

COMING FLIGHT TO GOLD

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By Scott Silva

Editor, *The Gold Speculator*

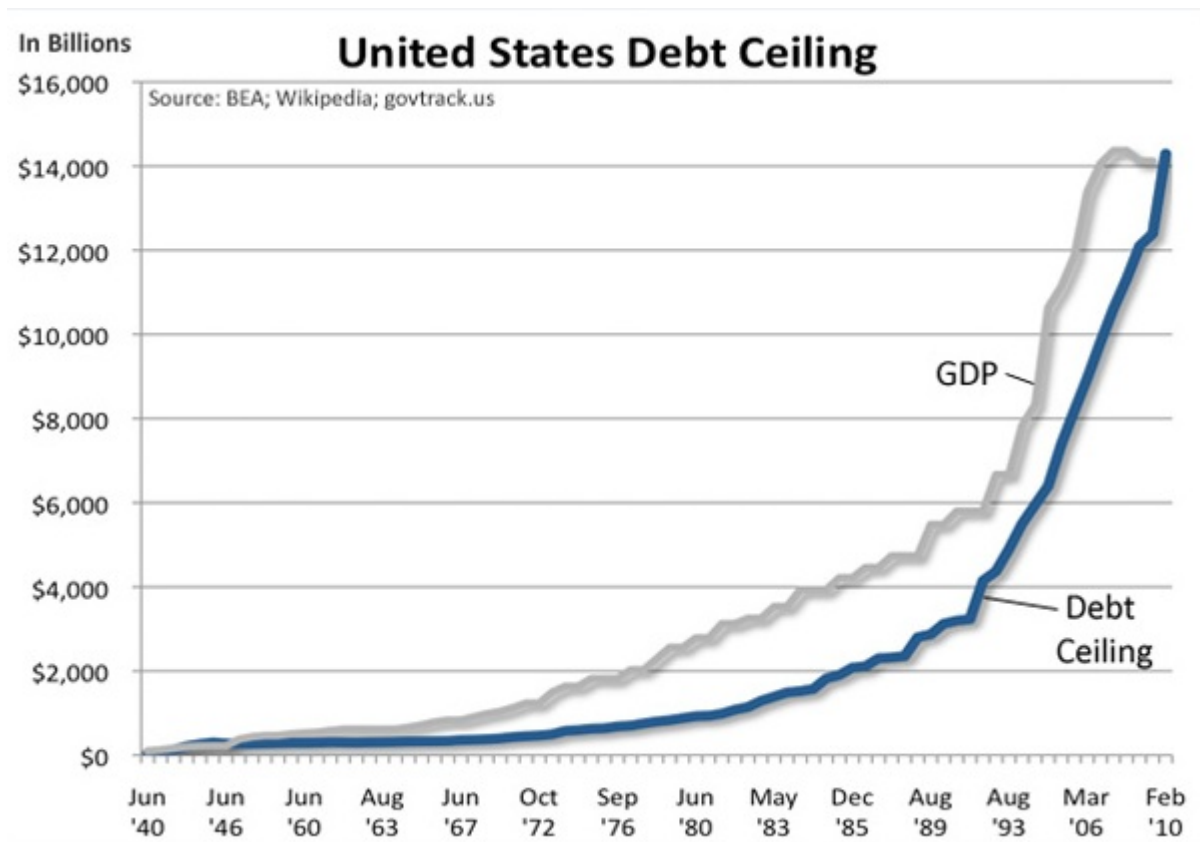
The battle to increase the US Debt limit will increase financial tensions in the US and impact markets around the world. The US debt is approaching its legal limit of \$14.3 Trillion. The debt limit sets the amount that the US Treasury can borrow from its citizens other government agencies and foreign investors by selling AAA-rated US Treasury securities, also known as US sovereign debt instruments. As with all spending measures, the US debt limit is authorized by the US Congress. Although Congress has authorized every increase in the debt ceiling requested by preceding presidents, this time the issue is likely to be a decisive political fight between Congressional deficit hawks and the progressive administration. The stakes are much higher than political victory; the sovereign credit rating of the United States is at risk; *Moody's Investors Service warned on Thursday that lack of U.S. government action on the budget deficit increases the likelihood of a negative outlook on the country's AAA credit rating.* Moody's report came just hours after Standard & Poor downgraded Japan's sovereign debt to AA. Today, S&P downgraded Egypt's rating as its government teeters on collapse.

