



The Unraveling Guarantee: Has the U.S. Lost Its Exorbitant Privilege?

A Thorough Look Into U.S. Federal Debt, Structural Unsustainability,
and the Rising Probability of Implicit Default



The information contained in this document is for informational purposes only and should not be construed as investment advice, a recommendation to buy or sell any securities, or an offer to participate in any particular trading strategy. The views expressed are subject to change without notice, and past performance is not indicative of future results. Investing in securities involves risks, including the potential loss of principal. Readers should conduct their own due diligence and consult with a qualified financial professional before making any investment decisions. The author and publisher assume no liability for any actions taken based on the information provided.



“Mohammad Ahmadi is a recent Tufts University graduate with a dual bachelor’s degree in economics and sociology. Over the past few years, he has worked in investment banking, consulting, and private equity, where he has been involved in M&A, deal sourcing, and capital raising. Mohammad enjoys learning about how businesses grow, how markets move, and how financial decisions create long-term value.”

Table of Contents

Executive Summary	1
I. Historical Architecture of U.S. Debt Dominance	2
1.1 The Post-Bretton Woods Monetary Order.....	2
1.2 The 2008 Global Financial Crisis and Its Global Externalities.....	2
1.3 The Post-2020 Inflection Point.....	3
II. The Current Fiscal Position: Anatomy of Unsustainability	4
2.1 Debt Levels and Trajectory.....	4
2.2 The Interest Expense Trap	4
2.3 The Maturity Structure Problem.....	4
III. Fiscal Dominance and the Erosion of Monetary Independence	6
3.1 What Fiscal Dominance Means.....	6
3.2 The Federal Reserve's Balance Sheet As a Contingent Liability.....	7
3.3 Political Dysfunction and The Debt Ceiling.....	7
IV. The Anatomy of Implicit Default	10
4.1 Distinguishing Explicit from Implicit Default.....	10
4.2 Channel 1: Inflation	10
4.3 Channel 2: Financial Repression	10
4.4 Channel 3: Dollar Debasement	11
V. Addressing the Counterarguments	12
5.1 "The U.S. Can Always Print".....	12
5.2 "Interest Rates Will Come Back Down"	13
5.3 "Growth Will Solve the Problem".....	13
5.4 "Japan Has Higher Debt And Is Fine"	14
VI. Why This Moment Is Different.....	15
6.1 The Confluence of Adverse Factors	15
6.2 The Weaponization of The Dollar	15
6.3 The Eroding Institutional Framework.....	16
6.4 The Nonlinear Risk.....	16
VII. Investment and Geopolitical Implications	17
7.1 For Fixed-Income Investors.....	17
7.2 For Global Reserve Managers	17
7.3 For The Global Economic Order.....	17
VIII. Conclusion: The Arithmetic Is Unforgiving.....	19
References	20

Executive Summary

The United States federal government carries over \$36 trillion in gross public debt as of early 2026 (U.S. Treasury, 2026), a figure that exceeds 120% of GDP and continues to grow on an accelerating trajectory (See Figure U.S. Federal & Fiscal Balance). This report argues that U.S. sovereign debt has crossed a threshold of structural unsustainability, not in the sense that a formal default is imminent, but in the more consequential sense that the fiscal position of the United States can no longer be stabilized through any politically plausible combination of spending cuts and revenue increases (CBO, 2025). The arithmetic of compounding interest on an expanding debt base, layered atop persistent primary deficits, has created a dynamic in which debt grows faster than the economy that services it.

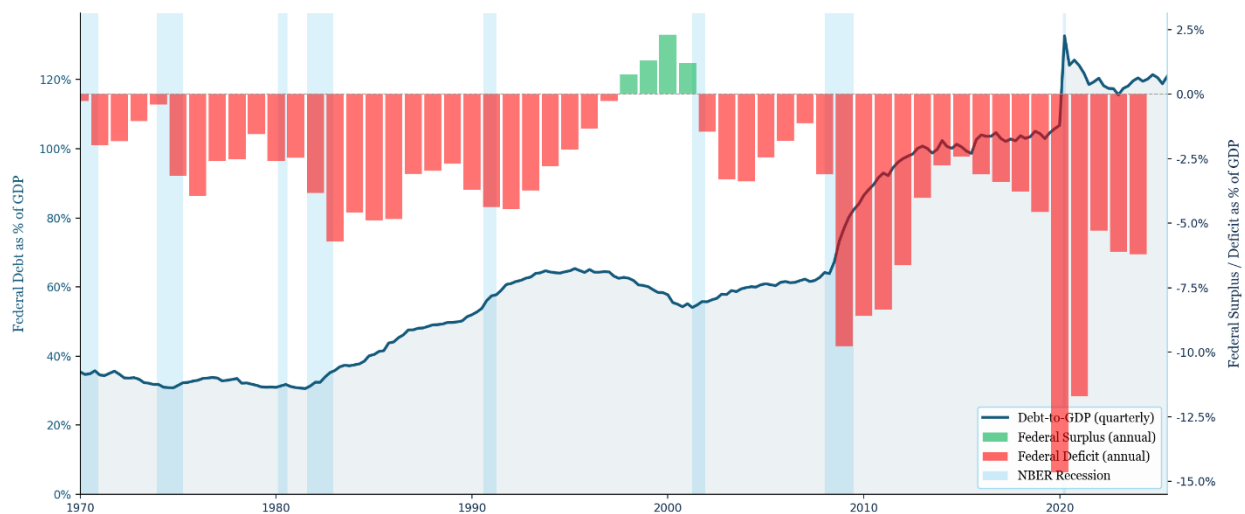
This draws a critical distinction between explicit default (a missed coupon or principal payment) and implicit default, which encompasses inflation-driven erosion of real bondholder returns, financial repression through yield suppression, and debasement of the dollar as a store of value. The central thesis is that the probability of implicit default, broadly defined, is higher today than at any point in modern U.S. history, including the inflationary 1970s and the post-2008 financial crisis era.

The mechanism through which this will most likely manifest is fiscal dominance: a regime in which the scale of government debt forces monetary policy to subordinate its inflation mandate to the government's financing needs (Sargent & Wallace, 1981). In such a regime, interest rates cannot rise sufficiently to contain inflation without triggering a sovereign debt spiral, and they cannot fall sufficiently to ease fiscal pressure without reigniting inflationary pressures. The Federal Reserve, in effect, loses its operational independence, not through legislation, but through arithmetic.

This report presents the data, traces the historical precedents, models the forward dynamics, and evaluates the counterarguments. The conclusion is not that the United States will default in the conventional sense. It is that the United States has become a structurally unreliable economic partner, one whose obligations to creditors, trading partners, and reserve holders are increasingly contingent on political choices that the American system appears incapable of making.

U.S. Federal Debt & Fiscal Balance

Gross federal debt as % of GDP (left axis) | Annual surplus/deficit as % of GDP (right axis) | Shaded = NBER recessions



I. Historical Architecture of U.S. Debt Dominance

1.1 The Post-Bretton Woods Monetary Order

The modern architecture of U.S. sovereign creditworthiness rests on a foundation that is younger and more contingent than most market participants appreciate. The Bretton Woods system, established in 1944, anchored the global monetary order to a dollar convertible into gold at \$35 per ounce (Eichengreen, 2011). When President Nixon suspended convertibility on August 15, 1971, the United States effectively defaulted on the terms under which foreign central banks had accumulated dollar reserves. The transition to floating exchange rates was not a neutral policy choice; it was a unilateral abrogation of commitments, facilitated by the absence of any enforcement mechanism against the world's dominant military and economic power (Irwin, 2013).

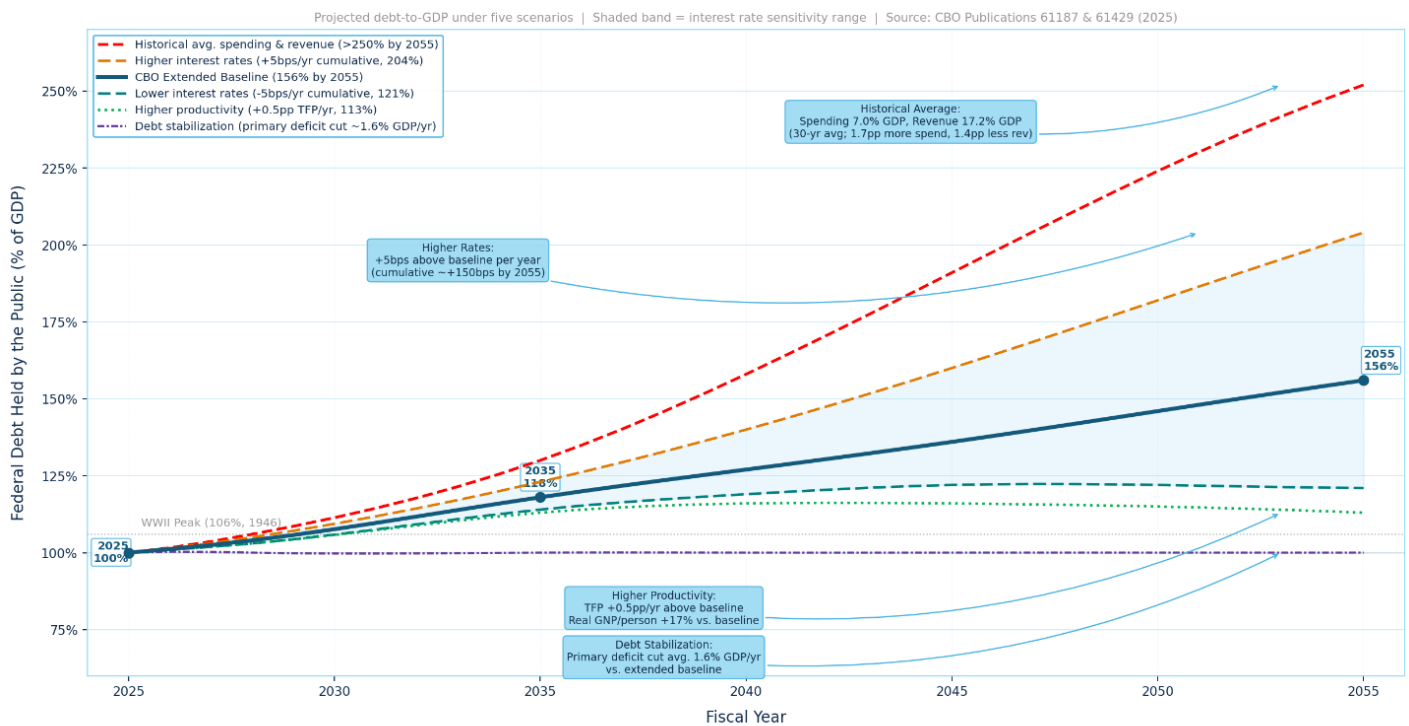
What replaced the gold standard was a system of fiat-currency hegemony in which the dollar's reserve status

derived not from an anchor to a scarce commodity but from the depth and liquidity of U.S. Treasury markets, the rule of law in U.S. jurisdictions, and a general confidence (increasingly circular in nature) that the United States would honor its obligations in real terms (Prasad, 2014). This confidence has been the critical input sustaining low borrowing costs for the U.S. government for over five decades.

