The $12 Trillion Federal Debt Bombshell

By Michael J. Kosares - Goldcore

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"Investment in gold now is insurance. It's not for short-term gain, but for long-term protection. I view gold as the primary global currency. It is the only currency, along with silver, that does not require a counter-party signature. Gold, however, has always been far more valuable per ounce than silver. No one refuses gold as payment to discharge an obligation. Credit instruments and fiat currency depend on the credit worthiness of a counter-party. Gold, along with silver, is one of the only currencies that has an intrinsic value. It has always been that way. No one questions its value, and it has always been a valuable commodity, first coined in Asia Minor in 600 BC." – Alan Greenspan, former Fed chairman

In a recent Financial Times editorial, Gillian Tett, who rose to prominence for her coverage of the 2008 financial crisis, raised the question of financing the U.S. debt. Headlined *America faces a battle to find buyers for its bonds*, her article begins by referencing a letter to Secretary Mnuchin from Beth Hammack, a Goldman Sachs banker who also chairs the Treasury Bond Advisory Committee. The letter, she says, contains a bombshell:

"According to TBAC calculations, America will need to sell an eye-popping $12 trillion of bonds in the coming decade, sharply more than it did in the past 10 years. This will 'post a unique challenge for the Treasury, Ms. Hammack warned, even 'without the possibility of a recession'. In plain English, the Wall Street luminaries on the committee were asking who on earth – or in global finance – will buy this looming mountain of Treasuries." [LINK]

When Jerome Powell and the president sat down for dinner at the White House in early February one wonders what was on the agenda. Treasury Secretary Steven Mnuchin, who also attended the dinner along with Fed vice-chair Richard Clarida, joked that having the Fed chairman over to dinner was "somewhat of a covert operation … so it didn't create speculation." The Fed press statement that followed went to great lengths to assure Wall Street and the rest of the world that nothing of consequence happened. Individuals at this level of government, though, do not have hastily-called, high-profile meetings at the White House simply to socialize and attend to their friendship.

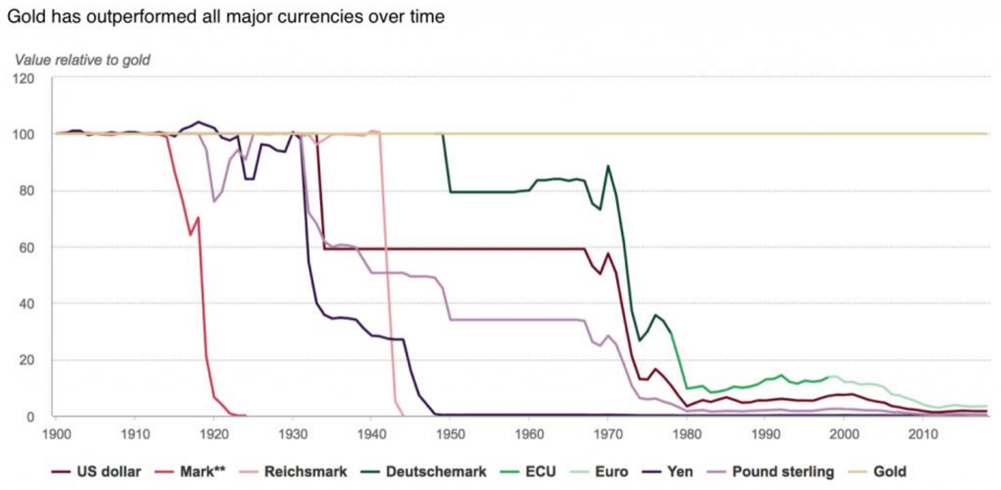
The rhinoceros in the room could very well have been how the federal government will go about financing the $12 trillion in debt Goldman's Beth Hammack earlier brought to the Treasury Secretary's attention and what role the Federal Reserve intends to play in the process. China and Japan, America's two largest financiers by far, have withdrawn from the market and there is no certainty as to when they might return. That leaves domestic U.S. private investors and financial institutions to fill the yawning gap and, failing that, the Federal Reserve with a new round of quantitative easing.

How the $12 trillion debt bombshell is handled will carry very large implications for the stock and bond markets, the value of the dollar and consequently the price of gold. Some would say we are a long way from another round of quantitative easing, but we will remind our readers it was only a few months ago that we were assured of at least two additional rate hikes in 2019 and stepped-up quantitative tightening. Circumstances and response, as we have seen over the past few weeks, can change in a heartbeat. Ominously, San Francisco Federal Reserve president Mary Daly told reporters last week that the Fed is considering quantitative easing as a permanent option in the monetary toolkit and not, as Bloomberg put it, "just as a last-ditch measure to deploy in emergencies." (Please see *Balance Sheet Could Be in Regular Fed Toolkit*/Bloomberg/2-8-2019)

We end with a timeless observation from the now-deceased Richard Russell (Dow Theory Letter):

"Paper money is now being created wholesale throughout the world. Stated simply, all paper currency is now valued against each other. But more important, ultimately ALL paper is ultimately valued against the only true, intrinsic money – gold. In world history, no irredeemable paper currency has ever survived. Since all the world's currency is now irredeemable (in gold), this means that in the end, the only form of money that will survive is real intrinsic money – gold. It's not a question of whether gold will survive, it's a question of when the world's current paper money will deteriorate and finally die. I can tell you that irredeemable paper will not survive – but obviously I can't tell you when it will die. The timing is the only uncertainty."

The chart below from the World Gold Council speaks to Russell's point. It shows the performance of various currencies – past and present – against gold over the long term. When the end comes, as the chart illustrates, it can come abruptly and without warning. For those who stick to the proposition that gold is not *really* an inflation hedge, or that it is not *really* a safe-haven against currency debasement, the chart offers instruction. For those who already own gold as a safe-haven, it provides justification. For those who do not own gold, it serves as an incentive. As the old saying goes: *All is well until it isn't*.



Sources: Bloomberg, Harold Marcuse, UC Santa Barbara, World Gold Council

Chart courtesy of the World Gold Council