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Donald Trump Believes What?!

By Kerry Pechter *Thu, May 26, 2016*

Trump talked about Treasuries bonds as if they were the dispensable top-timbers on a Jenga pile, when they actually comprise the indispensable bottom tier. No, Treasuries aren't in danger of default. They're not even slightly illiquid.

If you've played Jenga, the wooden tower game, you know that if you remove one of the finger-length timbers from the top of the tower, you're safe. But if you remove a timber from the lowest, most fundamental layer, the tower collapses. Game over.

Over the past week or so, a comment by Donald Trump about offering to buy back U.S. Treasuries from supposedly anxious debt holders has sparked a fresh round of debate about the federal debt and deficit. (I'm not sure what Trump said; often, instead of Trump's own words, we hear a reporter's riff on something that the presumptive Republican presidential nominee said.)

Distortions notwithstanding, the comment seemed to refer to printing dollars to buy back Treasuries at a discount. Trump was said to have suggested that the U.S. should offer debt holders less than 100 cents on the dollar for Treasuries—a partial default that creditors would presumably prefer to a complete default.

The media treated it like a real possibility. A Bloomberg TV reporter asked Randall Wray of Bard College, a noted Post-Keynesian economist and interpreter of the work of Hyman Minsky, if such a move could lead to hyper-inflation a la the Weimar Republic of the 1920s, when it took wheelbarrows full of Reichsmarks to buy a loaf of bread. Wray started to explain, but ran out of time.

Let me count the ways that these reports about a Treasury default, and what Trump said (if he said it), don't make sense.

The owners of Treasuries, foreign and domestic, obtained them with dollars. The dollars were spent into the U.S. economy. Presumably the money was put to good use, and generated profits at a rate higher than the Treasury coupon. (If it didn't, we wasted an opportunity.) As a country, we can afford to buy back our debt.

Treasuries are among the world's most liquid paper, almost the same as cash. Anyone who holds Treasuries today can easily convert them to cash. The prices of Treasuries are at an all-time high; their actual and perceived risk is at an all-time low. If Treasuries were hard to sell—if they were illiquid, like mortgage-backed securities during the financial crisis—the government might in theory have to intervene and *bail itself out* by exchanging one kind of Federal Reserve Note (cash) for another (bills and bonds). But that's not a big problem. A country whose debt is denominated in its own currency can always do that.

U.S. money, and U.S. bonds, which is U.S. money that pays interest, will be popular for as long as people all over the world want to buy stuff that dollars buy. And they will, for a very long time. Among the expensive things that Chinese families want to buy, for instance, are college educations for their young people in places like Cambridge, Mass. and Palo Alto, Calif. They also want our equities, and McMansions in Texas, and lots of other dollar-denominated assets. Like oil.

Now, back to the Jenga analogy. Treasuries are the bottom row of the financial Jenga pile. If Treasuries somehow became risky—if the price fell and the yield rose—then the prices of all of the other securities that are by definition riskier than Treasuries would lose even more of their value. Any sort of debt that's collateralized or backed by U.S. Treasuries—including the currencies of other countries—would drop in value and require fresh capital.

That would require the liquidation of other securities, which would cause the Mother of All Financial Crises. Soft Treasury prices would be the least of our problems. In fact, you'd see a flight to Treasuries, as we saw in 2008. To talk about U.S. Treasury bonds as casually as if they were the dispensable top-timbers on a Jenga pile, when they actually comprise the indispensable bottom tier, is ridiculous. A president who indulges in such fantasies would be dangerous.