1.2 The 2008 Global Financial Crisis and Its Global Externalities

The 2008 financial crisis represented the most severe test of dollar credibility since 1971, yet paradoxically it reinforced dollar dominance in the short term. As the global financial system seized, capital fled to the perceived safety of U.S. Treasuries even though the crisis had originated in the U.S. housing and shadow banking sectors (Bernanke, 2015). The Federal Reserve's response (zero interest rates and multiple rounds of quantitative easing totaling over \$4.5 trillion in asset purchases between 2008 and 2014) stabilized the domestic financial system but imposed significant costs on the rest of the world (Federal Reserve, 2015).

U.S. Federal Debt: CBO Baseline vs. Alternative Scenarios | 2025 - 2055



Sources: CBO Long-Term Budget Outlook 2025 (Pub. 61187, Mar 2025); CBO Alternative Scenarios (Pub. 61429, May 2025); CBO Budget Outlook 2025-2035 (Pub. 60870, Jan 2025) | 2026 Ahmadi Research | ahmadiresearch.com

Emerging market economies experienced volatile capital flows, commodity-price distortions, and currency instability driven by Federal Reserve policy choices made with little regard for global spillover effects (Rey, 2013; Rajan, 2014). The European sovereign debt crisis of 2010–2012, while primarily a function of eurozone structural flaws, was precipitated by a U.S.-origin financial shock. The moral hazard embedded in "too big to fail" guarantees extended to a global scale: the world learned that when U.S. financial institutions failed, non-U.S. creditors and economies would absorb a disproportionate share of the adjustment cost.

1.3 The Post-2020 Inflection Point

The COVID-19 pandemic response marked a qualitative break in U.S. fiscal behavior. Between March 2020 and December 2021, Congress authorized approximately \$5.2 trillion in emergency spending, financed overwhelmingly by debt issuance that was effectively monetized through concurrent Federal Reserve asset purchases (CBO, 2021; Federal Reserve, 2022). Federal debt held by the public surged from roughly 79% of GDP at the end of fiscal year 2019 to over 97% by the end of fiscal year 2021, an increase of nearly 20 percentage points in just two years (CBO, 2022).

What distinguishes the post-2020 period from prior episodes of wartime or crisis-driven debt accumulation is the absence of any subsequent fiscal consolidation. After World War II, the United States ran primary surpluses for over a decade and benefited from rapid real GDP growth, reducing debt-to-GDP from over 100% to below 50% by the mid-1960s (Reinhart & Rogoff, 2010). After the 2008 crisis, deficits narrowed from 9.8% of GDP in 2009 to 2.4% by 2015 (OMB, 2016). No comparable consolidation has occurred or is projected following the COVID-era spending surge. The Congressional Budget Office's latest baseline projections show deficits persisting above 5% of GDP through the entire forecast horizon, with debt-to-GDP reaching approximately 156% by 2055 (See Figure U.S. Federal Debt: CBO Baseline vs. Alternative Scenarios | 2025-2055).

II. The Current Fiscal Position: Anatomy of Unsustainability

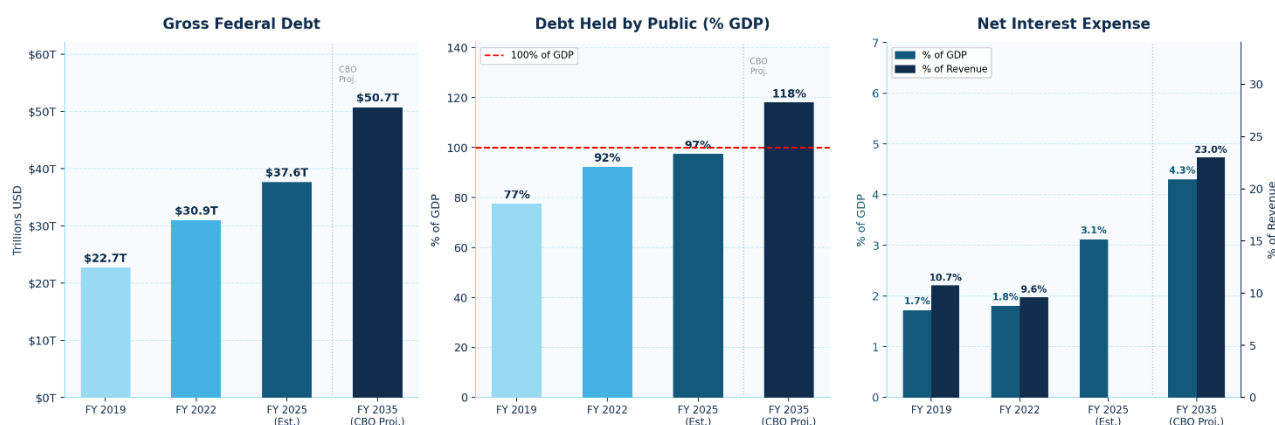
2.1 Debt Levels and Trajectory

As of Q4 2025, total federal debt stood at approximately \$37.6 trillion, two-third of which is held domestically (See Figure Gross Federal Debt). The gross Federal debt now exceeds 120% of GDP on a gross basis. Even on a net basis (adjusting for financial assets held by the government) the ratio exceeds historical precedent outside of the immediate post-World War II period (BEA, 2025).

marketable Treasury securities maturing within the next twelve months (a consequence of the Treasury's heavy reliance on short-duration bills during 2023–2024), the effective rate on the total stock will continue to climb even if market yields remain flat from current levels (See Figure Section 2.2 The Interest Expense Trap).

This creates a pernicious feedback loop: higher rates increase interest expense, which widens the deficit, which requires more issuance, which puts upward pressure on rates, which further increases interest expense. The Congressional Budget Office projects net interest costs will consume over 23% of all federal revenue by 2035, a level at which debt service crowds

U.S. Key Fiscal Metrics: 2019–2035 Projection



Sources: FRED (GFDEBTR, FYGDPUN, FYSGDA188S, MTSOS133FMS, FYOINT, FYFRGDA188S, GDP), FY2025 deficit from monthly MTS data, FY2035: CBO Long-Term Budget Outlook 2025 (Pub. 60870) extended baseline.

2.2 The Interest Expense Trap

The single most consequential development in U.S. fiscal dynamics is the explosion of net interest expense. In fiscal year 2025, net interest on the federal debt is estimated at approximately \$950 billion, exceeding defense spending for the first time in U.S. history (See Figure Net Interest Expense). This figure has roughly tripled from \$325 billion in fiscal year 2020, driven not by an increase in the debt stock alone but by the repricing of that stock at higher interest rates as low-coupon pandemic-era issuances mature and are refinanced (See Figure Net Interest Expense).

The weighted average interest rate on outstanding Treasury debt has risen from approximately 1.8% in mid-2022 to an estimated 3.1% of GDP as of late 2025 (U.S. Treasury, 2025). With roughly \$6.2 trillion in

out discretionary spending and constrains the government's ability to respond to economic shocks (CBO, 2025).

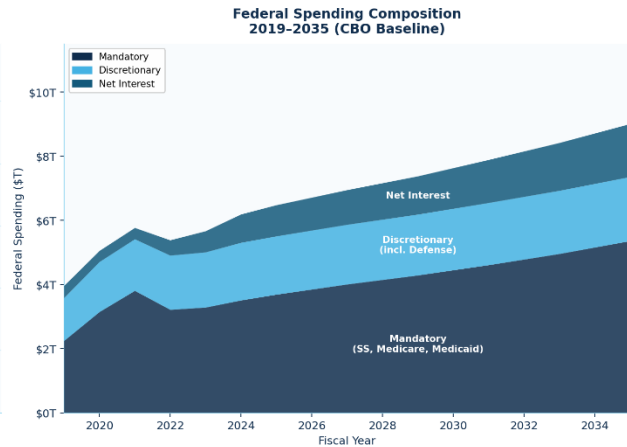
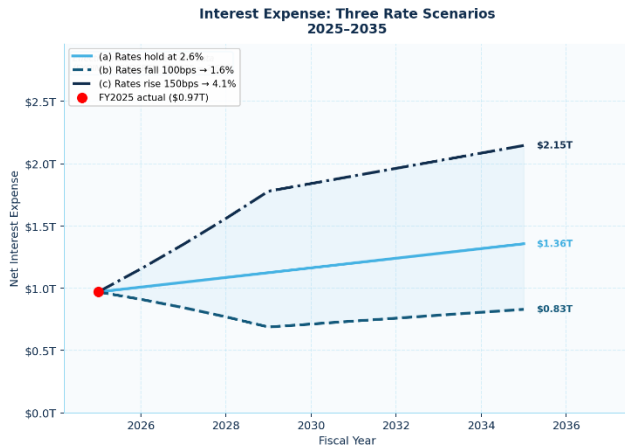
2.3 The Maturity Structure Problem

The maturity profile of outstanding Treasury debt compounds the refinancing risk. During 2023 and 2024, the Treasury leaned heavily on Treasury bills (maturities under one year) to fund deficits, partly to avoid locking in high long-term rates and partly because bill demand from money-market funds remained strong following the drawdown of the Federal Reserve's reverse repo facility (See Figure Weighted Average Marketable Treasury Debt). As a result, the weighted average maturity of outstanding marketable debt shortened from approximately 75 months in late 2021 to roughly 68

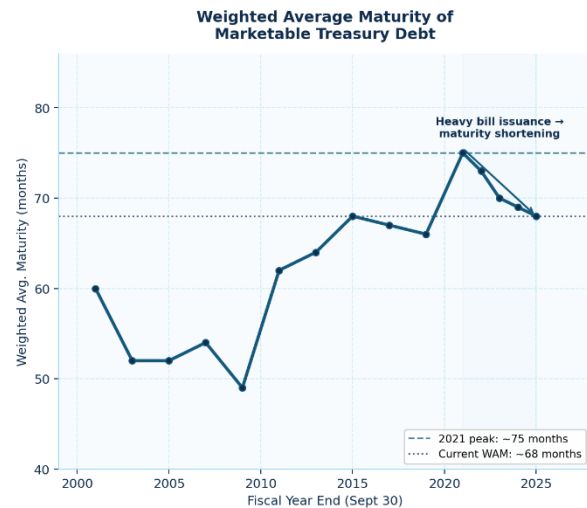
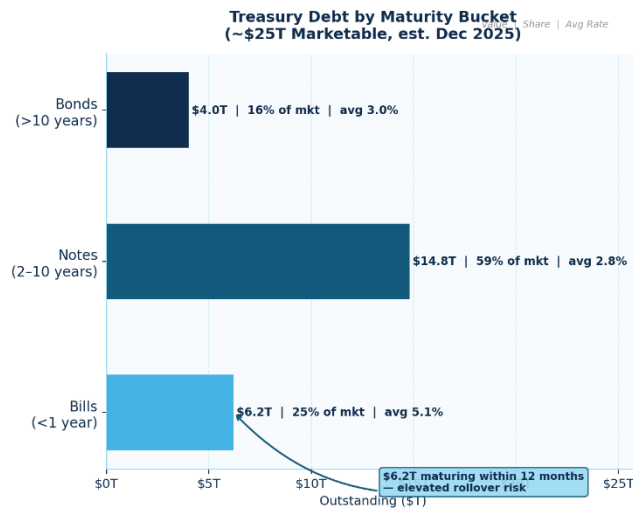
months by mid-2025 (See Figure Weighted Average Marketable Treasury Debt).

