Apex Macro

Apex Outlook

from Danny Robushi

War Games: Monetary & Fiscal

-- February 22nd, 2025

Summary

The Growing Fiscal Imbalance:

- U.S. deficits have surged post-pandemic, straining the economy despite low unemployment
- Rising debt and higher refinancing costs raise long-term fiscal risks

The Shift Toward Fiscal Dominance:

- Deficit spending now drives growth, making traditional monetary policy less effective
- High debt-to-GDP levels weaken the Fed's ability to control inflation

Structural Debt Challenges & Demographic Pressures:

- Aging populations and weak productivity growth fuel fiscal imbalances
- Entitlement burdens grow while labor force participation declines

The Dilemma of Debt Buyers & Market Stability:

- Foreign and domestic buyers of U.S. debt are shrinking
- The Fed may be forced to monetize more debt, worsening inflation and inequality

The idea that the United States is on an unsustainable fiscal path has been raised countless times over the past several decades. It has been debated so frequently—without immediate, catastrophic consequences—that it has come to resemble something akin to the "boy who cried wolf". However, post-pandemic, concerns over excessive government spending, rising deficits, and the expanding national debt have grown louder, to the point where they are now mainstream economic issues rather than niche policy discussions.

These concerns have even spurred the formation of a task force led by Elon Musk, known as D.O.G.E. (Department of Government Efficiency), which is actively auditing federal financials in an attempt to slow debt accumulation and prevent a fiscal crisis. Over the past five years, the national debt has grown by more than $14 trillion, pushing interest payments higher than nearly every other government expenditure—including defense spending. The only remaining outlier is Social Security.

Compounding this issue is the government's need to refinance 33% of its existing debt at significantly higher interest rates while simultaneously issuing new debt to cover an annual $2 trillion deficit—this, despite historically low unemployment. The market's capacity to absorb this level of issuance is being tested, and for the first time in decades, both citizens and policymakers are actively seeking ways to rein in deficit growth.

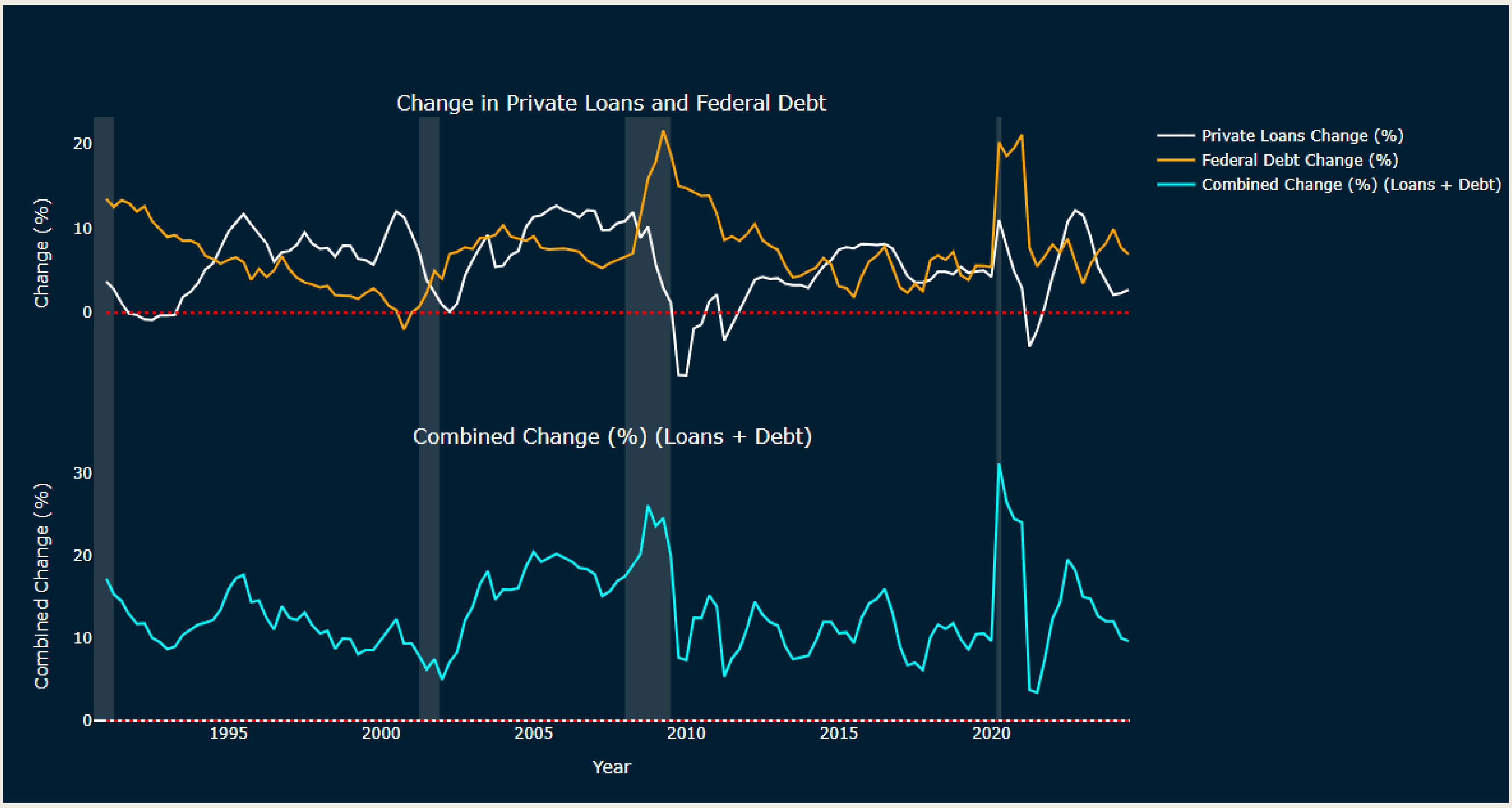
Yet, the situation has evolved beyond a traditional fiscal challenge. Deficits have grown so large that they are now primary drivers of both economic growth and inflation, overshadowing the impact of monetary policy. The conventional tool of raising interest rates, typically used to control inflation, appears to have exacerbated the problem rather than solving it. Government spending has become the dominant force in the economy, making inflation increasingly resistant to Federal Reserve actions.

This dynamic—where persistent deficits fuel inflation, and interest rate hikes fail to contain it—is more typical of an emerging market economy than a country that issues the world's reserve currency. In this piece, we examine the evolving relationship between fiscal and monetary policy, arguing that without meaningful reductions in government spending and a shrinking deficit, bringing inflation down to target will remain an uphill battle—one that the Federal Reserve is no longer positioned to solve alone.

Periods of rapid government debt growth typically coincide with economic crises, such as the Global Financial Crisis (GFC) or the COVID-19 pandemic. In both cases, debt issuance surged as the government provided a backstop to stabilize rising unemployment and ensure liquidity for refinancing existing obligations.

However, since 2020, the primary driver of debt accumulation has shifted. Unlike previous crises, where emergency spending tapered off as conditions improved, the Federal Government has continued to expand debt issuance, even in the absence of a clear economic emergency. This sustained level of deficit spending has likely propped up economic growth over the past few years but has also slowed the pace at which inflation has declined from its 9.1% peak.

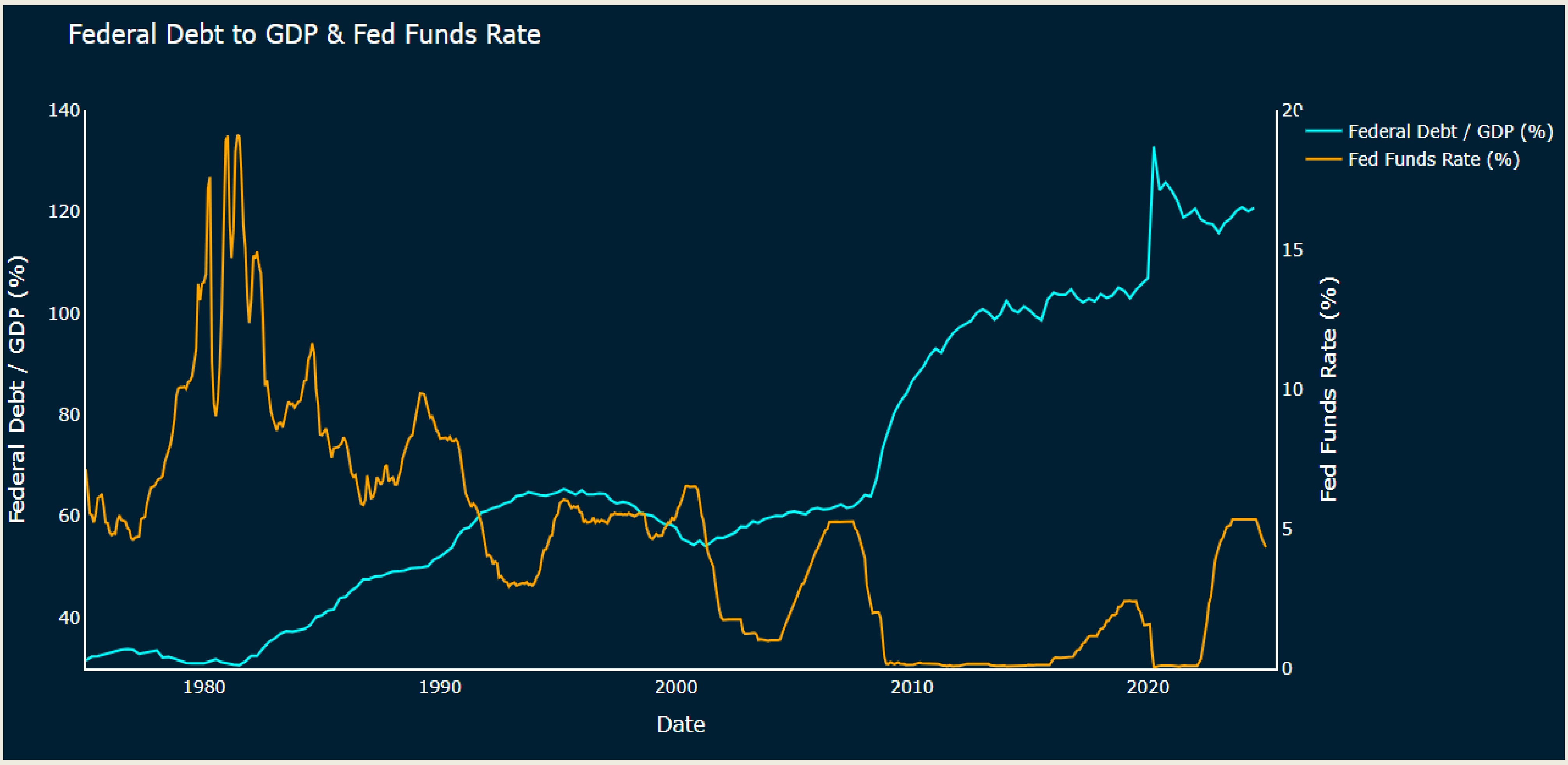
Unlike private sector debt, which is often allocated toward productive investment, public sector debt is frequently less efficient, as it injects demand into the economy without a corresponding increase in supply. This imbalance contributes to persistent price pressures, making it harder for inflation to moderate naturally.