The statutory limit on US federal debt began with the Second Liberty Bond Act of 1917, which helped finance the United States' entry into World War I. The sale of Liberty Bonds to the public at large helped keep interest rates low. Before World War I, Congress authorized specific loans, such as the Panama Canal loan, or allowed the Treasury to issue specific types of debt instruments, such as certificates of indebtedness, bills, notes and bonds. The Second Liberty Bond Act expanded Treasury authority to aggregate debt instruments. Debt limit legislation in the following two decades set separate limits for different categories of debt, such as bills, certificates, and bonds.

In 1939, Congress created the first aggregate limit that covered nearly all public debt. US debt tended to approach the limit under the new rules. For example, the 1919 Victory Liberty Bond Act (P.L. 65-328) raised the maximum allowable federal debt to \$43 billion, far above the \$25.5 billion in total federal debt at the end of FY1919. The debt limit in 1939 was \$45 billion, only about 10% above the \$40.4 billion total federal debt.

Congress raised the debt limit to cover the costs of World War II in each year from 1941 through 1945, when it was set at \$300 billion. After World War II ended, the debt limit was reduced to \$275 billion. The limit remained at \$275 billion until 1954 (the Korean War was financed primarily by tax increases). After 1954, Congress reduced the debt limit twice and increased it seven times, until March 1962 when it reached \$300 Billion, the same level as at the end of World War II. Since March 1962, Congress has enacted 75 separate measures that changed the debt ceiling.

How did we get to such a precarious position today? The answer is unchecked deficit spending. Most of the debt buildup has come from the various spending measures enacted stimulate the economy and solve the financial crisis of 2008-2009. In July 2008, the Housing and Economic Recovery Act increased the debt limit by \$800 billion to \$10.615 trillion. In October, a \$700 billion increase was attached to the Emergency Economic Stabilization Act of 2008. In February 2009, the American Recovery and Reinvestment Act of 2009 raised the statutory limit to \$12.104 trillion -- an increase of \$789 billion. Last February, The Statutory Pay-As-You-Go Act of 2010 (P.L. 111-139) raised the limit to the current level of \$14.294 trillion, an increase of \$1.9 trillion.



The effects of a negative outlook report or credit downgrade of US sovereign debt would be devastating. The floor would drop out of the US bond market. US interest rates would spike, sending a shockwave through the stock market. Massive Wall Street sell-offs would spread to equity markets around the world. Retirement accounts would be washed out. Real estate values would plummet. GDP would grind to a halt and unemployment would reach or exceed Great Depression levels. The US Dollar would collapse and ultimately succumb to a de facto new reserve currency, perhaps the BRIC Bancor, the UN Special Drawing Rights established by Russia, China, India and Brazil. The United States would relinquish its role as the strongest economy on the globe, and join the ranks of fallen empires.

By way of comparison, Japan's long-term government debt is set to reach 869 trillion yen (\$10.57 trillion) at the end of March this year, or 181 percent of its GDP. Greece's debt is 137 percent of GDP; Ireland is at 113%, according to data from the Organization for Economic Cooperation and Development. Could the US be close to such dire straits?

In a recent letter to Congress US Treasury Secretary Geithner said that if the government hits the debt ceiling, it would not be able to pay interest to those holding Treasury bonds and would default on that debt, "causing catastrophic damage to the economy, potentially more harmful than the effects of the financial crisis of 2008 and 2009."

The battle lines are drawn for a gangbuster Congressional showdown between fiscal conservatives in Congress and the high-spending White House. Any compromise will come only after bruising confrontations and divisive campaigns that are likely to whipsaw the markets, as we saw when the House rejected the initial \$700 Billion stimulus bill and again when the Administration outlined its "stimulus by spending" plan. In January 2008, when the president's stimulus plan finally was unveiled, the stock market tanked – the worst January performance in 113 years.

There can be no doubt that the next several months, if not the next two years will be a period of great uncertainty in the financial markets in the US and across the globe. And as we have seen during the last few weeks, political tensions in Tunisia, Lebanon, Egypt and Jordan are changing the balance of power in a region important to the developed world.

In uncertain times, prudent investors turn to the stability and certainty of hard assets, such as gold and silver. Gold has proved to be a safe haven and a hedge against the vagaries of inflation, political turmoil, war and revolution.

The question for you to consider is how are you going to protect yourself from the slings and arrows of outrageous fortune? We publish *The Gold Speculator* investment newsletter to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010. Subscribe by visiting our web site, www.thegoldspeculatorllc.com and pressing the PayPal button (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055

Thank you for your interest.

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