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Debt is devouring Sovereign Nations. In the US, the Deficit is being Funded and Monetized by the Fed

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While we wait, watch and listen, the Fed decides when the banks will be given the word to start lending to get the domestic economy back to neutral. Action is needed quickly because the world economy is quickly deteriorating, and the recovery is simply not happening, as the administration admits to a fiscal deficit of $1.4 trillion. That would be down from a deficit of $1.9 trillion in 2009. Our long-term estimate has been $1.6 to $2 trillion. Over the past 18 months and after joint expenditures by government and the Fed of $2.3 trillion, all the administration has to show for their efforts are five quarters of stimulus growth of about 3-1/2%, which is now ending. In addition, economies worldwide are slowing as well. At the same time the credit crisis continues as the Fed's money machine funds banks and other financial institutions worldwide in a sea of perpetually degraded dollars. The only real mission for the Fed is to keep the financial sector afloat until the elitists are ready to finally pull the plug and bring about worldwide deflationary depression, as a trigger mechanism to force people's of the world to accept world government. Most of the major banks of the world are insolvent and keeping them functioning is the Fed's primary mission.

Debt is devouring sovereign nations, especially in Europe, the UK, Japan and the US. Over the past 20 years ideas and policies have been discussed on how to handle such debt. Austerity programs and cutbacks have begun in a number of countries, each using their own formulas. In the US on the table are Social Security, Medicare and Medicaid, all of which run at a substantial deficit. In fact, they come close to consuming all government revenue. This is causing difficult problems because off budget items cannot be funded. They have to be funded via deficits, which are shrouded in secrecy. That is understandable as America's wars have already cost taxpayers well over $1 trillion. These dollar denominated assets, when in fact secretly, are being funded by the privately owned Federal Reserve. The big secret of the past seven years is not a secret anymore. These are policies that are secret. If you ask the Fed specific questions all you get is that the answer is a state secret, it is classified. Of course, this is done to hide the Fed's activities. The same is true of commissions appointed by the president under the cloak of executive orders. These are the bureaucrats that will formulate how spending will be cut and revenues will be enhanced. Their conclusions are then rubber stamped by a purchased Congress and Senate. This procedure bypasses all debate and allows progress in semi-secrecy.

The deficit is being funded and monetized by the Fed, but they won't tell you that. Yes, foreigners buy debt, but so does the Fed.

Behind all this lurking in the shadows is the administration's decision to allow low tax rates to elapse, which will increase taxes by some 15%. This change should be reverified after the next election. Recently Treasury Secretary Geithner said tax increases should be pursued.

Then we also expect that moves will begin to expose the administration's program to tax or offer an exchange for retirement plans with government. Government would offer guaranteed annuity plans. This would be a method of securing assets immediately to offset deficits.

Whatever the administration wants to do they'll have to do it before November's election because of anti-incumbent sentiment, and anger over the financial reform bill and the medical reform bill. Now incumbents are under severe pressure. That has been complicated by a federal court decision to strip an Arizona law of its most important elements regarding illegal aliens. Democrats are going to bear a great deal of blame regarding this issue. Two surveys showed 90% and 94% of Americans agreed with the Arizona law regarding immigration. In addition, many solons are realizing that the accelerating deficit impedes government. Some Democrats and many republicans are sophisticated enough to see higher taxes could subdue the economy even further. If the Fed were to raise interest rates that would further put downward pressure on the economy. All these things leave few viable options. There is no question that the Fed is going to accommodate the economy, as we explained earlier, by cutting interest on banks deposits at the Fed and forcing banks' to lend, which would invigorate the economy and raise employment. This is why the market rallied from 9800 to 10,500. Remember since Fed Chairman Ben Bernanke took office the government's short term debt rose from $8.2 trillion to $13.3 trillion. We are sure you remember his 2002 speech as he described the Fed's printing press abilities. All monetary expansion has been done is buy time – it has not in any way solved the underlying problems.

We wonder what the Fed will do with the trillions of dollars in toxic waste bonds held on its balance sheets? They'll sell them and you will get billed for it. Don't forget foreign exchange of foreign nations in dollars fell from 64.5% of assets to 59.5% of assets in just 1-1/2 years. Our friends are sellers, including China.