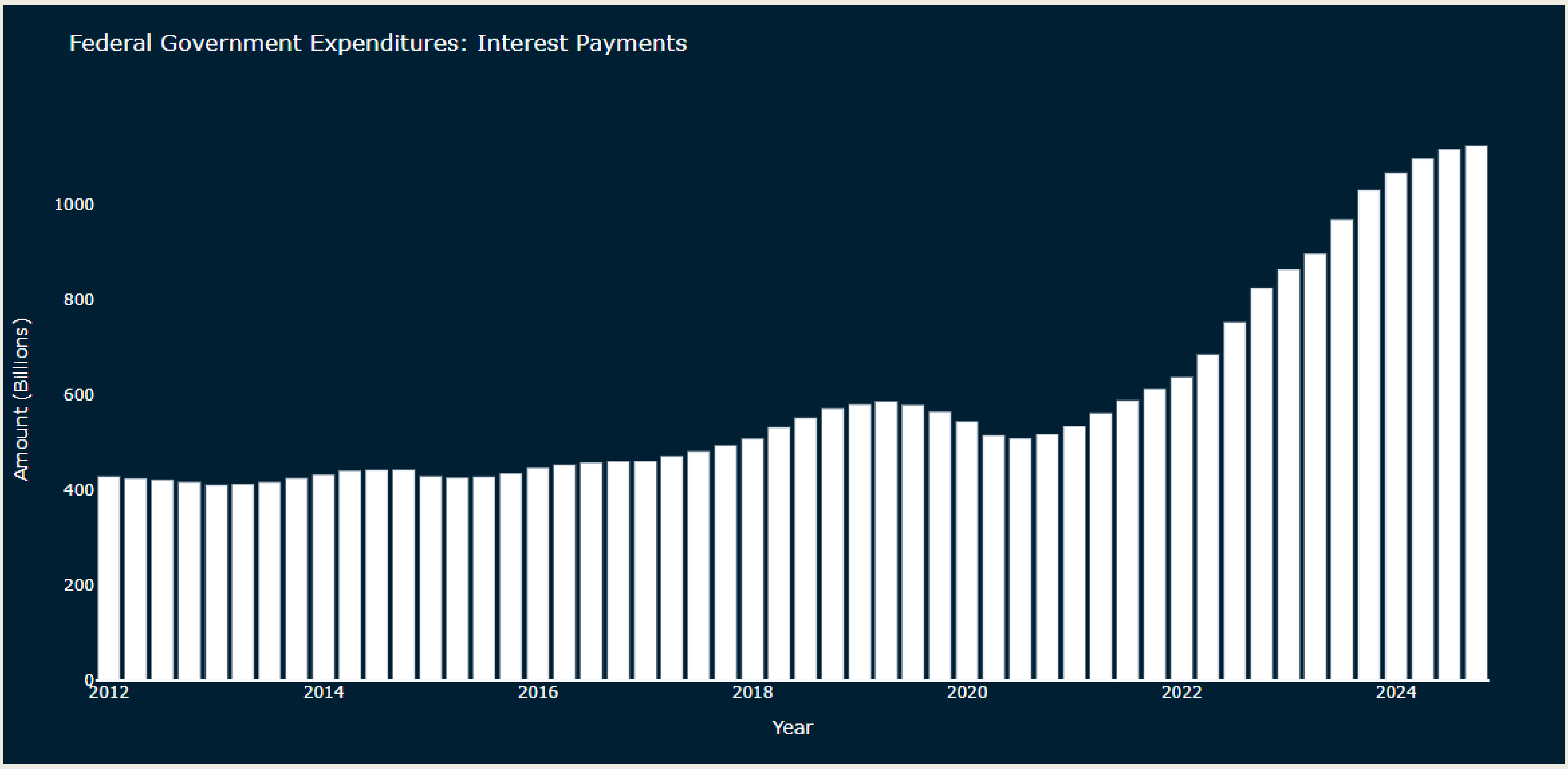
Rising debt levels and government spending are not unique to the United States. Across the developed world, particularly in G7 countries, projections indicate that debt burdens will continue to rise in the coming decades. A key driver of this trend is demographic shifts, which are increasingly acting as a headwind to economic growth. Without significant productivity gains to support nominal GDP growth, governments will face a widening gap between spending obligations and revenue generation. The politically expedient solution to this shortfall will likely be further debt issuance, as it is far more palatable than implementing austerity measures or allowing major debt defaults.

This dynamic will continue to challenge central banks in their fight against inflation, creating an environment increasingly susceptible to fiscal dominance. U.S. debt-to-GDP is now hovering at levels not seen since World War II, yet unlike past decades, interest rates are no longer in a structural decline. Since the late 1980s, steadily falling rates made it easier for both governments and central banks to manage and expand debt burdens without triggering market instability. However, with rates now moving in the opposite direction, this process becomes far more complex, raising the risks associated with persistent deficits and higher borrowing costs.

Over the past four years, the Federal Funds Rate has increased fivefold, while public debt-to-GDP has surged by more than 30%, surpassing 120%.



The combination of rising interest rates and growing debt levels has pushed annual interest payments above $1 trillion, making it the second-largest line item in the federal budget.



This massive debt burden and the rising costs of refinancing comes at a time when the federal government is expected to continue running large fiscal deficits for the foreseeable future. Compounding this issue, the current administration is exploring tax cuts while proposing to partially offset the revenue shortfall with tariff income—a strategy that relies on an unstable and unpredictable revenue base. These conditions have laid the groundwork for what we believe is a clear shift into a period of fiscal dominance. We've used the term several times, but to define it explicitly:

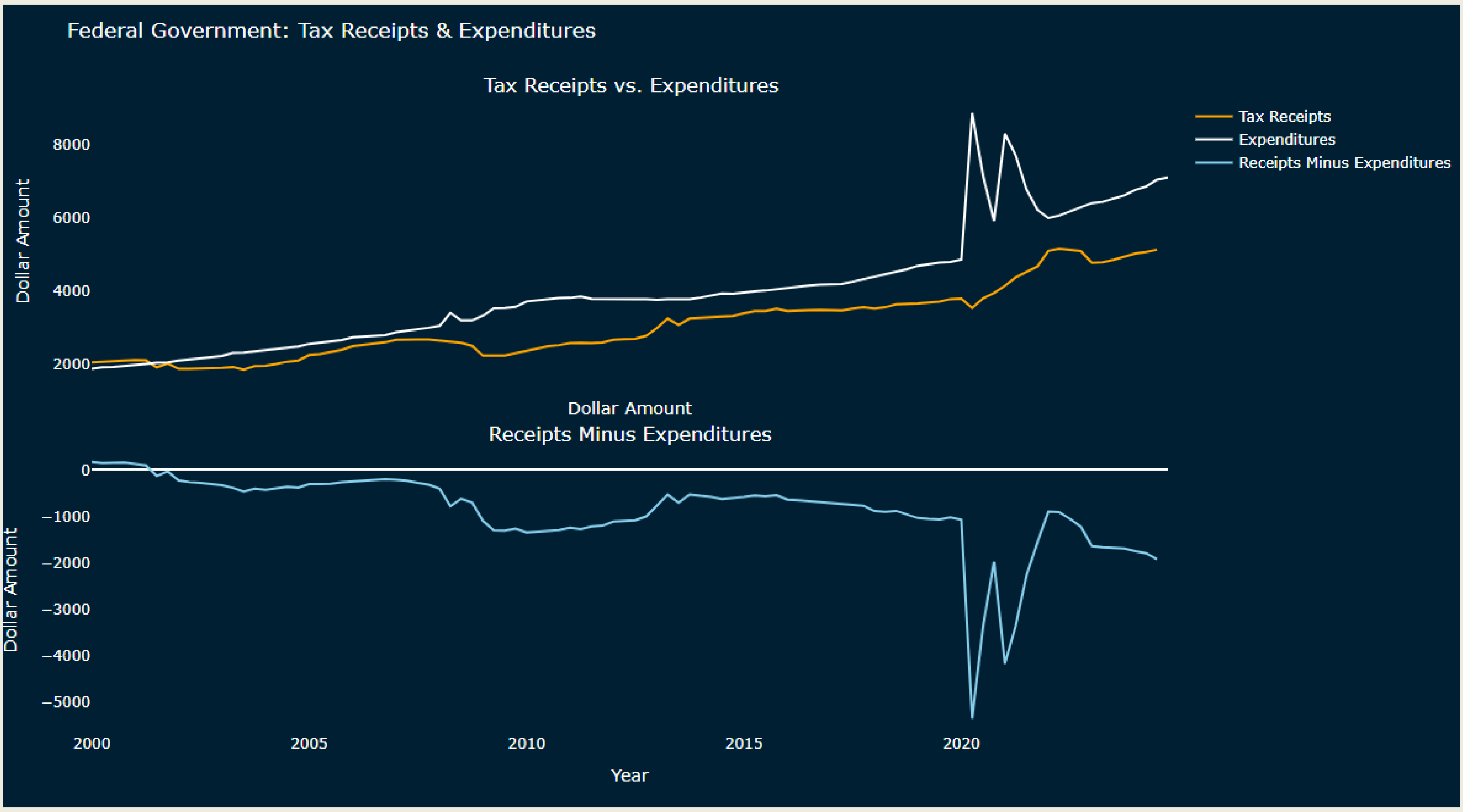
Fiscal Dominance occurs when a country's debt and deficit levels are so high that monetary policy is no longer an effective tool for controlling inflation. In this environment, persistently elevated interest rates—instead of dampening inflation—risk fueling it further, particularly when large deficits continue to inject demand into the economy.

To better understand Fiscal Dominance, it is essential to first examine the primary ways money is created:

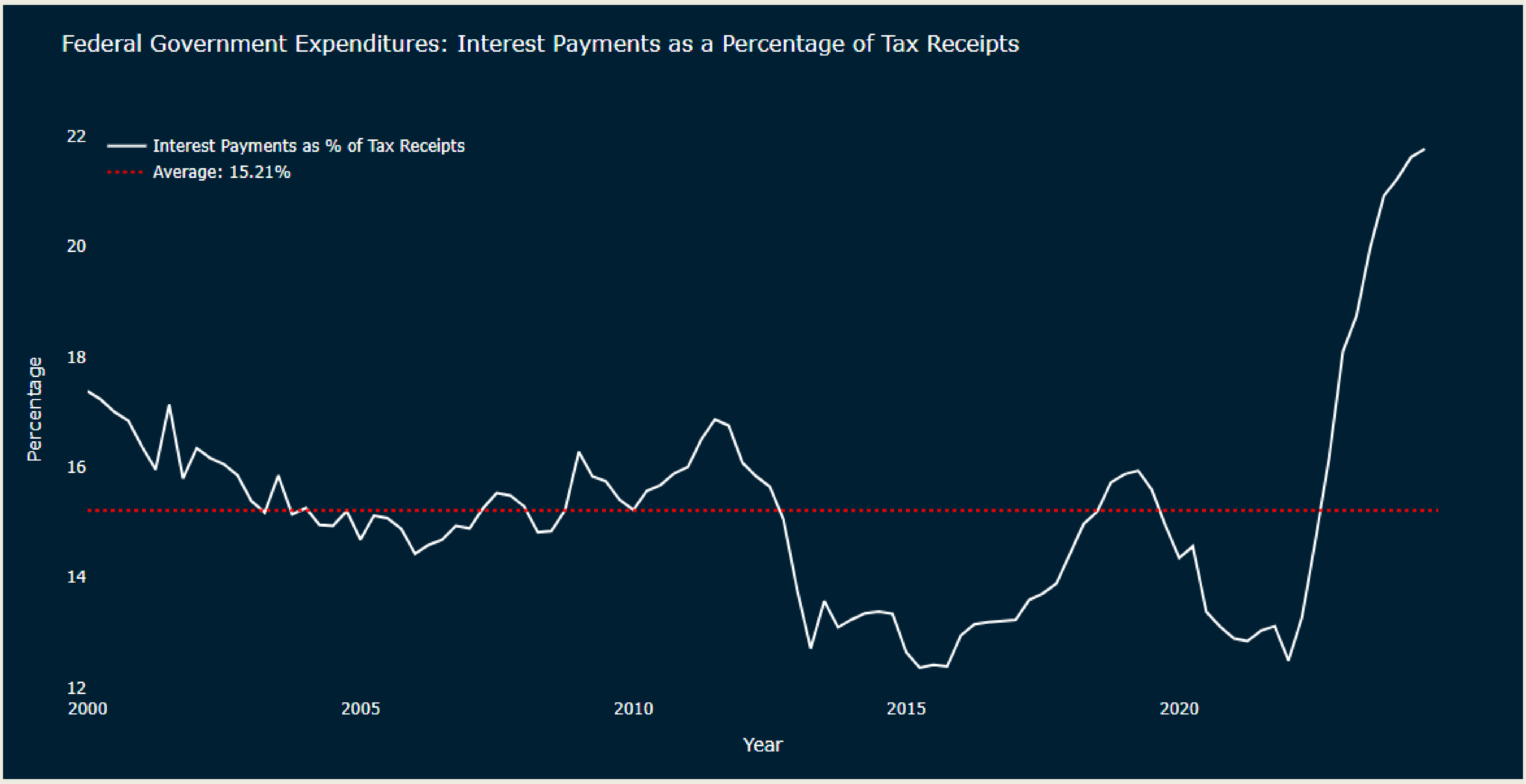
Private Sector Lending – Money is created when banks and private credit institutions (shadow banks) issue loans. Each new loan expands the money supply, and conversely, when loans are repaid or defaulted on, money is effectively destroyed, leading to a contraction in the money supply.

Monetized Government Deficits – When the government spends more than it collects in taxes, it issues debt to finance the shortfall. If the central bank funds government spending by purchasing this debt directly or indirectly, it expands the money supply. In this case, money is later destroyed when the central bank allows the debt to mature or actively sells its holdings of securities.

