

The Big Collapse Could Be Very Near

By [Robert Wenzel](#)

Global Research, June 02, 2009

[Economic Policy Journal](#) 2 June 2009

Region: [USA](#)

Theme: [Global Economy](#)

The Federal Reserve appears to be increasingly nervous about the long term bond market. This is serious. How panicked are they? After leaking a story on Friday, they are back at it on Sunday.

The Federal Reserve leaked to CNBC's Steve Liesman on Friday that they weren't targeting long rates. Why such a leak? Probably because the Fed did not want to appear impotent in controlling the long rate. So they put out the word through Liesman that they weren't targetting the long rate. Can you imagine what would happen to the markets if it sensed long rates were beyond the control of the Fed?

The Fed can of course print money to buy up every Treasury bond in existence, but the inflationary ramifications would be Zimbabwe like, and crush the dollar on international currency markets. Are we near the phase where all hell breaks loose? I have never even answered, maybe, to this question before. It's always been, "no." Now it's maybe.

What really has me spooked is another article out this afternoon (on a Sunday) that Drudge has even picked up. It's a Reuters story by Alister Bull. The headline: Federal Reserve puzzled by yield curve steepening.

Translation, the Fed doesn't know what is going on, but they are really scared.

Here's more from Bull:

The Federal Reserve is studying significant moves in the U.S. government bond market last week that could have big implications for the central bank's strategy to combat the country's recession.

But the Fed is not really sure what is driving the sharp rise in long-dated bond yields, and especially a widening gap between short and long term yields.

Do rising U.S. Treasury yields and a steepening yield curve suggest an economic recovery is more certain, meaning less need for safe haven government bonds and a healthy demand for credit? If so, there might be less need for the Fed to expand the money supply by buying more U.S. Treasuries.

Or does the steepening yield curve mean investors are worried about the deterioration in the U.S. fiscal outlook, or the potential for a collapse in the U.S. dollar as the Fed floods the world with newly minted currency as part of its quantitative easing program. This might be an argument to augment to step up asset purchases.

Another possibility is that China, the largest foreign holder of U.S. Treasury debt, has decided to refocus its portfolio by leaning more heavily on shorter-term maturities...

An obvious culprit for the move in bond yields is the country's record fiscal deficit, which will generate a massive amount of new government issuance.

The U.S. Treasury must sell a record net \$2 trillion in new debt in 2009 to fund a \$1.8 trillion projected fiscal deficit, resulting from falling tax revenues, an economic stimulus package and sundry bank bailouts.

It's the Chinese, and any other Treasury bond buyer who follows the markets, that have pulled away, to varying degrees from buying Treasury long securities. No one wants to be the last one holding bonds, where the new debt about to be issued is in the trillions.

Bull continues with the part of the message the Fed really wanted to get out: With officials still grappling to divine the factors steepening the yield curve, a speedy decision on whether to ramp up the Treasury debt purchase program or the related plan to snap up mortgage-related debt seems unlikely.

"I'm in wait-and-see mode," said one Fed official who spoke on the condition of anonymity. "We laid out the asset purchase plan and we're following it. That is going to have some affect on various interest rates, but together with a hundred other things. So I don't think we should be chasing a long-term interest rate," the official said. It's the same message as Friday. The Fed does not want to spook the world into thinking that it can't push long term rates down, so it says it is not trying. But if rates continue to climb, a panic out of Treasury securities is a very likely scenario. And Bernanke has only one play to force long rates back down, buy every long bond in sight, which of course is highly inflationary and puts upward pressure on rates. How's that for a dilemma?

The end of the current financial system, as we know it, may be imminent. If you would have asked me even two weeks ago if collapse was imminent, I would have said it was highly unlikely, now I am saying it is possible. Bernanke may be able to patch things up short-term, if he is lucky, but in the long term the U.S. financial structure is in serious trouble. There is just too much Treasury debt that needs to be raised. An international panic out of Treasury securities, even a slow controlled panic, means the Fed will be the major buyer. This will ultimately mean record inflation.

And keep this in mind, we have never seen a collapse of a currency like the dollar. Even the hyperinflation during Germany's Wiemar Period can not serve as an example. Since the dollar is the reserve currency of most of the world, a panic out of the dollar means more dollars will return to the U.S. shores than any country has ever experienced.

Other countries have had collapsed currencies, but never in the history of world of finance has so much currency been held outside a country of issue that could come flying back, almost on a moments notice. If the panic out of the dollar starts, even if Bernanke stops printing money (unlikely), all the dollars flying back into the U.S. could cause a huge price inflation all on its own.

[Comment on Global Research Articles on our Facebook page](#)

[Become a Member of Global Research](#)

Articles by: **[Robert Wenzel](#)**

Disclaimer: The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: publications@globalresearch.ca

www.globalresearch.ca contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: publications@globalresearch.ca