the truth and just says "no" to Wall Street.

The following table shows how various financial indicators fared in the third quarter of 2007 and in subsequent trading through October 26th. In general, the currencies, oil and precious metals have been consistently strong, rivaling the equity indices.

**Financial-Market Indicators at Quarter-End and October 26, 2007 Close**

	26 Oct 2007 and Change versus 30 Sep 2007		Third-Quarter 2007 Level      Qtr/Qtr Yr/Yr			Second-Quarter 2007 Level      Qtr/Qtr Yr/Yr			
<b>Equity Market</b>									
DJIA	13,806.70	-0.64%	13,895.63	3.63%	18.98%	13,408.62	8.53%	20.25%	
S&P 500	1,535.28	0.56%	1,526.75	1.56%	14.29%	1,503.35	5.81%	19.53%	
Wilshire 5000	15,518.12	1.02%	15,362.02	1.00%	15.11%	15,210.65	5.56%	18.38%	
NASDAQ Comp	2,804.19	3.80%	2,701.50	3.77%	19.62%	2,603.23	7.50%	19.85%	
<b>Credit Market(1)</b>									
Fed Funds Target	4.75%	0bp	4.75%	-50bp	-50bp	5.25%	0bp	25bp	
3-Mo T-Bill	3.96%	14bp	3.82%	-100bp	-107bp	4.82%	-22bp	-19bp	
2-Yr T-Note	3.77%	-20bp	3.97%	-90bp	-75bp	4.87%	29bp	-29bp	
5-Yr T-Note	4.04%	-19bp	4.23%	-69bp	-36bp	4.92%	38bp	-18bp	
10-Yr T-Note	4.41%	-18bp	4.59%	-44bp	-5bp	5.03%	38bp	-12bp	
30-Yr T-Bond	4.68%	-15bp	4.83%	-29bp	6bp	5.12%	28bp	-7bp	
<b>Spot Oil(2)</b>									
<b>US\$ per Barrel</b>									
West Texas Int.	91.87	12.49%	81.67	17.39%	29.80%	69.57	12.21%	-5.96%	
<b>Currencies/Dollar Indices(3)</b>									
<b>US\$/Unit</b>									
Pound Sterling	2.0514	0.61%	2.0389	1.65%	8.94%	2.0063	1.92%	8.50%	
Euro	1.4390	1.20%	1.4219	5.17%	12.08%	1.3520	1.22%	5.80%	
Swiss Franc	0.8601	0.39%	0.8568	4.87%	7.13%	0.8170	-0.93%	0.06%	
Yen	0.0088	0.84%	0.0087	7.32%	2.63%	0.0081	-4.72%	-7.20%	
Canadian Dollar	1.0396	3.54%	1.0041	8.43%	12.06%	0.9404	8.43%	4.85%	
Australian Dollar	0.9163	3.48%	0.8855	4.29%	18.68%	0.8491	4.78%	14.39%	
<b>Weighted Currency Units/US\$</b>									
Jan. 1985 = 100									
Financial (FWD)	47.04	-1.38%	47.70	-4.66%	-9.14%	50.03	-0.99%	-4.12%	
Change US\$/FX	--	1.40%	--	4.88%	10.06%	--	1.00%	4.30%	
Trade (TWD)	52.55	-1.83%	53.53	-5.42%	-9.10%	56.60	-2.33%	-3.13%	
Change US\$/FX	--	1.86%	--	5.74%	10.01%	--	2.39%	3.23%	



	26 Oct 2007 and Change versus 30 Sep 2007			Third-Quarter 2007 Level      Qtr/Qtr Yr/Yr			Second-Quarter 2007 Level      Qtr/Qtr Yr/Yr		
<b>Precious Metals (4)</b>									
<b>US\$ per Troy Ounce</b>									
Gold	779.15	4.87%		743.00	14.22%	23.99%	650.50	-1.70%	6.03%
Silver	14.07	3.08%		13.65	8.85%	20.26%	12.54	-6.07%	17.20%

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

*General background note:* The U.S. economy remains in a severe, structural inflationary recession, saddled with an impotent Fed and a federal government that is fiscally bankrupt in all but name. In combination, these factors offer the worst of all environments to the financial markets. Ahead lie higher long-term interest rates and much lower U.S. equity prices. On the plus side is the outlook for gold, which provides a solid hedge against many of the problems that have started to surface. Key to the near-term movements of these markets remains the fate of the U.S. dollar, which appears to have started a major downside move.

**U.S. Equities** -- The equity markets have remained generally positive, despite increased turmoil. The economic and financial fundamentals are deteriorating, and weakening earnings should suffer further with declining business activity. Stocks still could go on to further new highs or crash from current levels, but eventually they are headed much lower than they are now. Serious U.S. dollar selling pressure could become a major factor in the market.

*General background note:* As the equity markets catch up with the underlying economic and looming financial fundamentals, the downside adjustments to stock prices should be quite large, eventually rivaling the 90% decline in equities seen in the 1929 crash and ensuing several years. The decline might have to be measured in real terms (net of inflation), as a hyperinflation eventually will kick in as the Fed moves to liquefy the system. 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 below today's levels, adjusted for inflation.

*General background note:* The approaching financial maelstrom already has come over the horizon and now is nearing landfall. When it hits, those investors who have taken shelter in cash, gold and outside the U.S. dollar will be the ones with the wealth and assets available to take advantage of the extraordinary investment opportunities that should follow.

**U.S. Credit Market** -- Recent credit market activity has continued to be dominated by the still unfolding liquidity crisis and general financial-market and global-political instabilities that have fostered continued flight-to-safety effects. Over time, inflation traditionally has been the dominant force behind interest rate movements. The worsening inflation outlook and mounting flight from the dollar both favor higher long-term interest rates, with a steepening, positively-sloped yield curve.