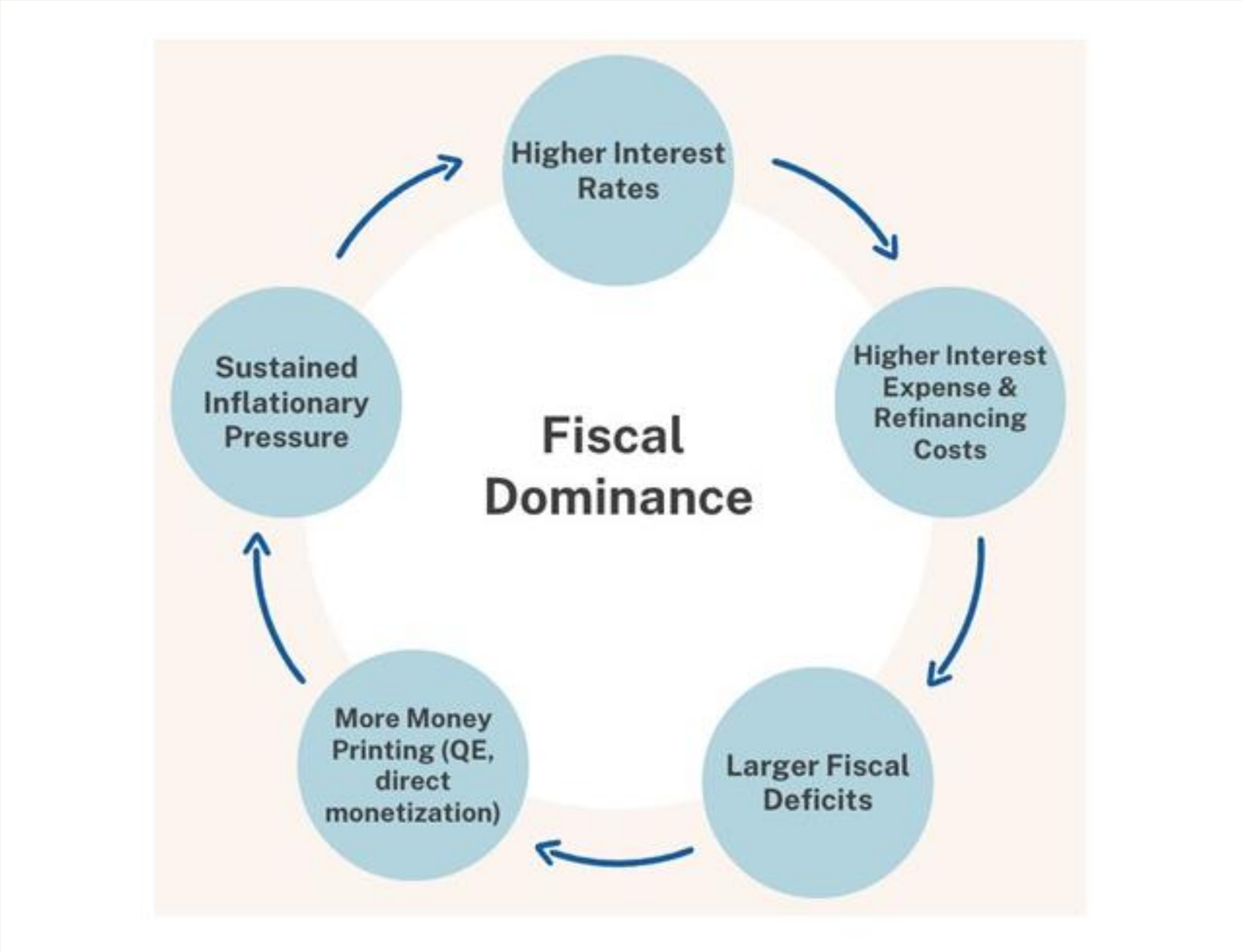
Historically, private sector lending—alongside central bank interest rate policy—has played a leading role in driving economic activity. However, in recent decades, government spending has persistently outpaced revenue collection, leading to larger fiscal deficits that have become an increasingly dominant force in the economy. As deficits continue to expand, their influence over economic growth and inflation will only grow, making fiscal policy—not monetary policy—the primary driver of macroeconomic conditions moving forward.



This shift is driven by the size and structure of government debt. With over $36 trillion in outstanding obligations and an increasing reliance on short-duration borrowing, higher interest rates now translate into rapidly rising borrowing costs. As these costs increase, so does the amount paid in interest to bondholders. The federal government collects nearly $5 trillion in tax revenue, yet over 20% of that is now being paid back out as interest, effectively recycling a significant portion of tax receipts back into the economy rather than funding essential services or investment.



This dynamic can be viewed as a form of stimulus, even as the Federal Reserve raises rates to constrain private sector lending. Higher interest payments on government debt inject additional liquidity into the economy, effectively creating demand and counteracting the Fed's tightening efforts. The result is an inflationary feedback loop: rising interest rates lead to higher government interest payments, which in turn widen the deficit and stimulate economic activity, preventing inflation from falling as intended. This cycle makes it increasingly difficult for monetary policy alone to rein in inflation, as fiscal expansion offsets the intended cooling effects of higher rates.



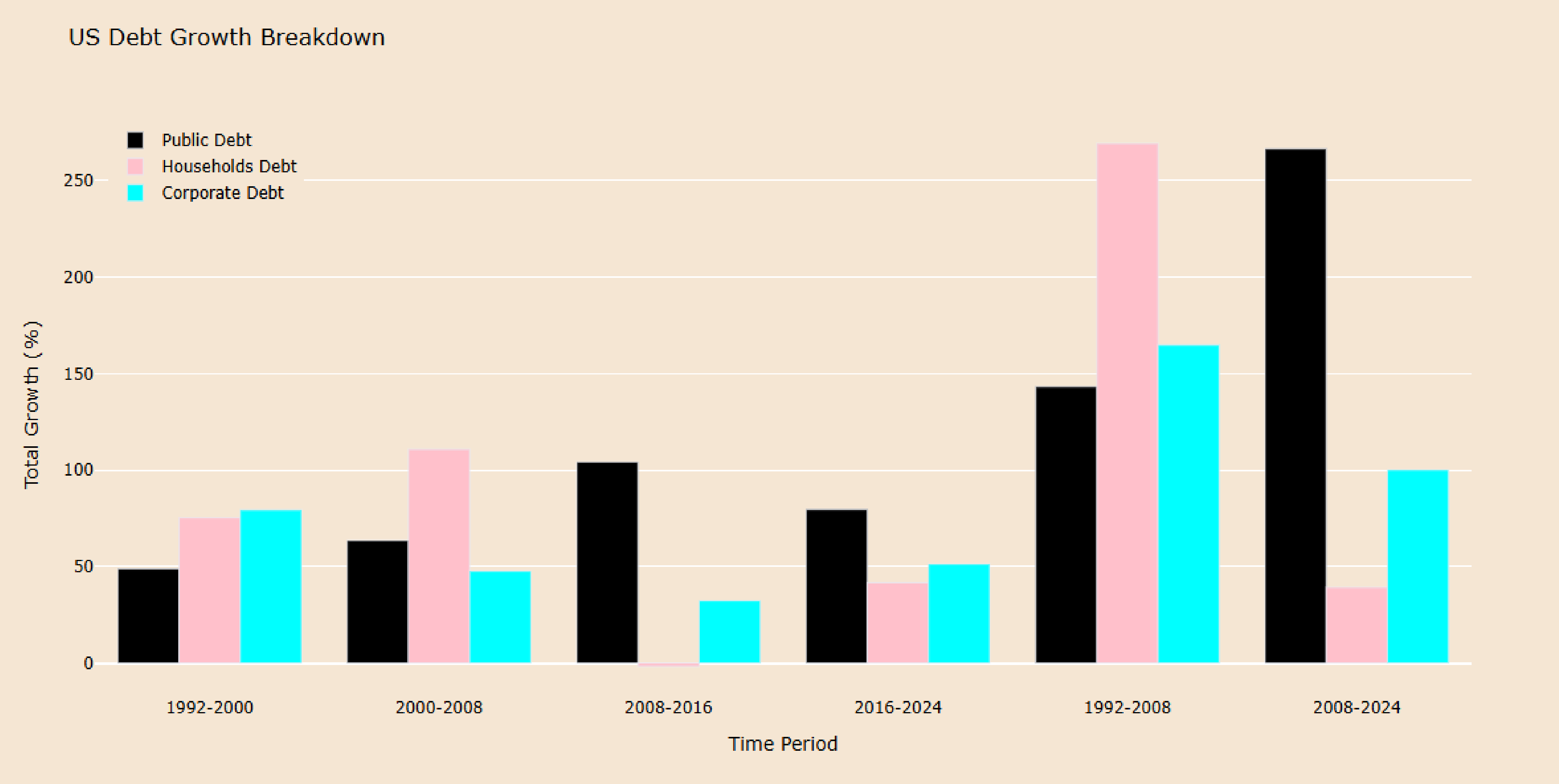
At the same time, much of private sector debt is fixed and locked in long-term rates, making it less sensitive to higher interest rates. In this environment, fiscal deficits become the primary driver of economic activity, while traditional monetary tools like rate hikes lose their effectiveness. If we are indeed in a period of Fiscal Dominance, then the Federal Reserve is relying on the wrong tool to bring inflation back to its 2% target.

The chart below illustrates the total growth in debt across different sectors from the 1990s through 2024, breaking it down into Public, Private, and Corporate debt. The data highlights distinct shifts in debt accumulation patterns:

- 1992–2000: Corporate debt grew the most, increasing 79%, leading up to the Dot-Com Crash of 2001
- 2000–2008: Household debt became the primary driver, surging 110%, culminating in the Great Financial Crisis (GFC)
- Post-2008: Public sector debt took over, growing 266% over the past 17 years, while household debt growth slowed to just 39%, a steep decline from its 269% growth in the pre-GFC era

When grouping these into two major periods—1992 to 2008 and 2008 to 2024—a clear shift emerges:

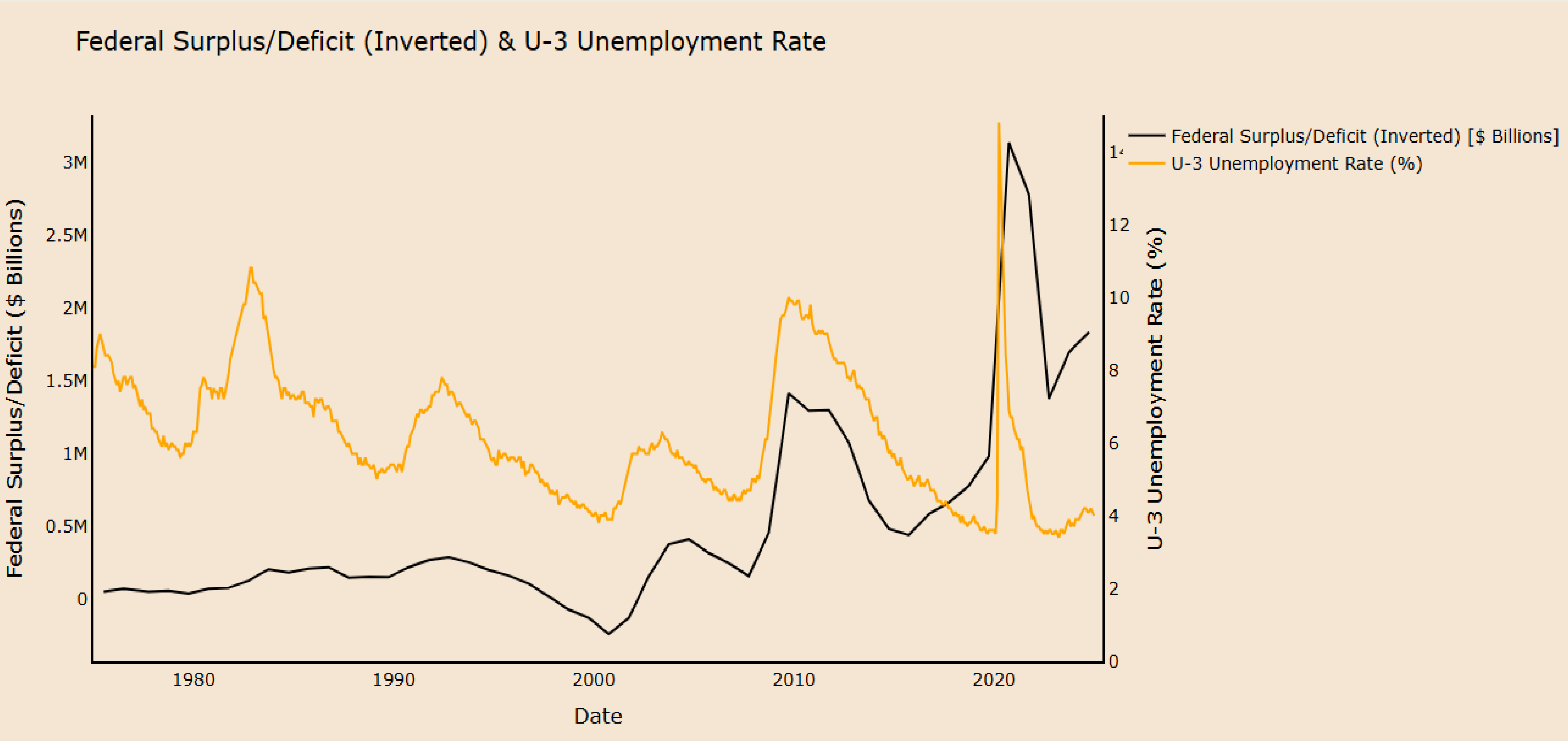
- 1992–2008: Public sector debt saw the least growth, while private debt expansion fueled economic cycles
- 2008–2024: Public sector debt became the dominant driver of economic activity, accelerating precisely when the Federal Reserve began monetizing debt to bail out the banking system post-GFC



With government spending taking the reins, it becomes increasingly clear why the U.S. economy has remained stronger than much of the rest of the world over the past four years. The United States has the largest fiscal flexibility, largely due to the natural global demand for the U.S. dollar, which remains the world's reserve currency and facilitates a vast portion of global debt issuance and trade. The challenge, however, is that these deficits appear to have become more structural than cyclical. This presents a binary choice moving forward:

- Continue supporting deficits through monetization, accepting a persistently higher inflation environment
- Cut deficits, triggering a sharp rise in unemployment and likely causing an economic downturn

A widely circulated chart that illustrates this dynamic is the inverted deficit plotted against the U-3 unemployment rate. The key takeaway is that deficits are already at record levels while unemployment remains at cycle lows. Historically, when the unemployment rate rises, the deficit expands further—meaning that when the next economic downturn arrives, the already elevated deficit is likely to worsen unless proactive steps are taken now to bring it under control.