A shorter maturity profile means a larger share of the debt stock must be refinanced each year, amplifying sensitivity to rate movements. If the Treasury pivots back toward longer-duration issuance to reduce rollover risk, it must offer yields sufficient to attract buyers at the long end of the curve, buyers who are increasingly skeptical of the long-term real return on U.S. sovereign obligations. The term premium, which had been compressed or negative for much of the post-2008 period, has turned persistently positive since late 2023, reflecting a structural repricing of duration risk in U.S. Treasuries (Adrian, Crump & Moench, 2013; Federal Reserve Bank of New York, 2025).

Section 2.2 — The Interest Expense Trap



Section 2.3 — The Maturity Structure Problem



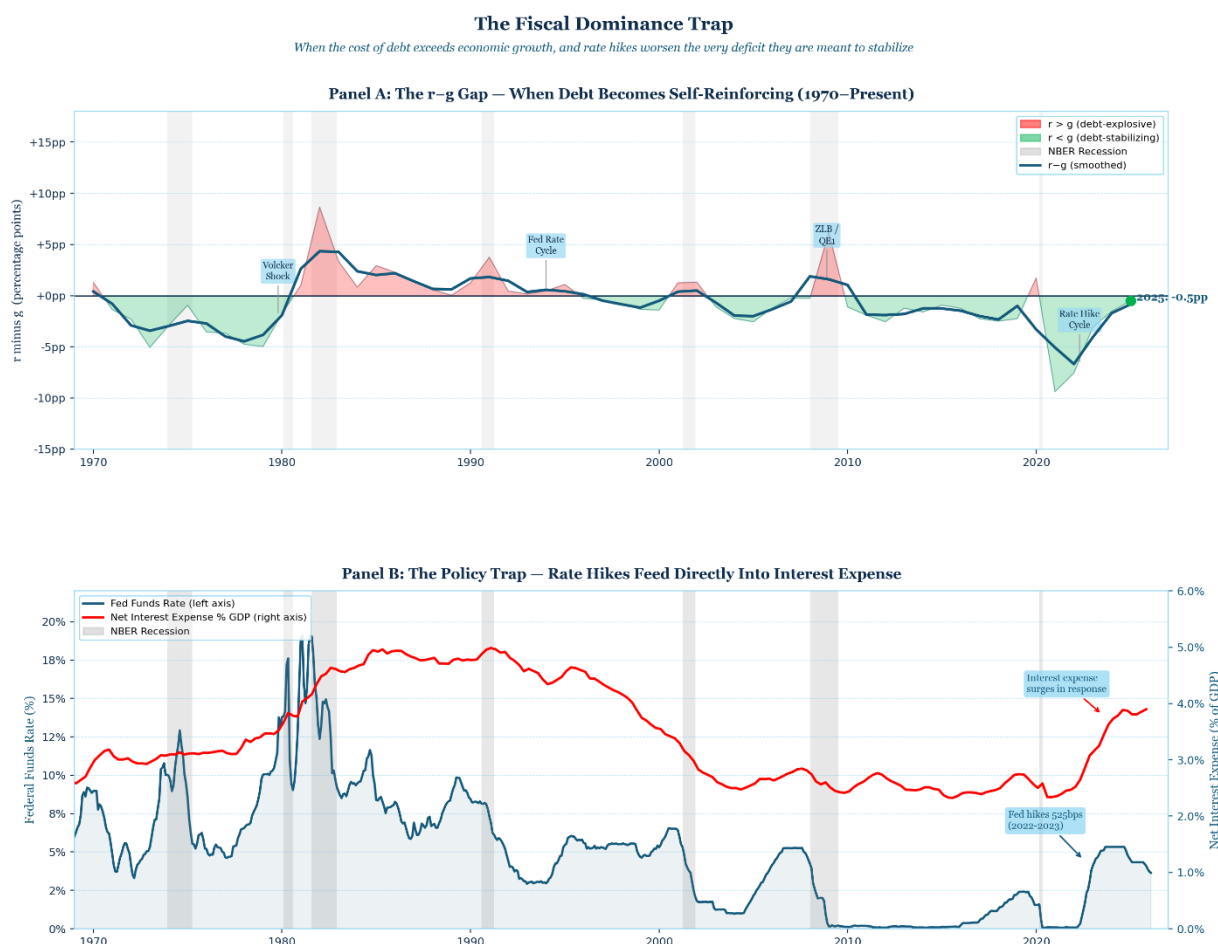
Left: U.S. Treasury Monthly Statement of the Public Debt, Dec 2025 (Table III-A). Right: U.S. Treasury Debt Management Annual Reports; TBAC Quarterly Presentations (2001-2025). WAM values are approximate fiscal-year-end readings.

III. Fiscal Dominance and the Erosion of Monetary Independence

3.1 What Fiscal Dominance Means

Fiscal dominance is a macroeconomic regime in which the central bank's policy decisions become subordinated (implicitly or explicitly) to the government's borrowing needs (Sargent & Wallace, 1981). In a textbook monetary-dominant regime, the central bank sets interest rates to achieve its inflation target, and fiscal policy adjusts to

The United States is not yet in a fully fiscally dominant regime, but it is moving unmistakably in that direction. The Federal Reserve's rate-hiking cycle of 2022–2023 (the fastest in four decades) raised the federal funds rate from near zero to 5.25–5.50% (Federal Reserve, 2023). This had the intended effect of slowing inflation from its 9.1% peak in June 2022 to approximately 2.8% by late 2025 (BLS, 2025). But it also increased the government's interest bill by hundreds of billions of dollars per year, contributing to deficits that exceeded 6% of GDP even in the absence of recession (See Figure Panel B).



Ahmadi Research | ahmadiresearch.com | Sources: FRED (FEDFUNDS, GSW, GDP, CPIAUCSL, A09BRC0002SBEA, GDP), NBER, CBO (2025)

remain solvent at those rates. In a fiscally dominant regime, the government's debt dynamics constrain the central bank's ability to tighten policy, because sufficiently high interest rates would trigger a debt spiral, forcing the central bank to either monetize the debt or accept a sovereign default (Cochrane, 2023).

The critical question is what happens in the next recession. When the economy weakens and deficits widen further through automatic stabilizers and potential discretionary stimulus, the Federal Reserve will face a dilemma with no good options: raise rates to fight any resurgent inflation (widening the deficit and risking a debt spiral) or cut rates to ease fiscal pressure (risking

inflation expectations becoming unanchored). The fiscal space for counter-cyclical spending has been largely exhausted in a period of economic expansion, the very opposite of responsible fiscal management.

3.2 The Federal Reserve's Balance Sheet as a Contingent Liability

The Federal Reserve's balance sheet, while reduced from its 2022 peak of \$9 trillion through quantitative tightening, remains at approximately \$6.7 trillion as of early 2026 (See Figure 3.2). The unrealized losses on the Fed's portfolio of long-duration Treasuries and mortgage-backed securities (acquired at much lower yields during 2020–2021) are estimated at over \$1 trillion (See Figure 3.2a). These losses do not force the Fed into operational difficulty (it can operate with negative capital by deferring remittances to the Treasury), but they create a political and perceptual vulnerability that constrains future policy.

More importantly, the Fed's accumulated deferred asset, representing future remittances owed to the Treasury that will not be made until the Fed's operating losses are recovered, stood at approximately \$210 billion as of late 2025 (See Figure 3.2b). This is a direct transfer of cost from monetary policy operations to the fiscal position, and it means the Treasury will receive no Fed remittances for years. In the decade prior to 2022, Fed remittances averaged over \$83 billion per year (See Figure 3.3).

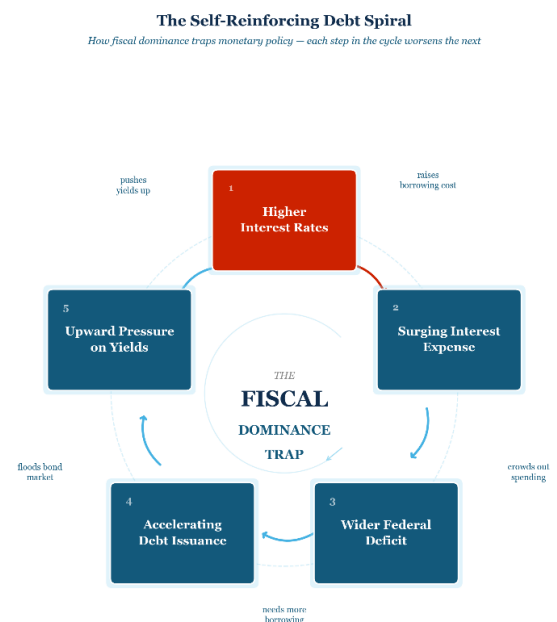
3.3 Political Dysfunction and the Debt Ceiling

The debt ceiling, a statutory limit on total federal borrowing that must be periodically raised by Congress, has become a recurring source of self-inflicted credibility damage. In 2011, a prolonged debt ceiling standoff led Standard & Poor's to downgrade the U.S. sovereign rating from AAA to AA+ (S&P Global Ratings, 2011), the first such downgrade in history. In 2023, Fitch Ratings followed suit, citing "the repeated debt-limit political standoffs and last-minute resolutions" as evidence of governance deterioration (Fitch Ratings, 2023). Both downgrades were met with market indifference in terms of immediate yield impact, but they are symptomatic of

a deeper erosion in institutional credibility that compounds over time.

The political economy of U.S. fiscal adjustment is deeply unfavorable. Mandatory spending programs, such as Social Security, Medicare, Medicaid, and interest payments, consume over 75% of total federal spending and are growing as a share of the budget due to demographic pressures (an aging population) and rising healthcare costs (See Figure 3.4 and 3.5). Discretionary spending has already been compressed relative to historical norms. Revenue as a share of GDP has remained largely flat at approximately 17–18% for decades (See Figure 3.6), and there is no political constituency for the tax increases that would be necessary to close the gap.

The 2017 Tax Cuts and Jobs Act and its anticipated extension or expansion further illustrate the political dynamic: both parties compete to offer tax reductions or spending increases, while neither proposes the fiscal consolidation that the arithmetic demands (CBO, 2024). The result is a ratchet effect in which deficits widen in bad times (through automatic stabilizers and stimulus) and fail to narrow in good times (through political unwillingness to impose austerity).



