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**THE PREHN INSTITUTE | RESEARCH**

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US ECONOMY · INFLATION, RATES & LIQUIDITY

# The Unthinkable Plan to Reset the Dollar

*Higher mortgage rates, a Fed that may be feeding the problem, a new way of measuring inflation, and $57 billion slipped back into the banks*

**FELIX PREHN**

Economist and former investment banker
The Prehn Institute

**REPORT SCOPE**

Educational explanation of the video “The Unthinkable Plan to Reset the Dollar”.

**RATING**

None

**PRICE TARGET**

None

America's official inflation gauge is being recalculated so it reads lower, while the Treasury quietly pumps money back into the banking system and the Fed talks tough. Put together, that is a path to shrinking a record government debt against a dollar that buys less every year. The people most exposed are savers who trust the official number.

## 7.45%

**30-year mortgage rate, up from 7.24% in 1 night**

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# About Felix Prehn and The Prehn Institute

## Felix Nikolas Prehn

Felix Nikolas Prehn is an economist and former investment banker. His work explains how the financial system actually operates, from central-bank policy and government debt to the plumbing that moves money between banks, in language regular investors can use.

## The Prehn Institute

Felix is the founder of The Prehn Institute, which publishes research on the financial markets and provides instruction in how they work. Its reports are educational. They carry no ratings, no price targets and no paid placements.

## Independence

Felix takes no sponsorships or endorsements. Nobody pays for a mention in a video or a report, which leaves him free to say what the evidence shows, including when it is uncomfortable for policymakers or for Wall Street.

## Winston

Winston is the research app Felix built to do the routine checking: tracking the names you own, testing them against past stress periods and flagging what has changed. Winston's Inflation Shield is used in this report. **winstondaily.com**

## Watch Felix on YouTube

**youtube.com/@felixprehn**

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## How to use this report.

Read it beside the video. The sections follow the video's order and use the same figures. The aim is not to predict the next market move. It is to show how rates, the inflation gauge and the Treasury's bank account fit together, so you can judge what that means for your own money.

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BOTTOM LINE

# One plan, 4 moving parts

Nobody would announce it this way, but the pieces are public. A government with record debt cannot afford high rates for long. The Fed has just raised anyway. The gauge the Fed steers by is being recalculated to read lower. And the Treasury is using its own account to push money back into the banks.

**Let prices run a little hot** → **Report them a little lower** → **Use the lower reading to bring rates down** → **Debt shrinks against a weaker dollar**

## THE PRESSURE

The 10-year government bond yield hit 5.23%, the highest since 2007, and the Fed raised its own rate for the first time since 2023. Mortgages jumped to 7.45% in 1 night.

## THE RULER

Tom Lee estimates the new method for core PCE could take close to half a percentage point off the reading, without any price in a shop falling.

## THE PLUMBING

It pulled about $100 billion out of the system in 1 week, then injected $57 billion the next by running down its account at the Fed.

## THE SIGNAL

Gold is more than 20% below its January record, yet central banks bought 289 tonnes in the second quarter, a record for that quarter.

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IT MOVED BEFORE WASHINGTON DID

