Record budget deficits and international fallout

by **gjohnsit**

Wed Jun 10, 2009 at 06:18:55 PM PDT

The federal budget deficit for May hit yet **another record.**

> (AP) -- The federal budget deficit soared to a record for May of $189.7 billion, pushing the tide of red ink close to $1 trillion with four months left in the budget year.

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Tax revenue is down 18% from last year while spending is up an equal amount. This problem is being noticed in the treasury market, where an auction today **failed to attract the buyers** it normally pulls in, and the 10-year reached 4% for the first time since October.

> "There are an awful lot of Treasuries being auctioned and there's going to be more and more and more and more," said Jay Mueller, who manages about $3 billion of bonds at Wells Fargo Capital Management in Milwaukee.
>
> The 30-year bond yield touched 4.83 percent, the highest in a year.
> ...
> "The auction was clearly disappointing," said Ira Jersey, head of U.S. interest-rate strategy at RBC Capital Markets in New York, the investment-banking arm of Canada's biggest lender. "These results don't bode well for the bond auction tomorrow."

Rates on long-dated bonds went up despite the Federal Reserve buying **$3.5 Billion** worth today.
A more alarming development that weighed on the treasury auction came from overseas, where **Russia and Brazil** were making noises.

> (Bloomberg) -- Russia and Brazil, seeking to reduce their dependence on the dollar, announced plans to buy $20 billion of bonds from the International Monetary Fund and diversify foreign-currency reserves.
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> Russia's central bank said it may cut investments in U.S. Treasuries, currently valued at as much as $140 billion, a week after China said it may reduce reliance on the dollar and American bonds. Brazil's Finance Minister Guido Mantega said his country will purchase $10 billion of debt sold by the IMF, China will buy $50 billion and India may announce similar funding.

America isn't Japan. We can't fund our own deficit spending. We need foreign creditors, and they are starting to get scared because our deficits are out of control.
What's more, if interest rates keep rising it will counter-act all the good done from the deficit spending and loose monetary policy of the Fed. We can't print our way out of this mess.

[Update: The NY Times has a **good article** about how we got here. I want to quote the end of the article.]

> Judd Gregg recently held up a chart on the Senate floor showing that Mr. Obama would increase the deficit — but failed to mention that much of the increase stemmed from extending Bush policies. In fact, unlike Mr. Obama, Republicans favor extending all the Bush tax cuts, which will send the deficit higher.
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> Republican leaders in the House, meanwhile, announced a plan last week to cut spending by

$75 billion a year. But they made specific suggestions adding up to meager $5 billion. The remaining $70 billion was left vague. **"The G.O.P. is not serious about cutting down spending," the conservative Cato Institute concluded.**

What, then, will happen?

"Things will get worse gradually," Mr. Auerbach predicts, "unless they get worse quickly." Either a solution will be put off, or foreign lenders, spooked by the rising debt, will send interest rates higher and create a crisis.

The solution, though, is no mystery. It will involve some combination of tax increases and spending cuts. And it won't be limited to pay-as-you-go rules, tax increases on somebody else, or a crackdown on waste, fraud and abuse. Your taxes will probably go up, and some government programs you favor will become less generous.

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