Ahmadi Research | ahmadi@ahmadi.com | Sources: CBO (2025a, 2022b), Surpreni & Wolfson (2018), Giedrowe (2022)

Figure 3.2

Federal Reserve total assets, 2006-2026

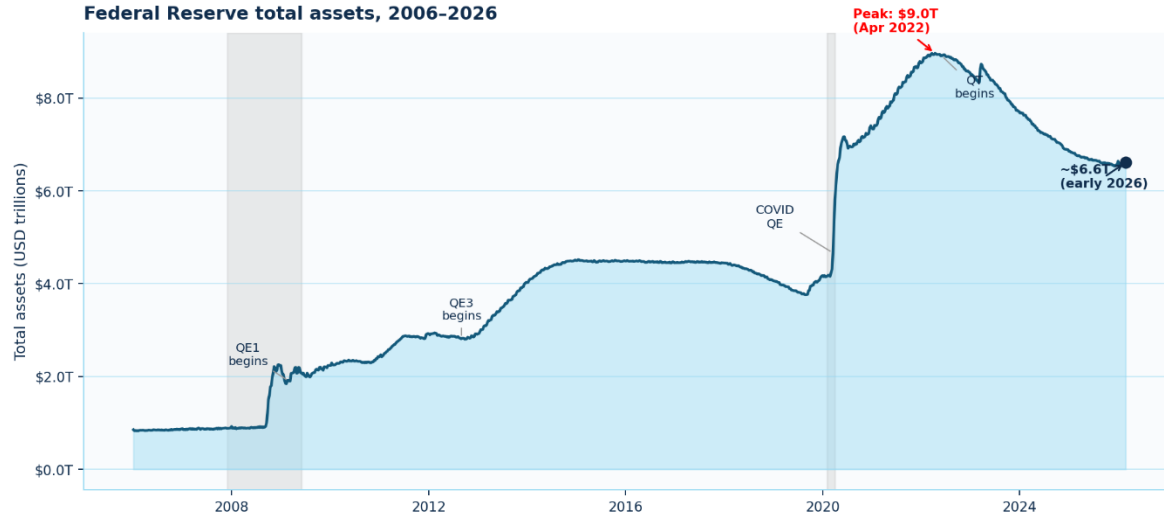


Figure 3.2a

Unrealized gains / losses on Fed SOMA portfolio

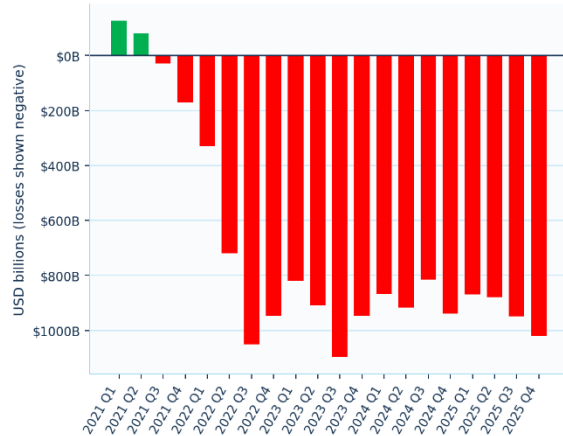
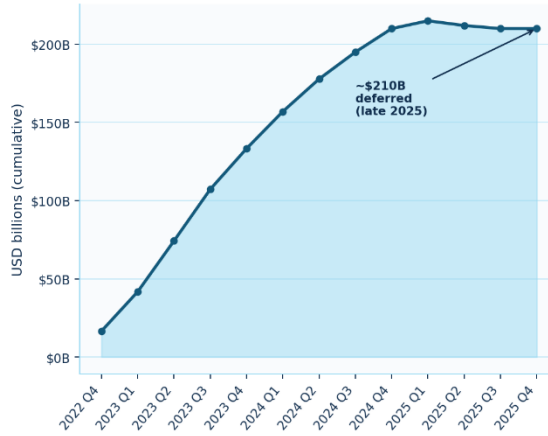


Figure 3.2b

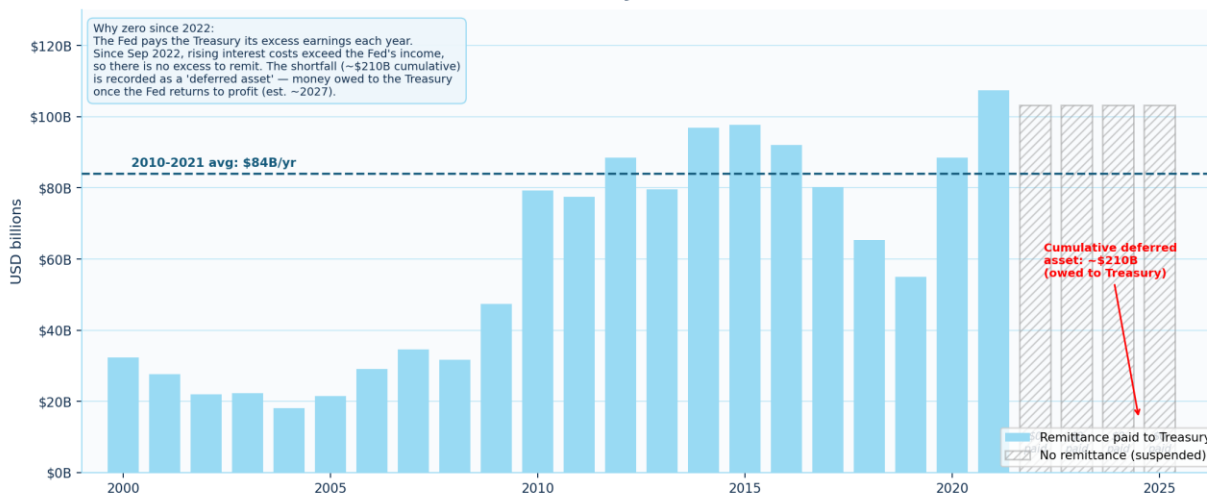
Fed deferred asset: cumulative unpaid remittances to Treasury



Source: Federal Reserve Combined Quarterly Financial Statements (2022-2025). Unrealized losses reflect SOMA portfolio mark-to-market. Deferred asset = cumulative remittances owed but deferred until operating losses recover.

Figure 3.3

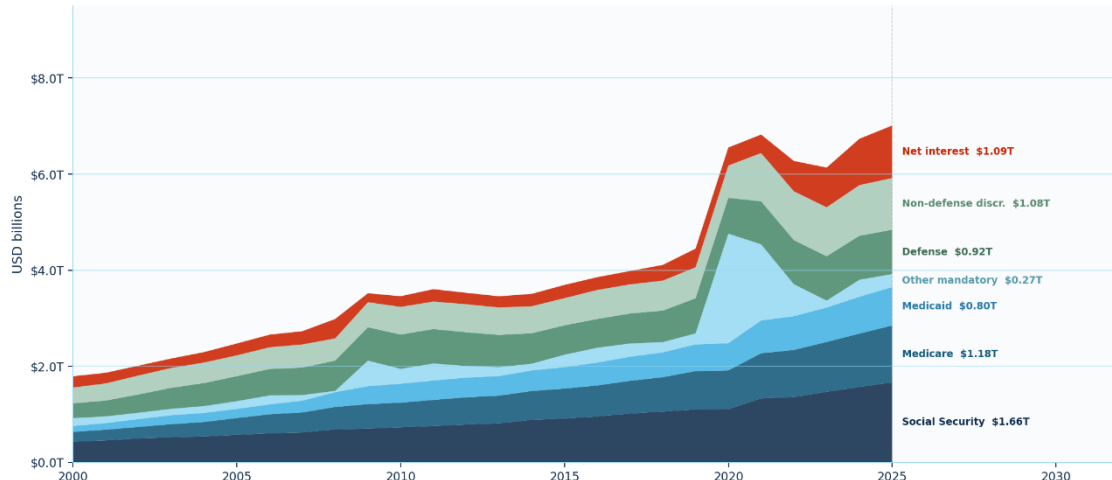
Federal Reserve annual remittances to the U.S. Treasury, 2000-2025



Sources: Federal Reserve Board Annual Reports; H.4.1 Historical Data. Remittances suspended from Sep 2022 when interest costs exceeded income. Deferred asset ~\$210B as of late 2025 (Federal Reserve, 2025b).

Figure 3.4

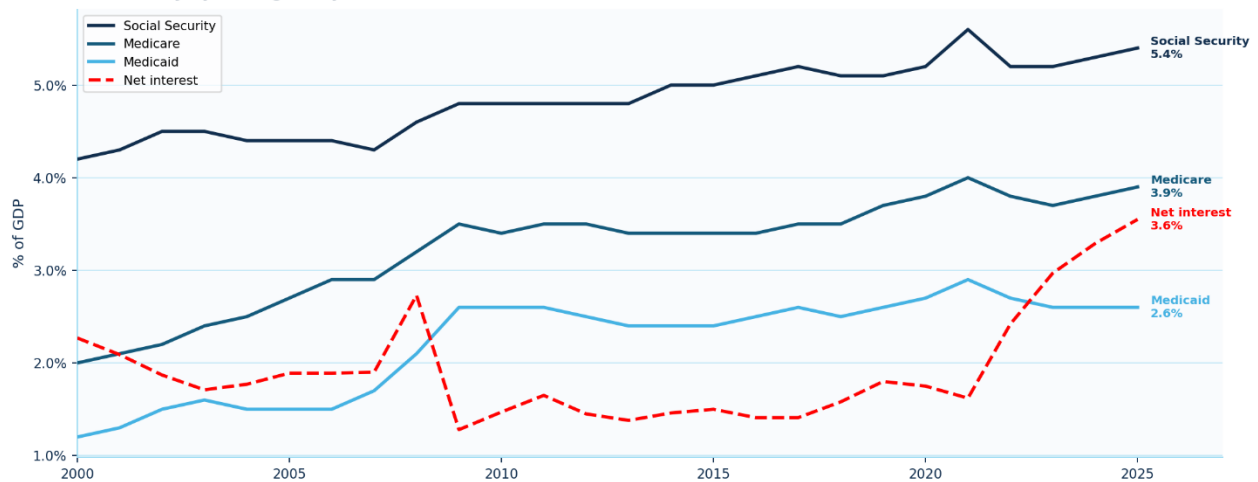
Federal spending by component, 2000-2025 (USD billions)



Sources: OMB Historical Tables (Tables 3.2, 5.1); CBO Budget and Economic Outlook (2025a); FRED FYONGDA1885, GDP. Dollar values = % of GDP × nominal GDP. Other mandatory = residual (COVID relief, SNAP, SSI, veterans benefits, unemployment insurance).

