

# forest for the trees

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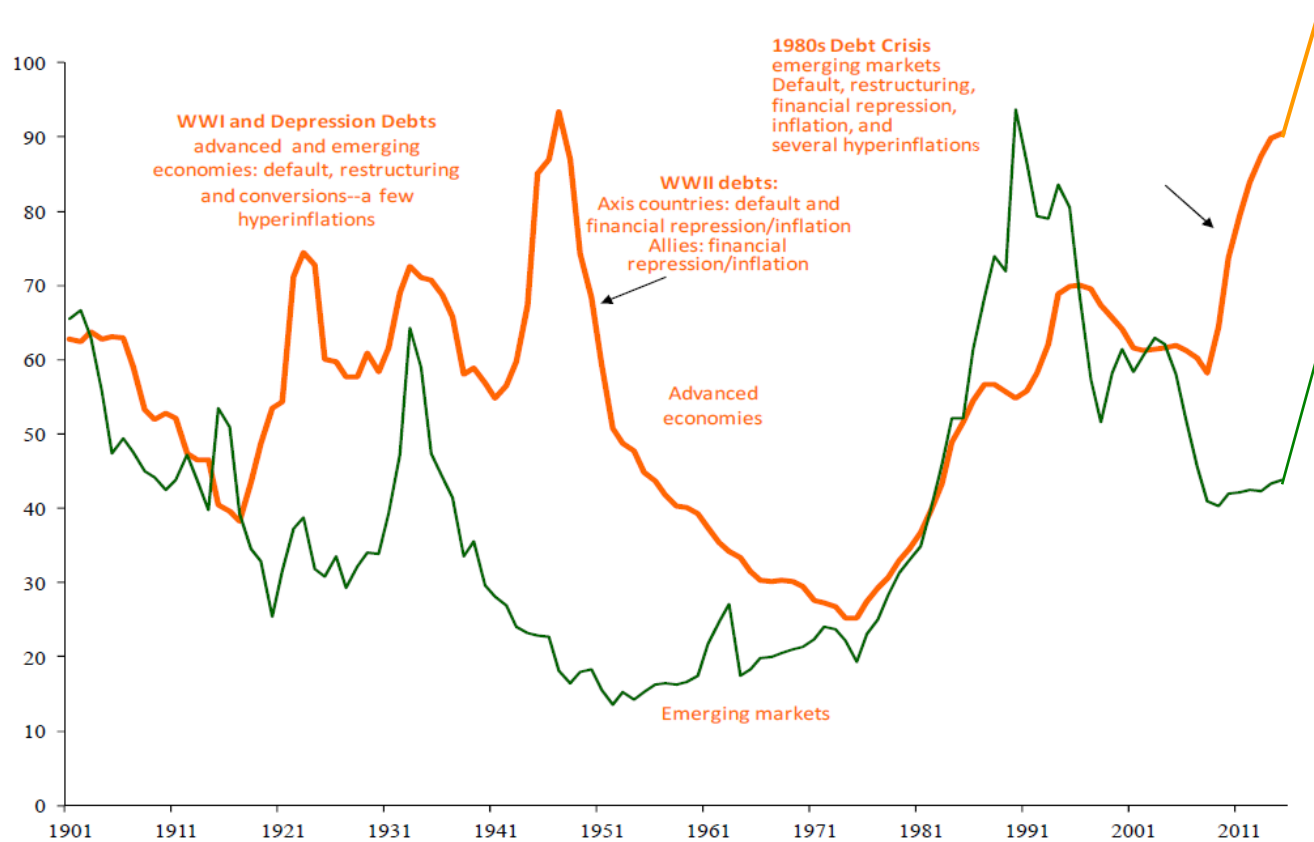
“WHY GOLD?” STATE OF UTAH PRESENTATION

MAY 29, 2024

[FFTT-LLC.COM](http://FFTT-LLC.COM)

First global sovereign debt bubble in 80-100 years...but this time centered in the west.  
*For 120+ years this has been resolved via default/restructuring or inflation (& a few hyperinflations)*

**Figure 1: Surges in Central Government Public Debts and their Resolution: Advanced Economies and Emerging Markets, 1900–2012**



Sources: Reinhart and Rogoff (2009 and updates), sources cited therein and the authors.

*“Since 1800, 51 out of 52 countries with gross government debt greater than 130% have defaulted, either through restructuring, devaluation, high inflation or outright default.”*

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## Hirschmann Capital

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### **Government Default Seems Unavoidable**

Since 1800, 51 out of 52 countries with gross government debt greater than 130% have defaulted, either through restructuring, devaluation, high inflation or outright default.<sup>1</sup> Examples are shown in an endnote.<sup>2</sup> The IMF expects US government (USG) debt to GDP to be a record 141% by year-end 2020. (See chart in an endnote.<sup>3</sup>) There is little reason the USG should not also default (see [year-end 2016 letter](#)).

Since 2008, the Fed has been buying assets by issuing short-term debt. (Interest-bearing deposits held at the Fed are equivalent to short-term debt issued by the Fed.<sup>4</sup>) In effect, the Fed has been executing a highly-leveraged carry trade by borrowing to purchase higher-yielding government, agency and corporate bonds.

# Examples

## Endnotes

<sup>1</sup> Present day Japan is the only example of a country avoiding default despite having government debt greater than 130% of GDP. However, as discussed in [our year-end 2016 letter](#), a Japanese default seems inevitable.

<sup>2</sup>

**Government Default Study Examples**

Country	Year 130% Threshold Crossed	Default Year	Default Type	Default Cause
Argentina	1827	1827	Outright default	Independence
Spain	1869	1877	Restructuring	Revolution
Turkey	1872	1876	Outright default	Drought and floods
UK	1919	1931	Devaluation	World War I
France	1920	1920	High inflation	World War I
Germany	1918	1922	Hyperinflation	World War I
Japan	1943	1943	Various	World War II
Australia	1945	1946	High inflation	World War II
Canada	1946	1946	High inflation	World War II
Ghana	1960	1966	Restructuring	Lower exports
Costa Rica	1981	1981	Outright default	Lower exports
Greece	2010	2010	Bailout	2008 Financial Crisis

Source: Reinhart and Rogoff, RIETI Japan, Bloomberg, HC estimates


# November 2013: China announces it will stop growing holdings of USTs


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## PBOC Says No Longer in China's Interest to Increase Reserves