# 7.24% to 7.45% in 1 night



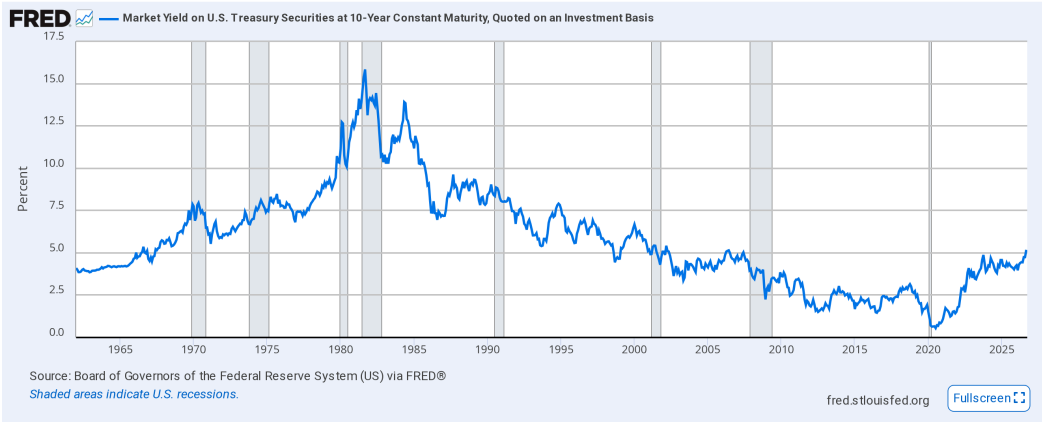

The post where the 7.45% figure first circulated. Traders in the replies were already discussing 8%.

## WHO SETS MORTGAGE RATES

A 30-year fixed mortgage in America follows the 10-year government bond. When investors demand more to lend to the government, banks demand more to lend to you.

## WHO FEELS IT FIRST

There are more adjustable-rate mortgages outstanding now than in 2008. Variable-rate borrowers, anyone remortgaging next year and anyone selling to a buyer who can now borrow less all feel it.




US 10-year Treasury yield, 1962 to today (FRED, DGS10). The yield reached 5.23%, the highest since 2007. The 30-year bond is at its highest since 2004.

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A UNANIMOUS RISE

# The first rate rise since 2023

**3.75–4%**
Fed rate after a quarter-point rise, every member voting for it

**16 of 18**
officials pencilling in at least 1 more rise (4 see 2)

**~70%**
market odds of another rise at the next meeting (~95% by year-end)

> The new chair, Kevin Warsh, said inflation had been too high for too long. The Fed's own projections and the market both expect more rises. That makes borrowing dearer for households, businesses and the government itself.

| Who | How the rise reaches them | What it costs |
|---|---|---|
| Variable-rate borrower | Payment resets upward | Higher monthly bill |
| Remortgaging next year | New deal priced off higher bond yields | Higher fixed rate for years |
| Home seller | Buyer can borrow less | Lower offers, slower sale |
| US government | Interest on its debt rises | Bigger deficits |

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THE MEDICINE THAT FEEDS THE DISEASE

# “I think the Fed might have just made a mistake”




Bill Ackman's post. His closing line: “Am I right or am I wrong?”

## DEMAND THAT IGNORES RATES

If the prize looks that big, a quarter-point rise does not stop companies buying chips and power stations. Companies are expected to sell between $300 billion and $570 billion of new debt this year just to fund AI.

## INTEREST IS A COST

The lorry, the warehouse, the supermarket's stock and the builder's bricks are all financed. When money gets dearer, those costs rise and are passed on at the till.

**Fed raises rates to fight prices** → **Business costs rise** → **Prices rise** → **Fed raises again**

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A SHORTAGE IS NOT A DEMAND PROBLEM

# The Fed is standing in a corridor with 2 doors

## TOO LITTLE SUPPLY

Much of America's inflation is a shortage of houses, computing power and healthcare. Higher rates make that worse, because the builder cannot afford to build and the power company cannot afford to expand.

## THE GOVERNMENT'S SIDE

Higher rates raise the interest the government pays on its own debt. That means bigger deficits, and bigger deficits are eventually covered by creating money.

## WHY THIS TIME DIFFERS

That was too much money chasing too few goods. This episode looks more like shortages, and you do not fix a shortage by making it dearer to build the thing that is short.

| Door | What happens | Who loses |
|---|---|---|
| 1. Keep raising | If Ackman is right, the loop feeds itself | Borrowers, and savers facing higher prices |
| 2. Stop raising | Inflation runs hotter than admitted | Cash, fixed incomes, savings earning less than prices rise |

**2029**
when the Fed expects inflation back at its 2% target

**4.6%**
inflation consumers already expect

**$103+**
oil, per barrel

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THE FED'S FAVOURITE GAUGE

# A lower number, with no lower prices

Core PCE, which strips out food and fuel, is the inflation number the Fed actually steers by. Its method is changing. Tom Lee estimates the change alone could knock close to half a percentage point off the reading.

