It Feels Like 2008 But it's Different and Worse

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In 2008, we entered a period of extreme illiquidity. As asset classes evaporated, starting with MBS, balance sheets blew up, the scramble for dollars began and the wholesale money market froze, shutting banks down. Banks were fragile because they were over-leveraged. Debt was unwound and the dollar soared, creating huge dollar problems here and in Emerging Markets. Gold fell from above 1000 to 700 in the fall of 2008. It took the Fed 6 weeks to understand the problem and then they poured trillions into the financial system and gold led the way higher as the dollar fell. There was no inflation then but there was a fear that it would result from QE so gold went to new highs, topping in 2013 when it was clear that old-style QE does not create increases in money supply and inflation because it's corralled in the financial system as excess reserves.

Now, inflation is running very hot. New style QE to combat COVID has spread printed money outside the financial system and increased money supply massively. Markets want the Fed to deal with this by tightening the financial system and they believe the Fed will do so. However, markets are very dependent on continuing liquidity injections. Anticipation of tightening is already removing liquidity from the system. Meanwhile, the Treasury market is having the worst year in its history. Yields are screaming higher at a record pace. Volatility in Treasuries, commodities and shares is pushing up margin requirements, pressing on dollar liquidity even further. Collateral is failing. Balance sheet blow-ups appear to be in progress. Excess liquidity has disappeared. Gold is easy to sell for dollars.

Foreigners are buying less Treasuries (since 2014), the Fed is no longer buying them (they intend to sell), Treasury issuance is rising again to fund the deficit and the economy is slowing. The economy and the Treasury cannot afford higher yields. Tax revenues don't fund the Treasury's combination of interest payments and social programs much less the rest of government. The Fed will need to pivot within a few weeks back to QE to take down yields despite inflation. Gold will then get free of the dollar which will crater. The dollar has already been weakened against gold by sanctions but is being propped up by illiquidity. The turn in gold and gold stocks, when it comes, will be extraordinary, a true jail break. In November 2008, the day of the turn gold stocks went up 10%.