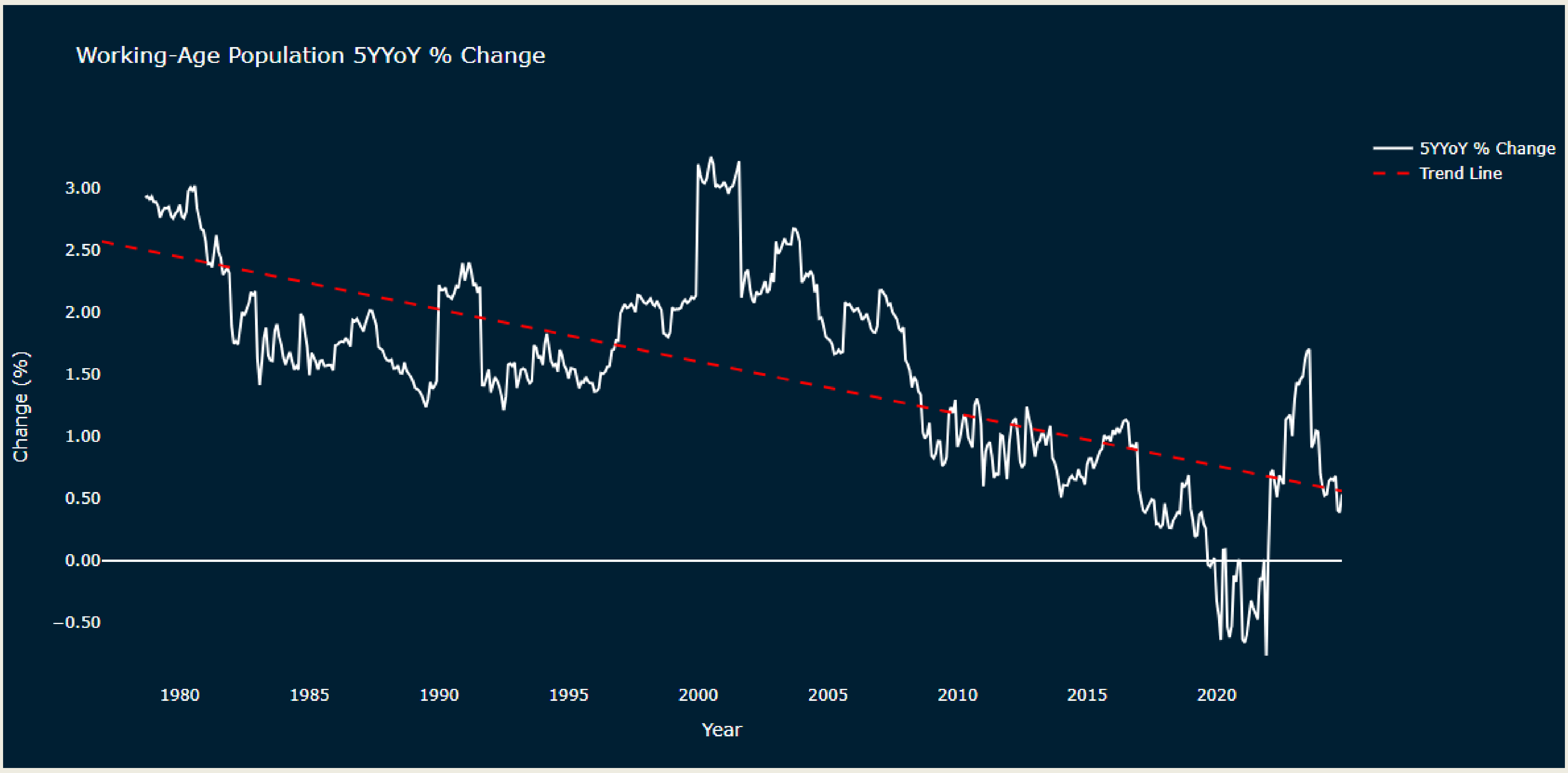


A quote from Nobel Laureate Paul Samuelson resonates deeply in today's environment:

"We should stimulate when the economy is weak and rein in when the economy is strong. It's not the idea of stimulus or deficits that's dangerous, it's the failure to turn off the tap."

With that in mind, what happens when policymakers fail to turn off the tap and are eventually forced to do so after a prolonged period of deficit-driven growth? This is a question the U.S. economy may soon have to answer. However, it's important to acknowledge that some of the factors driving the deficit are structural, rather than purely discretionary. An aging population, rising healthcare costs, and compounding interest payments on decades of accumulated debt all contribute to the growing fiscal burden. In other words, the deficit is not solely the result of policy choices, but also a byproduct of systemic obligations—this is what we mean by "structural."

One of the key forces behind this dynamic is the declining working-age population, which is the primary input for GDP growth and wage generation. Since the 1980s, the five-year rate of change in the working-age population has consistently trended lower, placing increasing pressure on the workforce to support a growing retired population. As more people exit the labor force than enter, entitlement obligations expand.

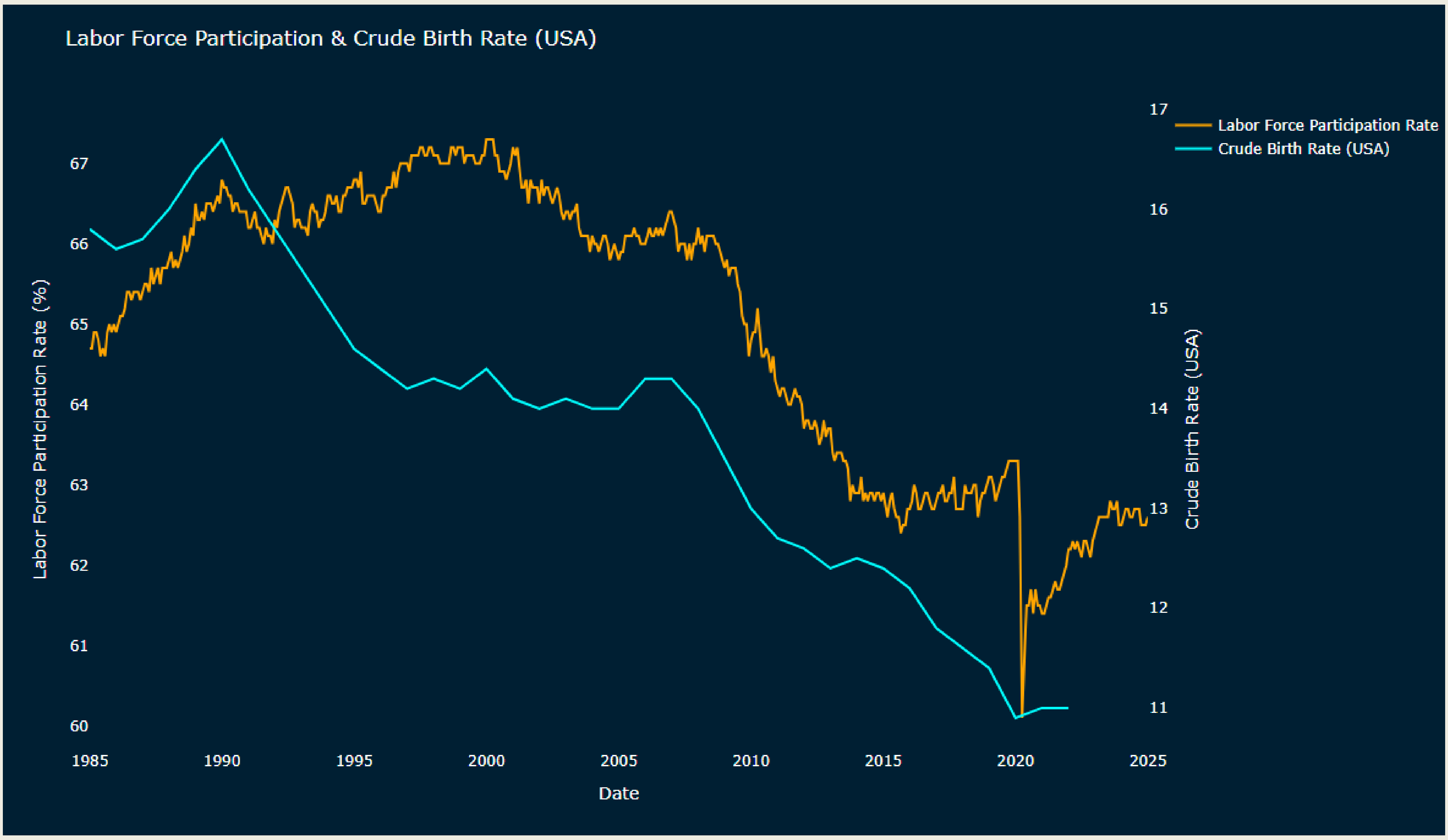


The declining working-age population is a direct consequence of a falling birthrate, which has been consistently declining since the 1990s. As a result, the Labor Force Participation Rate has also fallen, as shown in the chart below. Unlike in previous decades, when the U.S. workforce expanded significantly due to rising female labor force participation from the 1960s through the 1990s, there is no equivalent demographic offset today to help drive productivity and GDP growth. There are two potential solutions, but both come with significant challenges:

Immigration – While immigration can help expand the workforce, the past four years have shown how politically unpopular rapid immigration policies have become. Additionally, a country can only integrate incoming immigrants so quickly before living standards deteriorate, as infrastructure, housing, and social systems struggle to adjust. Beyond that, there is often a mismatch between the skills of incoming workers and the jobs required in a highly developed economy. Canada's recent push to drive population growth through immigration resulted in a significant decline in GDP per capita, illustrating the risks of this approach.

Increasing the Birthrate – Encouraging higher birthrates would require a major societal shift, yet trends in digital consumption, social media, and declining human interaction make this a difficult challenge. Cultural and economic factors—such as the rising cost of living, childcare expenses, and changing lifestyle preferences—further complicate efforts to reverse the trend.