Figure 3.5

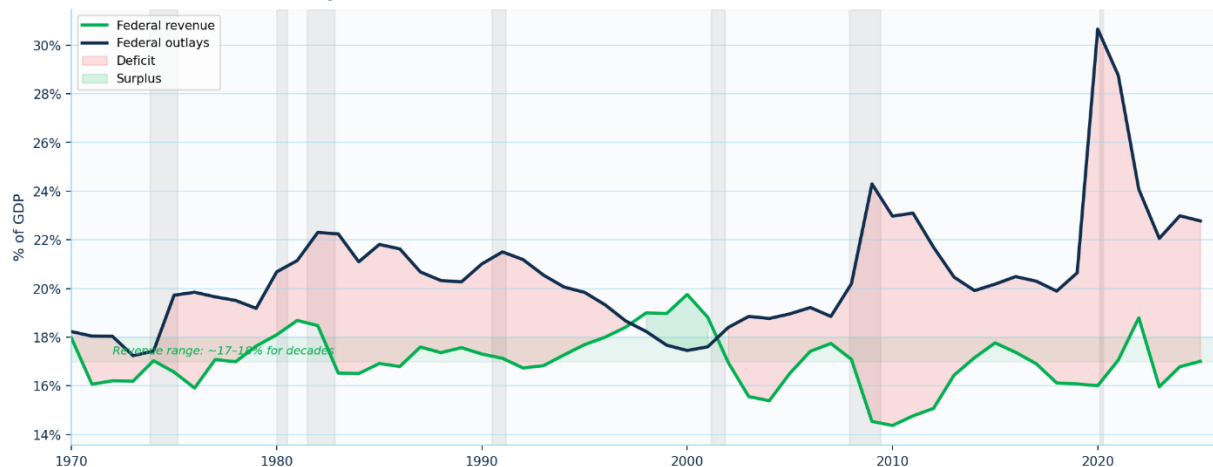
Mandatory spending components and net interest as % of GDP, 2000-2025



Sources: OMB Historical Tables (Table 3.2); CBO Budget and Economic Outlook (2025a). Net interest shown dashed; 2025 figures are estimates.

Figure 3.6

Federal revenue and outlays as % of GDP, 1970-2025



Sources: OMB Historical Tables via FRED (FYFRGDA1885, FYONGDA1885). Grey shading = NBER recession periods. Green band = 17-18% revenue range.

IV. The Anatomy of Implicit Default

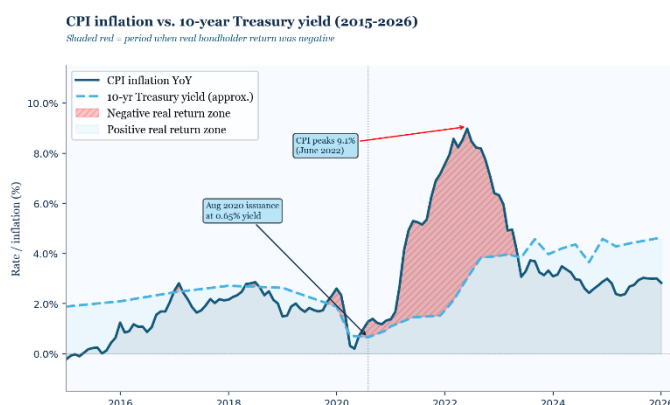
4.1 Distinguishing Explicit from Implicit Default

An explicit U.S. sovereign default (a missed payment of principal or interest on Treasury securities) remains a low-probability event, not because the fiscal position is sound, but because the institutional and political costs of explicit default are catastrophic and because the U.S. government retains the ability to create the dollars

a yield of 0.65% will deliver a deeply negative real return over its life if inflation averages anything close to its recent pace (U.S. Treasury, 2020).

The risk is not a repeat of 9% headline inflation but rather a persistent regime of 3–4% inflation, sufficiently elevated to erode real debt burdens over time, but not so dramatic as to trigger a full-scale bond market revolt. This is the most historically common form of implicit sovereign default, and it is the path of least political resistance (See Figure CPI vs. 10-year Treasury Yield).

Section IV | The anatomy of implicit default - Channel 1: Inflation



Sources: BLS CPI-U (CPIAUCSL) via FRED; 10-yr yield: representative series (Federal Reserve / U.S. Treasury). Avg 2020 yield cited in document (U.S. Treasury, 2020). BLS (2024).

necessary to service dollar-denominated debt (Reinhart & Rogoff, 2009). The relevant question is not whether the United States can pay, but what it pays with and what that payment is worth.

Implicit default occurs when creditors receive their nominal payments in full but suffer a loss in real terms. This can happen through three primary channels, each of which is already operating to varying degrees.

4.2 Channel 1: Inflation

Sustained inflation above the level priced into Treasury yields at the time of issuance constitutes a transfer of wealth from bondholders to the government. The 2021–2023 inflation episode, during which cumulative CPI inflation exceeded 20%, delivered precisely this outcome for holders of Treasuries issued at near-zero yields during 2020–2021 (See Figure CPI vs. 10-year Treasury Yield). A 10-year Treasury note issued in August 2020 at

4.3 Channel 2: Financial Repression

Financial repression refers to a constellation of policies that hold interest rates below the rate of inflation, imposing a hidden tax on savers and creditors (McKinnon, 1973; Shaw, 1973). Regulatory requirements that force banks and pension funds to hold government securities, caps on deposit rates, and central bank yield-curve control are all tools of financial repression. The United States employed aggressive financial repression from the 1940s through the 1970s to reduce its post-World War II debt burden, keeping nominal interest rates capped while inflation ran moderately above those rates (Reinhart & Sbrancia, 2015; See Figure Real Funds Rate (1955-2026)).

Section IV | The anatomy of implicit default - Channel 2: Financial repression

Real Federal Funds Rate (1955-2026)*Financial repression = nominal rate held below inflation; imposes a hidden tax on creditors and savers*

Sources: Federal Reserve FEDFUNDS via FRED, BLS CPI-U (CPIAUCSL) via FRED, BLS, McKinnon (1973); Shaw (1973); Reinhart & Shambaugh (2012) on historical financial repression episodes.

AHMADI RESEARCH | ahmadiresearch.com

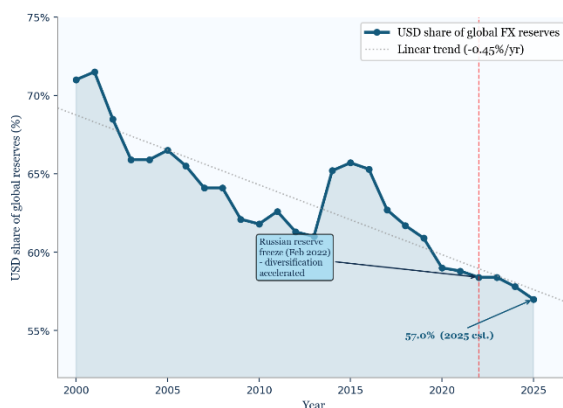
While the Federal Reserve has not implemented explicit yield-curve control in the manner of the Bank of Japan, quantitative easing programs that suppressed long-term yields served a functionally similar purpose. Any future return to large-scale asset purchases, which may become necessary to absorb Treasury issuance that private markets are unwilling to absorb at current yields, would represent a de facto return to financial repression (See Figure Real Federal Funds Rate (1955-2026)).

4.4 Channel 3: Dollar Debasement

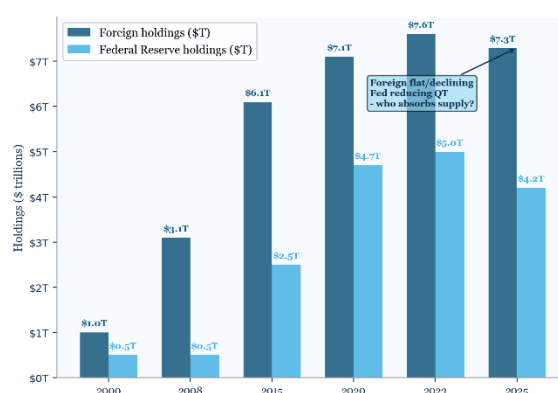
For foreign creditors, implicit default can also occur through depreciation of the dollar against other currencies. Foreign holders of U.S. Treasuries bear exchange-rate risk in addition to inflation risk, a decline

in the dollar's value reduces the purchasing power of their Treasury holdings in domestic-currency terms. The dollar's share of global foreign exchange reserves has declined from over 70% in 2000 to approximately 57% as of 2025, according to IMF COFER data (See Figure USD share of global FX reseves). While this decline has been gradual, it reflects a slow but persistent diversification by central banks that accelerated after the U.S. weaponization of the dollar-based financial system through sanctions (most notably the freezing of Russian central bank reserves in 2022) (Arslanalp, Eichengreen & Simpson-Bell, 2022).

Section IV | The anatomy of implicit default - Channel 3: Dollar debasement

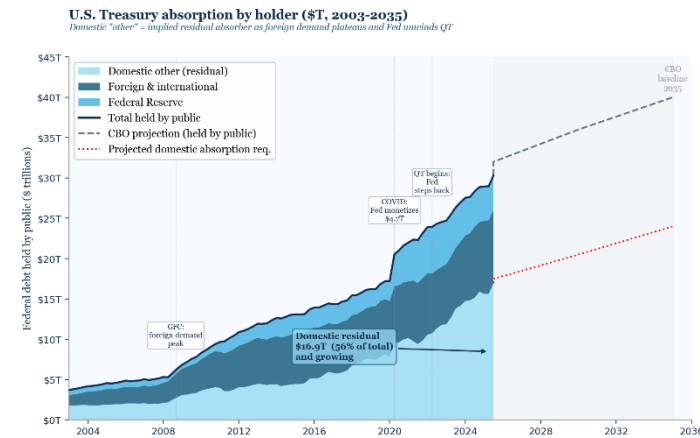
USD share of global FX reserves (IMF COFER, 2000-2025)*14 ppt decline over 25 years - structural reduction in marginal Treasury demand*

Sources: IMF COFER Database (IMF, 2025); Treasury International Capital System (U.S. Treasury, 2025c); Federal Reserve H.4.1 (2026); Table 3, document. Arslanalp, Eichengreen & Simpson-Bell (2022).

Foreign vs. Fed holdings of U.S. Treasury securities (\$T)*Foreign demand plateauing; Fed unwinding QT - structural absorption gap widening*

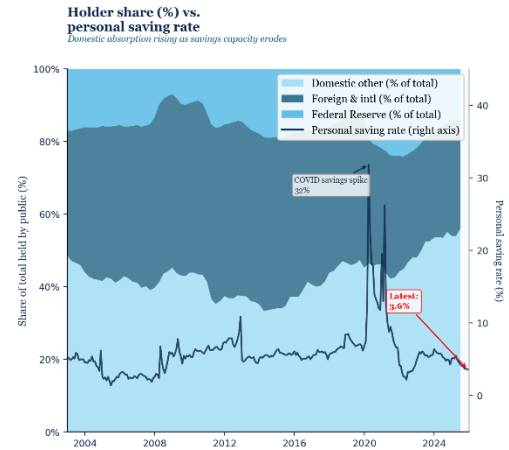
AHMADI RESEARCH | ahmadiresearch.com

Section IV | The anatomy of implicit default - Who absorbs U.S. Treasury supply?



Sources: FRED, FOMC, TREAS, PRASAD via FRED (live), CBO Long-Term Budget Outlook (2023b) for projection curves. Domestic "other" = held by public minus foreign & international minus Federal Reserve. Analysis: Eklundgreen & Stinson-Bell (2022); U.S. Treasury TIC (2023).

