Neg Frontlines

Foreigners Scared Bonds

1. Bloomberg - foreign investment has only gone down, because other people are purchasing domestically.
2. SCMP - China will always buy it is the most liquid market for its foreign reserves which is us bonds. Buying is expected to increase for two reasons a) China's foreign reserves are shrinking and b) China's debt obligations are growing. USAToday - China foreign exchange regulator said it was "fake news" that China was going to stop buying bonds.
3. SeekingAlpha - China will always buy they have to put trade surplus somewhere, better than EU treasuries bc they have negative int rates.
4. Reuters- Wall Street dealers buying up really fast.
5. CFR- decrease demand can be explained by two countries
    a. China - only decreased demand temporarily because were changing their foreign exchange policy, not actually going to no buy
    b. Japan - stopped buying a little bc our bonds are getting so expensive so everyone else wants them.

The last one is a good argument that falls flat when encountering a broad array of evidence suggesting that foreigners have been buying, are likely to continue to buy, but are being crowded out by other buyers. The upshot is that while $1 trillion budget deficits for the foreseeable future are scary for a variety of sound reasons, the lack of demand, especially on the foreign front, isn't one of them. That should reassure markets, especially after the U.S. Treasury Department said Monday that government borrowing this year will more than double from 2017 to $1.34 trillion as the Trump administration finances a rising budget deficit.

First consider the motivation, the Fed is hiking, which has and will give support to the dollar. Also, the very high rates in the U.S. relative to the rest of the developed world remain a very compelling enticement. Second, Europe's geopolitical woes, from Brexit to Italy's budget and German politics, hardly make for a confident currency or bond stance. And strange as this may sound

— relatively speaking — President Donald Trump's penchant for creating geopolitical jitters hasn't inhibited foreign investors — or domestic buying for that matter — which I'll suggest is something of a surprise. His trade policy is inflaming domestic inflation, but between that and the deficit-boosting tax plan, it seems reasonable for the Fed to counter with a return to neutral rates or beyond via more tightening, which should further bolster the dollar's appeal to foreign investors.

Let's look at this in terms of flows. The chart below shows who owns Treasuries. Foreign ownership is flat at $6.2 trillion, or 47.8 percent of privately held debt. **Although that's down from 59 percent in 2014, foreign ownership is flat in nominal terms. This is mainly due to rising demand a category of buyers dubbed "other" as well as purchases by mutual funds and governmental entities including the Fed. Foreigners are not shying away; others have just been more assertive.**

I don't see these trends changing. If anything, with somewhat higher yields will make Treasuries that much more competitive with, say, the S&P 500 Index dividend yield of 1.80 percent and foreign rates in general. Plus, we are at a stage late in the cycle where stocks are showing some sign of anxiety and a simple rebalancing that favors bonds seems prudent, especially for pension funds.

Yes, the latest Treasury International Capital, or TIC, report from earlier this month showed that overall holdings of U.S Treasuries by America's two biggest foreign creditors — China and Japan — were down in in August, that's a half-empty view. Although they cut their holdings of Treasury bills, China and Japan actually bought Treasury notes and bonds, which seems like a bullish view. China bought almost $9.44 billion of notes

and bonds, while Japan purchased $4.45 billion in its most active month since June 2017. Overall, foreign investors bought a whopping $63.1 billion of coupon-bearing Treasuries in August, the most in more than three years.

Interest Rates Increase w/ debt increase

1. Spiro of the Business Economics Journal - no study has ever found a correlation

Foreign Investor Confidence Down = Interest rate increase

1. SeekingAlpha- although rising , its really low.
2. NYT -Fed is raising interest rates.
3.

Inflation bc Print Money

1. Solman of Brandeis University writes that because of the defaults in the 2008 recession and the risks of overinvestment, investors and businesses who receive newly created money just invest these excess profits into savings, where banks redeposit these funds back into the Federal Reserve. This is why even after the Federal Reserve has printed trillions of dollars, this money has only ended up back at the Fed and created zero inflation. Even if inflation does begin to occur, the Federal Reserve has the power to take money out of the economy and end inflation.

2. Very gradual have done forever, use money to keep growth up with inflation
3. Spross- Money that pays off interest to investors is not use to consume goods its for investment so does not create inflation
4. When US takes on debt in takes dollars out of the economy, printing money is just paying that back.

Harvey Forbes- money growth ≠ inflation

But perhaps the real nail in the coffin of the “money growth==>inflation” view is this: the phenomenon that Milton

Friedman identifies as key to the whole process, i.e., the excess of the money supply over money demand, cannot happen in real life. The irony here is that something else we already cover in the intro macro class makes this evident. How is it that the Federal Reserve increases the money supply? Remember that Friedman used a helicopter–indeed, he had to, for there was no other way to make the example work. This wasn't just a simplifying device, it was critical, for it allowed the central bank to raise the money supply despite the wishes of the public. **However, that can't happen in the real world because the actual mechanisms available are Fed purchases of government debt from the public, Fed loans to banks through the discount window, or Fed adjustment of reserve requirements so that the banks can make more loans from the same volume of deposits. All of these can raise M, *but, not a single solitary one of them can occur without the conscious and voluntary cooperation of a private sector agent*. You cannot force anyone to sell a Treasury Bill in exchange for new cash; you cannot force a private bank to accept a loan from the Fed; and private banks cannot force their customers to accept loans. Supplying money is like supplying haircuts: you can't do it unless a corresponding demand exists.**