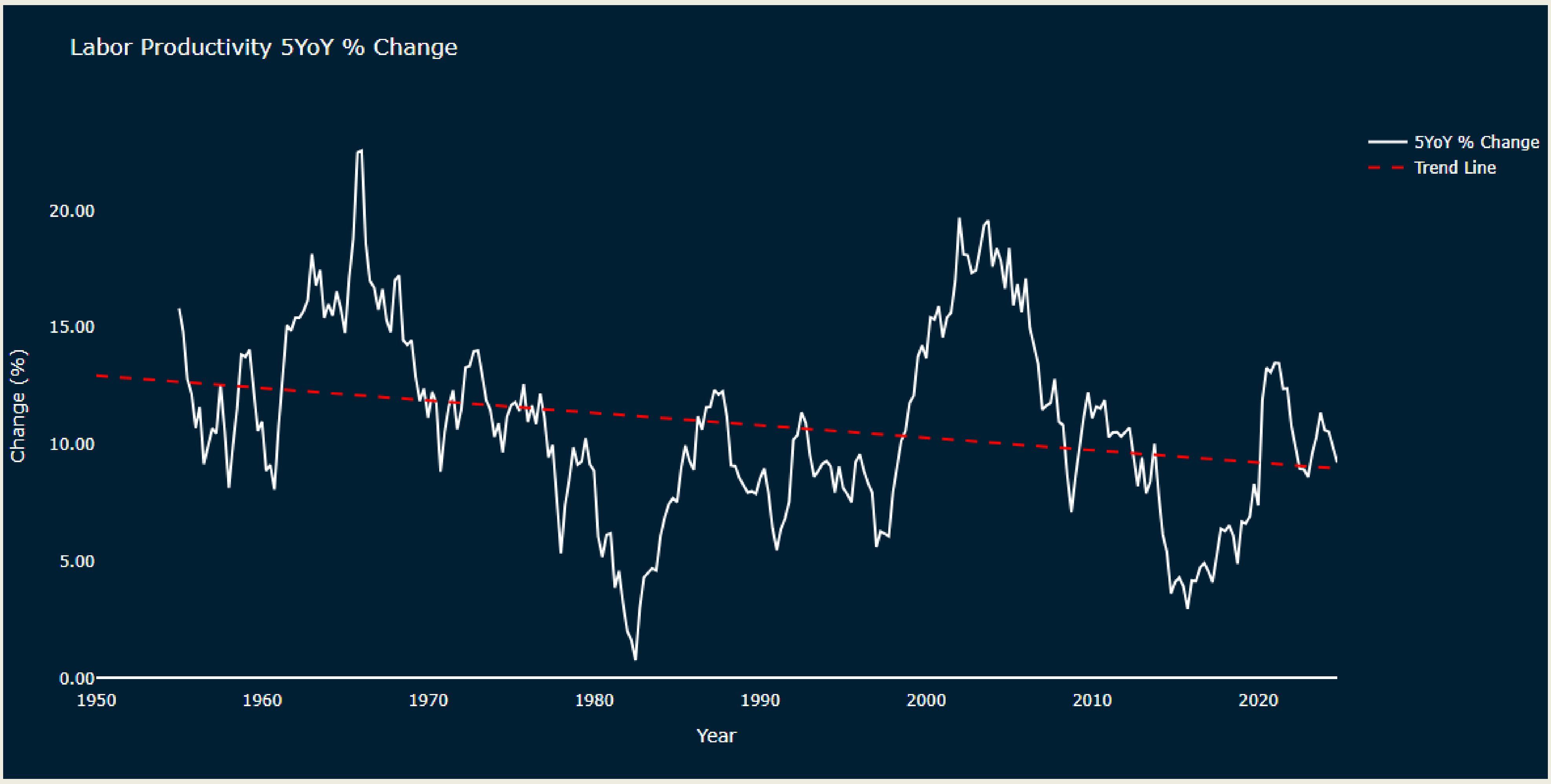
The alternative solution that is already taking shape is automation, which explains the aggressive push toward AI development. In many ways, AI and automation are being positioned as a new labor force to compensate for structural labor shortages. However, while automation may fill the gap, it also introduces entirely new economic and social challenges, particularly around job displacement and wage pressures.



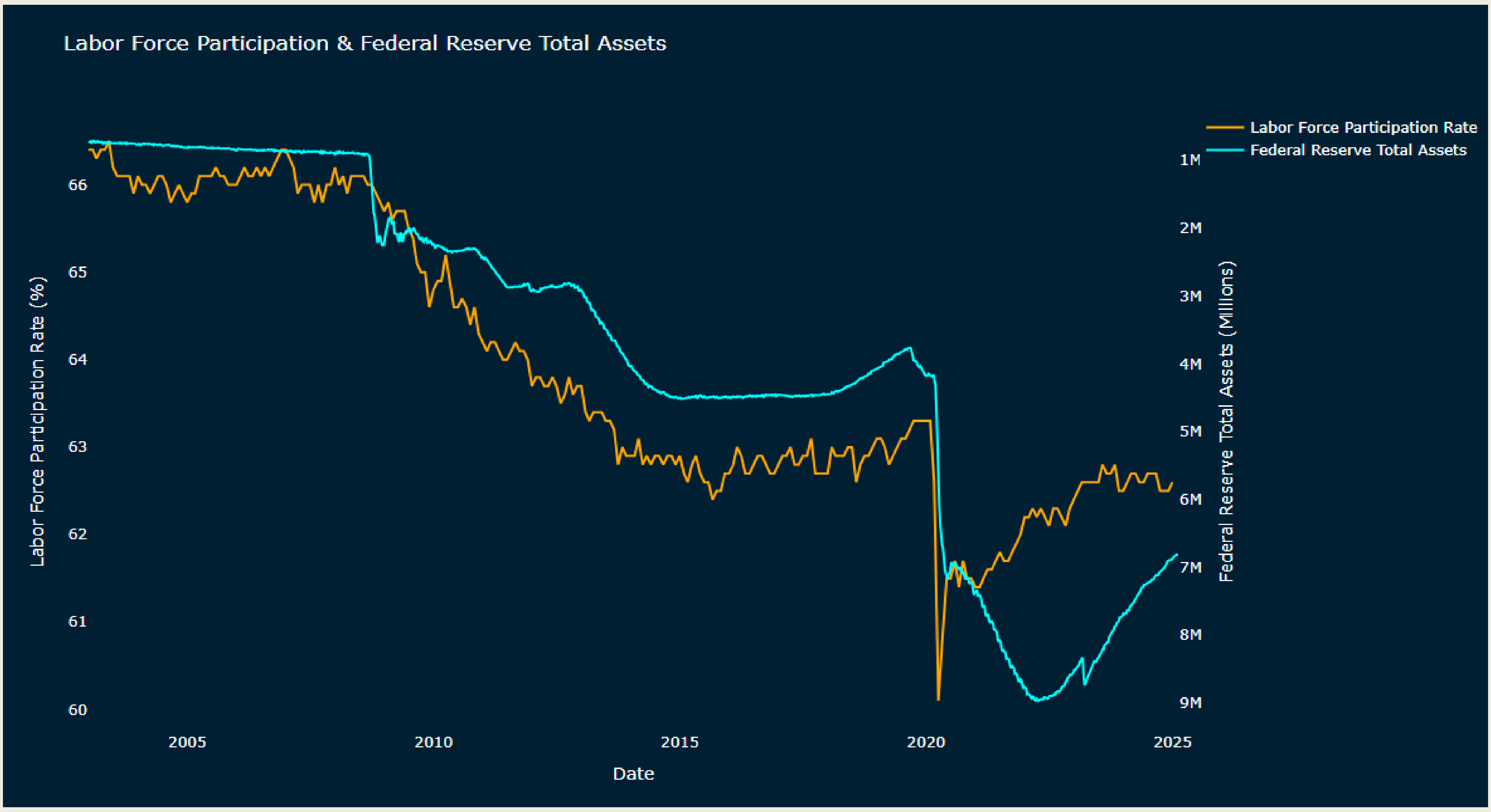
The other major input into GDP growth is productivity. While the internet and computers have undoubtedly made people more productive in both their jobs and daily lives, they have also introduced significant distractions, which, in our view, have offset much of those productivity gains. Today, the hope is that AI and large language models (LLMs) will enable the development of new agents and automation tools that provide a substantial boost to productivity. This potential explains why major tech companies are collectively investing an estimated $400 billion into AI research and development. A simple way to think about productivity's role in economic growth is through workforce efficiency:

Imagine a company with 100 employees where 10 retire—their output is now lost, leading to a 10% drop in production. However, if new technology is introduced that makes each remaining worker incrementally more productive while working the same number of hours, they can compensate for the lost output. This is the fundamental mechanism behind productivity gains and their role in GDP growth.

Looking at the same long-term trend chart used for the working-age population, but replacing it with productivity growth, we see a similar structural decline. While productivity has trended lower since 1950, the slope has been less steep, yet the downward trajectory remains evident. This makes the expected productivity boost from AI even more critical in the coming years. If AI-driven automation can reverse or stabilize this trend, it could play a key role in sustaining long-term economic growth despite demographic headwinds.



For the past 20 years, the solution to bridging the gap between GDP growth (and thus tax revenue) and rising government spending has been large deficits and increasing debt levels. These fiscal policies have been used to prop up the economy and maintain the broader population's standard of living. A particularly telling relationship emerges when we invert the Federal Reserve's balance sheet against the Labor Force Participation Rate—a correlation that highlights how government intervention has injected liquidity into the banking system precisely as structural shifts in the workforce have unfolded. This dynamic has kept GDP per capita elevated, sustaining economic stability for those who own assets. And that last point is key—the benefits of these policies have disproportionately accrued to asset holders, reinforcing wealth inequality as financial markets have been the primary recipient of excess liquidity.



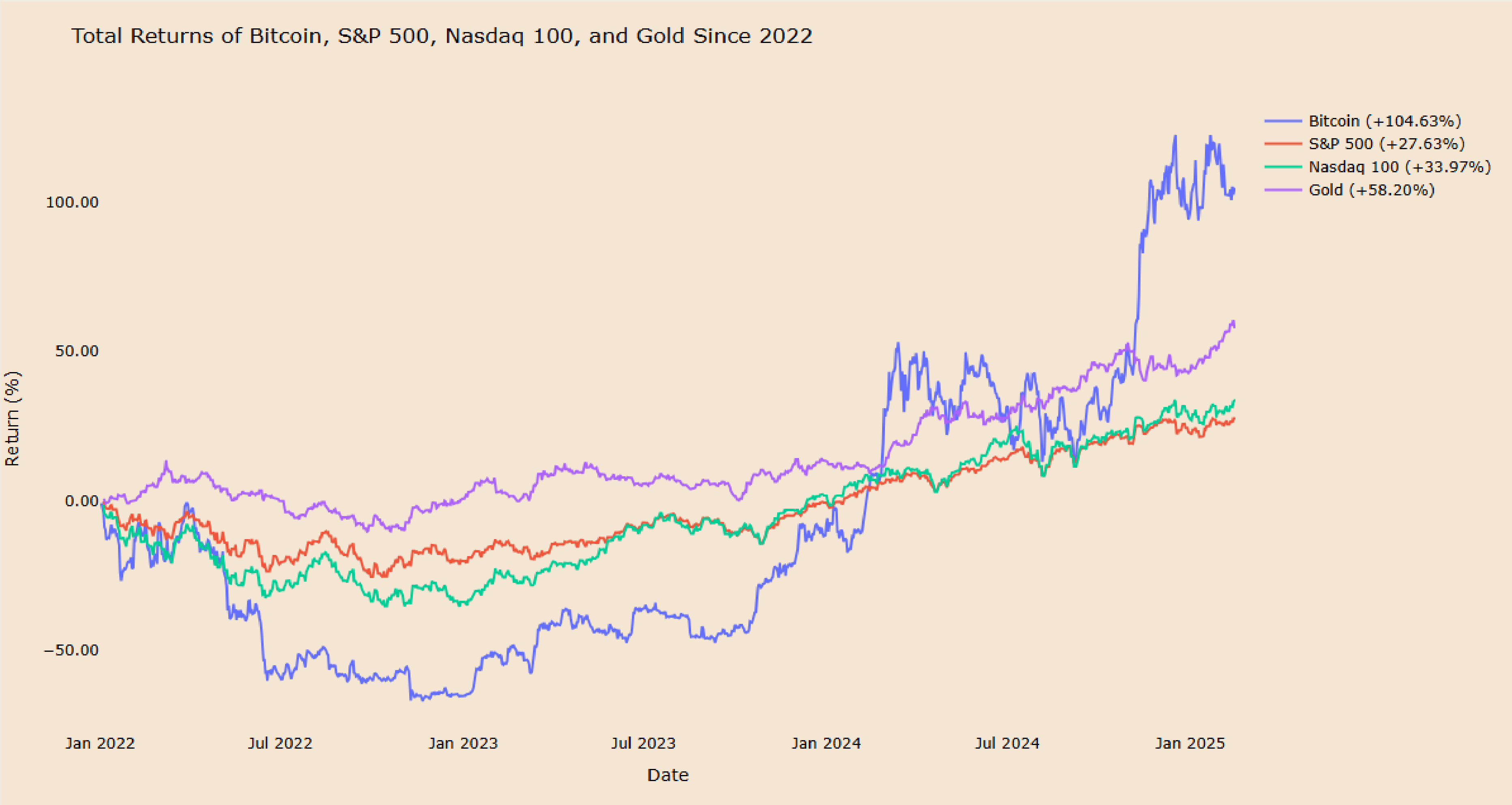
Expanding on our emphasis on asset ownership, this also highlights one of the major consequences of structural deficits—the growing wealth divide and, in turn, the rise of populism in the U.S. When the money supply expands, it inevitably leads to inflationary pressures. However, inflation does not manifest exclusively in consumer prices—it appears across a broader spectrum of economic variables. These include:

Monetary Inflation – This occurs when the broad money supply expands at a rate that exceeds the economy's productive capacity. The total stock of money, often measured by M2, increases as governments engage in deficit spending, central banks inject liquidity, and financial institutions expand credit. When this excess liquidity is not absorbed through higher economic output, it results in inflationary distortions, affecting various markets and eroding the purchasing power of currency over time.

Consumer Price Inflation – This refers to the increase in the nominal price of goods and services over time. It results from a combination of demand-side pressures, such as rising incomes or government stimulus, and supply-side constraints, like shortages in key inputs or production bottlenecks. If wage growth fails to keep pace with rising consumer prices, real wages decline, reducing purchasing power and increasing the cost of living.