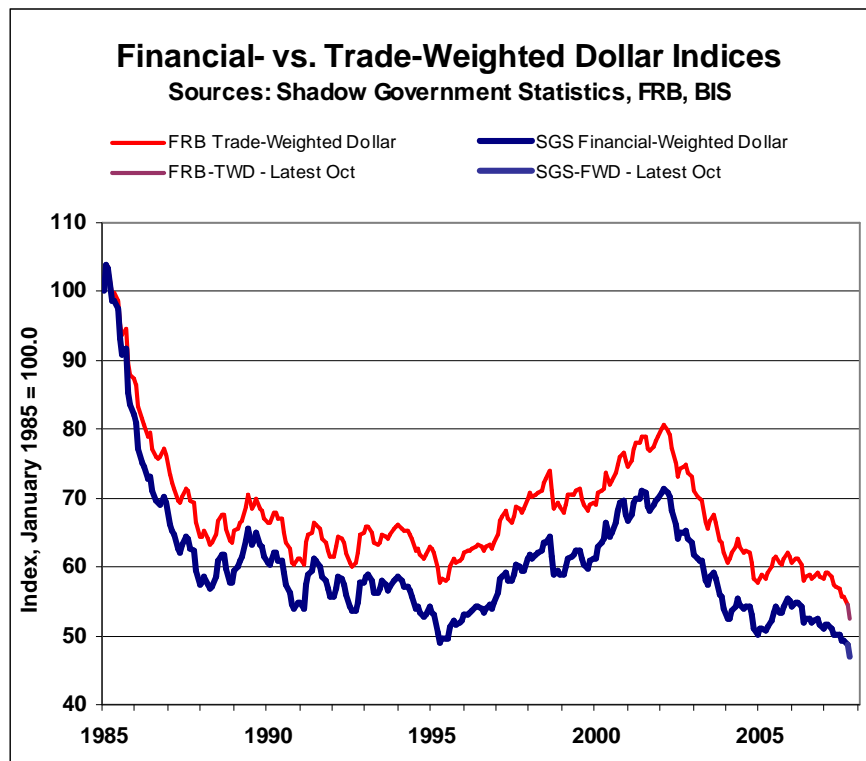
**U.S. Dollar** -- The Fed's last round of rate cuts and market expectations for a further easing on October 31st have taken an increasing toll on the foreign exchange value of the U.S. currency. Selling has been heavy enough to invite central bank intervention, but if the dollar is being supported artificially, the action so far has been covert.

Potentially exacerbating the circumstance are recent stories of Communist China threatening the use of their dollar sales "nuclear option," of Iran requesting that Japanese buyers pay for oil purchases in yen, of the Saudis looking to de-link from the U.S. dollar. The U.S. markets remain particularly vulnerable, at the moment, to "surprises" from those countries that are not so friendly to the United States, or even from those who simply would like to avoid large losses on the dollars they hold. Accordingly, reports of slowing official foreign investment in U.S. Treasuries likely signal a major investment shift already underway. The more the Fed eases, the greater the shift will be out of the U.S. dollar.

Outside of further Federal Reserve rate cuts or additional major negative news out of the liquidity/funding crisis, the proximal trigger for a dollar panic could come from a bad economic statistic (statistics appear increasingly to be massaged in a dollar-friendly manner), political missteps by the Administration, negative trade or market developments in Asia, or a terrorist attack or even the increasingly likely expansion of U.S. military activity in the Middle-East. When the trigger hits, the broad selling pressure should be strong enough to overwhelm short-lived central bank intervention.

*General background note* In terms of underlying fundamentals that tend to drive currency trading, the dollar's portfolio could not be worse. Relative to major trading partners, the U.S. economy is much weaker, interest rates are lower and anticipated possibly to go lower still, inflation is higher, fiscal and trade-balance conditions are abysmal, and relative political concerns are rising sharply at the same time. The President's approval rating commonly has moved currency trading in the past, and, despite any near-term bouncing, it remains lower than has been seen for any other U.S. President in the post-World War II era. Relative political stability issues are compounded by the presence of a Congress that is increasingly hostile to the President, and that is rated even lower by the American people than is the President. 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.

As shown in the following graph, the U.S. dollar fell sharply in September and so far in October, regularly setting new record lows on both a financial- and trade-weighted basis. The added latest October data points are as of October 26th.



*General background note:* Historical data on both dollar series are available for download on the Alternate Data page of [www.shadowstats.com](http://www.shadowstats.com). See the July 2005 SGS for methodology.

**U.S. Dollar Indices** The Shadow Government Statistics' Financial-Weighted U.S. Dollar Index (FWD) is based on dollar exchange rates weighted for respective global currency trading volumes. For September 2007, the monthly dollar average fell by 1.83% after rising by 0.29% in August. The September 2007 average index level of 48.59 (base month of January 1985 = 100.00) was down 6.95% from September 2006, with August down 4.71% from the year before. The index has set a new historic monthly-average low, breaking below the prior low of 48.98 in April 1995. The October 26th index close was 47.04.

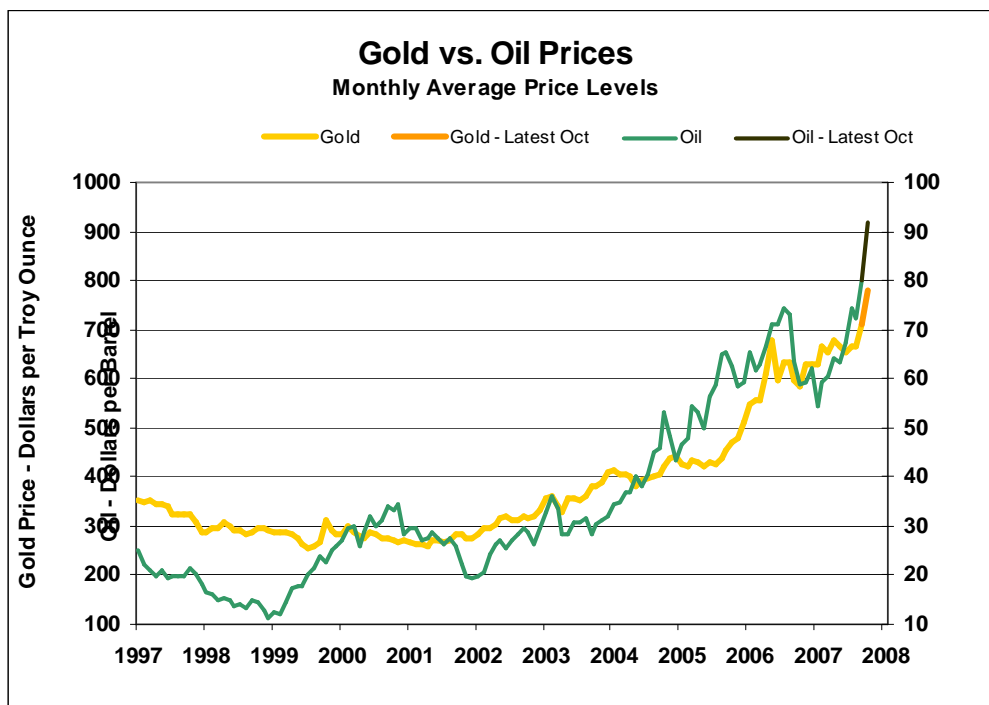
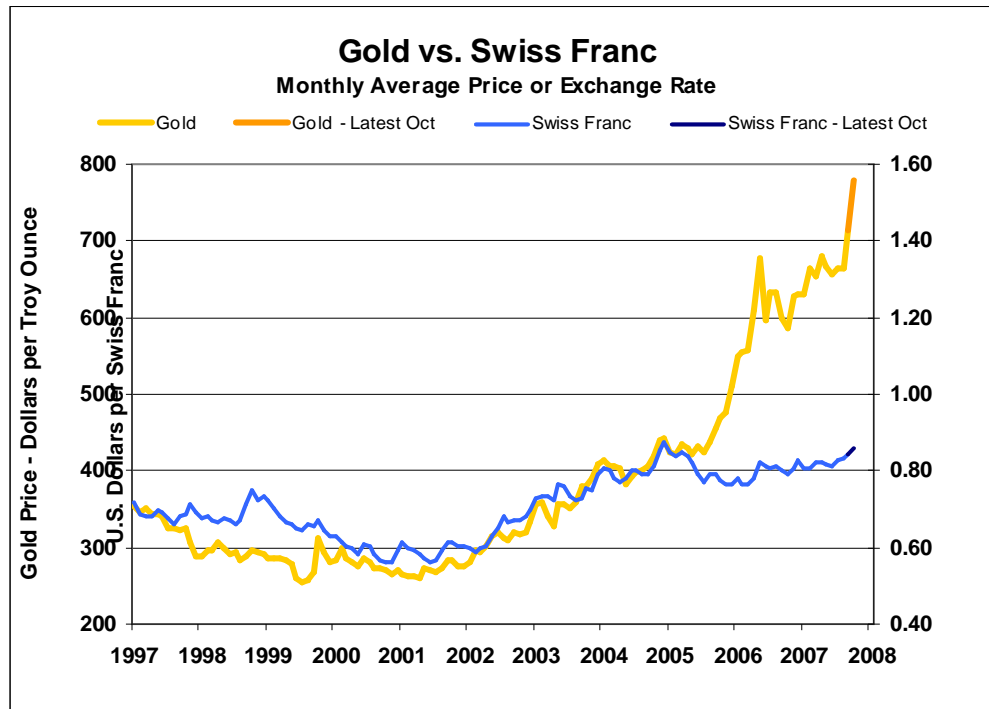
Also setting a new all-time monthly-average low, September's level of the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD) was down 2.07% from August, which, in turn, was unchanged from July. The September 2007 index level of 54.62 (base month of January 1985 = 100.00) was down 6.96% from September 2006, against August's 4.51% decline from the year before. As of October 26th, the TWD closed at 52.55.