**~0.5**

percentage point off core PCE from the new method (Tom Lee)

**0**

prices in shops that have to fall for it to happen

**Weeks**

between the rate rise and the gauge being adjusted

If the thermometer shows 38 degrees and you don't like the reading, you can bring the fever down, or you can relabel the thermometer. A lower reading gives the Fed cover to stop raising, which is why Lee called it bullish for stocks in the short term. Your weekly shop and your insurance renewal cost exactly what they cost before.

## IN FAIRNESS

Spending habits shift and new products arrive. Nobody is suggesting a law is being broken.

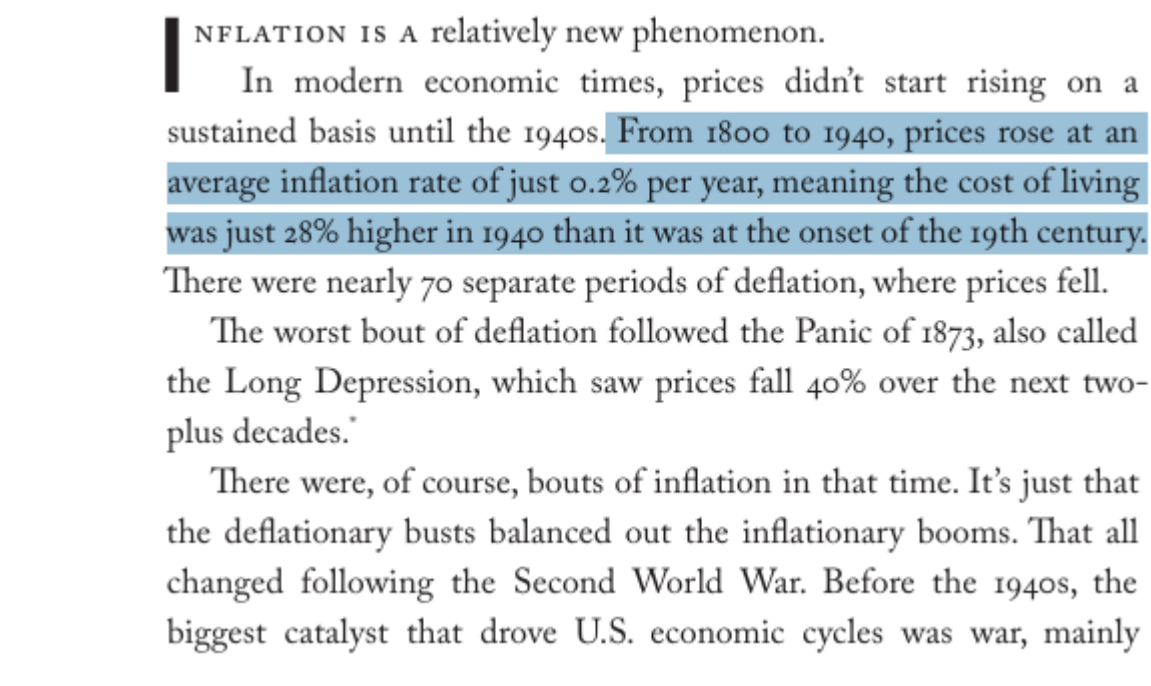
## THE QUESTION TO ASK

The answer is the borrower carrying the biggest debt pile in its history: the US government.

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140 YEARS OF STABLE PRICES, THEN NOT

# $1 in 1940 is more than $22 today



INFLATION IS A relatively new phenomenon.

In modern economic times, prices didn't start rising on a sustained basis until the 1940s. From 1800 to 1940, prices rose at an average inflation rate of just 0.2% per year, meaning the cost of living was just 28% higher in 1940 than it was at the onset of the 19th century. There were nearly 70 separate periods of deflation, where prices fell.

The worst bout of deflation followed the Panic of 1873, also called the Long Depression, which saw prices fall 40% over the next two-plus decades.*

There were, of course, bouts of inflation in that time. It's just that the deflationary busts balanced out the inflationary booms. That all changed following the Second World War. Before the 1940s, the biggest catalyst that drove U.S. economic cycles was war, mainly

Ben Carlson's statistic on US inflation from 1800 to 1940.