Asset Price Inflation – This occurs when an expansion of the money supply disproportionately flows into financial assets, driving up valuations of stocks, bonds, real estate, and commodities. Unlike consumer price inflation, which directly affects everyday goods and services, asset price inflation benefits those who hold financial assets while making it harder for those without assets to accumulate wealth. It is particularly pronounced during periods of monetary easing and fiscal expansion, where liquidity injections support financial markets rather than broad-based economic growth.

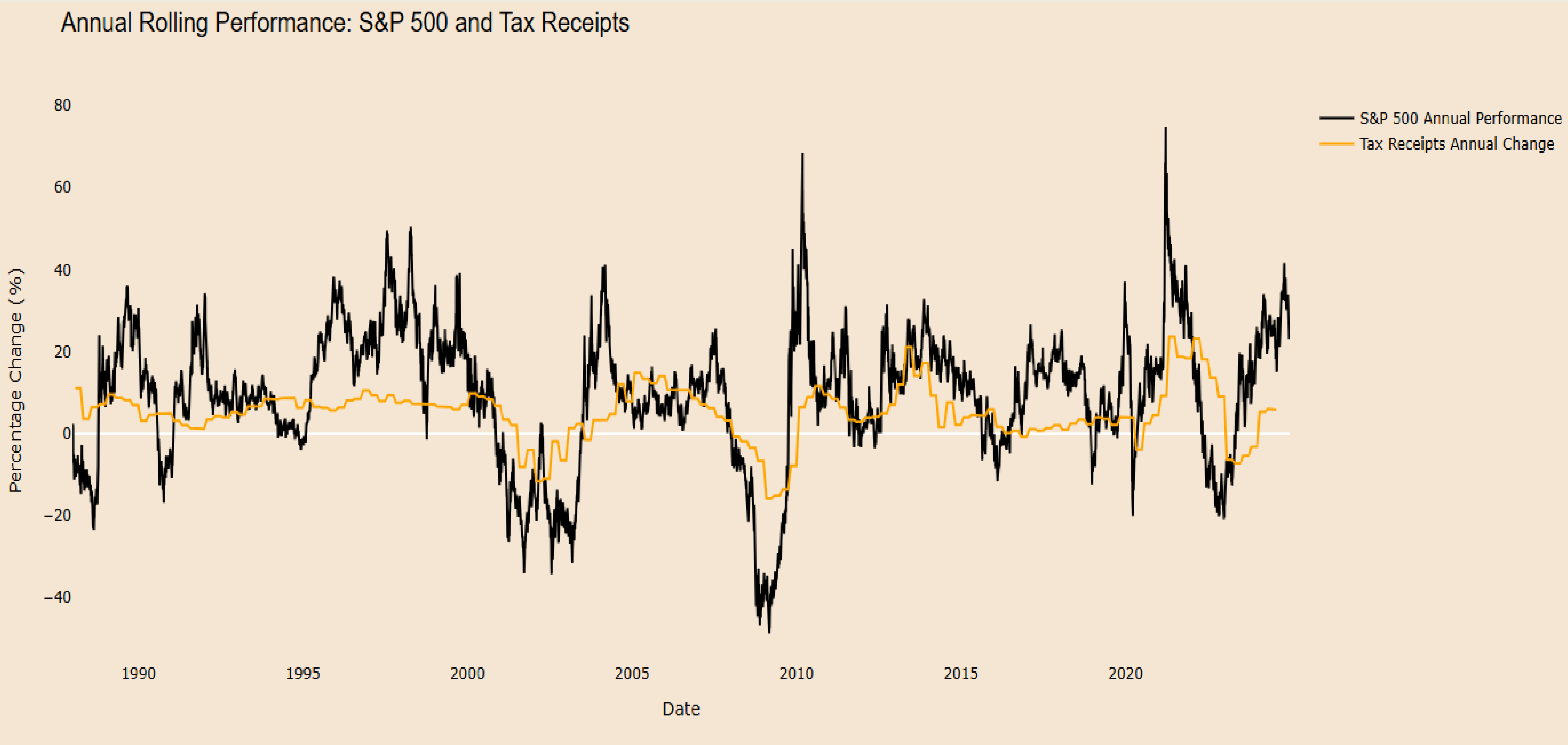
Without significant supply constraints in energy, raw materials, and other commodities, fiscal dominance and liquidity injections through government spending tend to flow disproportionately into financial assets, rather than significantly driving up the price of goods and services. This has been particularly evident since CPI peaked in mid-2022, as financial markets and real estate values have continued to rise while broader inflation pressures have stabilized.



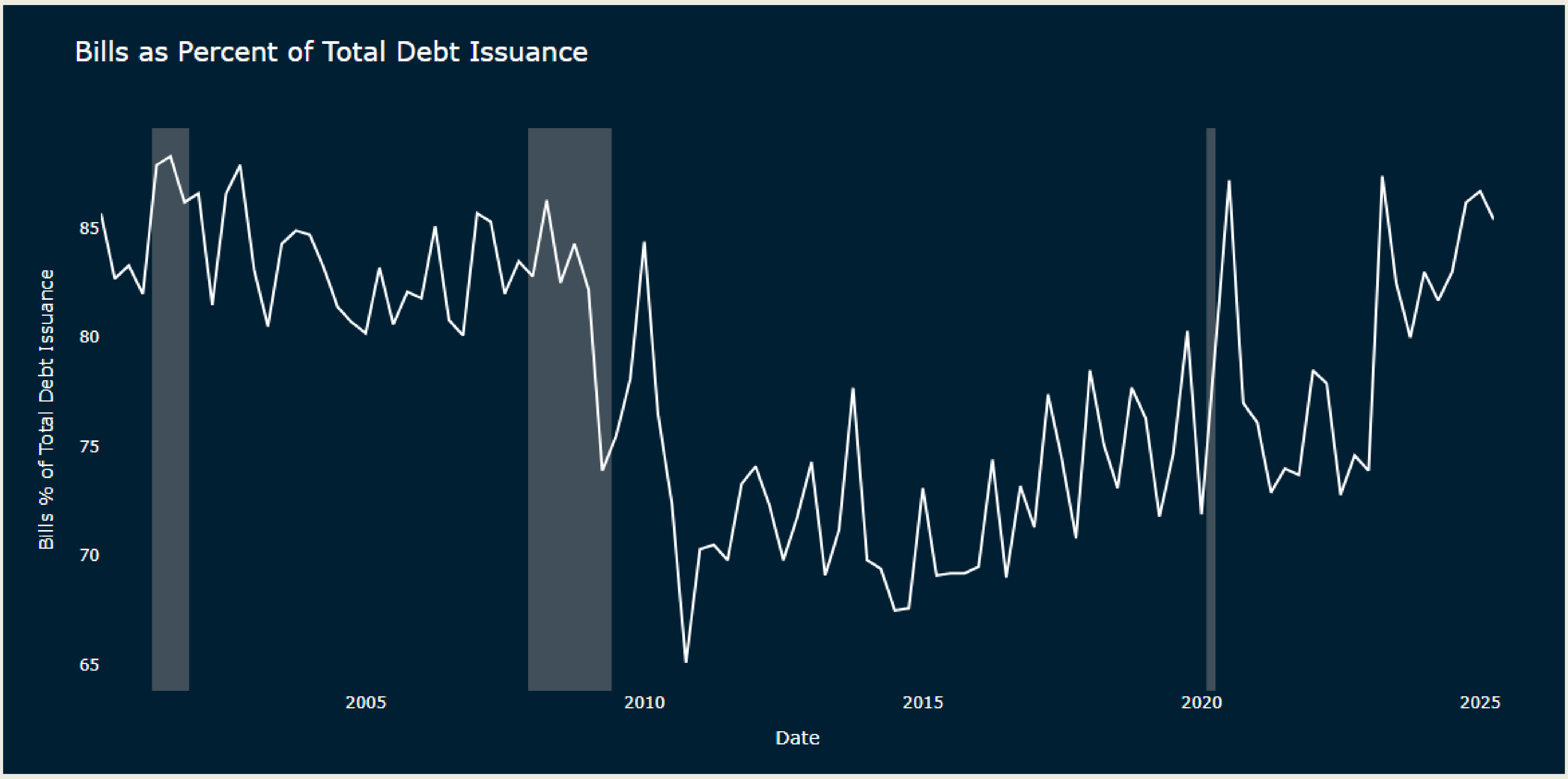
The rise in asset prices has deepened the divide between those who own assets and those who do not, underscoring a frustrating reality: while inflation may appear under control according to the CPI, surging asset prices erode purchasing power, making them increasingly unaffordable. Asset price inflation disproportionately benefits high-income earners and households with substantial holdings, exacerbating social divisions as wealth inequality continues to expand.

Moreover, while the Federal Reserve's rate hikes may suppress demand in certain sectors, they fail to address the root cause of today's inflation: structural fiscal deficits. These deficits have become the primary driver of liquidity and inflation, rendering the Fed's traditional tools largely ineffective. Worse still, keeping interest rates elevated only worsens the fiscal imbalance by increasing borrowing costs and widening deficits.

An additional consequence of this scenario is the increasingly strong correlation between tax revenues and asset prices. As a result, economic growth—and by extension, deficit control—has become increasingly reliant on maintaining elevated asset prices. A downturn in asset performance risks a decline in tax receipts, further widening the deficit in a self-reinforcing cycle.



This explains why Janet Yellen shifted debt issuance to the front end of the yield curve back in 2023 and why Scott Bessent has continued this policy, as reflected in the first Quarterly Refunding Announcement (QRA) released under his tenure as Treasury Secretary. Despite previously criticizing Yellen's strategy, Bessent recently stated in a Bloomberg interview that extending the maturity of U.S. debt remains a distant prospect.



Both Yellen and Bessent are well aware that disrupting the long end of the yield curve would negatively impact asset prices and, in turn, widen the deficit. Bessent's call to push the 10-year yield lower, along with the administration's acknowledgment that it is less concerned about short-term rates, speaks volumes. This suggests that a soft form of yield curve control will persist, aimed at sustaining elevated asset prices and maneuvering around the constraints of monetary policy.

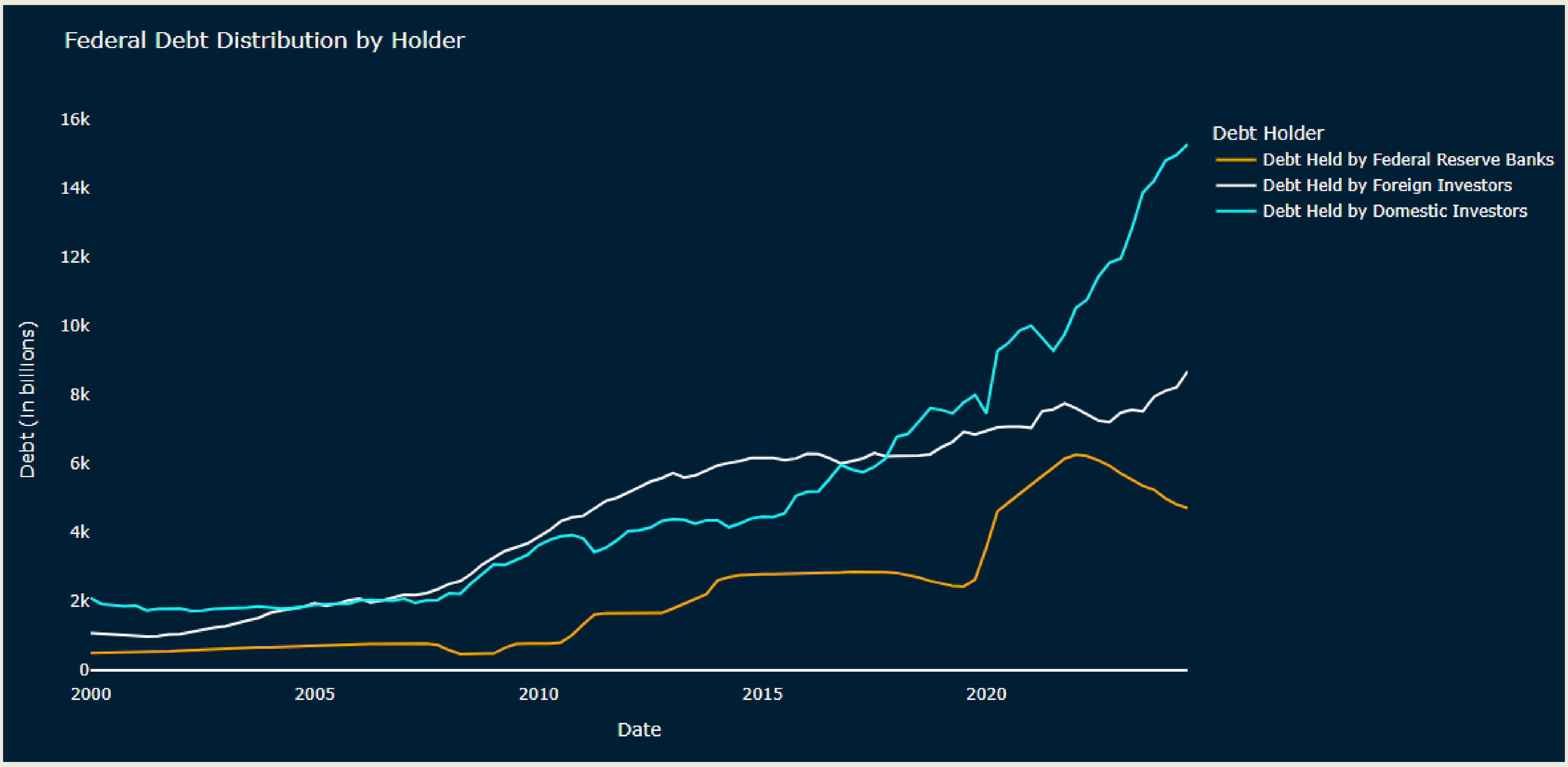
Who Will Buy the Debt?