**Gold** -- As of Friday (October 26th), London gold closed at \$779.15 per troy ounce, with silver at \$14.07. For September, the monthly-average gold price (London afternoon fix per Kitco.com) averaged \$712.65 per troy ounce, against August's \$665.41 per troy ounce. Silver averaged \$12.40 per troy ounce versus \$12.36 in August.

Gold price volatility continues, generally soaring to the upside. Of some risk here remains the possibility of covert or overt central bank intervention in tandem with intervention aimed at muting the effects of

dollar selling. Despite any central-bank machinations or intervention, the upside potential for the precious metals remains explosive, new record high prices loom.

*General background note:* As discussed in the Hyperinflation Series (see the December 2006 to March 2007 SGSs), the eventual complete collapse of the U.S. dollar -- the world's reserve currency -- will force the creation of a new international currency system. Gold likely will be structured into any replacement system, in an effort by those organizing the new currency structure to gain public acceptance.



The updated gold versus oil and Swiss franc graphs show September averages as well as added points for closing prices on October 26th. As of Friday's closing prices, gold was at \$779.15, oil at \$91.87 and the Swiss franc at \$0.86. All three measures should trade significantly higher in the months ahead.

## REPORTING PERSPECTIVE

### The Big Three Market Movers

The Fed continues to face a troubled financial system and unstable markets. Despite Wall Street pressures for further easing by the U.S. central bank, Mr. Bernanke has to be painfully aware of the risks he faces with intensified selling of the U.S. dollar. Therein lies the primary motivation for any near-term rigging of key U.S. economic data, with a likely bias to the upside for reports of economic growth. Nonetheless, the reality of a recessionary economy beset by inflation problems will continue to dominate honest economic reporting.

Also, the continued bottom bouncing of the President's positive rating adds pressure on the statistical agencies to generate upside numbers on economic growth and downside numbers on inflation. Where statistical games are being played for both the perceived political needs of the Administration and the increasingly heavy financial-market needs of an impotent Federal Reserve, the need for rigged numbers continues to border on what might be considered as national security issues.

Absent manipulation, and against lagging and still largely distorted market expectations, most near-term economic reporting should tend to surprise the markets on the downside, while most inflation reporting should continue to surprise expectations on the upside.

**Employment/Unemployment** -- As discussed in the October 7th Flash Update, the Bureau of Labor Statistics reported seasonally-adjusted September payrolls up by 110,000 (228,000 net of revisions) +/- 129,000, with August gaining 89,000 in revision, after an initial report of a 4,000 jobs loss. The report was not credible and was highly suggestive of a move to take some easing pressure off the Federal Reserve. Nonetheless, unadjusted year-to-year payroll growth slowed to 1.19% in September, from 1.23% in August. Consistent adjusted and unadjusted annual growth rates, in combination with the massive revision, suggest September would have shown a gain of 142,000. As discussed in previous newsletters, with monthly seasonal factors being readjusted each month as needed, the BLS can generate any desired result.

Nonetheless, as discussed and graphed in the Opening Comments, annual payroll growth is signaling a recession. In terms of slowing jobs growth, the last time annual payroll growth slowed to 1.2% was in February 2001, the month before the official onset of the 2001 recession. Yet annual growth already is even weaker, since these data were released along with a BLS announcement that the next benchmark revision will show that unadjusted March 2007 payrolls were overstated by roughly 297,000 jobs. That means the currently reported levels will be revised downward by perhaps 500,000 as the BLS models readjust history.

In the household survey, which counts the number of people with jobs, as opposed to the payroll survey that counts the number of jobs (including those of multiple job holders), seasonally-adjusted employment rose by 463,000 in September, following a 316,000 employment decline in August. The seasonally-adjusted September U.3 unemployment rate was reported at 4.70% +/- 0.23%, up from 4.64% in August, while unadjusted U.3 eased to 4.5% in September from 4.6% in August. The broader U.8 rate held at an adjusted 8.4% in September and fell to 8.0% from 8.4%, unadjusted. Net of the "discouraged workers" defined out of existence during the Clinton Administration, the actual unemployment rate continues to run around 12%.

The September employment gain was against a background of bottom-bouncing help-wanted advertising, rising new claims for unemployment insurance, and weak, but mixed employment numbers in the September purchasing managers surveys (see respective sections). These background numbers remain consistent with continued weakness in official jobs and unemployment reporting.