**0.2%**
a year, 1800 to 1940 (28% in total over 140 years)

**3.7%**
a year since 1940 (over 2,200% in total)

**$22+**
what something costing $1 in 1940 costs now

## WHY IT MATTERS

It is the difference between a world where savers are rewarded and one where they are slowly, politely robbed.

## THE DEBT CONNECTION

Let prices run a little ahead of the interest paid, and every year the debt is worth less in real terms. It is a quiet transfer from savers to borrowers.

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THE UNTHINKABLE PLAN, ASSEMBLED

# A gap between the official number and your bills

**A government with record debt cannot afford high rates for long**

↓

**The Fed has raised and may raise again, making the interest bill worse**

↓

**The Fed's gauge is recalibrated to read lower**

↓

**The lower reading justifies bringing rates back down**

> The reset won't arrive as a big bang or a new currency on a Monday morning. It shows up as a gap between the official number and your actual bills. Every month the gap stays open, money moves from people who save in dollars to people who owe in dollars.

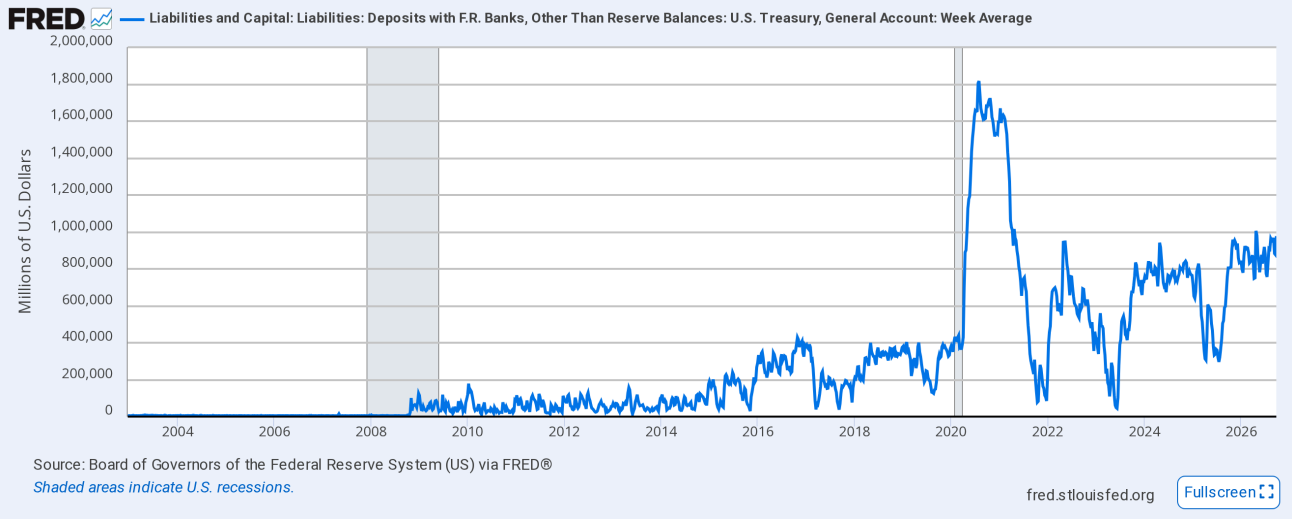
| Most exposed | Why |
|---|---|
| Retiree on an indexed pension | It rises with the official figure, not the real one |
| Family sitting in cash | Cash earning less than real inflation loses buying power |
| Fixed-income saver | Income is fixed; bills are not |

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THE MONEY MOVING UNDER THE FLOOR

# $57 billion injected in 1 week

The Treasury General Account is the government's current account at the Fed. Fill it up and money drains out of the banks. Run it down and money goes back in.




Treasury General Account, weekly (FRED, WTREGEN).

