

Be-BOP: Sudden Stop

April 19, 2009

Once upon a time in lands not far away - a different paradigm - held sway. Economists, bankers, bad boy dictators. They drummed up trouble with inflation, and debt. The typical targets? Emerging markets. And when things got hot, all the hot money stopped. Balance of Payments - also known as *BOP* - went negative. Fast. This mostly happened in the 80's. Asia some. South America lots. Ecuador, Malaysia, and Argentina (twice). Money's like rice. You must fear rot. But most of all you must fear *The Sudden Stop*.



Now we come to 2009 and, (I will now drop the rhyme) lots of attention has turned to the faltering capital flows into the United States. To be blunt, the United States now has to print money to fund its operations. Because there is not enough demand to cover the issuance of US Treasuries.

This situation actually started to develop back in 2007, as foreign demand for Agency Debt started on its present downward path. Brad Setser, [in a November 2007 post](#), even used the term *Sudden Stop* to capture the totality of the falling *net* inward flows to US assets. As we know, the bulk of the Federal Reserve's monetization was focused through through mid-March of 2009 on Agency debt. But, with the March FED meeting, the FED added its first 300 billion of planned purchases of actual Treasuries, to its gargantuan purchases of Agencies. The reason is simple.

When we take the current rate of private savings in the US combined with inward flows of demand, for Treasuries, and we compare this to the **acceleration** in US Treasury supply—the result is a shortfall. I currently peg this at about 300 billion. And I agree with a number of analysts who are forecasting a *tripling* of this shortfall this year.

Now, there have been a number of wrong-headed views about this developing situation floating about in the last six months. Please don't tell me, for example, that *the US has printed its way out of a hole before*. Sure, we've printed. But whenever we have printed in the past, there were actually buyers for the new debt issuance. We have not printed and then *monetized* the operating budget of the United States, using the Federal Reserve as the buyer. Equally, please stop claiming that the US is in a *nifty little catbird seat of untouchable privilege* because it can simply print fresh money to pay off holders of maturing Treasuries. Sure, we're doing that right now. We've been doing so for only a month.

And how does it feel? Can we go on like this for a couple of years? The fact is that the US is already experiencing Sudden Stop. US Treasury issuance is dwarfing the **pace of US savings** (at 450 billion) and the inward demand flow for Treasuries (200-400 billion). The Fiscal Year is only half over, and the budget deficit is already hitting one trillion. A big part of the collapsed demand for US Treasuries from foreign central banks is actually less discretionary, at this point, and is the direct result of the drop in global trade. The previous consumption generated by Americans is no longer there, to come back to us in the form of US Treasury demand. Alas, US Treasury demand relied also on the credit cycle.

Were the US Argentina, the currency crisis and debt crisis so familiar to many would already be underway. In February I wrote that [we would eventually repudiate the debt](#), and we are indeed repudiating. It's nothing short of outrageous that we are printing to fund our own operating budget. But, the notion that the US Dollar can remain the singular reserve currency of the world under such conditions is *absurd*. Sorry, but, the Ivy League doesn't do correspondence-course undergraduate degrees, and Reserve Currency nations don't print. The UK, Switzerland, and the US can print away all they like. But the price they'll pay is to be replaced by the Chinese Yuan, Gold, or yes, [even lowly Copper](#). Being displaced by a base metal used in electrical wiring seems quite fitting.

The only phase that remains in this dance is what I would call the Recognition Phase. As soon as the Epiphany hits and consensus reality stumbles, as it always does, then [the changes which are already underway](#) will become extant. Plan for it.

-Gregor

Photo: Buenos Aires Mural 2004, *Traveller and his Sheep*, by [Bleck le Rat](#)

Further Reading: Calvo: [Explaining Sudden Stop, Growth Collapse, and BOP Crisis: The Case of Distortionary Output Taxes, 2003](#)

Janszen: [Headed for a Sudden Stop, 2008](#)