Keep in mind that the payroll data have been boosted by 1,118,000 jobs in the last 12 months by the addition of regular bias factors, a.k.a. the birth/death model. September's bias was to the upside by 17,000 jobs including 6,000 in the financial and 12,000 in the construction sectors. This bias system never has been adjusted to handle a recession, where the biases likely would turn negative. Accordingly, in the current recessionary environment, the payroll data are being significantly overstated versus underlying reality. Where the October 2006 bias factor jumped to 108,000 from 13,000 in September 2006, such suggests some upside pressure on the October 2007 payroll estimate.

**Next Release** (November 2): The October payroll survey should show intensifying economic weakness but likely will be massaged towards market expectations, or higher. Expectations seem to be set for a payroll gain below 100,000, with the unemployment rate unchanged; an outright payroll contraction would be more credible, along with rising unemployment. If the numbers come in unusually strong, as they did in September, what most likely will be at work is manipulation, as a cheap form of market intervention aimed at discouraging further speculation of Fed easing and at helping to prop the U.S. dollar.

**Gross Domestic Product (GDP)** -- The "final" estimate revision of annualized real (inflation-adjusted) growth for the second quarter of 2007 was 3.82% +/- 3%, per the Bureau of Economic Analysis (BEA), down slightly from the 3.95% reported in the "preliminary" estimate, but still up from the "advance" estimate of 3.38%. The second quarter's gain rebounded from 0.60% in the first quarter, while second-quarter year-to-year growth revised to 1.89% from the "preliminary" 1.92% and from the "advance" 1.78%, and was up from 1.55% in the first quarter. In general, the revision was little more than statistical noise.

On the inflation front, the second-quarter GDP deflator helped to spike real growth, with annualized inflation of just 2.64% in revision, previously 2.68% and 2.69%, against the 4.23% inflation pace estimated for the first quarter.

The BEA also published its revised estimates of two broad alternate GDP measures, 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 theoretically-equivalent income number that matches the



GDP's consumption number. Annualized quarterly real growth in second-quarter GNP revised to 4.01% from 3.96%, up from 0.66% in the first quarter, while second-quarter GDI revised to 4.46% from 4.38%, versus 1.17% in the first quarter.

*General background note:* Although the GDP report is the government's broadest estimate of U.S. economic activity, it is also the least meaningful and most heavily massaged of all major government economic series. Published by the BEA, it primarily has become a tool for economic propaganda. Adjusting for methodological distortions built into GDP reporting over time, the SGS-Alternate GDP measure suggests economic reality is much weaker than officially reported. Alternate year-to-year annual contractions continue, with an annual 2.3% contraction in the second quarter deepening from the 2.2% decline in the first quarter (see the graph in the Alternate Reality section of the Opening Comments).

**Next Release** (October 31): The "advance" estimate of annualized quarterly real GDP growth for the third quarter could weaken slightly, per market expectations. Reality would be a quarterly contraction, but financial-market and political considerations favor a happy upside surprise.

**Consumer Price Index (CPI)** -- The BLS reported the seasonally-adjusted September CPI-U (I.6) up by 0.27% (up 0.28% unadjusted) +/- 0.12% (95% confidence interval) for the month, compared with a drop of 0.14% (down 0.18% unadjusted) in August.

Annual inflation jumped to 2.76% in September, from 1.97% in August. Annualized year-to-date inflation through the first nine months of the year was 3.6% adjusted, 4.4% unadjusted. The accounting for both CPI-U and PPI inflation again was suspiciously shy in the areas of energy and food inflation, and reporting of so-called "core" inflation continues to appear to be managed, staying conveniently placid for the needs of the Federal Reserve.

Annual inflation for the Chain Weighted CPI-U (C-CPI-U) (I.5) -- the substitution-based series that increasingly gets touted by the manipulators as the replacement for the CPI-U, and which has no relationship whatsoever to a cost of living measure that reflects maintaining a constant standard of living -- was 2.31% in September, up from 1.86% in August.

Adjusted to pre-Clinton (1990) methodology (I.7), annual CPI growth was about 6.1%, up from 5.4% in August, while the SGS-Alternate Consumer Inflation Measure (I.8), which reverses gimmicked changes to official CPI reporting methodologies back to 1980, was roughly 10.4% in September, up from 9.9% in August. The eight levels of annual inflation, I.1 to I.8, are detailed in the table in the Alternate Reality section, along with the graph of SGS-Alternate Consumer Inflation.

**Next Release** (November 15): Assuming some pick-up in monthly inflation for October, annual inflation should spike again and continue rising into 2008. Seasonally-adjusted, monthly CPI-U fell by 0.4% in October 2006. Accordingly, any monthly reporting above or below that for the pending release of October 2007 CPI will add or subtract directly to or from the current annual CPI-U inflation rate. Reporting risks generally favor an upside surprise to market expectations, barring targeted manipulation. The renewed upside movement in core inflation remains long overdue and is highly suspect by its absence.

### Other Troubled Key Series

**Federal Deficit** -- The federal government's fiscal 2007 (fiscal year-end September 30th) accounting-gimmicked deficit narrowed to \$162.8 billion from \$248.2 billion in 2006. The U.S. Treasury's financial statement for 2007 (due mid-December), prepared based on generally accepted accounting principles (GAAP), likely will show an actual deficit in excess of \$4 trillion (it was \$4.6 trillion in 2006, up from \$3.5 trillion in 2005).

Although it lacks the accrual accounting of the GAAP numbers, the change in gross federal debt bypasses several of the reporting manipulations and is a better indicator of actual net cash outlays by the federal government than is the official, gimmicked deficit reporting. As of fiscal year-end 2007, the gross federal debt stood at \$9.007 trillion, up by \$500 billion from 2006, which was up \$574 billion from 2005.

*General background note:* The Administration and Congress continue playing bookkeeping games. Even so, the gimmicked deficit should widen in the next 12 months, as government finances begin to suffer from tax revenue losses due to the intensifying recession and relative tax receipt declines after the expiration of recent corporate tax incentives. While GDP growth estimates can be gimmicked, incoming tax receipts (based on consistently applied tax policies) remain an independent estimate of underlying economic reality and eventually will reflect the economy's mounting difficulties.

**Initial Claims for Unemployment Insurance** -- The trend in annual growth has continued to firm (an economic negative). On a smoothed basis for the 17 weeks ended October 20th, annual growth rose to 1.0%, versus the 17 weeks ended September 15th, where annual growth was 0.5%.

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

**Real Average Weekly Earnings** -- September's seasonally-adjusted monthly real earnings rose by 0.1%, following a 0.5% gain in August. Annual growth eased to 1.3% in September from 2.1% in August.