Over the longer-term, sustainability of the current fiscal trajectory hinges on the ability to secure consistent buyers for government debt. Longer-term yields are primarily determined by market participants, and when confidence in the fiscal outlook deteriorates, bond prices decline, and yield volatility increases.

A clear example of this dynamic unfolded in the UK in September 2022, when then-Prime Minister Liz Truss introduced a budget proposing tax cuts without outlining a credible plan to offset the lost revenue. The market reaction was swift—UK government bonds (Gilts) sold off aggressively, causing yields to surge. This created a major problem for UK pension funds, which were heavily invested in Gilts and, due to being underfunded, had leveraged their positions to enhance returns.

As yields spiked, margin calls were triggered, forcing pension funds to sell Gilts to raise liquidity, further accelerating the selloff in a self-reinforcing loop. The situation deteriorated so rapidly that the Bank of England was forced to intervene, injecting liquidity to prevent a systemic crisis that could have led to the collapse of the UK pension system. This episode serves as a stark reminder of how excessive debt and deficits can spiral into financial instability if fiscal policy missteps undermine market confidence.

In the U.S. the main buyers of the debt have been private institutions and households.



This raises a critical question: Can financial institutions and households continue absorbing large volumes of Treasury debt in an environment of persistent deficits? Banks, in particular, face increasing constraints due to post-Great Financial Crisis regulations, such as the Liquidity Coverage Ratio (LCR), which requires them to hold significant amounts of Treasuries to ensure financial stability. While this regulation boosts demand for government debt, it also limits banks' ability to take on additional Treasury holdings and restricts their capacity to lend to the private sector. As a result, banks are increasingly being funneled into financing the government rather than extending credit to businesses, potentially stifling economic growth. Recognizing the growing debt challenge, Federal Reserve officials have started exploring alternative solutions to secure new buyers for Treasuries. Just a few weeks ago, Fed Governor Michelle Bowman proposed that the Fed take proactive regulatory measures to ensure that primary dealers have sufficient balance sheet capacity to intermediate the Treasury market. Her proposal includes amending the leverage ratio and G-SIB (Global Systemically Important Bank) surcharge regulations for the largest banks, effectively allowing them to purchase more Treasuries without regulatory penalties. Bowman's advocacy for these adjustments highlights a broader reality: the Fed is actively searching for mechanisms to ensure demand for U.S. government debt. If implemented, such changes would suppress interest rates by expanding the pool of Treasury buyers while simultaneously bolstering bank reserves to maintain financial system stability. However, this approach underscores the growing interdependence between the banking system and federal debt markets

Traditionally, insurance companies and pension funds have been key buyers of Treasury debt, as it allows them to match future expected payouts with stable, predictable income. However, rising interest rates, increased rate volatility, and persistent inflation have pushed these institutions toward shorter-duration instruments to mitigate risk.

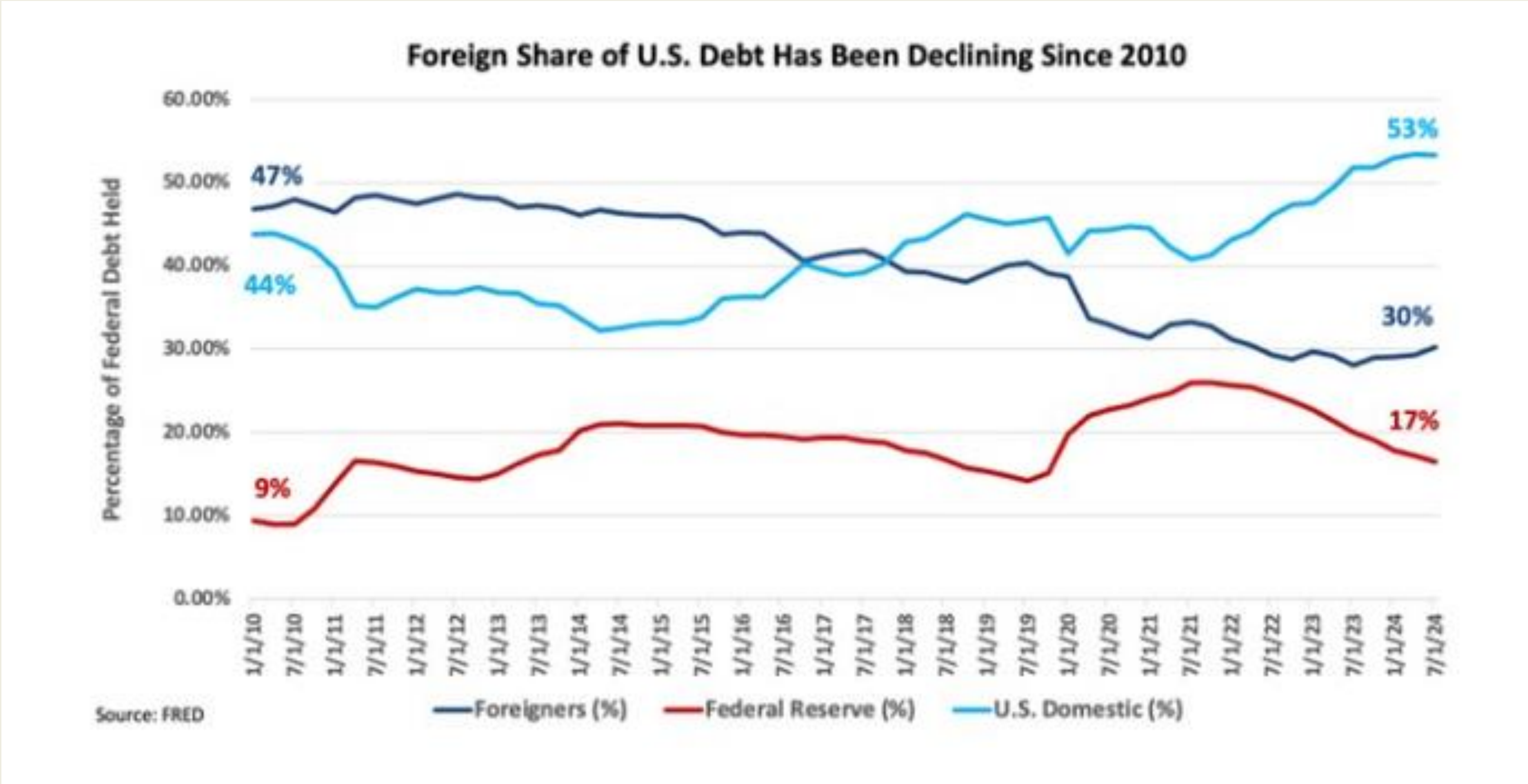
This shift has been further exacerbated by the evolving stock-bond correlation, which has moved deeper into positive territory in recent years—a trend historically observed when Core CPI exceeds 3%. Under such conditions, the diversification benefits of holding Treasuries diminish, reducing their appeal as a hedge against equity market downturns.

Similarly, households that own Treasuries through retirement accounts and mutual funds are also highly sensitive to interest rate volatility and inflation. For households, inflation erodes real returns, making bonds less attractive since the income generated from them fails to keep pace with the rising cost of goods and services.

Additionally, in an inflationary environment, other asset classes tend to outperform, as inflation often boosts corporate margins and drives stock prices higher. This dynamic creates a strong incentive for households to participate in equity market rallies rather than holding bonds, as fixed-income investments struggle to preserve purchasing power. As a result, households face increasing pressure to shift away from Treasuries in favor of assets that offer higher returns and better inflation protection, further reducing the natural base of demand for government debt.

With domestic institutions and households likely reducing the pace at which they purchase Treasuries, some believe that foreign investors might step in to fill the gap. However, foreign ownership as a percentage of total U.S. debt has been declining for over a decade.

A common misconception is that foreign buyers have picked up the slack, largely due to media reports highlighting the nominal value of foreign U.S. Treasury holdings. While it is true that these holdings have increased in absolute terms, the more important context is that their share relative to total U.S. debt has been steadily shrinking. This decline suggests that foreign demand is not keeping pace with the rapid expansion of U.S. government borrowing.



The decline in foreign ownership of U.S. Treasuries has become a structural trend, beginning after the Great Financial Crisis (GFC) when the U.S. government chose to bail out the banking system and engage in Quantitative Easing (QE) for the first time. The decision to inject liquidity into the financial system and reinflate domestic asset prices came at the cost of diminishing the value of the U.S. dollar. This effectively meant that foreign creditors were paid back with a currency that had reduced purchasing power, causing a gradual shift away from Treasuries.

As a result, investors at the margins began reallocating to alternative assets like gold, recognizing the risk that the U.S. might sacrifice its currency's value to avoid short-term economic pain during crises. Over time, other structural factors accelerated this trend, including:

- Rising geopolitical tensions
- The need for diversification
- The weaponization of the U.S. dollar as a policy tool

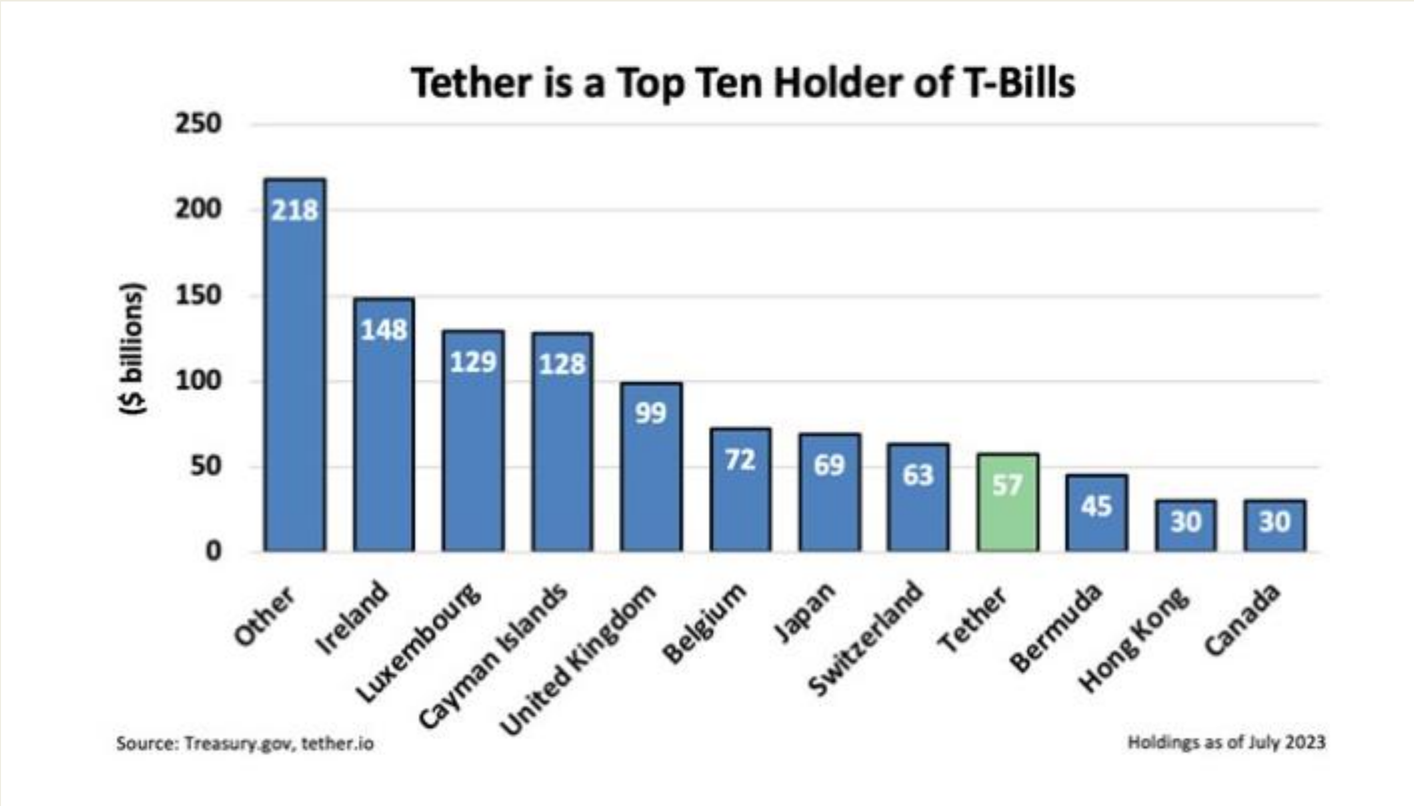
A major turning point came when the Biden administration froze Russian assets following the Ukraine invasion. This action accelerated a global shift toward neutral reserve assets, as it underscored a new reality: beyond just facing reduced real returns on U.S. debt, foreign holders now risked having their assets seized entirely. In response, central banks around the world ramped up record levels of gold purchases, further reinforcing the de-dollarization trend.