AHMADI RESEARCH | ahmadi@ahmadi.com



V. Addressing the Counterarguments

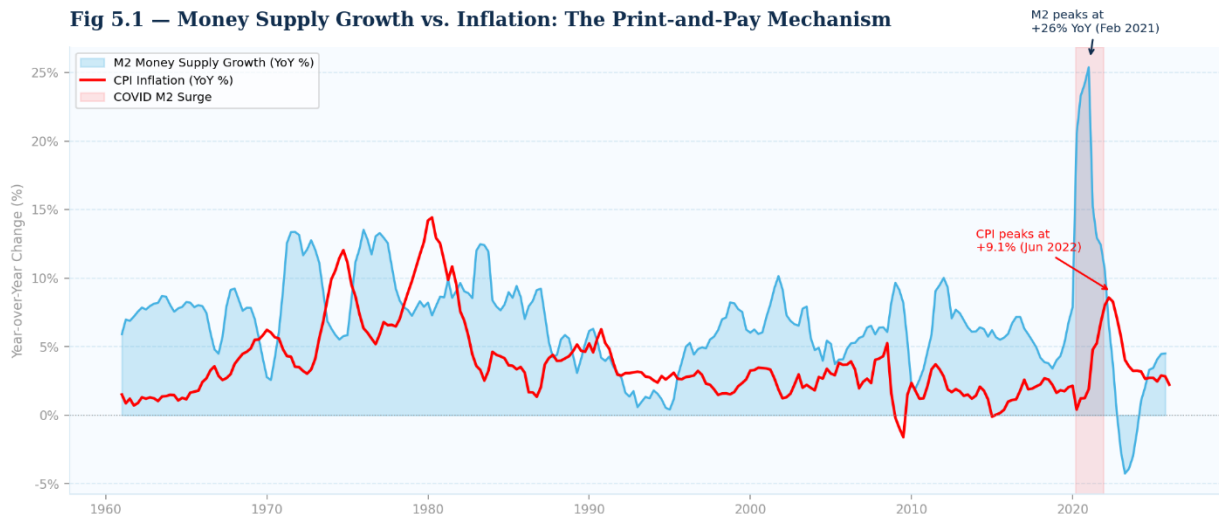
5.1 "The U.S. Can Always Print"

The most common dismissal of U.S. default risk rests on the observation that, because U.S. debt is denominated in a currency the U.S. government can create, technical default is impossible. This is arithmetically correct and analytically empty. The ability to print money to meet nominal obligations is precisely the mechanism through which implicit default occurs (Cochrane, 2023). Weimar Germany, 1990s Zimbabwe, and 2010s Venezuela all "paid" their debts in nominal terms while destroying the real value of their currencies (Reinhart & Rogoff, 2009).

The United States is not these economies, but the principle is the same: the power to create money is the power to debase money, and the exercise of that power beyond certain limits constitutes default in everything but name (See Figure 5.1 Money Supply Growth vs. Inflation: The Print-and-Pay Mechanism).

The more sophisticated version of this argument holds that the dollar's reserve status creates a structural demand for Treasuries that gives the U.S. far more fiscal space than other sovereigns (Prasad, 2014). This is true but time-variant. Reserve status is earned through decades of credible behavior and can be lost through sustained abuse. The demand for Treasuries as reserve assets is a function of confidence, and confidence is a function of the very fiscal metrics that are deteriorating.

Fig 5.1 — Money Supply Growth vs. Inflation: The Print-and-Pay Mechanism

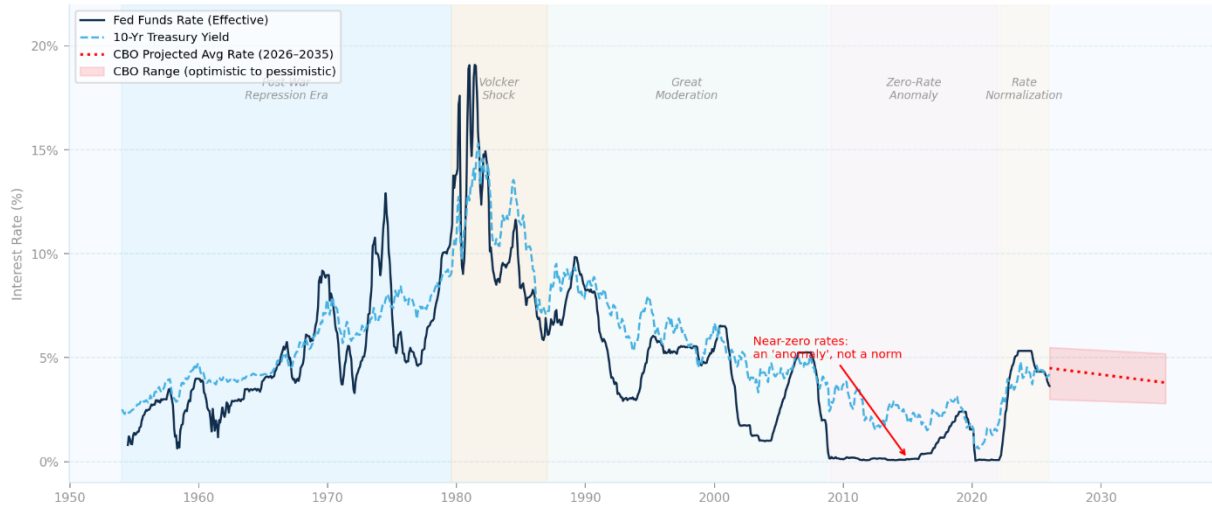


5.2 "Interest Rates Will Come Back Down"

Some analysts argue that the current elevated rate

still projects an exploding debt trajectory (CBO, 2025b). The problem is structural, not cyclical.

Fig 5.2 — Federal Funds Rate & Treasury Yields: The End of the Zero-Rate Anomaly

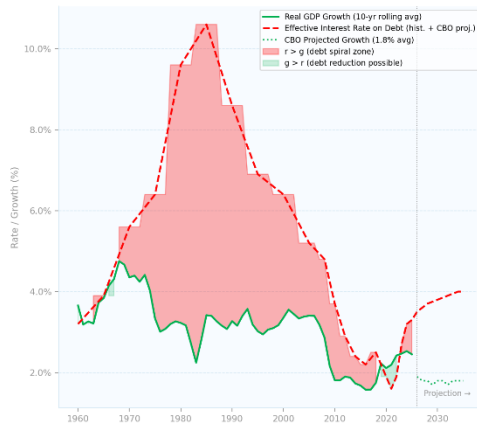


environment is transitory and that a return to near-zero rates will ease fiscal pressures. This view faces two challenges. First, even if rates decline from current levels, they are unlikely to return to the anomalous near-zero regime of 2009–2021, which was the product of unique disinflationary forces (post-GFC deleveraging, globalization-driven cost suppression, demographic savings gluts) that are now reversing (Goodhart & Pradhan, 2020; See Figure 5.2). Second, even a moderate decline in rates does not solve the fiscal problem if primary deficits remain large. The CBO's baseline already assumes a gradual decline in interest rates and

5.3 "Growth Will Solve the Problem"

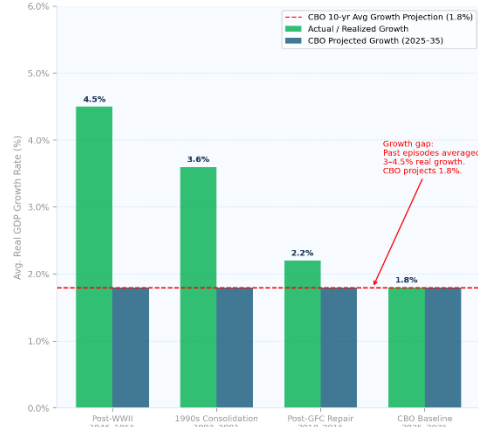
The post-World War II debt reduction was accomplished largely through rapid real GDP growth that outpaced the interest rate on debt. For a similar dynamic to operate today, the United States would need sustained real growth of 3–4% per year for decades, a rate not achieved since the 1990s and inconsistent with projected demographic and productivity trends (Gordon, 2016). The CBO projects average real GDP growth of approximately 1.8% over the next decade (CBO, 2025; See Figure 5.3). Even optimistic AI-driven productivity scenarios struggle to close the gap between the growth

Fig 5.3A — The $r - g$ Spread: When Debt Becomes Self-Perpetuating



Sources: FRED (GDPFC1, FEDFUNDS); U.S. Treasury Average Interest Rate on Debt; CBO Budget & Economic Outlook 2025; OMB Historical Tables; Ahmadi Research, Feb 2026.

Fig 5.3B — Required vs. Projected Growth: Historical Debt Reduction Episodes



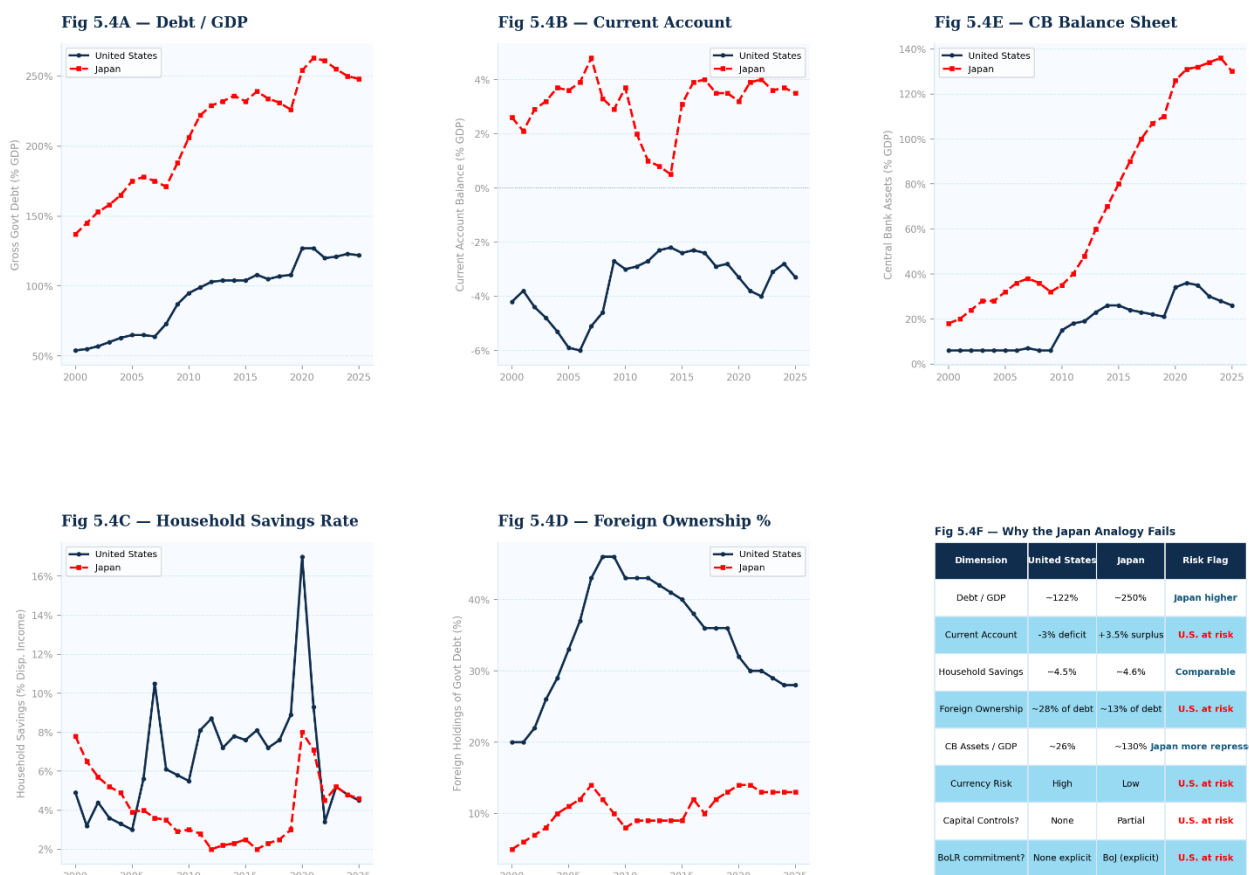
rate and the effective interest rate when primary deficits are persistently negative.