*General background note:* Gyration in the poor quality of reported CPI growth account for most month-to-month volatility in this series. Adjusting for the major upside biases built into the CPI-W inflation measure used in deflating the average weekly earnings, annual change in this series shows the average worker to be under severe financial stress in an ongoing recession.

**Retail Sales** -- September's seasonally-adjusted retail sales rose by 0.58% (up 0.68% net of revisions +/- 0.9% (95% confidence interval), after August sales gained 0.30% (previously 0.28%). Net of reported CPI inflation, September sales were up by 0.31%. On a year-to-year basis, September retail sales were up by 5.01% before inflation and by 2.55% after inflation, compared with respective annual growth numbers for August of 3.80% and 1.83%. The September data appear to have been inflated in an effort to soften pressure on the Fed for another easing.



*General background note:* Real (inflation-adjusted) year-to-year growth in retail sales below 1.8% (using the official CPI-U for deflation) signals recession, and a signal first was generated in this business cycle back in June 2006.

**Next Release** (November 14): Not only should October retail sales tumble anew, below expectations, but higher October inflation should generate real contractions on a monthly and possibly also on a year-to-year basis.

**Industrial Production** -- Seasonally-adjusted industrial production rose by 0.1% in September, following a revised unchanged August reading (previously a monthly gain of 0.2%). Annual growth in September eased to 1.90% from August's 1.98% (previously 1.69%).

**Next Release** (November 16): Look for October industrial production to decline, moving into a pattern of contraction, barring data massaging. Eventually, monthly contractions in this series should become regular, with the rapidly slowing annual growth turning negative.

**New Orders for Durable Goods** -- For September, the usually volatile durable goods orders fell by 1.7% (down by 2.3% net of revisions), seasonally adjusted, after having fallen by 5.3% in August (previously a 4.9% monthly drop). On an annual basis, durable goods orders declined by 8.4%, showing an ongoing pattern common for this series during recessions. As discussed and graphed in this month's Opening Comments, the year-to-year change in the inflation-adjusted, six-month moving average of the series is in contraction.

The closely followed nondefense capital goods new orders rose by 4.4% for the month in September, after falling by 12.2% in August. September's annual change was a decline of 12.0%.

*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** -- Again lacking credibility in an environment where the Fed would like to support the U.S. dollar any way possible, the seasonally-adjusted monthly trade deficit for August narrowed to \$57.6 billion from a revised \$59.0 billion (previously \$59.2 billion), despite picking up some of the recent surge in oil imports.

Games still are being played with data, and the current trade shortfall remains well shy of reality. Continued trade deficit underreporting may be intended to help the dollar some, with Bernanke abandoning the U.S. currency as Greenspan did in 1987. Historically, such as in 1987/1988, disruptions of import paper flows have been used to adjust initial trade deficit reporting. Revisions next year should tell the story.

**Next Release** (November 9): Underlying reality favors renewed deterioration in the monthly trade deficit, soon, possibly with the September number, barring ongoing manipulation. Reporting risk generally remains on the negative side of consensus forecasts. The months ahead should see a pattern of regularly increasing deficits that soon will be setting new records.

**Consumer Confidence** -- September and October consumer confidence measures have taken hits due to the mounting financial market and economic uncertainties. In September, the Conference Board Confidence measure fell 5.5% for the month, 5.8% year-to-year. The University of Michigan Sentiment measure was unchanged for September; it fell by 3.0% in October and was down 5.1% year-to-year. The October Conference Board measure will be published on October 30th.

These lagging, not leading, indicators tend to reflect the tone of the popular financial media and are showing renewed concern as to faltering business activity.

*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 Michigan survey is unadjusted. How does one seasonally-adjust peoples' attitudes? Also, beware the mid-month Consumer Sentiment release from the University of Michigan. Its sampling base is so small as to be virtually valueless in terms of statistical significance.

**Short-Term Credit Measures** -- Patterns of annual growth in commercial borrowing have been altered by the liquidity crisis, with a sharp fall-off in annual growth for commercial paper outstanding being countered somewhat by a rise in commercial and industrial bank loans. Consumer credit numbers show no impact, so far.

For seasonally-adjusted consumer credit, which includes credit cards and auto loans, but not mortgages, annual growth held at a soft 4.8% in August, same as in July, down from 5.0% in June. 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 in consumer debt expansion keeps an ongoing constraint on economic growth.

Commercial borrowing growth varied sharply, again, with annual growth in September commercial paper outstanding showing a 0.8% decline, down from a 4.7% gain in August and a 21.7% gain in July. In contrast, annual growth in commercial and industrial loans rose to 16.5%, after 12.9% annual gains in both August and July. The problems in commercial paper, though somewhat stabilized, will place a dent in broad business activity.

**Producer Price Index (PPI)** -- The seasonally-adjusted September finished goods PPI rose by 1.1% (1.0% unadjusted) after declining by 1.4% (down by 1.4% unadjusted) in August. Annual PPI in September doubled to 4.4% from August's 2.2%. Seasonally-adjusted intermediate and crude goods rose 0.4% and 0.1%, respectively for the month, after declining by 1.2% and 2.0% in August.

**Next Release** (November 14): Despite the regular random volatility of the monthly price variations, PPI inflation reporting over the next six-to-nine months generally should come in above market expectations, partially as a result of the rapid rise in the price of oil. As with the CPI, the core PPI inflation rate still is long overdue for an upside surprise, but such may be further delayed by the financial-market needs of the battered Federal Reserve.

### **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** -- Continuing to catch up and maintaining its trend toward showing a recession in manufacturing, the overall September ISM manufacturing eased to 52.0 from 52.9 in August, with the September employment index notching to 51.7 from 51.3 in August. Accelerating decline in the broad series is a good bet in the next several months, based on further declines in annual activity in a variety of underlying series.

The September new orders index dropped to 53.4 from 55.3 in August. Seasonal-factor distortions, which have been present, usually are overcome by viewing the series using year-to-year change on a three-month moving average basis. On that basis, the September new orders index was up by just 1.1% versus a 3.3% gain in August.

*General background note:* Published by the Institute for Supply Management (ISM), the new orders component of the purchasing managers survey is a particularly valuable indicator of economic activity. The index is a diffusion index, where a reading below 50.0 indicates contracting new orders. The index gradually has notched lower from its peak annual growth of 42.6% in April of 2004. As an SGS early warning indicator of a major economic shift, the new orders measure breached its fail-safe point in mid-2005, generating a signal of pending recession.

**Service Sector Index.** The service-sector ISM index does not have much meaning related to overall business activity, since new order activity at law firms, hospitals or fast-food restaurants has little obvious relationship to broad economic activity. That said, the overall September services sector index fell to 54.8 from August's 55.8. Both the services employment and prices paid components, however, have some meaning. The September employment component rebounded to 52.7 from 47.9 in August. The prices paid component is covered in the Inflation Indicators.

