The First Domino in the US Debt Crisis

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SUMMARY

The United Arab Emirates (UAE) has approached the US Treasury for a financial lifeline, warning that failure to assist could lead to a crash in the US bond market. This situation highlights a critical vulnerability in the US Treasury market, where foreign countries, facing cash shortages due to energy crises, may sell off their Treasury holdings, leading to rising interest rates and increased borrowing costs across the economy.

- *The UAE requested a currency swap line from the US to avoid selling its Treasury bonds amid cash flow issues caused by energy supply disruptions.*
- *Foreign central bank holdings of US Treasuries have dropped to their lowest levels since 2012 as countries sell off assets to raise cash.*
- *When multiple countries sell Treasuries simultaneously, bond prices drop, causing yields to rise and increasing borrowing costs for the US government.*
- *The US government relies on borrowing to cover its spending, making it vulnerable to rising interest rates that could destabilize the economy.*
- *The Federal Reserve's swap lines are emergency credit facilities that allow foreign central banks to borrow dollars while pledging their own currency as collateral.*
- *Critics debate whether these swap lines constitute a bailout, but they primarily serve to protect the US Treasury market from forced sales by foreign countries.*
- *The UAE's situation may lead to other countries, like Kuwait, seeking similar financial assistance, potentially expanding the list of nations eligible for US swap lines.*
- *The ongoing closure of the Strait of Hormuz could trigger further demand for dollars, increasing the likelihood of more countries needing financial support from the US.*

In April, the United Arab Emirates, one of the wealthiest countries on Earth, approached the US Treasury and asked for a financial lifeline. Now, stripped of the diplomatic language, their message amounted to this: help us or we will have no choice but to crash your bond market. Now, 2 weeks ago, I told you that the United States was fighting two wars, one that you could see and one that you can't. And last week, this invisible war drew its first blood. Stay with me. In a video called two wars, I laid out a vulnerability in the United States Treasury market that most investors don't think about, but one that I am now convinced will define the next 12 months or more of market activity. So, let's do a quick recap because this part really, really matters. When the United States government spends more money than it collects in taxes, which it does every single year to the tune of trillions it borrows the difference. And it does this by selling IOUs called Treasury bonds. Now, a 10-year Treasury is a simple promise from the US government to pay you back in 10 years with interest.

And these bonds have been considered the safest investment in the world because in theory, the US government will always pay its debts. And so, countries around the world, Japan, UK, China, South Korea, and dozens of others hold roughly 9.4 trillion dollars worth of these American IOUs. They bought them because Treasuries are safe, they're liquid, and they're denominated in US dollars, the currency that every country needs to transact globally.

So, for decades, this system worked beautifully. The US could borrow cheaply and foreign governments could park their savings in a safe asset. Everybody won. Now, this system is flawless until a situation where everybody needs their cash back at the exact same time. Now let me ask you a question. If you were running Japan Central Bank and your country was staring down an energy crisis that threatened to shut down your factories, your power plants, your shipping routes, and you needed dollars immediately to buy oil on the open market, what would you sell first? Well, I can tell you you would sell your most liquid dollar asset. You would sell US Treasuries.

And that is exactly what's beginning to happen. So many countries have been impacted by the closure of the Strait of Hormuz and their oil or energy supply has been cut off. They need to raise cash to buy fuel on the open market. >> [music] >> Foreign central bank holdings of Treasuries at the New York Federal Reserve have dropped to their lowest level since 2012. [music] Countries short on energy and desperate for dollars are selling American government bonds to raise cash to pay for fuel. Japan holds 1.2 trillion in Treasuries. The United Kingdom holds 895 billion. These are not small positions.

Now here is the problem. When lots of people sell the same asset at the same time, the price drops. Now when the price of a Treasury bond drops, its interest rate, what Wall Street calls the yield, goes up. That yield is the incentive investors receive to lend money to the US government. And because Treasury yields set the baseline for borrowing costs across the entire economy, everything gets more expensive. We're talking about mortgages, car loans, corporate debt, government refinancing, all of it. Now let me take a quick minute to break this down simply. Put yourself in the position of the US government. You spend more than you make, so you need to borrow some cash to pay your bills. So let's say I loan you a thousand dollars and you agree to pay me 5% interest, $50 a year for 5 years. Now, I'm earning annual interest and I'll get my $1,000 back in 5 years. Sounds like a pretty good deal.