U.S. can replicate Japan's conditions (See Figure 5.4 for the U.S. vs. Japan comparison).

5.4 "Japan Has Higher Debt and Is Fine"

Japan's debt-to-GDP ratio exceeds 250%, and it has not defaulted (See Figure 5.4A). The comparison is instructive but not reassuring. Japan's debt is overwhelmingly held domestically, its current account is in surplus, its household savings rate is high, and the Bank of Japan has been the buyer of last resort for decades through explicit yield-curve control (Bank of Japan, 2024; IMF, 2024). The United States, by contrast, runs persistent current account deficits, relies heavily on foreign capital inflows, has a negative household savings rate in recent years, and cannot engage in open financial repression without risking an immediate and destabilizing capital flight (BEA, 2025). Japan's experience demonstrates that high debt can persist for a long time; it does not

Fig 5.4 — Japan vs. United States: Why High Debt Is Not Equivalent



Sources: IMF WEO; OECD National Accounts; Federal Reserve H.4.1; Bank of Japan; U.S. Treasury TIC. Data to 2025. Ahmadi Research, Feb 2026.

demonstrate that it can persist indefinitely or that the

VI. Why This Moment Is Different

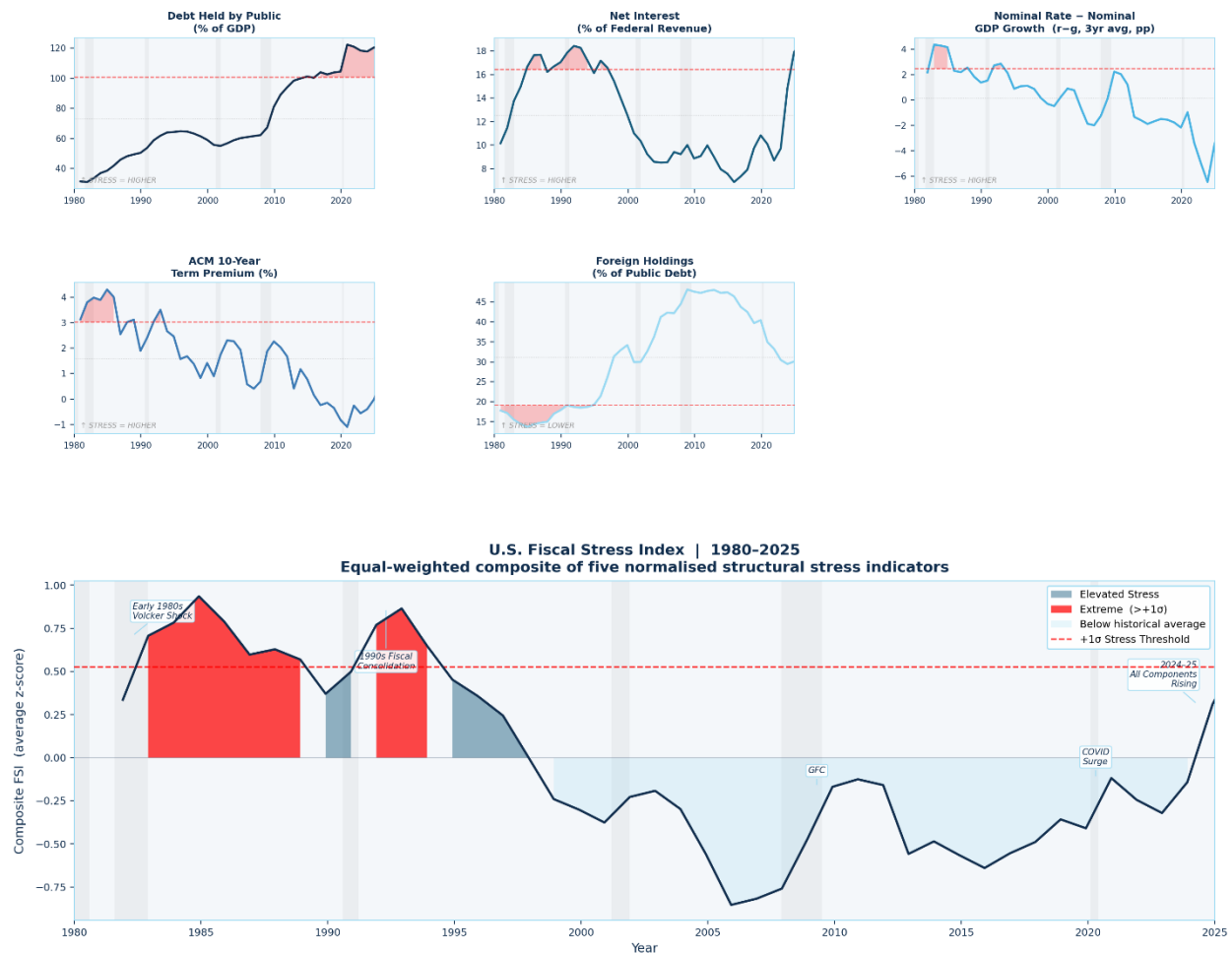
6.1 The Confluence of Adverse Factors

Prior episodes of elevated U.S. debt were characterized by at least one favorable tailwind: rapid growth (post-WWII), falling interest rates (post-2008), or political capacity for fiscal adjustment (1990s deficit reduction). The current episode lacks all three. Growth is structurally slower due to demographic headwinds and declining labor-force participation. Interest rates have normalized after a decade of artificial suppression and show no signs of returning to the zero lower bound. And political polarization has rendered bipartisan fiscal compromise functionally impossible.

6.2 The Weaponization of the Dollar

The decision in 2022 to freeze approximately \$300 billion in Russian central bank reserves held in Western financial institutions, while justified on geopolitical grounds, fundamentally altered the calculus for foreign holders of dollar-denominated assets (Arslanalp, Eichengreen & Simpson-Bell, 2022). It demonstrated that dollar reserves are not truly sovereign property but are contingent on alignment with U.S. foreign policy objectives. Central banks in China, India, Saudi Arabia, and across the Global South have accelerated reserve diversification in response, increasing gold holdings and exploring alternative payment systems (World Gold Council, 2025). This is not yet a crisis, but it represents a

The U.S. Fiscal Stress Index: Five Structural Fault Lines
COMPONENT PANELS → Red shading marks readings above the historical $+1\sigma$ stress threshold



Sources: Federal Reserve Bank of St. Louis (FRED): GFDEGQ188S, FYONGDA188S, FYRGDA188S, GS10, GDP, FDHBFIN, FYGDPJUN. Federal Reserve Bank of New York: ACM Term Premium Model.
Methodology: (i) Debt/GDP level, (ii) Net interest as % of federal revenue, (iii) Nominal rate – nominal GDP growth 3yr avg ($r-g$), (iv) 10yr ACM term premium, (v) Foreign Treasury holdings % of public debt (inverted).
Each component z-scored over the 1980-2025 sample. Composite = equal-weighted average. NBER recession shading shown.

structural reduction in the marginal demand for Treasuries at a time when supply is expanding relentlessly.

6.3 The Eroding Institutional Framework

The credibility of U.S. fiscal institutions depends on a perception that, when necessary, the political system will act to prevent a fiscal catastrophe. This perception is increasingly difficult to sustain. The recurring debt ceiling crises, the inability to pass a federal budget through regular order (continuing resolutions have become the norm rather than the exception), the credit rating downgrades by two of three major agencies (S&P Global Ratings, 2011; Fitch Ratings, 2023), and the growing prominence of fiscal nihilism in political discourse (the explicit argument that deficits do not matter) all contribute to a slow but measurable erosion of institutional credibility.

For foreign creditors and reserve managers, the question is no longer whether the United States will face a fiscal reckoning, but when and in what form. The rational response to this uncertainty is gradual diversification, precisely the behavior we observe in the data.

6.4 The Nonlinear Risk

Fiscal crises do not unfold linearly. They proceed gradually, then suddenly (Reinhart & Rogoff, 2009). The U.K.'s 2022 gilt market crisis in which a modest fiscal package triggered a cascading sell-off that forced a prime ministerial resignation within weeks demonstrates how quickly confidence can evaporate in sovereign bond markets (Bank of England, 2022). The United States' deeper and more liquid market provides a larger buffer against such sudden stops, but it does not provide immunity. A failed Treasury auction, a geopolitical shock that triggers coordinated foreign selling, or a loss of confidence in the Federal Reserve's willingness to maintain price stability could trigger a nonlinear repricing of U.S. sovereign risk. The probability of such an event in any given year may be low, but it is no longer negligible, and it is growing.

VII. Investment and Geopolitical Implications

7.1 For Fixed-Income Investors

The traditional role of U.S. Treasuries as a risk-free asset and portfolio ballast is undergoing a fundamental reassessment. Long-duration Treasuries are no longer risk-free in real terms; they are a leveraged bet on the continuation of moderate inflation and the maintenance of dollar purchasing power. Investors with long-duration liabilities, such as pension funds, insurance companies, endowments, face a structural mismatch between the nominal certainty of Treasury payments and the real uncertainty of those payments' value. TIPS (Treasury Inflation-Protected Securities) provide partial protection, but their breakeven spreads reflect current inflation expectations that may prove too sanguine (See Figure A).

7.2 For Global Reserve Managers

The slow-motion diversification away from dollar reserves will accelerate as the fiscal position deteriorates. Gold, which has appreciated from approximately \$1,800/oz in early 2023 to near \$5,000/oz in early 2026 (See Figure B), is the primary beneficiary of this trend, as it is the only reserve asset that carries no counterparty or sovereign risk (World Gold Council, 2025). The Chinese yuan is unlikely to serve as a full alternative reserve currency given China's capital controls and institutional opacity, but bilateral currency arrangements, commodity-backed trade settlement, and digital currency innovations will continue to chip away at dollar dominance at the margin (Eichengreen, Mehl & Chifu, 2018).

7.3 For the Global Economic Order

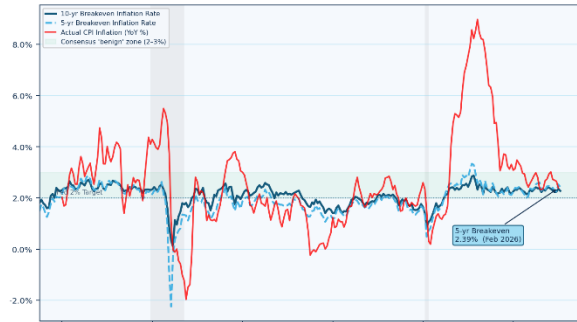
The most consequential implication is the erosion of the United States' ability to function as a reliable anchor for the global economic system. The Pax Americana economic order rested on two pillars: military security guarantees and monetary/financial stability. Both pillars are cracking simultaneously. The weaponization of the dollar undermines the second pillar directly (See Figure B & D). The fiscal constraints imposed by unsustainable

debt dynamics will eventually undermine the first, as defense spending is crowded out by mandatory spending and debt service (See Figure C).