**Help-Wanted Advertising Index (HWA)** -- The Conference Board reported that seasonally-adjusted help-wanted advertising bottom bounced in September after hitting a five decade low in August. September's reading of 24.0 notched up from August's 23.0 nadir. Even allowing for the advertising volume lost to the Internet in recent years, the current weakness is severe enough to signal a deepening problem in the employment sector. The September number was down 17.2% from the year before, versus a 23.3% annual contraction August.

Viewed on a three-month moving-average basis, September's year-to-year contraction was 20.0% versus 20.4% in August. The series still indicates rapidly deteriorating employment conditions. Where the index never recovered from the 2000/2001 recession, its renewed and ongoing plunge has signaled a new and rapid contraction in economic activity. Continued deterioration remains likely in the months ahead.

**Housing Starts** -- September's seasonally-adjusted housing starts fell by 10.2% +/- 10% (95% confidence interval) for the month, after a decline of 3.2% (was 2.6%) in August. As discussed and graphed in this

month's Opening Comments, September's level was down 30.8% from the year before, beginning to reflect the impact of the subprime mortgage crisis and suggestive of an intensifying recession.

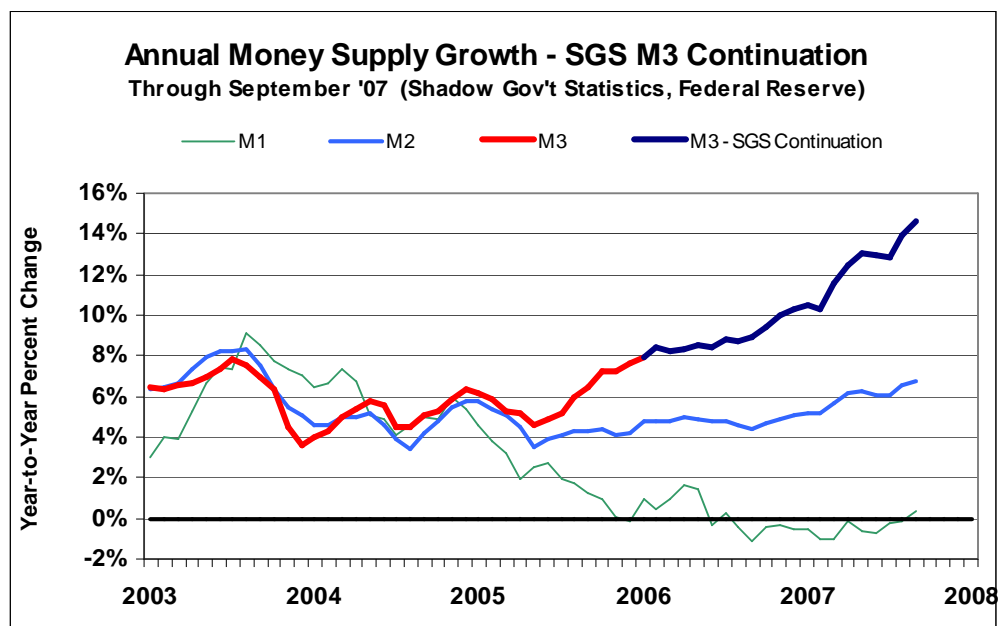
Confirming ongoing weakness in the housing sector, year-to-year contractions in September were 25.9% for building permits, 19.1% for existing home sales and 23.3% for new home sales. The new home sales number reflected an extraordinary 7.5% down revision to the prior month's level, which had the effect of making the monthly change look like a gain.

### ***Inflation Indicators***

**Money Supply** -- The SGS Ongoing M3 estimate of annual growth for September showed annual growth at 14.7%, up from 13.9% in August. The September growth rate is the highest since November 1971, two months after Richard Nixon closed the gold window. The current pace of growth has disturbing inflationary implications.

Some subscribers have asked where the M3 growth is being seen. Some growth reflects the shifting of certain commercial paper funding to commercial bank loans (see the Short-Term Credit section). Some reflects movement out of M2 into M3 accounts. Some reflects liquefaction actions by the Fed, including handling other foreign central bank investments in U.S. Treasuries.

Keep in mind that our numbers reflect year-to-year changes and may not necessarily mirror not seasonally adjusted week-to-week activity by the Fed. Among the M3-related components, as reported by the Fed, seasonally-adjusted large time deposits at commercial banks have risen by roughly \$95 billion in the most recent four weeks, where institutional money funds have picked up about \$70 billion in the same period.



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

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

Feb 06	10.349	Jul 06	10.643	Dec 06	11.228	May 07	11.877
Mar	10.366	Aug	10.750	Jan 07	11.318	Jun	11.930
Apr	10.436	Sep	10.867	Feb	11.419	Jul	12.014
May	10.509	Oct	11.002	Mar	11.563	Aug	12.243
Jun	10.565	Nov	11.112	Apr	11.738	Sep	12.461

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

Based on the September data, annual growth for monthly M1 turned to the plus side by 0.40%, after being down by 0.15% in August, while September M2 annual growth rose to 6.72% from 6.58% in July.

**Purchasing Managers Surveys: Prices Paid Indices** -- The September prices paid indices were mixed and still not reflective of the ongoing surge in oil prices, which should show up in the next month or so. The levels, however, remain high and in inflation territory, suggestive of ongoing inflation issues in both purchasing managers surveys.

On the manufacturing side, the September price index eased to 59.0 from 63.0 in August. On a three-month moving average basis, September's annual change was down by 29.1%, following August's 14.0% drop. The manufacturing price indicator is not seasonally adjusted and, therefore, is a generally the better indicator of pricing activity.

On the non-manufacturing side, the seasonally-adjusted September prices diffusion index jumped to 66.1 from August's 58.6. On a three-month moving-average basis September's annual change was a decline of 8.0% after August's 14.3% drop.

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

**Oil Prices** -- For the month of September, the monthly-average West Texas Intermediate spot price (Department of Energy) jumped 10.4% from August to a record high \$79.93 per barrel. Against last year's average, September's level was up by 25.1%, compared with August's 0.9% annual decline.

As of Friday, October 26th, West Texas Intermediate closed at another all-time high of \$91.87. Price movement remains highly volatile, but broadly is trending higher, and should continue setting new daily record highs, with \$100 oil being widely touted in the market place. Even current levels, however, are an absolute disaster for pending U.S. inflation. Regardless of any near-term price swings, meaningful upside risks to oil prices remain in place, both from the intensifying dollar weakness and related OPEC rumblings, and from ever-volatile Middle Eastern political tensions.

