

The First Tee...

Glass Ceiling...government debt ceiling comes back in force on March 1st (*capricious controls*):

- The new cap will be set at the amount of current U.S. debt outstanding (about \$22 trillion):
 - Political hot potato...the timing for ending the debt ceiling suspension comes at a tenuous time considering the recent government shutdown, as past breaches of the cap have led to closures:
 - The Treasury Department will be executing extraordinary accounting measures to finance government operations beyond March 1, but a legislated increase or suspension in the cap will need to be executed later this year.
- **Living on leverage...government debt issuance will hit a record high again this year (*a repeating routine*):**
 - New Treasury bond sales are projected to hit \$1.4 trillion this year...more than doubling the \$550 billion sold in 2017:
 - Future auction expectations are calling for the government to sell \$1.2 to \$1.4 trillion during the next 4 years.
 - The U.S. budget deficit hit a 6-year high last year at \$780 billion...according to the Congressional Budget Office:
 - The CBO is forecasting a budget shortfall of \$973 billion for this year and over \$1 trillion in 2020 (*fiscal responsibility?*):
 - The budget shortfall is expanding due to tax cuts, spending increases and the aging population (*Geritol generation!*):
 - The administration had anticipated the added economic growth that resulted from the tax reduction would generate enough revenue to offset the income lost from lower tax receipts...GDP growth was the best since the start of the recovery at 3%:
 - Despite companies posting strong revenues last year (+25%), corporate income tax receipts declined by \$205 billion, down 31% from 2017.
- **Living on a prayer...politicians and government officials are hoping interest rates remain low (*so should tax-payers!*):**
 - The government currently has about \$16 trillion in outstanding public debt...**over the next 10 years the CBO is projecting it will cost \$7 trillion dollars just to service the debt** (even with low interest rates):
 - **Stalemate**...longer-term U.S. Treasury rates have remained at historically low levels, besides being late in the economic cycle there are a litany of factors impacting rates...issues placing upward pressure include a record amount of bond issuance, the FOMC raising rate target, the Fed reducing balance sheet, inflation growth on target:
 - **Bond Issuance**: as discussed above, the U.S. Treasury securities auctioned last year increased by 144%:
 - The current size of Treasury bond issuance exceeds the annual amounts needed to fund spending for the Great Recession recovery.
 - **FOMC Rate Hikes**: the Fed has increased its rate target 9 times since 2015, increasing the level by 225 basis points (to 2.40%).
 - **Fed QE Reduction**: the Central Bank balance sheet rose to 25% of GDP in 2017 at \$4.5 trillion (up from 6% of GDP in 2007):
 - The Fed started reducing its bond holdings in late 2017...Treasury holdings declined by \$248 billion by the end of 2018, expectations are for \$271 billion to be redeemed this year, although, **the latest Fed Minutes indicate plans to cease bond reductions later this year.**
 - **Inflation Gains**: core CPI has been over the Fed's 2% inflation target since last March, core PCE stands at 1.9% (most in 6 years).
 - Some of the variables keeping longer Treasury rates low include concerns over faltering international economies, pension and retirement funds protecting gains, international purchases and stability of U.S. government:
 - **International Economies**: issues ranging from Brexit, U.S./China's trade conflict, Italian government instability, rising emerging market funding costs and the conclusion of central bank monetary stimulus have reduced global economic outlook.
 - **Fund Purchases**: with the large number of baby-boomer retirees, domestic funds hedged stock gains by purchasing longer-term low-risk fixed-income assets...funds purchased half of every 10-year T-Note auction last year (up from a 20% average in 2010).
 - **Foreigner Purchases**: global sovereign-debt interest rates have remained ultra-low for developed countries:
 - Government bond interest rates with 10-year maturities in countries such as Germany, Japan and Switzerland are close to 0% or negative.
 - The amount of negative yielding global debt outstanding has risen to \$8.9 trillion, the most in over a year (*better stash money in the mattress*).
 - Foreign buyers remain large buyers of U.S. government bonds...for some countries, even with close to 0% interest rates, purchasing U.S. securities remain unattractive due to the high cost of hedging currency risk (primarily due to varying LIBOR rates between countries).
 - **U.S. government stability**: despite the differences on Capitol Hill, the U.S. is still one of the most stable governments in world...in periods of geopolitical uncertainty and slowing economic growth, U.S. Treasury securities are a protection holding.
 - The average maturity date of outstanding U.S. Treasury debt is about 5-years, during the past 2-years the interest rate on 5-year paper has only increased by 40 basis points (*a windfall for the government*):
 - The average yield on the 10-year T-Note since 2000 is 3.69%...currently, the benchmark's yield stands 100 basis points lower.