What Washington, the Fed and Wall Street have to understand is that you cannot borrow your way to wealth. There is an eventual law of diminishing returns. Present prosperity cannot be paid for by future production and services. The public senses this and their confidence continues to dissipate. Seventy percent believe there will be no recovery. They are angry and want to purge congress and the Senate of the criminals they previously elected. This is a reflection in part of unemployment of 22-3/8%, falling hours and wages and perpetual loss of purchasing power.

As we pointed out previously Europe and the UK and the US have chosen different paths to solve their debt, finance and economic problems. Europe has raised taxes and implemented austerity. The US so far has done neither and continues to believe that quantitative easy (QE) is the best hope of success. Heretofore it has been unsuccessful, but they keep on doing it anyway for lack of an acceptable alternative. The US is in double dip recession already. The question is can the Fed act fast enough to stave off deflationary depression? This is what Europe has done and they are about to find out much to their chagrin that they have a deflationary depression on their hands, and they have lost control. That should eventually knock the euro for a loop. The solvent members of the euro zone are going to find they have thrown good money after bad. Europe heads for depression and the US will soon follow. It is the intention to create $5 trillion in QE over the next two years to carry the US economy through the next election. There is just three months to elections. The race is on to convince the US electorate that America is ok. We do not believe that will be successful.

The Fed continues to buy toxic debt instruments. They admit to having purchased $1.3 trillion worth, but we believe that the figure is more like $1.8 bullion worth. The difference is parked offshore.

As Fed chairman Bernanke says unemployment is the most pressing challenge. The way to help that situation is to have banks lend to small- and middle-sized businesses that create 70% of the jobs.

As of now we have not emerged from our inflationary depression and we are not going too. We may have a period of grace due to QE but that will be transitory.

Housing is locked into a long-term depression. Can you imagine building 549,000 new homes with a 3-year overhang, when four months is normal? Eighty percent of the building industry is dead in spite of $8,000 credits and $1.25 trillion or $1.8 trillion in purchases of MBS and CDO bonds. Foreclosures hitting the market are endless with no relief in sight. Millions of homes are underwater and will probably stay that way for years to come.

46.2% of the unemployed have been out for 27 weeks or more. They cannot buy houses – that is double the worst ever recorded. The average worker has been out of work for 35.2 weeks. Real unemployment is 22-3/8%. The average workweek is 34.1 hours. You certainly cannot have recovery with these kind of numbers.

We ask how do you have a recovery under such circumstances? By the end of the year, in the absence of a quick QE injection we should see GDP growth in the minus column or close to it. All QE sights, except for more bank lending will focus again on banking and Wall Street making sure they do not collapse.

Economists tell us the apposite, but they are only correct 1/3rd of the time. It is obvious the economy is still in deep trouble. Payrolls have fallen, state and federal revenues are way off, state unemployment disbursements are up, as are the use of food stamps, welfare and Medicaid. All these problems and we have seen $2.3 to $2.5 trillion in stimulus and zero interest rates to boot. As the planning at the Fed figures out how the 3rd stimulus will be applied the Fed still won't talk about an exit strategy, because they have none. Bernanke, like his predecessor Greenspan, doesn't have any workable solutions. That is because he won't purge the system and its malinvestment. That is why his only answer can be QE and monetary inflation. After the 2012 election it will be very obvious that the banking system will be unable to properly function. This has been a lonely vigil, but others are now coming to the same conclusion as we have. Mark Farber, Jim Willie, DavidRosenberg, Jim Grant and Ambrose Evans-Pritchard have all joined us in a chorus of warnings.

We have seen a continual fall in M3 at a 9.5% contraction rate. This reduction has been going on for over a year, as money stock declined by $300 billion. All we can say is this reduction allows the Fed lots of room to reincrease M3 again.

The Fed, Wall Street and the Treasury know current levels, which are receding, cannot be maintained without more massive infusion of money and credit. Problems are about to occur if quick action is not taken.

That is reflected in the statements of St. Louis Fed President James Bullard's comments, or should we say trial balloons. The bottom line is monetize and inflate or die.

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