Metals and mining commentary

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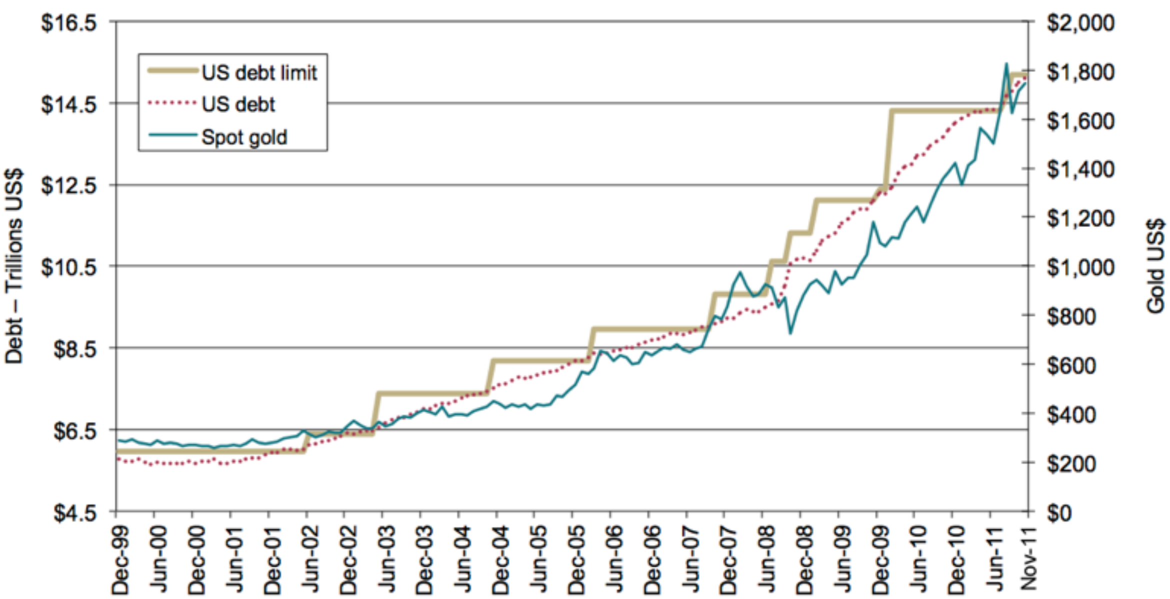
"The velocity of a body remains constant unless the body is acted upon by an external unbalanced force." – Isaac Newton's First Law of Motion

The US Super Committee has decided not to apply any external unbalanced force against the motion of the US debt. They seem to understand the concept of inertia, and are willing to embrace it by doing nothing prior to 2013 to reduce the US operating deficit. As such, the debt has resumed its steady climb upward post the August 2nd debt ceiling increase. Since then, it has grown at the rate of US$180 billion per month – from $14.3 trillion (T) to an estimated $15.2T by year end, just five months later. Without fanfare, outstanding debt has crossed the $15T level and is now pulling away from GDP, which is struggling to chin itself over that $15T bar. The new ultimate debt ceiling limit of $16.4T is being dutifully increased in increments to stay just ahead of the debt.

Have a look at the chart below. It is worth noting that gold is also an object in motion, which appears to be tied to the bumper of the US debt-mobile by a short bungee cord. So, it bounces around a bit, as the debt drives on but it keeps coming back to smack against that debt ceiling bumper. At the moment, the bungee cord has stretched a bit because of capital flight from Europe but let's do some math on the inevitable snapback.

Gold prices against US debt limit



Source: sharelynx.com

In just seven months at the current borrowing rate, the painfully achieved $2.1T increase in the debt ceiling will be maxed out. This wasn't supposed to happen until after the election so President Obama would not have to suffer the embarrassment of begging for cash again. Based on the tight correlation of gold to the US debt build-up, the chart suggests gold snaps back to $2,000 in the second half of 2012, as the $16.4T debt ceiling is reached.