>> [music] [music] >> But here's the problem. 2 years into that 5-year period, I get a cash call and I need my money back right now. But the problem is you don't owe me the full amount back for another 3 years. It was a 5-year loan. So, I go looking for someone to buy the loan from me and I find a third party and I tell them, "Look, this person owes me $1,000.

They're paying me 5% per year. Now, the full amount is due in 3 years, but I need the money today. So, buy this loan from me and those payments, that 5%, are yours and in 3 years, you'll get your $1,000 back from them." The problem is that third party can smell my desperation. They know I need the money today. And so, what they tell me is, "Look, I'll buy the loan, but I'm not going to give you full value. I'll pay you $800 for that $1,000 loan." Now, I'm not getting full value, but I am getting the cash today, which is what I need.

So, I take the deal. Now, think about what just happened. That third party just paid $800 for a loan note that will pay them $1,000 in 3 years plus interest along the way. His effective return, his yield, just went up because he paid less for the same stream of payments. Now, imagine this happening at scale. Not one lender, but entire countries. Japan, the UK, South Korea, all desperate for cash to buy oil. All selling US Treasury bonds at the same time. All willing to take less than full value. And we're not talking thousands of dollars, we're talking trillions. So, why is this a problem?

It's a problem because the United States is still spending more than it earns. So, it continues to need new loans. But, if I can buy an existing Treasury bond on the open market for $800, why would I pay the US government $1,000 for a brand new one? Look, I wouldn't, and nobody would. So, the government is forced to offer higher interest rates on its new bonds just to attract new lenders, which means the cost of borrowing goes up for the government itself at exactly the moment when it can least afford it. And because Treasury yields set the baseline for nearly every interest rate in the economy, suddenly mortgages, car loans, corporate debt, everything gets more expensive all at once. And this is the predicament. The United States needs to offer higher interest rates to incentivize other countries to lend it money, but paradoxically, higher interest rates will break its own economy.

So, why does this all matter today? In late April, the United Arab Emirates approached the US Treasury and asked for a wartime financial lifeline. >> [music] >> The UAE is one of the foreign holders of Treasuries that we just spoke about. Now, the Strait of Hormuz has been effectively closed for about 12 [music] weeks. That means the UAE cannot sell oil like it used to, [music] and they have bills to pay. But, here's the thing, the UAE is a fabulously wealthy country. So, it has not run out of money in the conventional sense. It holds roughly 95.6 billion dollars in US Treasury bonds alone.

It has approximately 270 [music] billion in foreign exchange reserves, and it controls trillions more through its sovereign wealth fund. So, the UAE is far from [music] broke, but its cash flow has stopped. And when your cash flow stops, you dip into your savings. But if the UAE had dipped into its savings, meaning sold its US assets like Treasuries to raise the cash it needed, that would have meant unloading tens of billions of dollars of US Treasuries onto the open market during an already stressed moment. The price of those bonds would have dropped. The yield on the 10-year Treasury would have climbed, the exact spiral we just described, and the UAE would have been the country that started it. So, instead, they did something different. They approached Washington with a proposal. They said, effectively, we did not ask for this war. We were dragged into it. If we run short on cash and you don't help us, we'll have no choice but to raise it ourselves, and you know what that means for your bond market.

Let's avoid this. So, the UAE asked for a short-term loan known as a currency swap line, an emergency credit facility that allows the US Federal Reserve to lend dollars directly to a foreign central bank. This is not a bailout of the UAE. I look at it as a bailout of the Treasury market. Let me take a minute to break this down because everybody is going to be talking about swap lines in the months ahead, and very few people actually understand them.