*General background note:* Whether from supply and demand, geo-political or currency pressures, oil prices will remain at highly inflationary levels and will continue as a major contributing factor to U.S. inflation woes. Historically high oil prices still are working their way through all levels of U.S. economic activity, ranging from transportation and energy costs, to material costs in the plastics, pharmaceutical, fertilizer, chemical industries, etc. These broad inflationary pressures will remain intact despite any near-term oil price volatility. Although these pressures may be slow to surface in government reporting of the so-called "core" inflation measures, they will surface.

### **Reporting/Market Focus**

#### **Some Perspective on Historical U.S. Economic Downturns and Financial Market Panics**

The table that follows is an updated version of one I published 15 years ago, covering the history of economic downturns in the United States. It also covers most of the notable financial panics, which also were associated with business contractions. The notable exception is the 1987 stock market crash, discussed later.

Prior to the Great Depression, economic contractions generally were called depressions. Recession, which is the down-phase of a depression, is the euphemism for an economic downturn, which came into use post-World War II.

The main body of the table represents about as close to an official or consensus picture that I can put together. The second portion of the table gives a slightly different SGS Version.

## United States of America - Economic Contractions, 1784 to Date

President When It Began	Peak-to-Trough Of Cycle	Months	Change In GNP	Nature	Background
Pre- Constitution	1784 to 1789	48	Severe	Str/Liq	Post-Revolution. No central authority, lack of sound money, excessive trade deficit.
Jefferson	1807 to 1810	24	-20%	Exg	European war blocked shipments of goods to the United States.
Madison	1815 to 1821	60	-15%	Str/Liq	Post-War of 1812. Debt excesses led to currency inflation, then debt/liquidity collapse and severe deflation.
Van Buren	1837 to 1843	60	-25%	Liq/Str	Excess debt and currency inflation fueled by speculative lending out of England. U.S. crop failure and English banking crisis led to debt and liquidity collapse.
Polk	1847 to 1848	12	-4%	Exg	Post-Mexican War. Effect of severe European depression was offset partially by raised expectations from discovery of gold in California.
Buchanan-I	Jun 1857 to Dec 1858	18	-12%	Liq	Banking crisis and liquidity collapse.
Buchanan-II	Oct 1860 to June 1861	8	-10%	Str	Tied to secession movement.
Lincoln/ A Johnson	Apr 1865 to Dec 1867	32	-13%	Str/Liq	Post-Civil War. Retirement of greenbacks and English Panic.
Grant-I	June 1869 to Dec 1870	18	-5%	Str/Liq	Secondary downturn following Civil War. "Black Friday" panic from Gould & Fiske's efforts to corner the gold market.



President When It Began	Peak-to-Trough Of Cycle	Months	Change In GNP	Nature	Background
Grant-II	Oct 1873 to Mar 1879	65	-15%	Liq/Str	Over-building of rail-roads. Over-extension of debt. Foreign funding collapse with Vienna Panic of 1873. Collapse of savings banks. Fear of currency debasement.
Arthur	Mar 1882 to May 1885	38	-12%	Liq	French Panic of 1882. Collapse of commodity prices. Silver and stock panics of 1884.
Cleveland-I	Mar 1887 to Apr 1888	13	-4%	Liq	Government paid off debt, forcing reduction of circulating banknotes.
B Harrison	Jul 1890 to May 1891	10	-3%	Liq	Baring Panic in England forced liquidation of foreign holdings of U.S. stocks.
Cleveland-II	Jan 1893 to Jun 1894	17	-16%	Liq	Failure of Reading Railroad triggered panic.
Cleveland-III	Dec 1895 to Jun 1897	18	-15%	Liq/Inv	Lack of confidence in currency system.
McKinley	Jun 1899 to Dec 1900	18	-4%	Liq	German stock market panic of 1899.
T Roosevelt-I	Sep 1902 to Aug 1904	23	-10%	Liq/Inv	Temporary layoffs. "Rich Man's Panic" of 1903/04.
T Roosevelt-II	May 1907 to Jun 1908	13	-15%	Liq/Exg	1906 San Francisco earthquake. March 1907 panic and banking crisis.
Taft	Jan 1910 to Jan 1912	24	-5%	Exg	Increasing government regulation of railroads and trusts.
Wilson-I	Jan 1913 to Dec 1914	23	-13%	Exg/Liq	Collapse of foreign markets, loss of foreign liquidity as World War I broke out. Stock market closed.
Wilson-II	Aug 1918 to Mar 1919	7	-5%	Str	Post-World War I. Over-production of war goods, not enough jobs.



## Shadow Government Statistics October 2007

<b>President When It Began</b>	<b>Peak-to-Trough Of Cycle</b>	<b>Months</b>	<b>Change In GNP</b>	<b>Nature</b>	<b>Background</b>
Wilson-III	Jan 1920 to Jul 1921	18	-9%	Inv/Liq	Commodity inflation/ deflation, sugar scandal.
Harding	May 1923 to Jul 1924	14	-4%	Inv	Inventory lay-offs.
Coolidge	Oct 1926 to Nov 1927	13	-2%	Inv/Liq	Real estate bust. Bank failures. Automobile over-production.
Hoover	Aug 1929 to Mar 1933	43	-33%	Str/Liq	The Great Depression. Collapse of debt excesses from 1920s and liquidity crisis. Stock crash. Banking collapse. Industrial restructuring as long-term aftershock of Panama Canal construction and World War I. Permanent job loss. Overbuilding. Extreme income variance.
F Roosevelt-I	May 1937 to Jun 1938	13	-18%	Str	Second-dip of Great Depression.
F Roosevelt-II	Feb 1945 to Oct 1945	8	-21%	Str	Post-World War II. Start of conversion to peace- time economy.
Truman	Nov 1948 to Oct 1949	11	-2%	Inv	Residual post-war reconversion, recoil from excess post-war production.
Eisenhower-I	Jul 1953 to May 1954	10	-3%	Inv	Post-Korean War.
Eisenhower-II	Aug 1957 to Apr 1958	8	-3%	Str	Delayed post-war downturn ended with Sputnik.
Eisenhower-III	Apr 1960 to Feb 1961	10	-1%	Inv/Exg	105-day steel strike.
Nixon-I	Dec 1969 to Nov 1970	11	-1%	Inv	Cyclical blow-off of "Guns and Butter" era.
Nixon-II	Nov 1973 to Mar 1975	16	-5%	Str/Exg Liq	Post-Vietnam War. Oil embargo. Aftermath of wage and price controls and U.S. dollar flotation.
Carter	Jan 1980 to Jul 1980	6	-3%	Liq	Disruption from credit card controls.