This shift also disrupted a long-standing market dynamic—the inverse relationship between gold and real interest rates. Historically, rising real rates pressured gold prices lower. However, despite real rates climbing in recent years, gold has continued to rise. This divergence suggests that holding U.S. debt now carries increased geopolitical and financial risk, leading central banks to prioritize gold as a safer reserve asset.

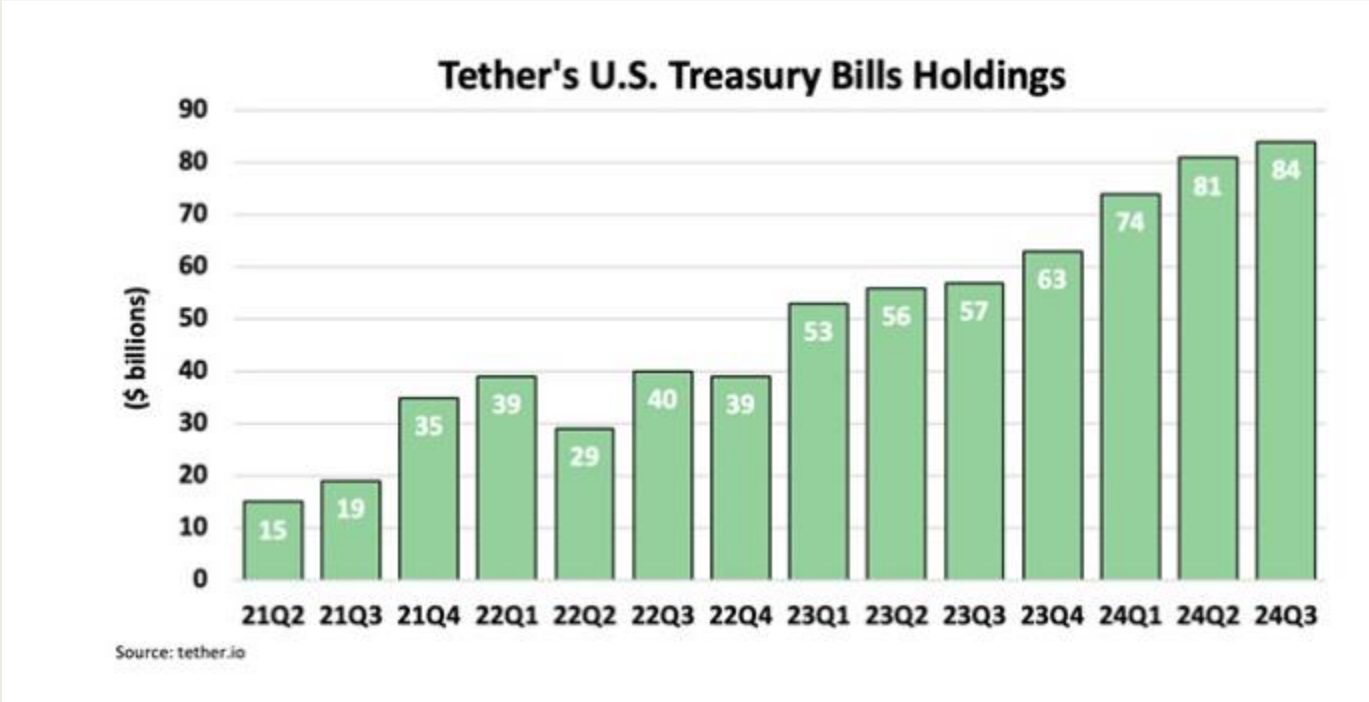
Hope has emerged in an unsuspecting market for a potential new buyer of U.S. Treasuries as the market capitalization of cryptocurrencies has surged dramatically over the past five years. The buyer is stablecoin issuers. Former House Speaker Paul Ryan recently highlighted stablecoins as a possible solution to help mitigate a future debt crisis, stating that they have become "an important net purchaser of U.S. government debt." This sentiment was echoed by the Trump administration's newly appointed Crypto/AI Czar, David Sacks, who emphasized the potential of stablecoins in reinforcing U.S. dollar dominance:

"Stablecoins have the potential to ensure American dollar dominance internationally, increase the usage of the U.S. dollar digitally as the world's reserve currency, and in the process, create potentially trillions of dollars of demand for U.S. Treasuries, which could lower long-term interest rates."

As stablecoin supply has skyrocketed, so too has its demand for U.S. Treasury Bills. The latest July 2023 data on foreign holders of U.S. debt revealed that Tether (USDT) was the 9th largest holder of Treasury Bills, ranking among the world's top foreign creditors.



Since this data was made public Tether holdings of T-Bills have exploded to $84 Billion up 400%



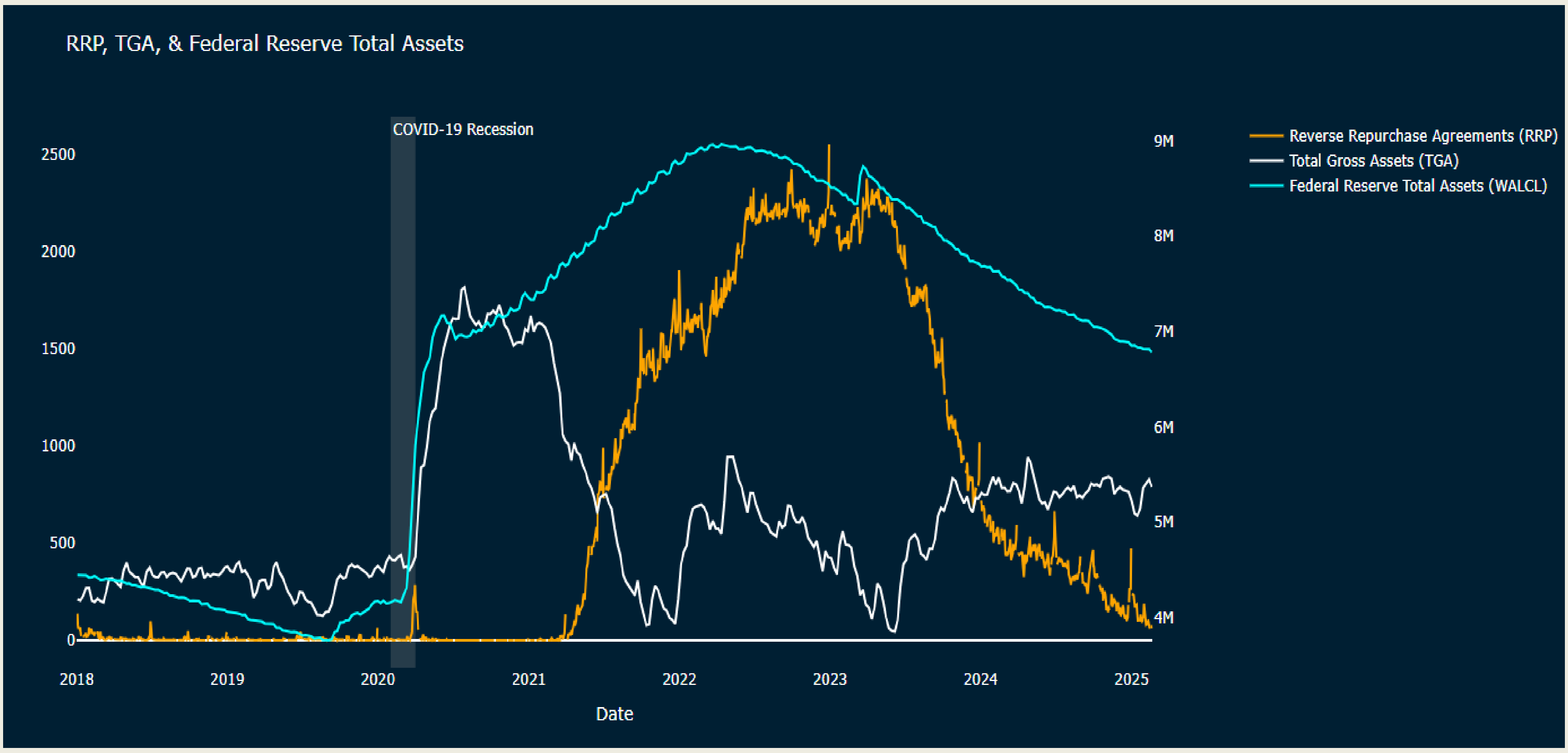
Stablecoins hold U.S. Treasury Bills as their primary cash-equivalent security, ensuring liquidity within crypto payment systems. As cash flows into stablecoins, issuers must back those reserves with pristine collateral, allowing stablecoin holders to redeem their tokens for cash on demand. This dynamic has positioned stablecoins as a growing source of short-term demand for U.S. Treasuries, potentially helping to fill gaps in the market—as long as the overall market capitalization of cryptocurrencies continues to rise. However, this demand is largely concentrated in short-term Treasury Bills, offering little support to the long end of the yield curve, which remains critical for U.S. funding needs. When asked about the possibility of Tether expanding its holdings into longer-term securities, Tether CEO Paolo Ardoino made the company's stance clear:

"The single most important thing for stablecoins is that we need to be able to liquidate our reserves immediately and pay out our users."

Ardoino further emphasized that holding long-duration government debt poses significant liquidity, geopolitical, and financial risks. This concern is particularly relevant given that crypto assets—many of which exhibit volatility exceeding 70% and trade 24/7—require an exceptionally high level of liquidity to accommodate rapid redemptions. In many ways, the liquidity demands of stablecoin issuers may even exceed those of traditional banks, given the frequency and scale of capital movements in the crypto ecosystem.

If stablecoin issuers were to extend into longer-duration Treasuries, they would face increased risk of becoming undercollateralized in the event of a liquidity crisis, where Treasuries—despite their safety—could prove illiquid at precisely the wrong moment. This underscores the structural limitation of stablecoins as a long-term buyer for U.S. debt, as their primary role remains concentrated on short-term Treasury liquidity rather than broader sovereign debt financing.

As foreign ownership of U.S. Treasuries continues to decline, the Federal Reserve has nearly doubled its share of debt holdings to fill the funding gap, which widens significantly during times of crisis. These large-scale Treasury purchases, known as Quantitative Easing (QE), began after the Great Financial Crisis (GFC) and have since become a critical tool in managing financial market stability. With rising concerns over fiscal dominance and debt sustainability, uncertainty around the long-term buyer base for U.S. Treasuries has become increasingly relevant. If demand from traditional buyers continues to fade, the Fed will likely be forced to step in once again as the primary buyer, leading to a structurally weaker U.S. dollar relative to financial assets as liquidity injections devalue the currency. After implementing Quantitative Tightening (QT) in 2022—allowing $60 billion per month to roll off its balance sheet—the Fed slowed the pace of QT in 2024. Now, according to the latest FOMC minutes, policymakers have hinted at the possibility of halting QT altogether amid the upcoming debt ceiling debate. This potential policy shift is largely driven by the anticipated drawdown in the Treasury General Account (TGA), which will be used to keep the government funded until a debt ceiling agreement is reached. Should QT be paused or reversed, it would signal a renewed shift toward monetary accommodation, further reinforcing the Fed's long-term role as a structural buyer of U.S. debt and raising broader implications for the trajectory of both Treasury yields and the U.S. dollar.



The Federal Reserve's interventions, such as acting as the buyer of last resort, will only exacerbate the problem of fiscal dominance by enabling unsustainable government spending. As the Fed continues to inflate the money supply, asset prices will rise further, deepening wealth inequality and fueling populist tensions between the "haves" and "have-nots." The sustainability of this path—and the broader financial system—hinges on meaningful fiscal reform or a restructuring of global capital flows. Without such changes, the Treasury's increasing reliance on a shrinking pool of buyers poses significant long-term risks to the U.S. fiscal outlook and inflation, further entrenching the economy in a state of fiscal dominance.

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