At the turn...

The Back Nine...

I hope we're not turning Japanese...it's been 20 years of 0% interest rates in Japan...during the 1980's, the Japanese economic model was mistakenly deemed the one to emulate

- From 1980 to the end of 1989, the Japanese Nikkei rose by 494% (sounds like U.S. stocks since 2010):
 - After peaking at 38,915 in December 1989, the Nikkei lost almost 25,000 points in 8 months:
 - **The Lost Decade:** for the following 10-years the Japanese economy endured several recessions, with per capita GDP growth averaging .05% per year, as well as deflationary price trends and the Nikkei dead in the water:
 - During the same period, U.S. GDP averaged 2.7% annual per capita growth and the S&P 500 rose by 314% in value.
- **Crisis déjà vu...the problems in Japan's economy appeared to repeat on the world's stage in 2008:**
 - After years of runaway loan growth, Japanese policy makers decided to manage down risks in 1989:
 - The Bank of Japan increased interest rates and constricted property loans, bursting the over-valued asset bubbles in equity and real-estate (*sound familiar?*)...despite the market collapse the Japanese central bank was slow to reverse monetary policy:
 - Japanese stimulus began in earnest ten years later in 1999, as the BOJ took rates to 0% and the banks recapitalized:
 - One of the key problems for a recovery in Japan was the large number of so called "zombie firms"...these were highly leveraged companies who chose to repay loans instead of increasing investment, slowing economic demand that resulted in deflation.
- **Debt domination...one of the underlying themes over the past four decades has been Japanese debt:**
 - During the five years leading up to the 1989 Japanese collapse, household and corporate debt rose by almost 42% of GDP...in comparison, U.S. household and corporate debt to GDP rose by 22% prior to the Great Recession:
 - Japan's debt to GDP is the highest in the world at 250%, Greece is second at 178% (U.S. debt to GDP is 106%):
 - Japan's debt per capita is over \$71k...has a population of 127 million that is shrinking and an aging workforce.
 - In 2016, Japan's debt was fifteen times larger than the amount of revenue received from taxes (*the epitome of deficit spending*).
 - Japan is the world's third largest economy at \$4.8 trillion...the U.S. economy is \$19.5 trillion:
 - Since the BOJ initiated its 0% interest rate stimulus program 20 years ago, Japanese GDP has averaged a .95% annual growth rate...U.S. GDP growth averaged a 2.3% annual gain during the same period.
- **Government funding the government...Bank of Japan has been purchasing majority of Japanese government bonds:**
 - The past two years of Japan's quantitative easing bond buying stimulus program saw the BOJ buy over 90% of all Japanese government bonds that were issued (*many have infinite maturity dates...helicopter bonds*):
 - Japan's government debt currently totals \$9.8 trillion, the BOJ's balance sheet bond holdings total \$4.9 trillion:
 - Very little of Japan's government debt is held by foreign investors, before the Japanese central bank started its buying program a majority of the government bonds were purchased by the Japanese private sector.

19th Hole...

I fear explanations explanatory of things explained.

Abraham Lincoln

Ross Elford, First Vice President

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