



KEEP YOUR EYES OPEN

By Anthony Moore

© 2006

Many people go through life without paying attention to the “**world**” around them—notice I said “**world.**” I’m a strong believer in the notion that all human beings are somehow connected regardless of how far apart their lifestyles and locations. So, if a rain forest is cut down in Brazil, it affects people in the United States somehow. I don’t necessarily suggest that you adopt this point of view, but I do suggest that you realize we live in a global economy that ultimately determines what happens in the U.S. economy (or any other country’s economy for that matter). This includes student loan interest rates, the job market, college costs, and if you have a fetish for things like, say gasoline and oil, you really better do your homework.

The U.S. economy—despite its massive size—isn’t independent from the world economy (despite the actions of “certain” high ranking officials who seem to believe it is). Consider that on August 15, 2005, China held \$144.5 billion of U.S. government-sponsored enterprise (**GSE**) debt. That translates to 25% of all such debt. This reflects 25% of the bonds of **Fannie Mae** and **Freddie Mac**—the agencies that more or less fuel the entire U.S. housing market. If China decided to suddenly sell a large percentage of these bonds, it could spell disaster for the U.S. Such a scenario would decrease the value of the bonds, which would in-turn cause their interest rates to increase (as well as the rates of any new ones issued). Yet, please note that this scenario is on the more positive side of potential outcomes—yep, as warped as that may sound, this is the more desirable and “friendly” end result. In a more extreme worst-case outcome, foreign investors would no longer invest in U.S. government backed bonds at all, which is totally not a good thing—believe that!

Let’s focus on the worst-case scenario for a minute. Say that all foreign investors decided to stop investing in U.S. government backed bonds, which include U.S. Treasury bonds. (By the way, China also had \$150 billion in U.S. Treasury bonds—sort of puts that \$100 Treasury bond I got for my eighth birthday into perspective. Don’t worry Mom and Dad, I still appreciate it.) The financial state of the U.S. economy without Treasury bonds would probably be worse than the financial state of a church without collection plates—can you say “no income coming-in?” When the U.S. issues Treasury bonds the money it receives is technically not income (because it’s not money earned for providing a good or service at a profit) but in actuality it is a loan (borrowed money that has to be paid back with interest). However, considering how things have been going with the U.S. for some time now, if it didn’t receive loans from Treasury bonds and notes, well...have you heard the saying “it’s like borrowing from Peter to pay Paul.” Well, in this situation it’s like borrowing from Peter and a whole bunch of other folks to pay Paul and a whole bunch of other folks. Wait, there’s more. Without foreign money, not only would it be hard for new houses to be built within the U.S., it would be hard to sell, buy, or refinance mortgages on existing houses.

Think about it. Not too many people in the U.S. have enough money to pay the entire cost of a house upfront (if you are one of the relatively few people who can do this, contact me—I can always use some more millionaires and billionaires in my life). Since most people aren't able to pay the entire cost of a house upfront, they have to borrow money (in the form of mortgages) to acquire the needed financing. This same reality exists if people decide to refinance their mortgages. Doing so usually means going to a bank or some other type of lender.

Still with me right? Just wanted to make sure. The thing about banks and other mortgage providers is that they usually don't like to hold lots of mortgages, which are essentially IOUs. In other words, mortgages are just a (legally binding) promise to pay cash, but they are not the same as actual cash. While banks usually receive money every month from the mortgages they hold, they need cash on hand to make more mortgages, which ultimately makes them more cash. Makes sense, doesn't it? As a result, banks often sell the mortgages they finance after taking a cut from facilitating the sell (which is included in the closing costs). After all, you wouldn't have been able to buy the house without their money. (Plus, they happen to believe that they deserve something for checking you out—you know, making sure you can and will pay off the money you will owe. Mortgage holders seem to have something against people that don't pay their mortgages. Go figure.)

When it comes to mortgages, banks (or whatever entity loans the money) often serve as the front line for the much bigger buyers that ultimately fund homebuyers and mortgage refinancing. These bigger buyers include larger banks and other financial entities, along with pension funds as well as entire countries (or more exactly their governments). When a buyer (such as China) purchases \$144.5 billion in mortgages it's not trying to check out the credit worthiness of any individual mortgage holder. **Think about it,** \$144.5 billion comprises a whole bunch of mortgage holders! The larger buyers depend on the smaller banks and other go-betweens to have already done this. Plus, in the case of *Fannie Mae* and *Freddie Mac*, the U.S. government has given an implicit promise that it will step in if the mortgages turn out to be bad. So, investors in GSEs are pretty much placing their faith in the U.S. government's willingness and ability to step in if necessary.

Now I must recommend the three R's—relax, relate and release, because the above info might have been a lot to take in. Nonetheless, (hopefully) you get the point. I pointed out all the above to give an idea of the importance of foreign countries to the U.S. The ability of banks to provide and refinance mortgages is largely dependent on foreign investment dollars. (As we now well know, one particular foreign investor is currently looming very large in this equation. Chinese takeout anyone?) Without foreign investment dollars, it would be very hard for U.S. banks (or banks in many other countries for that matter) to get the funding necessary to support the country's housing market.

The Foreign Impact on Student Loans

In other words, without enough foreign investment—or if foreign investors suddenly decided to stop investing in the U.S.—the housing market (as well as many others) could collapse. Remember what I said before—this is the worst case scenario. A collapse of the housing market is definitely a more extreme and—we hope—unlikely scenario (although who’s to say, right).

Yet, a more likely result (and more favorable one, as ironic as that may seem) would be for mortgage interest rates to go up if foreign investors greatly scaled back on investing in mortgage-backed securities. This would cause a negative chain reaction that would ultimately affect the interest rates you pay on student loans and other items. If interest rates went up, it would slow down the housing market, which would slow down the U.S. economy, because less people would buy houses. Banks would start charging higher interest rates, as they would need to in order to pay higher interest rates for the monies they borrow to fund the housing market. The resulting impact would likely spread to the market for student loans, since the two markets are greatly connected. **Think about it,** majority of student loans are guaranteed to some extent by the U.S. government.

What Does All This Mean To You?

So, as convenient as it is to stay in one’s very own box and think that the entire world is confined to one’s own personal space, it’s not that kind of party. Currently in the U.S. we are feeling the impact of global economics as gas prices hover around all-time highs, while more and more jobs are being shipped overseas, not to mention the people who come from foreign countries who are willing to do some jobs that do remain here for less money. In any event, I strongly recommend developing a global awareness and realizing that we live in a global environment versus just the U.S. alone. Also, look to see in which markets the U.S. is strong on a global level. Study the trends of what jobs are being outsourced overseas (probably not the ones you want to be in unless you plan on going overseas for less money). At the same time, you may find a better employment opportunity overseas (one with higher pay and greater opportunities for advancement) if you are willing to relocate. Also, I recommend traveling abroad and doing internships overseas if given the opportunity (there are several scholarships available for this specific purpose). Furthermore, I recommend studying world history (whether your curriculum requires you to or not. If your curriculum does require it, you probably want to go above and beyond the study required). The next time a global trend negatively impacts the U.S., plan and prepare for it so you can prosper from it instead of being a victim of it.



Positive Prerogatives Inc.

www.ScholarshipRich.com