**+$100B**

TGA swelled in 1 week, to over $1 trillion at the peak

**−$84B**

bank reserves over the same week

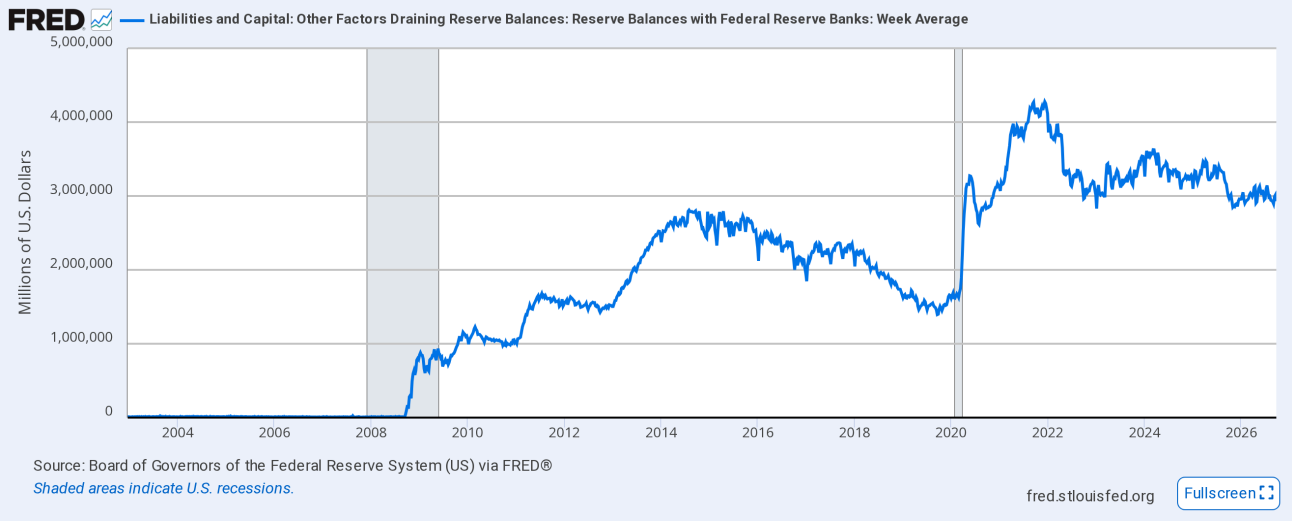
**$57B**

pushed back into the system last week via the TGA

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SAY THE TOUGH THING, DO THE SOFT THING

# Drain, inject, drain again




Reserve balances held at the Fed, weekly (FRED, WRESBAL). The drain week coincided with the jump in bond yields and mortgage rates.

## AN IDEA, NOT A DECISION

At the New York Fed's conference on the Treasury market, officials discussed Treasury lending its spare cash straight into the overnight lending market banks use every night. Nothing has been announced.

## WHY YOU'D WANT IT

The Fed cannot pump money in right after raising rates. The Treasury can, through an account most people have never heard of.

## WHAT COMES NEXT

The Treasury's own plans have the account refilling, which means draining money out again. Each drain tightens things for banks and pushes yields up. Each injection is money that finds its way into prices.

**Drain: yields rise, mortgages jump** → **Inject: money flows into prices** → **Refill above $1T: drain again**

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GOLD, WHILE EVERYONE LOOKS AWAY

# The public sells, central banks buy




Gold (XAUUSD), daily candles (TradingView). Gold pays no interest, so rising rates make it look less attractive on paper.

**~$4,290**

gold per ounce now

**20%+**

below January's record of about $5,500

**289t**

central-bank buying in Q2, up 62% on a year earlier, a Q2 record (World Gold Council)

Central banks say their currencies are sound. Then they buy record amounts of the one asset that isn't anyone's currency.