Of course, the debt build-up may slow from today's record pace. Perhaps the Iraqi demobilization will pay a peace dividend of sorts, tax cuts will be rescinded or the economy will simply respond well to the resumption of massive government spending. Such an optimistic outcome is still the norm for Congressional Budget Office (CBO) deficit forecasts. Recall that the March 2011 forecast called for a debt increase of $6.7 Trillion over 10 years, as shown in the following chart (see next page).

CBO debt increase forecast over 10 years

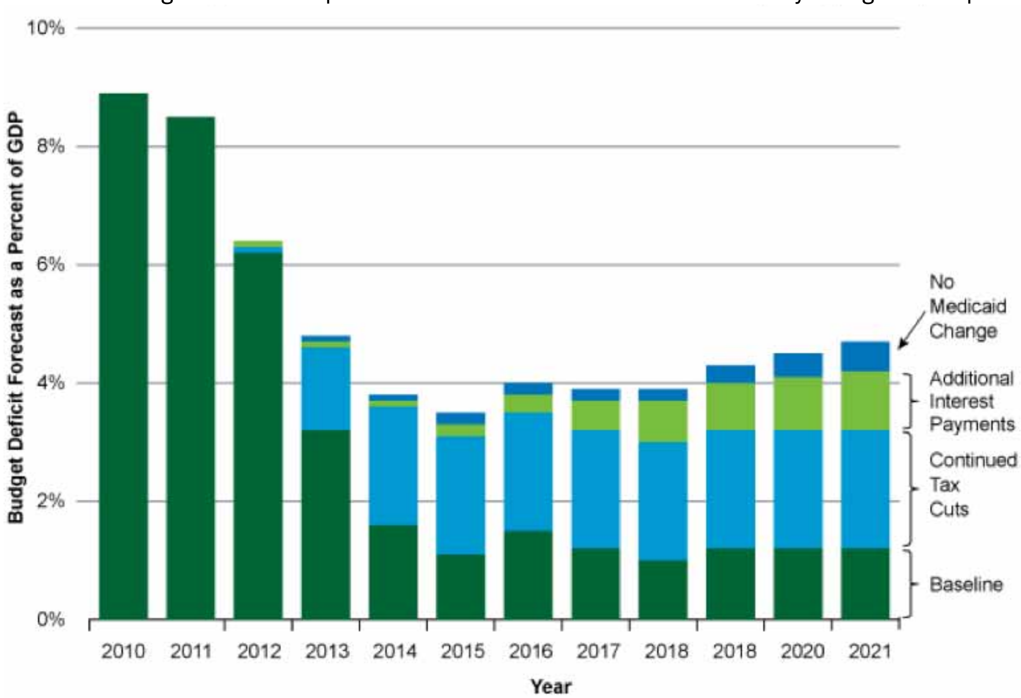
	ACTUAL											TOTAL	
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012- 2016	2012- 2021
							CBO'S MARCH 2011 BASELINE							
REVENUES	2,163	2,230	2,558	3,087	3,440	3,642	3,826	4,071	4,271	4,483	4,703	4,951	16,554	39,032
OUTLAYS	3,456	3,629	3,639	3,779	3,954	4,180	4,460	4,661	4,856	5,148	5,412	5,680	20,012	45,770
TOTAL DEFICIT	-1,294	-1,399	-1,081	-692	-513	-538	-635	-590	-585	-665	-710	-729	-3,459	-6,737

Source: Congressional Budget Office

Six months later, the CBO sliced the forecast debt increase in half by adding in some positive assumptions: the end of tax cuts; cuts in Medicaid payments to doctors; and sustained low interest rates while the economy hums along recession free.

CBO deficit forecasts depend heavily on tax increases set to expire this year

Forecast of budget deficits as a percent of GDP: baseline and with assumed key changes not implemented



Source: Congressional Budget Office

The new forecast suggests debt would stabilize near $18T. Based on the earlier relationship between debt and gold, gold would peak around $2,200 per ounce. Spoiler alert: $18T debt is reached in 16 months at the current rate of climb!