The world is entering a period of monetary multipolarity, not because any single alternative has emerged to replace the dollar, but because the dollar's claim to unquestioned supremacy is no longer supported by the fundamentals. This transition will be messy, volatile, and protracted. It will impose costs on all participants, but especially on those who remain most concentrated in dollar-denominated assets.

[A] TIPS Breakeven Spreads vs. Actual CPI Inflation

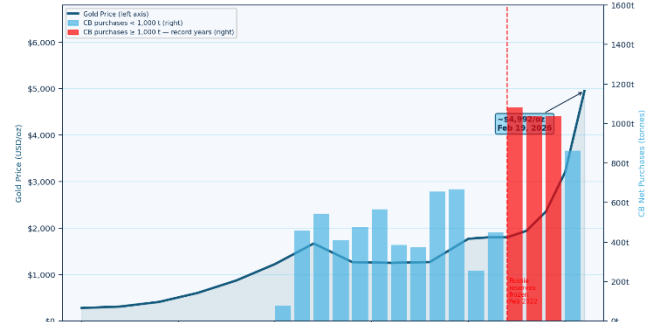
Market pricing a benign 2-3% outcome despite fiscal dynamics that suggest upside risk



Source: FRED: T30YR, T5YR, CPICUSL | NBER recession shading

[B] Gold Price & Central Bank Net Purchases

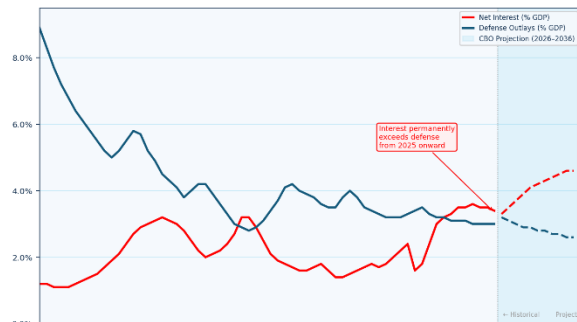
Sanctions risk drove CB buying above 1,000 t/yr in 2022-24; gold now ~20% of official reserves, surpassing the euro



Source: WGC Gold Demand Trends 2025, WGC / Macrotrends gold price series

[C] Net Interest vs. Defense Spending — % of GDP

CBO: Interest exceeds defense 2025-2036+; defense as % GDP approaching lowest since pre-WWII

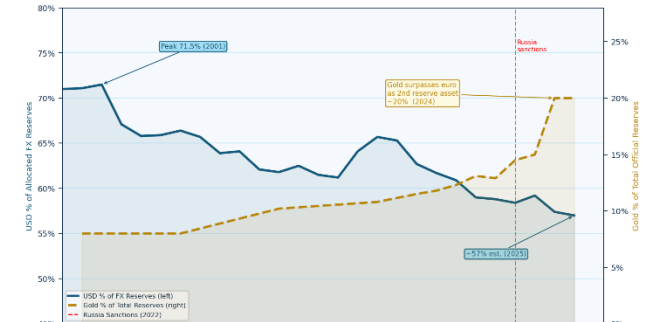


Source: OMB Historical Tables (FY01, FY02, FY03), CBO Budget & Economic Outlook, Feb 2026

Data: FRED (Federal Reserve Bank of St. Louis) | IMF COPER Database | World Gold Council Gold Demand Trends 2025 | CBO Budget & Economic Outlook, Feb 2026 | OMB Historical Tables

[D] Dollar Reserve Share vs. Gold Share of Official Reserves

USD down ~14 pts since 2001; gold doubled as share of reserves, overtaking the euro in 2024



Source: IMF COPER Database, WGC Gold Demand Trends 2025, ICB International Role of the Euro 2025

VIII. Conclusion: The Arithmetic Is Unforgiving

The United States is not on the verge of an Argentine-style sovereign crisis. Its institutions, despite their degradation, remain stronger than those of most nations. Its economy, despite its imbalances, remains the largest and most dynamic in the world. Its military, despite the fiscal constraints ahead, remains unmatched. These are real advantages that buy time. But they do not buy solvency.

The arithmetic of U.S. sovereign debt is unforgiving. When the effective interest rate on the debt exceeds the growth rate of the economy, and the government runs persistent primary deficits, the debt-to-GDP ratio rises without bound absent a fiscal correction (Blanchard, 2019). All three conditions hold today and are projected to hold for the foreseeable future (CBO, 2025). No politically plausible combination of spending cuts and revenue increases can close the gap. The only remaining

levers are inflation (implicit default), financial repression (implicit default), or outright monetization (also implicit default). The question is not whether creditors will bear losses, but how those losses will be distributed and over what time horizon.

For the rest of the world, the implication is stark. The United States, which has served as the anchor of the global monetary system for eight decades, has become a source of systemic risk rather than a guarantor of stability. The transition to whatever comes next will define the macroeconomic landscape for a generation.

We do not know when the inflection point will arrive. We do not know what form it will take. What we know is that the trajectory is unsustainable, the political capacity for correction is absent, and the window for orderly adjustment is closing. Investors and policymakers who fail to position for this reality do so at their own risk.

References

- Adrian, T., Crump, R.K. & Moench, E. (2013). Pricing the Term Structure with Linear Regressions. *Journal of Financial Economics*, 110(1), 110–138. Updated estimates available via Federal Reserve Bank of New York, Treasury Term Premia.
- Arslanalp, S., Eichengreen, B. & Simpson-Bell, C. (2022). The Stealth Erosion of Dollar Dominance: Active Diversifiers and the Rise of Nontraditional Reserve Currencies. IMF Working Paper No. 2022/058. Washington, DC: International Monetary Fund.
- Bank of England. (2022). Financial Stability Report, October 2022. London: Bank of England. Retrieved from <https://www.bankofengland.co.uk/financial-stability-report/2022/october-2022>
- Bank of Japan. (2024). Monetary Policy Framework. Tokyo: Bank of Japan. Retrieved from <https://www.boj.or.jp/en/mopo/outline/>
- Bernanke, B.S. (2015). *The Courage to Act: A Memoir of a Crisis and Its Aftermath*. New York: W.W. Norton & Company.
- Blanchard, O. (2019). Public Debt and Low Interest Rates. *American Economic Review*, 109(4), 1197–1229.
- Bureau of Economic Analysis (BEA). (2025). National Income and Product Accounts (NIPA) Tables. Washington, DC: U.S. Department of Commerce. Retrieved from <https://www.bea.gov/data/gdp>
- Bureau of Labor Statistics (BLS). (2024). Consumer Price Index: All Urban Consumers (CPI-U), Historical Data. Washington, DC: U.S. Department of Labor. Retrieved from <https://www.bls.gov/cpi/data.htm>
- Bureau of Labor Statistics (BLS). (2025). Consumer Price Index Summary, December 2025. Washington, DC: U.S. Department of Labor. Retrieved from <https://www.bls.gov/cpi/>
- Cochrane, J.H. (2023). *The Fiscal Theory of the Price Level*. Princeton, NJ: Princeton University Press.
- Congressional Budget Office (CBO). (2021). An Update to the Budget and Economic Outlook: 2021 to 2031. Washington, DC: CBO. Retrieved from <https://www.cbo.gov/publication/57339>
- Congressional Budget Office (CBO). (2022). The Budget and Economic Outlook: 2022 to 2032. Washington, DC: CBO. Retrieved from <https://www.cbo.gov/publication/57950>
- Congressional Budget Office (CBO). (2024). Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues. Washington, DC: CBO. Retrieved from <https://www.cbo.gov/>
- Congressional Budget Office (CBO). (2025a). The Budget and Economic Outlook: 2025 to 2035. Washington, DC: CBO. Retrieved from <https://www.cbo.gov/>
- Congressional Budget Office (CBO). (2025b). The Long-Term Budget Outlook: 2025. Washington, DC: CBO. Retrieved from <https://www.cbo.gov/>
- Eichengreen, B. (2011). *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*. New York: Oxford University Press.
- Eichengreen, B., Mehl, A. & Chifu, L. (2018). *How Global Currencies Work: Past, Present, and Future*. Princeton, NJ: Princeton University Press.
- Federal Reserve Bank of New York. (2025). Treasury Term Premia (ACM Model). New York: Federal Reserve Bank of New York.
- Federal Reserve. (2015). Credit and Liquidity Programs and the Balance Sheet: Recent Balance Sheet Trends. Washington, DC: Board of Governors of the Federal Reserve System. Retrieved from <https://www.federalreserve.gov/monetarypolicy/bst.htm>
- Federal Reserve. (2022). Factors Affecting Reserve Balances (H.4.1), Historical Data. Washington, DC: Board of Governors of the Federal Reserve System.

- Federal Reserve. (2022b). Federal Reserve Banks Combined Financial Statements: Remittances to Treasury. Washington, DC: Board of Governors of the Federal Reserve System.
- Gordon, R.J. (2016). The Rise and Fall of American Growth: The U.S. Standard of Living Since the Civil War. Princeton, NJ: Princeton University Press.
- Goodhart, C. & Pradhan, M. (2020). The Great Demographic Reversal: Ageing Societies, Waning Inequality, and an Inflation Revival. Cham, Switzerland: Palgrave Macmillan.
- International Monetary Fund (IMF). (2025). Currency Composition of Official Foreign Exchange Reserves (COFER) — World Aggregates, Third Quarter 2025. Washington, DC: International Monetary Fund.
- McKinnon, R.I. (1973). Money and Capital in Economic Development. Washington, DC: Brookings Institution.
- Office of Management and Budget (OMB). (2016). Historical Tables, Budget of the U.S. Government. Washington, DC: Executive Office of the President.
- Prasad, E.S. (2014). The Dollar Trap: How the U.S. Dollar Tightened Its Grip on Global Finance. Princeton, NJ: Princeton University Press.
- Rajan, R.G. (2014). Competitive Monetary Easing: Is It Yesterday Once More? Speech delivered at the Brookings Institution.
- Reinhart, Carmen M., and M. Belen Sbrancia. 2015. “The Liquidation of Government Debt.” *Economic Policy* 30 (82): 291–333. Published March 24, 2015
- Reinhart, C.M. & Rogoff, K.S. (2010). Growth in a Time of Debt. *American Economic Review*, 100(2), 573–578.
- Reinhart, C.M. & Rogoff, K.S. (2009). This Time Is Different: Eight Centuries of Financial Folly. Princeton, NJ: Princeton University Press.
- Rey, H. (2013). Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence. Proceedings of the Jackson Hole Economic Policy Symposium.
- Sargent, T.J. & Wallace, N. (1981). Some Unpleasant Monetarist Arithmetic. *Federal Reserve Bank of Minneapolis Quarterly Review*.
- Shaw, E.S. (1973). Financial Deepening in Economic Development. New York: Oxford University Press.