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DIRECTION, NOT A TARGET

# What sits under the gold price

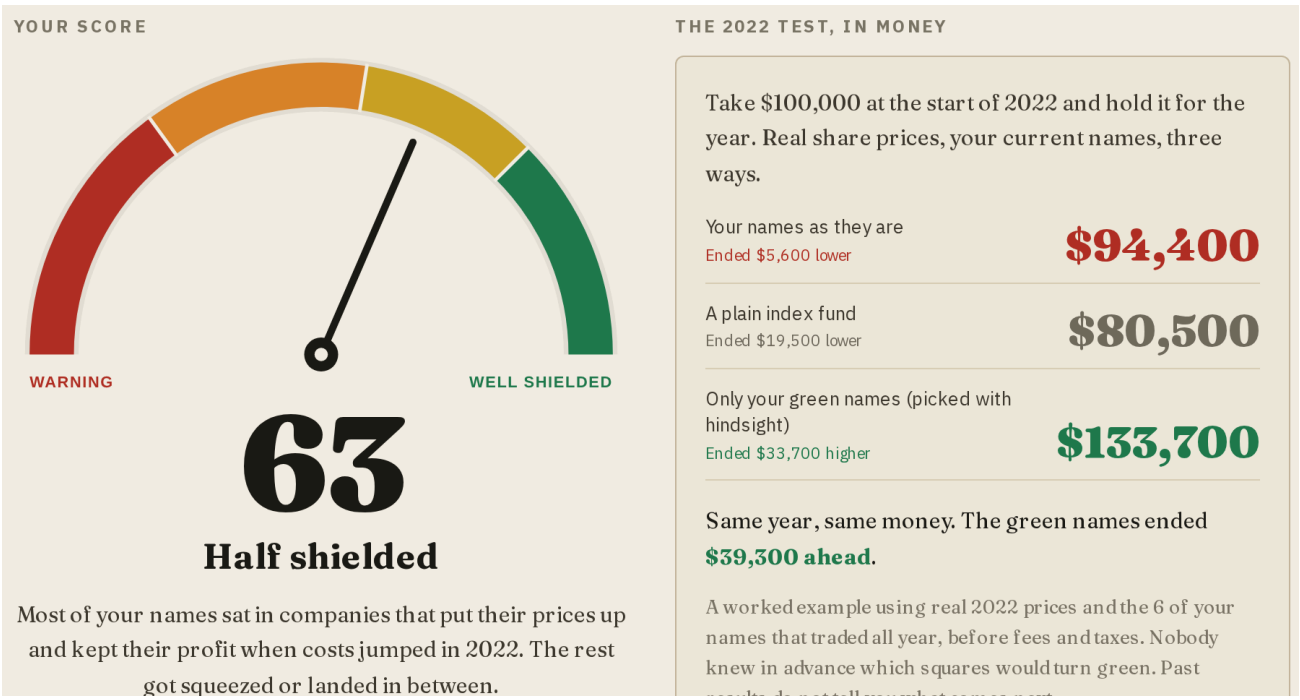
| Force | What it does |
|---|---|
| Central-bank buying | Record Q2 demand from the institutions that print money |
| India's festival and wedding season | Seasonal household buying that ignores the Fed |
| Options positioning | Goldman Sachs notes options have amplified moves both ways |
| $4,000 | The level many traders watch as a floor |
| Rising rate bets and a firmer dollar | The reason for the recent slide |

> If a government that can't afford its interest bill needs rates back down, and a new ruler gives it cover, the asset hurt most by rising rates is often the one helped most when they turn. Not overnight and not in a straight line. This report gives no target, because nobody knows.

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WINSTON INFLATION SHIELD

# Would your holdings have passed 2022?




Winston's Inflation Shield for a sample mix: an oil major, a cereal company, a tobacco company, 2 big tech names and an index fund. Illustration only, not a recommendation.

## THE TEST

Prices ran hot, rates went up fast and the S&P 500 fell about 19%. Winston runs the names you own through that year.

## WHAT IT SHOWS

Name by name, it shows which holdings held their profit margins as costs rose and which were squeezed, with a dial from warning to well shielded.

Winston Inflation Shield sits on the Risk exposure page beside the AI bubble test: **winstondaily.com/survive-the-bubble?tab=inflation**

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TURN UNDERSTANDING INTO PROCESS

# 5 questions before the next inflation reading

- ✓ Is my mortgage variable, or does my fixed deal end within 2 years?
- ✓ How much cash am I holding, and is it earning more than the inflation I actually pay?
- ✓ Does my pension or income rise with the official figure or with my real bills?
- ✓ Can the businesses I own pass rising costs on, or do they eat them?
- ✓ Am I still running my money on a rulebook written for 40 years of falling rates?

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**Analyst:** Winston, Lead Analyst for The Prehn Institute.

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