Trapped Capital

U.S. Treasury debt has grown over the years. When the oldest current living president left office in January 1981, total federal debt was measured in billions. We are now used to talking about the National Debt with a T not a B. Currently the National debt is \$ 2.14×10^{12} ... just about equal to Gross National Product. But on the other hand at least it is substantially smaller than a mole (Avogadro's constant at) 6.02×10^{23} .

When the U.S. Treasury issues new debt it traps the capital... never to leave... unless the federal government runs a surplus (1998-2001) and pays down the National debt. If you own a Treasury and want to sell it, you have to find someone to buy it from you. If you hold a Treasury to maturity the government has to find a new buyer to replace the maturing debt. The sum total of the National Debt is trapped capital. However, it can be used as collateral in a borrowing scheme to purchase other assets or goods. There is a limit to this activity however, so liquidity is still reduced overall when new government debt is issued.

When the Federal Reserve began its Quantitative Easing program ten years ago, its principal objectives were to increase liquidity and reduce long term interest rates. It worked. As the first year of **Quantitative Tightening** comes to an end, \$180 B of Treasuries were sold to the public by the Fed. The trapped capital moved from the Fed's balance sheet to someone else's... reducing liquidity. Beginning in the 4th quarter of this year the "cruise control" of Treasury sales by the Fed is \$360 B a year, further reducing liquidity. (And by the way, the Fed is also reducing its holdings of Agency securities.)

With the Job and Tax Act of 2017, large deficits are projected for the future. Trapped capital will continue to grow. One effect of a government deficit is it creates income. Government spending ends up being someone else's income. Past incomes are for historical statistical accounts, but past deficits still carry on their existence as trapped capital.

The U.S. does not save enough to finance current fiscal deficits. It is dependent on demand for U.S. Government securities **from the Rest of the World.** Current trade disputes could interrupt the flow of foreign savings into the U.S. Treasury market.

The Federal Reserve released its Z.1 report through the second quarter of 2018 on September 20th. In table F.210 it reports the flow of funds for Treasury debt holdings. The following is a summary of the two holders discussed above: the Fed and the Rest of the World.

Trapped Capital: The Fed and the Rest of the World (Billions annualized)

		2015	2016	2017	2018(QII)
The Fed	\$	0.2 B	2.1 B	-9.4 B	-186.6 B
Rest of the World	\$	42.7 B	-107.9 B	306.8 B	191.4 B

The Fed's current Quantitave Tightening could be a much bigger deal than markets currently expect. The rest of the world needs to help out... otherwise liquidity will be further reduced and long-term rates will be higher. Trapped capital always needs to be financed.