By Bloomberg News

November 21, 2013 at 3:52 AM EST

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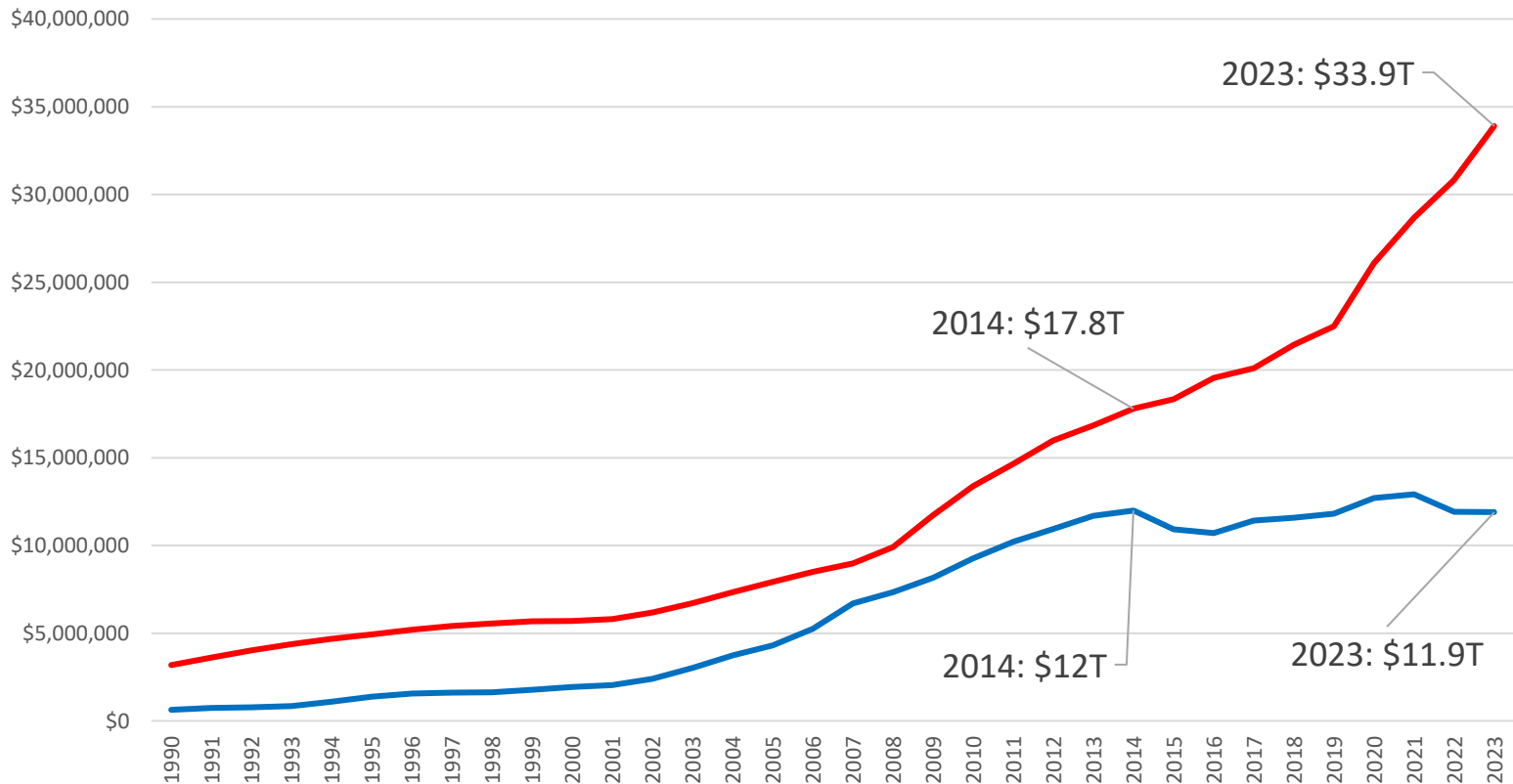
 This article is for **subscribers only**.

The People's Bank of China said the country does not benefit any more from increases in its foreign-currency holdings, adding to signs policy makers will rein in dollar purchases that limit the yuan's appreciation.

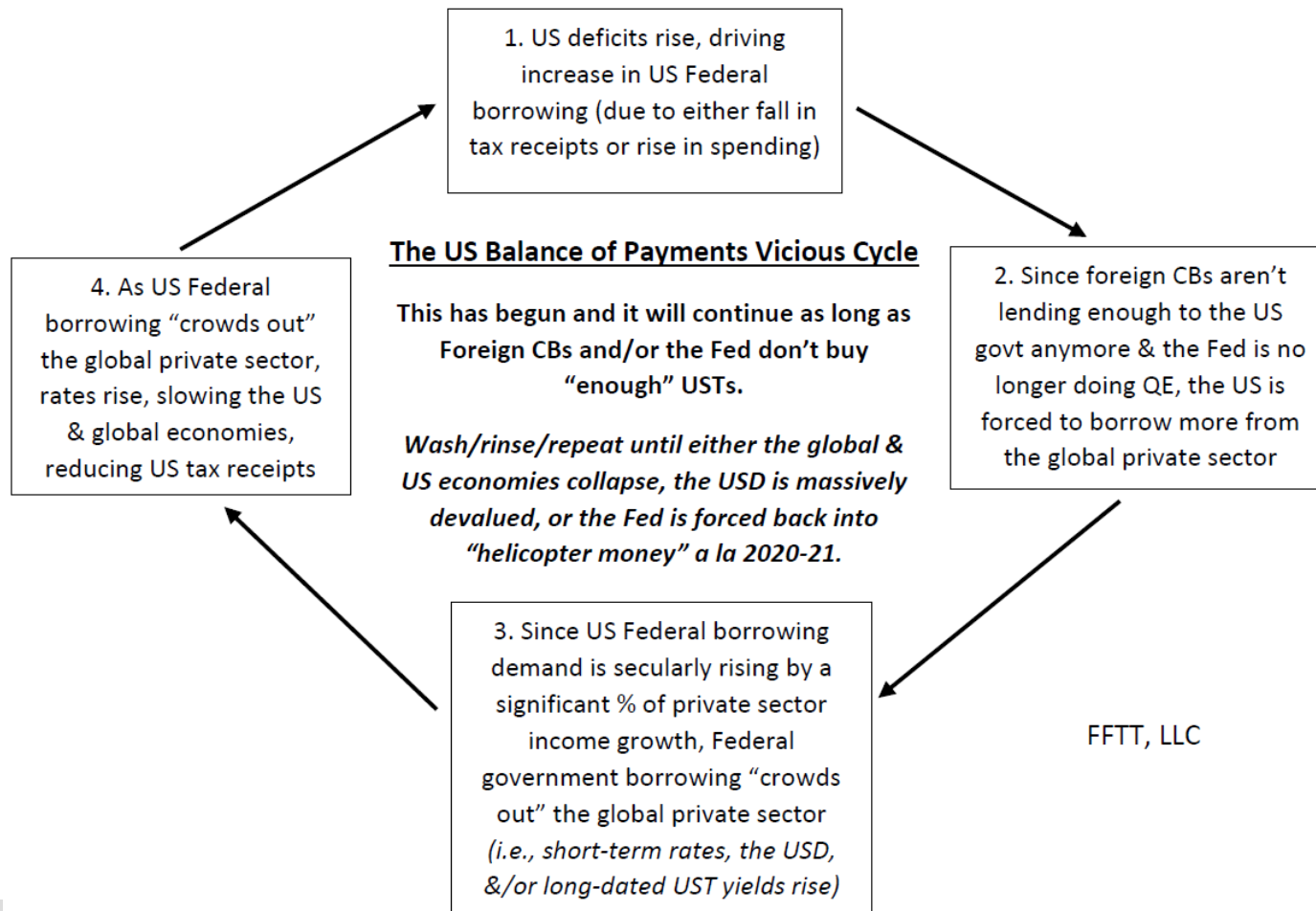
# Global Central Bank FX reserves stopped growing in 2014; UST issuance... didn't.