## Shadow Government Statistics October 2007

<b>President When It Began</b>	<b>Peak-to-Trough Of Cycle</b>	<b>Months</b>	<b>Change In GNP</b>	<b>Nature</b>	<b>Background</b>
Reagan	Jul 1981 to Nov 1982	16	-3%	Inv	Inflationary environment that led to high interest rates.
Bush Sr	Jul 1990 to Mar 1991	8	-2%	Inv/Exg	Started with Iraq invading Kuwait and ended with Gulf War I, as consumer pulled back and then returned. (See SGS Version: Bush Sr.)
Bush Jr	Mar 2001 to Nov 2001	8	less than 1% con- trac- tion	Liq	Driven by collapse in stock-market bubble. (See SGS Version: Clinton-II.)

### *SGS VERSION Since 1981*

<i>Reagan-I</i>	<i>Jul 1981 to Nov 1982</i>	<i>16</i>	<i>-3%</i>	<i>Inv</i>	<i>Inflationary environment that led to high interest rates.</i>
<i>Reagan-II</i>	<i>4th-Q 1986 to 3rd-Q 1987</i>	<i>11</i>	<i>-1%</i>	<i>Str/Liq</i>	<i>(See text.)</i>
<i>Bush Sr</i>	<i>4th-Q 1989 to 2nd-Q 1993</i>	<i>42</i>	<i>-4%</i>	<i>Str/Liq</i>	<i>(See text.)</i>
<i>Clinton-I</i>	<i>1995</i>	<i>9</i>	<i>-1%</i>	<i>Str</i>	<i>(See text.)</i>
<i>Clinton-II</i>	<i>3rd-Qtr 2000 to 3rd-Qtr 2003</i>	<i>36</i>	<i>-4%</i>	<i>Liq/Str</i>	<i>(See text.)</i>
<i>Bush Jr</i>	<i>3rd-Qtr 2006 to (ongoing)</i>	<i>12+</i>	<i>-4%+</i>	<i>Str/Liq</i>	<i>(See text.)</i>

### Notes:

All estimates of timing and depth are approximate. GNP is used throughout for consistency; GDP is GNP net of international transactions in factor income (interest and dividends).

**Nature of contraction:** Structural (Str), Liquidity (Liq), Inventory (Inv), Exogenous (Exg).

Various sources have been combined.

**Peak-to-Trough:** Before 1857 - Business Cycles and Forecasting, Elmer C. Bratt (Bratt), 1940. 1857 and after - National Bureau of Economic

Research (NBER) as published on their Web site (<http://www.nber.org/cycles.html/>).

**Months:** Before 1857 - Bratt, 1857 and after - NBER.

**Depth, Nature and Background:** Percentage change shown is the approximate peak-to-tough decline in economic activity as measured in constant-dollar GNP. 1784 to 1937 - Bratt, 1790 to 1987 - Ameritrust, Cleveland, Ohio (estimated as a percent variation from a projected economic trend line), 1867 to 1960 - A monetary History of the United States, 1867-1960, Milton Friedman and Anna Jacobson Schwartz, 1963, 1900 to 1995 - Albert Sindlinger, Sindlinger & Co., Wallingford, Pennsylvania, 1920 to 1993 - Center for International Business Cycle Research, Columbia Business School, 1929 to date - Bureau of Economic Analysis (BEA), full period and SGS Version - [www.shadowstats.com](http://www.shadowstats.com).  
[/table]

**Structural Changes and Liquidity Problems Dominate Economic History.** Major economic and financial market upheavals usually reflect a confluence of factors. Leading up to the Great Depression, for example, the U.S. manufacturing sector had been in contraction as result of the loss of production after World War I and after the completion of the Panama Canal. The U.S. economy already was in contraction prior to the 1929 stock crash, but it was the liquidity implosion that followed the financial panic, combined with the structural change in the economy, which enabled the scope and depth of the Great Depression.

Starting with the loss of the U.S. manufacturing base to offshore facilities in the 1970s, the U.S. economy began a long-term structural change that still is ongoing and that has provided a base for many of the economic difficulties since the 1980s. With a confluence of factors ranging from accelerating dollar weakness to a period of economic weakness, the issues came to a head with the stock-market crash and liquidity panic of 1987. Alan Greenspan was the new Fed chairman, and he decided to abandon any support of the U.S. dollar in favor of stabilizing and salvaging the domestic financial markets and financial services industry.

Gerald Corrigan of the New York Fed, the entity that usually handled the various financial markets for the Federal Reserve Board, led the initial charge. Though never officially confirmed, the New York Fed worked an arrangement with a major New York investment house to buy stock futures on the second day of the stock crash, with the effect of rallying the market and bringing it back to life. Out of this action evolved the present day Plunge Protection Team, which still is active in managing unstable or disorderly financial market conditions.

The Fed did everything it could to forestall a further day of reckoning that loomed because of ever increasing trade and fiscal imbalances, along with an increasing dependence on foreign capital for the liquidity of the U.S. markets. Due to Greenspan papering over these issues, the same problems now are at uncontainable levels that threaten basic stability of the U.S. financial system and eventually the very existence of the U.S. dollar as the world's reserve currency.

As the structural economic changes intensified, the average U.S. consumer found it increasingly difficult to make ends meet. An additional family member might end up working, but even that failed to keep the average household ahead of inflation. The difference in consumption was made up in debt expansion, which ultimately is an unsustainable process.

Without sustained growth in real (inflation-adjusted) income, there cannot be sustained economic growth. Aware of that, Greenspan helped to fuel a stock-market bubble, which had the short-lived result of fueling wealth-effect consumption. When that bubble burst and helped to trigger the 2000 recession, he tried the same gimmick with home prices. Such enabled increased home equity lending, but the bubble burst there now is exacerbating the current downturn.

The problem now is that there is little further the Fed can gimmick. A long-delayed day of reckoning is nearing, and its impact on the financial markets and economic activity will not be pretty.

### **Upcoming Reporting/Market Focus for November -- Home Sales**

With home sales and related construction activity such a hot topic in the current environment, the various related economic series will be revisited and the developing circumstance assessed.

---

*PLEASE NOTE: The Hyperinflation Summary Report still is pending and may be released in conjunction with the November newsletter. The November "Shadow Government Statistics" newsletter currently is targeted for the week of November 12th, likely a day or two after the CPI release on November 15th. Postings on the Web site of monthly newsletters, interim Flash Updates and Alerts are advised immediately by e-mail.*

*OCCASIONALLY, BRIEF UPDATES ARE COMMUNICATED DIRECTLY BY E-MAIL. IF YOU ARE NOT RECEIVING E-MAIL COMMUNICATIONS FROM US, PLEASE LET US KNOW at [johnwilliams@shadowstats.com](mailto:johnwilliams@shadowstats.com) or by using the Feedback option on [www.shadowstats.com](http://www.shadowstats.com).*