As already mentioned, the most important inflationary episode in post-WWII history was that during the 1970s and early 1980s. From 1968 through 1972, consumer price inflation averaged 4.6%. Over the next ten years it was 7.5%. What happened? What caused this sudden and dramatic acceleration in prices? Did the Fed accidentally print too much money? As already explained, that can't happen–you simply can't raise the money supply above the demand. M did rise, however, and largely proportionally to the increase in P. This is a much more realistic story of those events.
As the price of oil skyrocketed, so costs of production rose for many, many US businesses. Because there is a lag between purchasing inputs and selling output, most firms have to borrow money (working capital) to bridge the gap. As the ripple effect of the OPEC price increases moved throughout

the economy, the demand for cash by these businesses rose. Quite reasonably, private banks and the Fed did what they could to accommodate. These were fair requests on the part of US entrepreneurs. Loans were extended and government debt sold by the private sector to the central bank. This raised the supply of money. Therefore, *the rising prices led to an increase in the supply of money and not the other way around*. QE, QE II, and the federal government deficit cannot by themselves cause inflation.

[Conover American Enterprise Institute]- money print ≠ growth

What the new base money does change is banks' *ability* to make new loans — but if banks' increased ability to lend to entrepreneurs and businesses is not accompanied by an increased *desire* to lend to them, then public borrowing, spending, and investing won't increase. In that case (which has been our situation for several years), Fed money-printing ends up generating little if any boost to economic activity or inflation pressure.

Figures 1 and 2 show that money printing has failed to induce money lending and spending, which in turn is why it has also failed to induce inflation. True to the old adage, the Fed's money-printing policy, so far, has been like "pushing on a string."

Lack of sufficient economic growth is behind most if not all of our fiscal and monetary problems. For example, unemployment is a sign of an output gap — that is, an economy operating at less than its capacity, as shown in a previous article; sufficient growth would (by definition) close that gap. **Also, inflation is a sign of insufficient growth relative to the pace of bank credit creation** (i.e., lending to businesses and entrepreneurs). In both cases, growth is an underlying solution. Robust growth is as close as we can get to a panacea for our monetary and fiscal problems. **Too much bank credit is inflationary; insufficient bank credit is contractionary. When the Fed senses the former, it effectively "unprints" money; when it senses the latter, it prints more.** But even if the Fed gets the timing right, there's no guarantee that its policy will work. As Figures 1 and 2 confirm, money printing hasn't yet reversed the decline in the pace of money spending, nor has it been inflationary.

Yuan Replace The Dollar

1. Quartz- dollar wont be replaced it's just yuan will be on equal footing
2. Quartz- China still faces several hurdles in having a truly international currency. Capital controls and a lack of regulatory transparency make financial institutions reluctant to invest in Chinese assets.

On October 5, the Department of Labor gleefully announced that unemployment dropped to 7.8%. My initial response was I'm sure like everyone else's, surprise and really happy to hear it. Of course, immediately many anti-Obama conspiracy theorists jumped out and claimed the numbers were manipulated to help the president win re-election. The numbers indeed are true, but the scary part lies in the bare real numbers: where these new jobs are coming from.

C1 Bubbles

FL2- Investors won't switch to risky investments.

1. O'Brien of the Washington Post explains investors bundle up low-rated risky coprorate bonds so that they become triple-A rated bonds, because theoretically there should be less risk with a greater number. This makes them percieve that they arent risky, but when the industry becomes overleveraged the bubble pops.

O'Brien
https://www.washingtonpost.com/business/2018/11/20/two-big-reasons-there-really-might-be-recession/?utm_term=.230627d2632b
In a certain foreboding sense, that's understandable. **That's because, by and large, they aren't holding onto these loans themselves but are rather bundling them together into securities known as "collateralized loan obligations" (CLOs) to sell to investors. That, thanks to the magic of modern finance, lets them turn a big chunk of their BBB-rated corporate loans into AAA-rated bonds, since there should be safety in numbers: Any single borrower might default, but the chance that most of them would at the same time should be negligible.** At least it is according to their mathematical models, which, as we know, are never . . . never mind.

All of this should sound uncomfortably familiar. **After all, replace "businesses" with "households," and you'd have a pretty good description of what went wrong in 2008. Just as before, lenders are stretching the definition of "creditworthy" to include anyone who wants to borrow money in an attempt to make — and then sell — as many loans as possible. And also as before, it's not always banks but, rather, unregulated lenders like hedge funds and private equity firms that are the ones doing this. Which, if it weren't bad enough, just got worse, thanks to a new loophole courtesy of the conservative judges at the U.S. Court of Appeals for the D.C. Circuit.** As my colleague Steven Pearlstein points out, they decided to **exempt the non-bank entities that slice and dice these loans together from the post-crisis rules that required them to hold on to at least 5 percent of them themselves as long as they weren't the ones who had made the loans in the first place.**

FL2- Investors going to risky investments right now

1. Leong ‘18 of Reuters writes that Wall Street is completely sopping up the increased supply of Treasuries after Trump’s tax cuts.

FL2- Bubbles Non-UQ

1. Delink; Strubel ‘18 of Seeking Alpha writes that the only types of bubbles that matter are those that threaten the economy as a whole, indicating that these bubbles have to exist across different sectors of the economy. Of these bubbles,
    a. Household Debt: while pundits claim that household debt is at an all-time high, when we consider it relative to GDP, household debt is actually on the decline, indicating that there isn’t a bubble right now.

    b. Stock Market Valuations: while people say that stock market valuations have risen sharply, this is because the stock market has shifted increasingly towards tech-based companies with higher profit margins, thus logically increasing valuations, and there isn’t an actual bubble.

    c. For other bubbles, he continues that even if there were asset bubbles in other sectors, these bubbles are too small to bring down the economy as a whole.