Global FX Reserves (blue) v. US Federal Debt (red)

Source: IMF, Federal Reserve, FTTT LLC

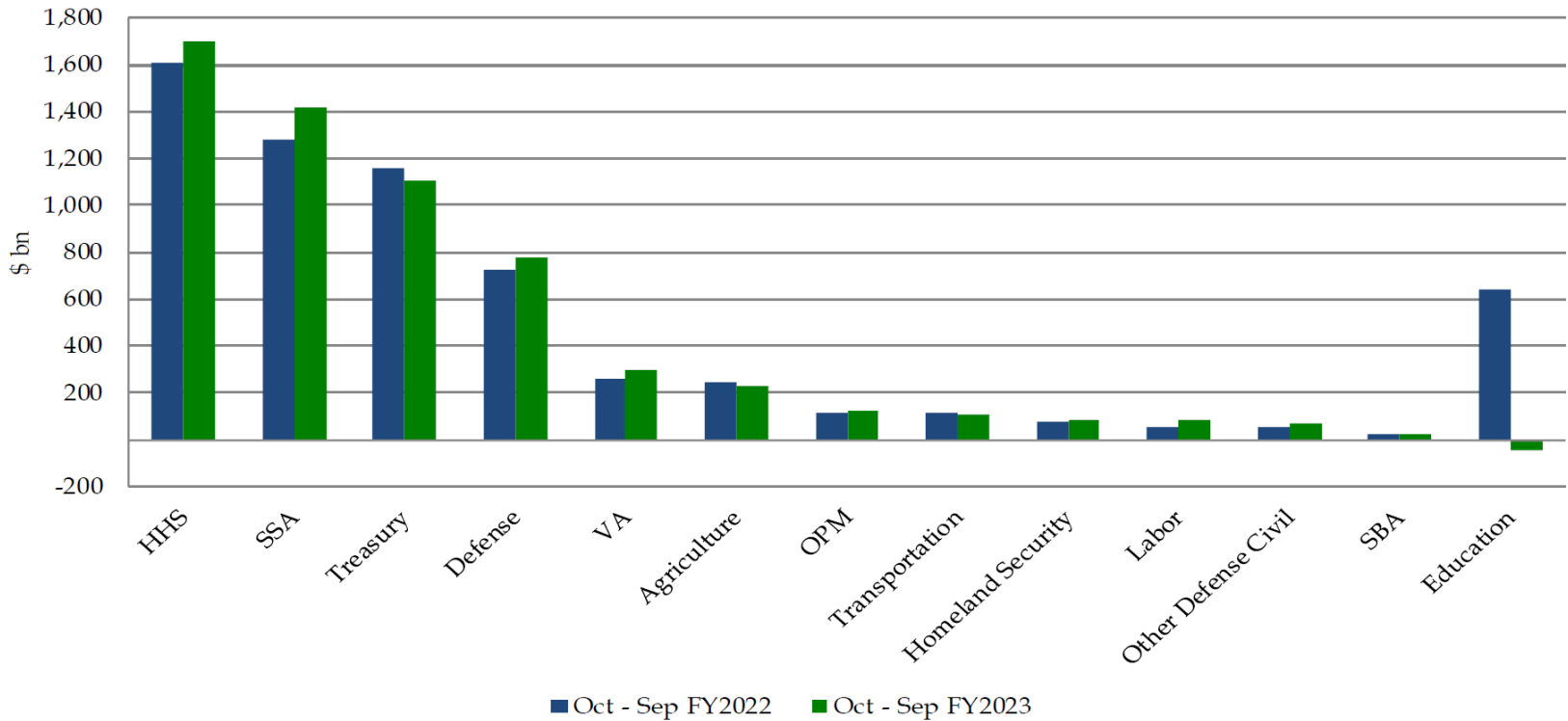


Foreign Central Banks ceasing to buy USTs while US Federal debt level rose exponentially activated this vortex; this vortex spins until US policymakers supply more USD liquidity under the auspices of “preventing UST market dysfunction.”



# Entitlements + Interest Expense now by far the biggest US expenditures

## Largest Outlays

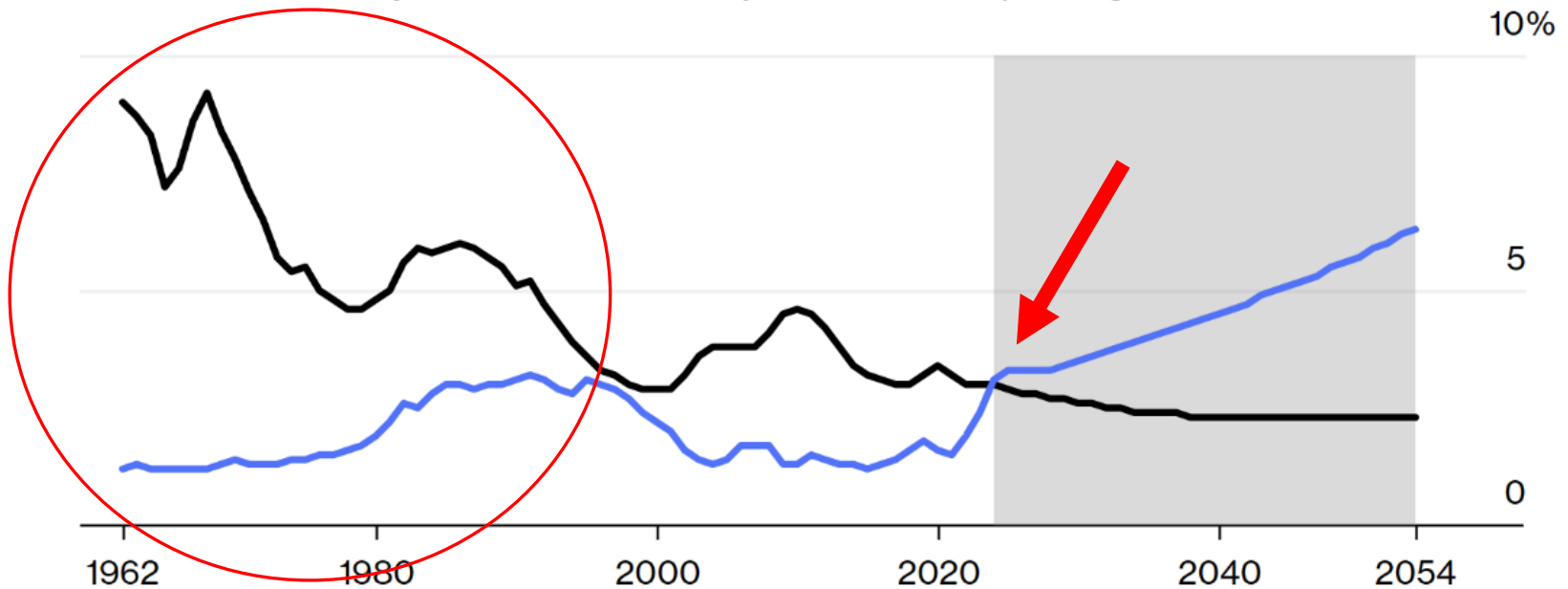


US Interest Expense was NEVER above DoD spending in Cold War 1.0...it already is now.  
*Do you think US will lose "Cold War 2.0" for lack of printed USDs? We don't.*