The US Federal Reserve agrees to lend dollars to a foreign central bank. The foreign central bank pledges its own currency as collateral locked at a fixed exchange rate. Now, when the swap matures, meaning the loan becomes due, the foreign central bank pays back the dollars with interest, and the exchange rate at maturity is the same as the rate at the start, regardless of how the two currencies have moved in between. Now, every swap line or emergency credit facility that the United States has offered in 2008 and 2020, they've all been repaid.

Sort of. And this is where it gets a bit controversial. Because as long as they're repaid, they are not technically a bailout. But I use the term sort of because in 2013, the Federal Reserve quietly changed the terms on swap lines with five countries from temporary to permanent. Now, I'm not sure there's a meaningful difference between a loan that doesn't get paid back and a loan that doesn't mature. But I'll leave that part with you to decide.

I do have a prediction. Over the next year, the swap line program is going to expand dramatically. And with it, the standing roster of countries the United States has accepted responsibility for during a dollar crisis will expand, too. So, if I'm right, two things will happen. First, the list of countries that the United States deems eligible for swap lines will grow. It will expand beyond key US allies like the European Central Bank, the Bank of Japan, the Bank of England, the Bank of Canada, the Swiss National Bank, and will begin to include a much wider net of less reliable partners with much less stable currencies. And as the eligibility criteria drops, the fragility of these loans will go up.

Now, second, the number of swap lines that shift from temporary to permanent like the quiet announcement the United States made in 2013, will also grow. And in that environment, swap lines don't get repaid in any meaningful sense. They just get rolled over. The Fed extends the maturity and the borrower draws a new swap to repay the old one. Each transaction shows as repaid on the books, but the aggregate balance never really goes down. Coincidentally, Wall Street has a name for this. They call it the amend, extend, and pretend. You amend the terms of the loan to extend the payment deadline to pretend that everything is just fine. Now, the evidence that this prediction is materializing will be simple. First, the UAE will get their swap line approved. And then, Kuwait is going to get one next.

Why Kuwait? Because oil revenues fund roughly 90% of Kuwait's government budget. Kuwait exported zero barrels of oil in April 2026. Zero the entire month. That hasn't happened in over 30 years. Now, why does this matter? Kuwait has $66 billion in US Treasuries. So, they will either sell their Treasuries, which would be the trigger to cause the debt spiral that we just talked about, or they will follow the UAE's lead and ask Washington for a swap line of their own, growing the pool of eligible countries for these emergency credit facilities. So, let me address one question because this is definitely going to come up in headlines over the next few weeks. And the question is, is a swap line a bailout? Now, critics of the US administration would say, yes, it's absolutely a bailout. The country is strapped for cash, and the US is bailing them out. But US bulls would say, no, absolutely not. They're short-term emergency facilities, and to date, they've all been paid back. It's not a bailout. But I will tell you that both of those parties are simultaneously right, and the reason is because they're thinking about the bailout backwards.

Let me explain. A swap line can look like a bailout for the borrower because the borrower receives the dollars. That's typical of a bailout scenario. But in this case, the real beneficiary of the swap line, or the emergency loan, is the lender, not the borrower. Now, why is that the case? I'd say it's because what's the alternative? The alternative is that a dollar starved country like Kuwait, like the UAE is forced to sell their most liquid dollar asset that they own being US Treasuries.

And they have to sell that into a falling market. So treasury prices drop, yields rise, Washington's borrowing costs climb, and then mortgages, car loans, corporate debt, and government refinancing all get more expensive all at once. And that is the debt spiral. So when the Fed opens a swap line, it is not merely helping out a foreign central bank. It is preventing that foreign central bank from becoming a forced seller of US government debt. So it's not a bailout for the UAE. It's a bailout for the US Treasury market. And if the Strait of Hormuz remains closed, the question is not whether more countries will need dollars because they will. The question is whether Washington chooses to let them sell Treasuries to raise those dollars or quietly lend them the dollars first. [music] And that is why the UAE matters so much. It is not the end of the story. It is [music] the first domino. Time will tell if I'm right. Now if you enjoy my content here on the J. Martin Show, do me a favor.

Hit subscribe, [music] hit like, but most importantly, share this video with a friend. That is the best way we can reach more people. [music] I publish here every single week. I hope you enjoyed this video. I will see you next Saturday.