## Rising US Debt Service Will Swamp Defense Spending

Share of GDP

Net interest outlays / Defense / Projected defense spending and debt interest

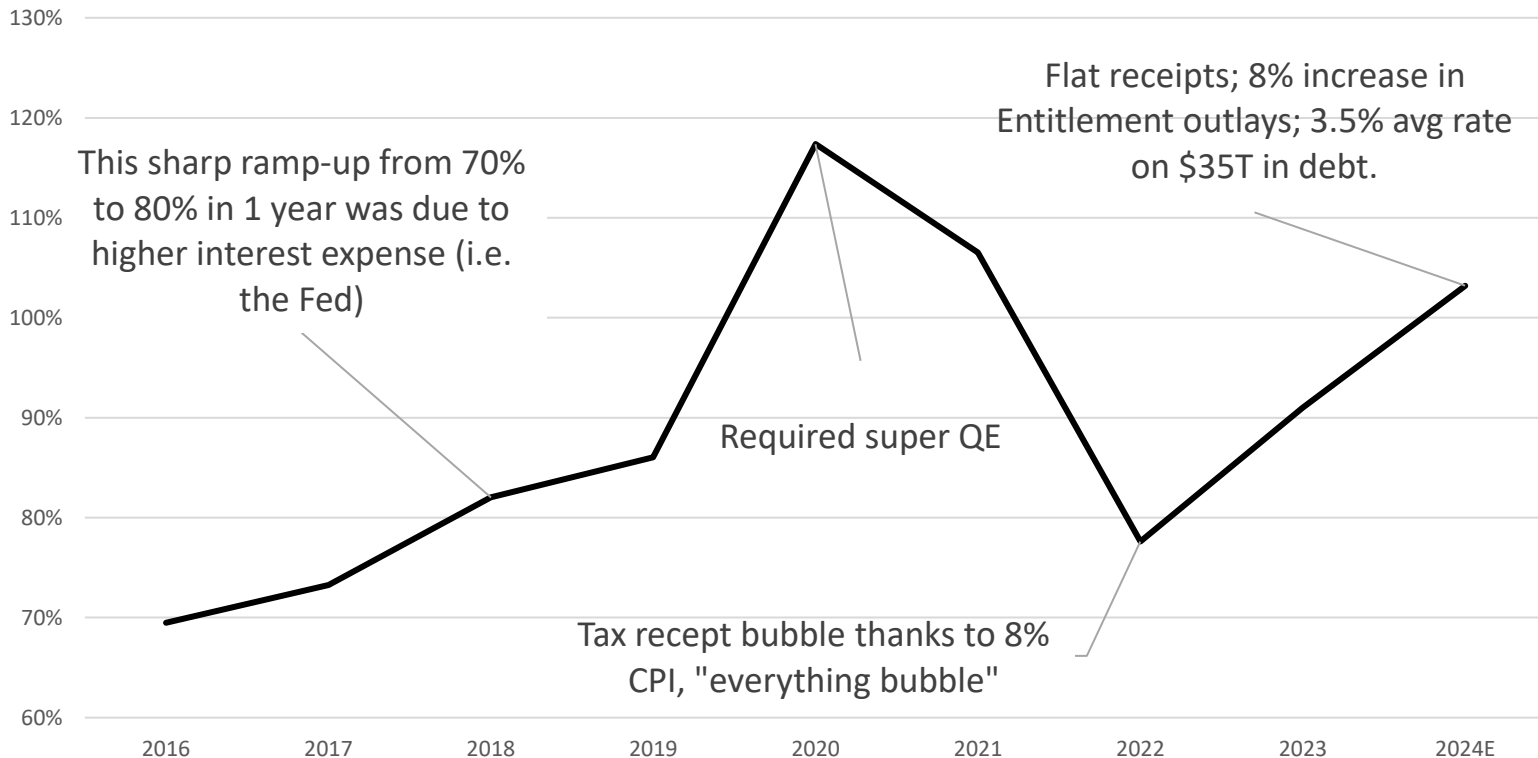


Source: Congressional Budget Office

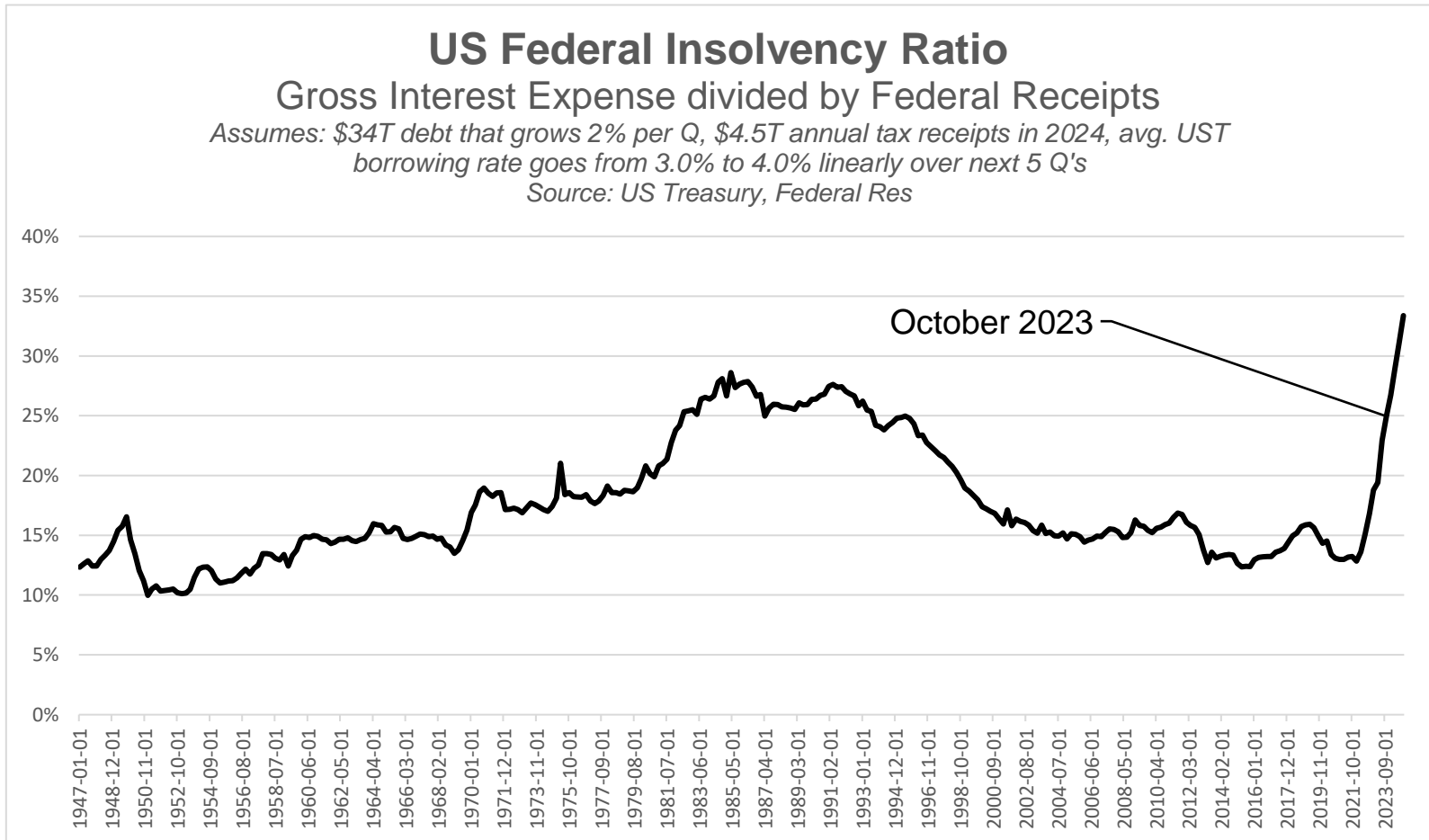
The US fiscal problem becomes acute once the strong USD and rising rates sends US "True Interest Expense" > US Federal receipts (driven by a decline in US receipts and increase in US True Interest Expense). **WE ARE JUST ABOUT THERE.**

### US "True Interest Expense" as % of US Tax Receipts [Treasury Spending+ Entitlement Pay-Go (SSA + HHS)] Base Case

Sources: US Treasury, Fed, FTTT



The US fiscal problem becomes acute once the strong USD and rising rates sends US Insolvency Ratio >30%.  
**WE ARE JUST ABOUT THERE.**



Last time “US Insolvency Ratio” was this high was late 1984 (red circle)...the USD proceeded to fall notably (*Plaza Accord to weaken the USD was signed Sep-1985*)

### U.S. Dollar Index (\$DXY)

106.68 +0.52 (+0.49%) 13:12 ET [ICE/US] DELAYED



Source: Barcharts.com

# US Fed &/or Treasury have injected USD liquidity repeatedly and at shortening intervals since 3q19 “to maintain UST market functioning.”

lukegromen published on TradingView.com, Apr 30, 2024 14:37 UTC



Gold/LT USTs began rising as soon as FX reserves stopped growing; in our view, gold v. USTs breakout in 2022 is gold discounting more USD liquidity to combat increasingly frequent UST market dysfunctioning.

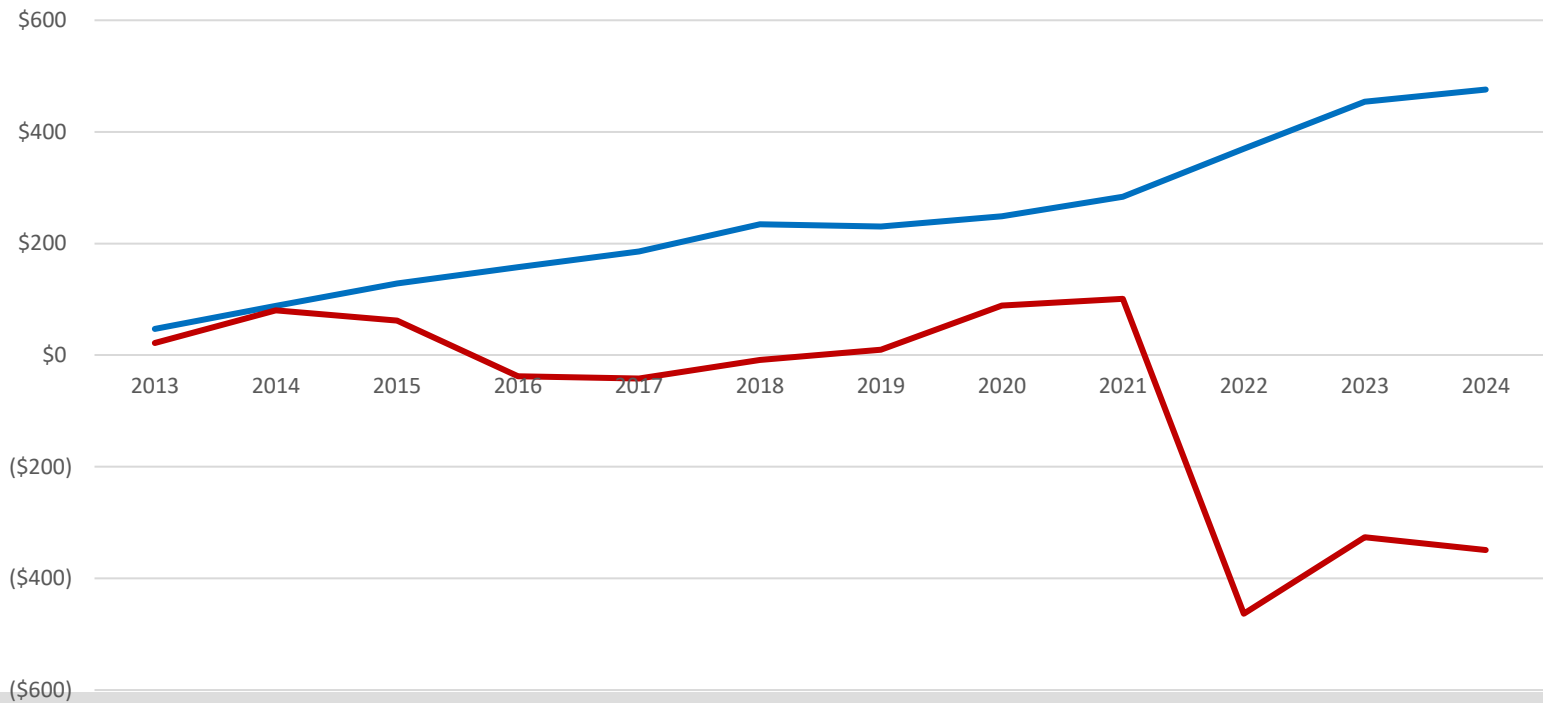
lukegromen published on TradingView.com, May 28, 2024 20:29 UTC



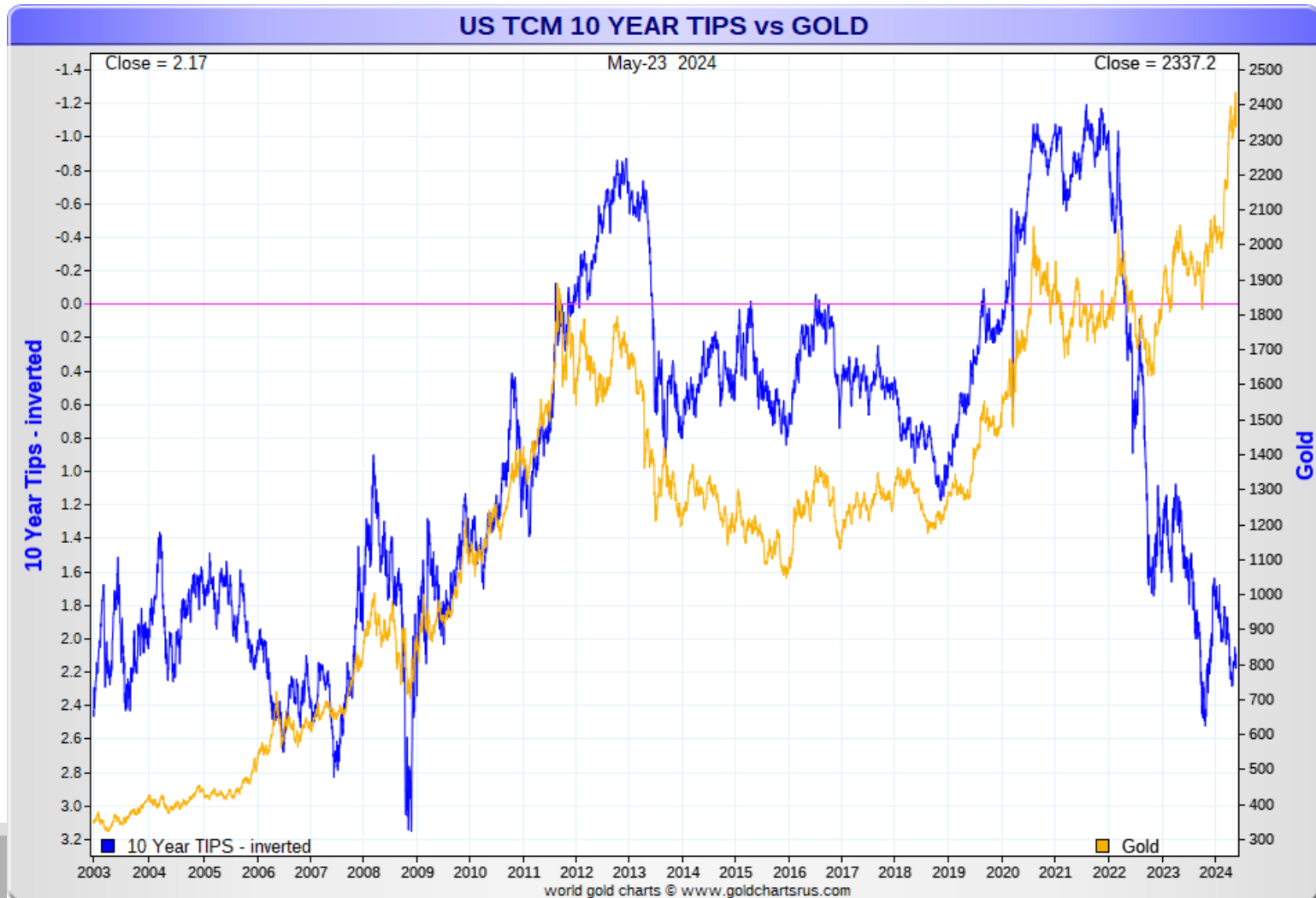
# In no small part because global Central Banks have been buying gold instead of USTs since 2014.

Central Bank Purchases of Gold (blue, \$B) v.  
Foreign Official Purchases of USTs (red, \$B)  
Cumulative since PBOC said "No longer in China's interest to grow FX reserves" in  
2013

Source: US Treasury, World Gold Council, FFTT



Gold diverging from inverted US 10y real rates is a sign of markets recognizing that positive US real rates are mathematically unsustainable given the US' fiscal and debt positions.



Bond investors seem to have forgotten that annualized real bond returns were negative from 1900-1981 (as the last global sovereign debt bubble burst, 1914-1945.) ***Long-term bonds do poorly in Fourth Turnings (on a real basis).***



# Biggest variant perception in markets entering 2024:

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- Most market participants still assuming and acting as if the Fed's "dual mandate" (inflation, unemployment) are the key drivers.
- Consensus does not realize the Fed's "shadow 3<sup>rd</sup> mandate", maintaining UST market functioning, has become dominant post-COVID.
- Fed made things WORSE by fighting inflation. As soon as US real rates hit 2%, the long-term UST market crashed.
- *US is in fiscal dominance, which in short means the US government cannot afford to pay both Entitlements and Interest Expense without printing money unless US real rates are significantly negative.*
- This is most bullish for gold and BTC, as well as stocks (we prefer industrial stocks), but bullish for all assets and inflation, except for LT bonds (on a real basis), and the USD, over time.

Further complicating/reinforcing these trends:

*“An estimated 20% of global oil this year was bought & sold in non-USD”* -WSJ, December 28, 2023

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## The Dominant Dollar Faces a Backlash in the Oil Market

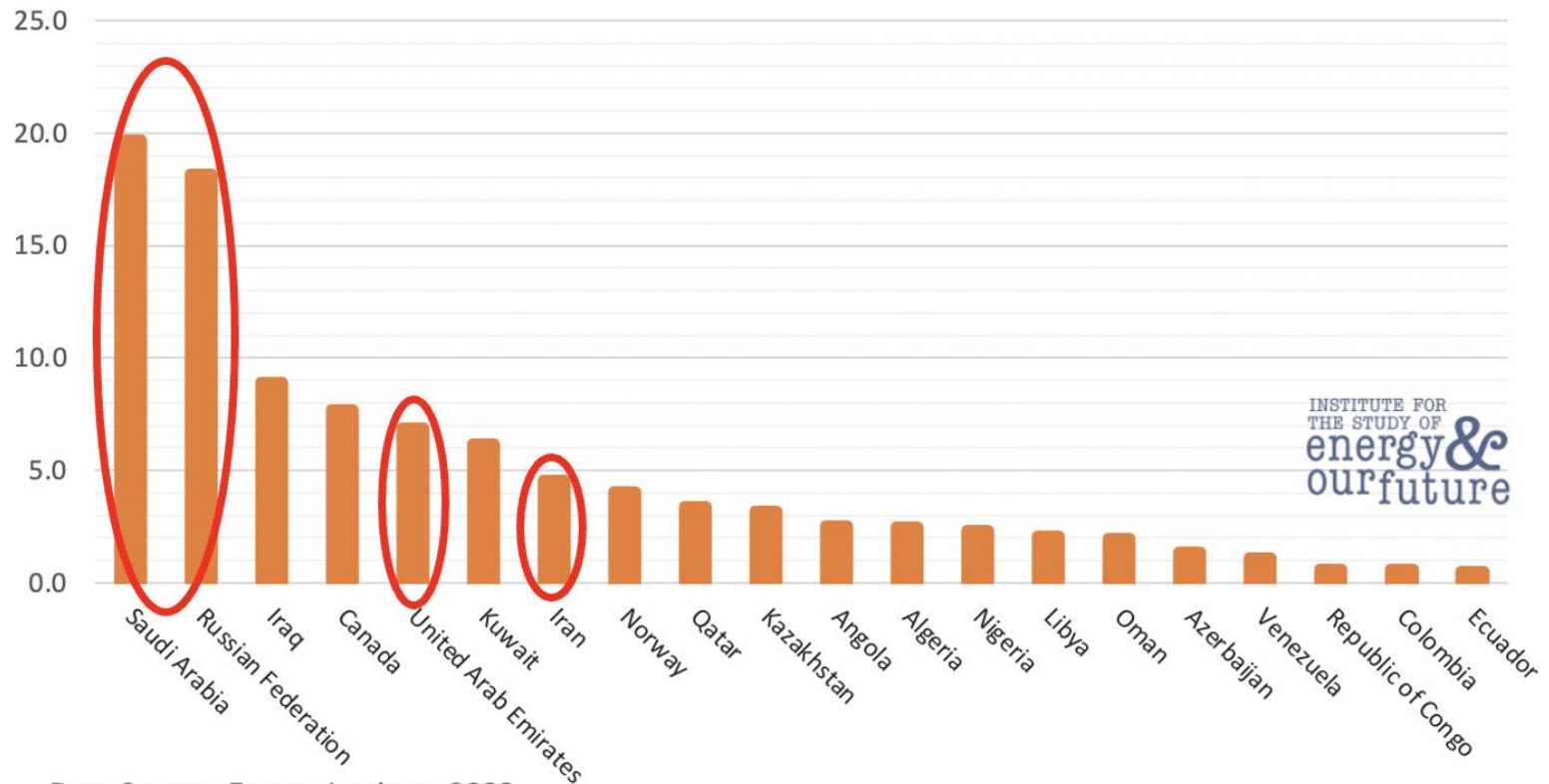
An estimated 20% of global oil this year was bought and sold in other currencies as Russia and Iran sold cargoes to China and other buyers

By [Anna Hirtenstein](#) [Follow](#)

Updated Dec. 28, 2023 12:00 am ET

And with >50% of global oil exports now in or soon to be in the BRICS, non-USD oil volumes seem likely to rise, likely further structurally reducing global FX reserve demand for USTs

Countries as % of World Oil Exports 2022



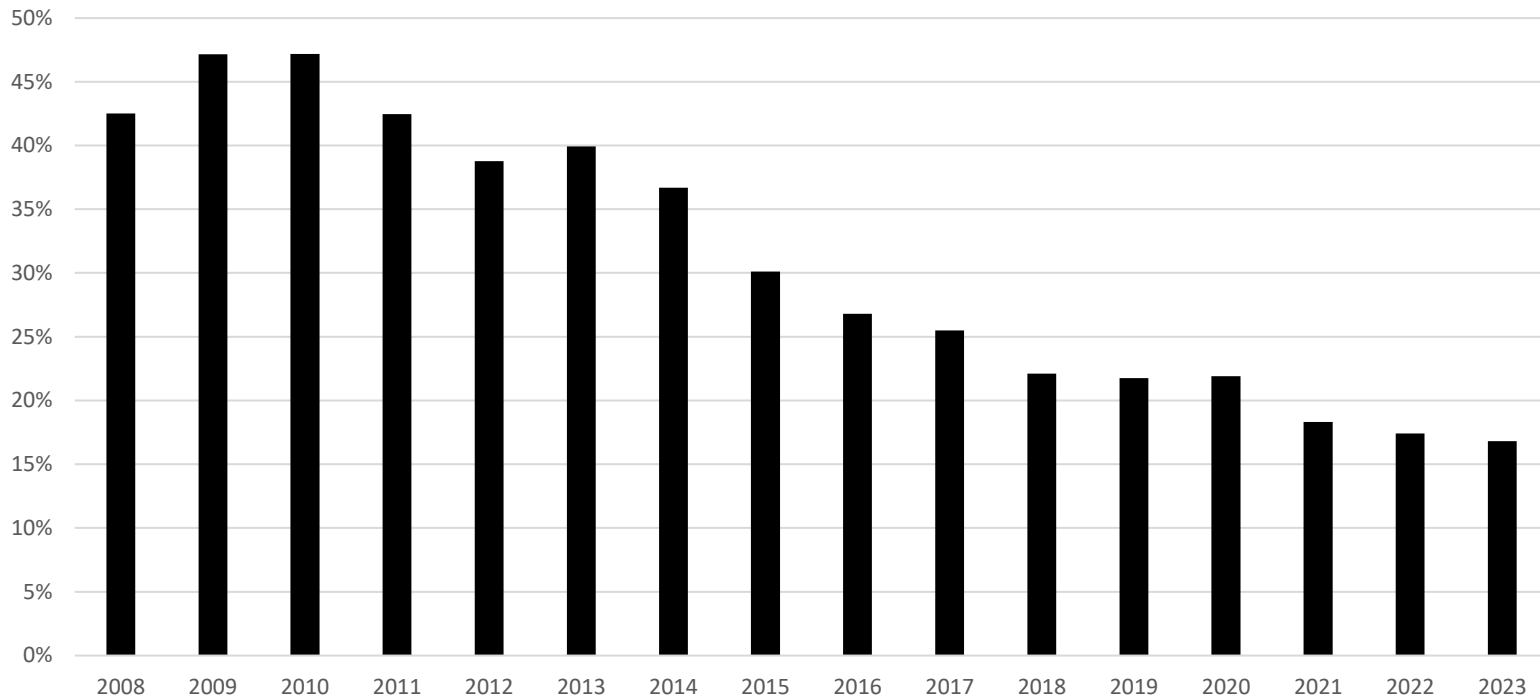
Data Source: Energy Institute 2022

**Key implication of non-USD oil:** China doesn't need to hold as many USD reserves for oil when it can buy oil in CNY; non-USD oil means Central Bank FX reserve holdings of USTs unlikely to grow and may shrink further. **China's need to hold USTs is falling as US's issuance of USTs is rising.**

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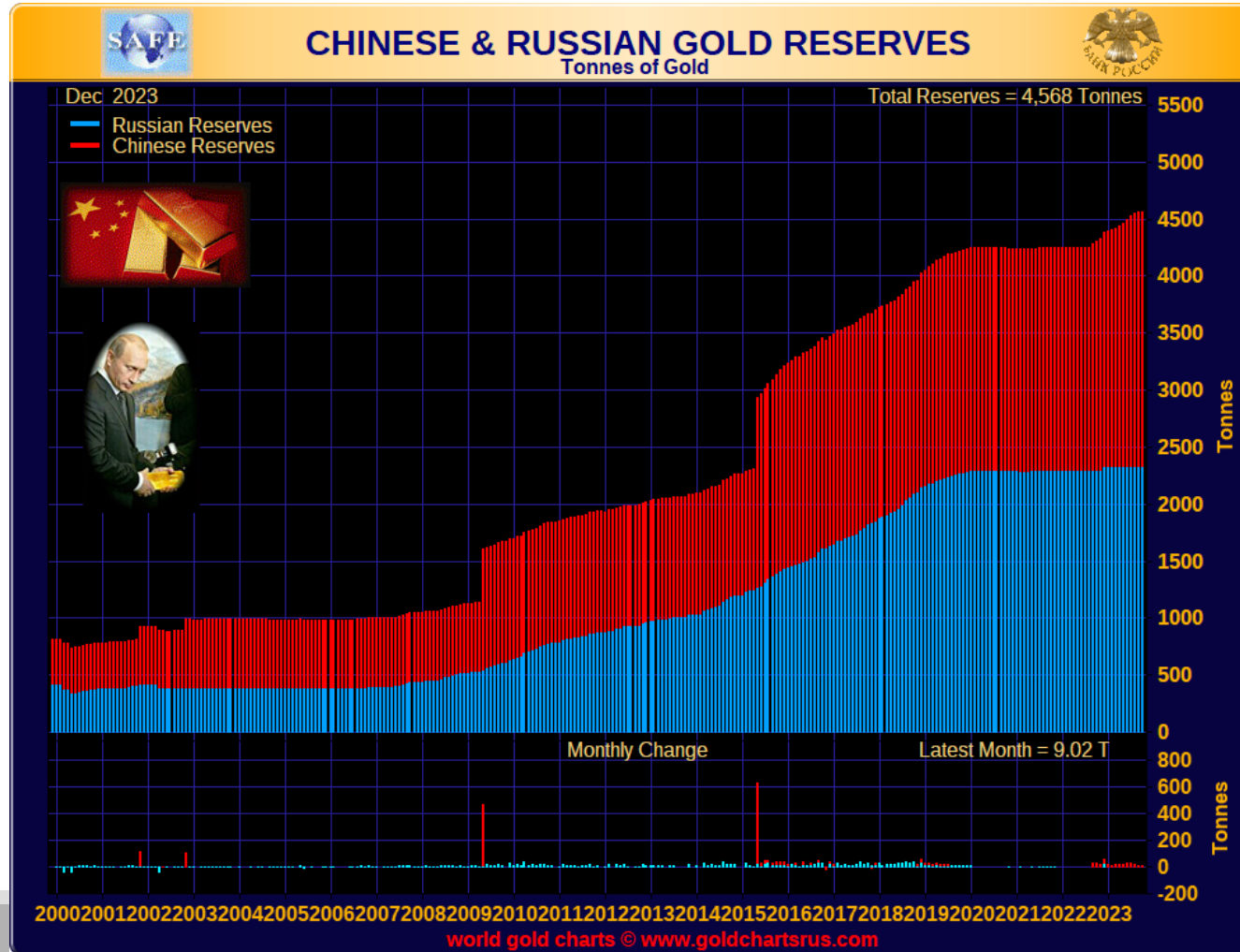
### China FX reserves as a % of GDP

*Source: IMF, PBOC, FFTT*



*“But what will oil exporters buy with their CNY?”*

Chinese goods, and with any net surpluses, gold.



200-DMA of gold in CNY = “CNY is our currency AND our problem.” Settle CNY net surpluses in gold that rises in CNY terms over time, increasing Chinese creditor’s CNY purchasing power = a virtuous cycle.

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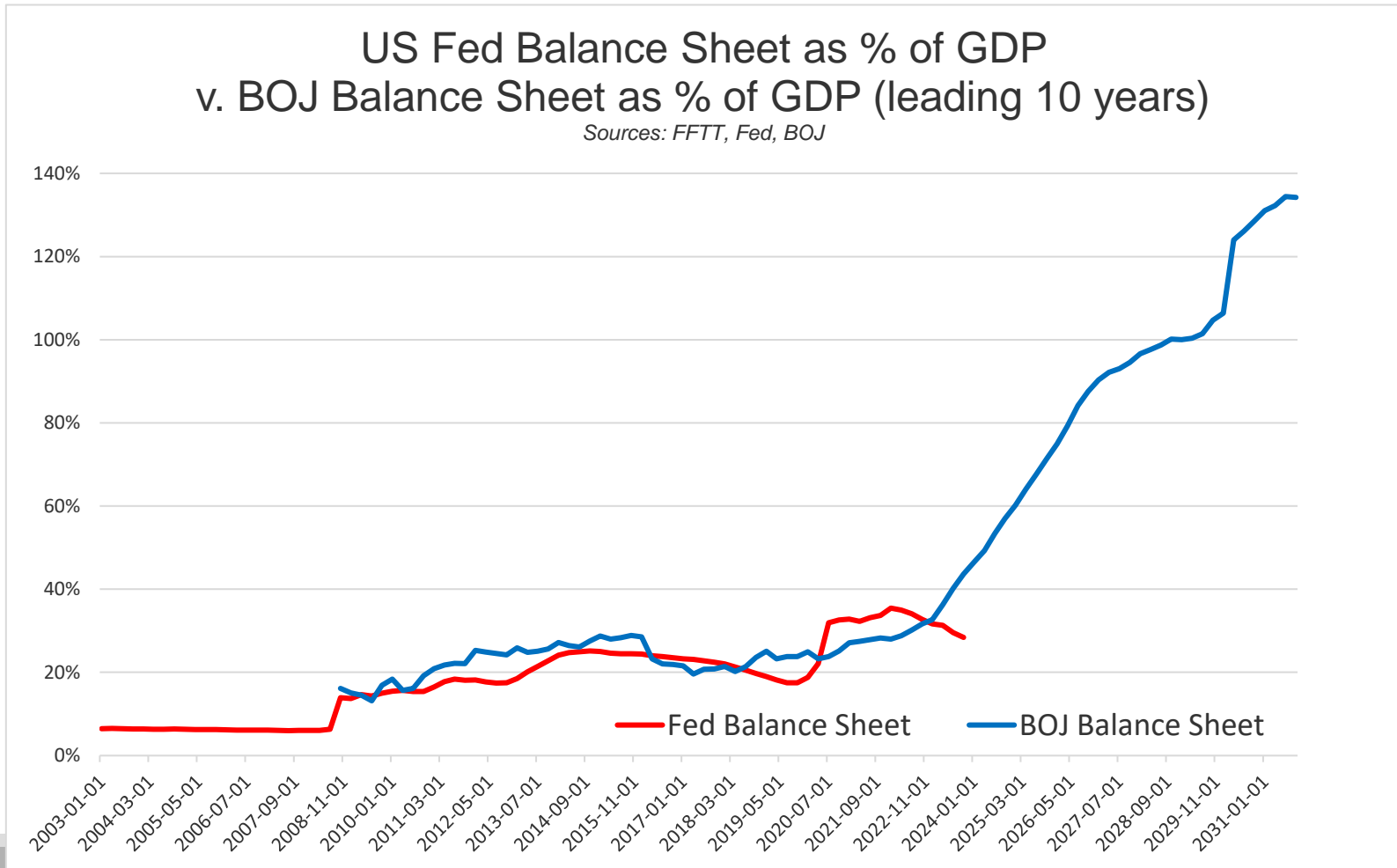
US policymakers have been and are going to have to continue to supply secularly more USD liquidity to support the UST market over time (a.k.a. finance US fiscal deficits.)

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**“The US is going to be Japan”**: Yes...but US twin deficit and US NIIP positions that are 180-degrees opposite of Japan, and with US financing externally (v. Japan internally) means “US being Japan” will feel like “Argentina with US characteristics” – **US stocks up in USD terms, but flat to down in gold and BTC terms.**

**Translation:** In the absence of a productivity miracle ASAP, the red line will eventually have to follow the blue line below, directly or by proxy (SRF, SLR exemptions, HF borrowing from SRF, UST buybacks, eSLR.)



# It's not the end of the world; just the end of an era. Gold outperforming long-term USTs (by ~3x) since 2014 since CB's stopped growing FX reserves (Gold/ZB shown)

lukegromen published on TradingView.com, May 28, 2024 20:29 UTC



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