The Negative Interest Rate Policy (NIRP) Spells Financial Disaster?

By Bill Holter
Global Research, December 10, 2014
Region: USA
Theme: Global Economy

Negative interest rate policy (NIRP) has arrived to the U.S. for large deposits at commercial banks. This is something we have already seen in Europe over the last few months and a sign (at least to me) that stress is again building. As of January 1st, bank capital will be classified differently making some large and very mobile deposits at large banks a potential liability and thus not profitable http://finance.yahoo.com/news/banks-urge--clients-cash-elsewhere-015700767.html. This is being done because of the "mobility" of these deposits, the worry is the potential speed of flight capital if (when) it begins to run.

Let me explain what I mean by "stress" and you can decide which one fits the best if not a combination of "all of the above". First, the real economies of the Western world are again slowing and in many cases declining again. Remember, this is happening even though fiscally, deficits are being run everywhere and monetarily, loose policy runs rampant. As the real economy continues to slow, "more power" is being screamed from the helm to the engine room. "More", as in more debt, more liquidity and more of what created the problem in the first place. This explanation is fairly obvious.

Two other and less obvious explanations for NIRP are "velocity" and "making preparations". Looking at velocity, it continues downward with no signs whatsoever of reversing. Money is being printed by the trillions but it's not making it onto the streets. The money is piling up at banks who are hoarding the cash and making a "risk free" (really?) return by carrying the deposits at central banks. This works well for the banks and the central banks themselves …but not so much for the real economy as actual "flowing" money feels tight and scarce. As far as the real economy is concerned, credit policy is anything but loose.

The other aspect is that many large deposits (over the FDIC limits) are very "mobile". By this I mean they can move quickly. So quickly in fact that back in 2008 there were "electronic" and overnight bank runs which no one saw …except the banks. Banks "borrow low and lend high", this is how they earn profits. They traditionally borrowed via deposits and then turned around and lent these deposits out at a higher rate to earn a spread…banking 101 if you will. But 2008 exposed a flaw in this model, as soon as even the whiff of a rumor of weakness at a bank would arise, this "hot money" would move to safer ground. Whether this safer ground was another bank or even Treasury securities made no difference, the result was a bank(s) being left unfunded. Their capital ran away and they were left with too many loans and assets (impaired?) carried by not enough capital.

I know the above explanation was very simplistic, I did this so you could understand the "what or why" the Federal Reserve is changing the banking rules …they see something coming and are trying to prepare the system ahead of time. I believe they see another crisis dead ahead and are trying to position banks where they have less hot and mobile money in their fundings.

The problems as I see it are several fold. The days leading up to Jan. 1st may see some hiccups if enough money does in fact move elsewhere. Also, if this scheme does "work", money moves and actually begins to turn velocity around, hyperinflation could be a very real result. Fiat money is a very funny duck as it is strictly based on confidence, there is no way to tell at what point this confidence will turn once it starts to move.

The biggest problem as I see it could be a break in confidence, one which is caused by the perception of "something else is better". If banks actually start to charge for holding balances, depositors will have to make some sort of decision. They can move to another institution which blesses them with either no interest or less negative interest. They can also buy Treasury securities or even stocks …or any other number of assets. This would initially levitate markets even more because of the flow …but what happens when some "leakage" starts? What happens when some depositors decide to buy "stuff", any kind of stuff as a form of savings? What happens if included in this stuff are commodities and other monies such as gold and silver?

This then brings the actual currency into question. If you cannot earn interest on anything then the comparisons of apples to apples will begin. The question will arise, which is better, a $20 bill or 6 pounds of copper? Which would you prefer twelve $100 bills or one ounce of gold? Can a painting really be worth $100 million? What does this say about the value of $100 million? These questions are being asked every day, all day, all around the planet…but there will be a difference. The difference being, more money will be forced to make these decisions. "More money" because of the Fed's January 1st edict!

I am not here to tell you that I understand all of the ramifications or fallout, I do not. What I do know is banking, the way it has been done even after morphing over the last 20 years is changing. With this change will come consequences, some seen…some not. The financial system has never been as leveraged as it is today, this is a fact. Another fact is, leverage "forces" the actions of participants in ways they would not prefer during crisis. Leverage will force some who would like to buy…to sell. Leverage will cause a solvent someone today into insolvency tomorrowmorning. Not to pick on JP Morgan (though they more than deserve it), they hold some $70 trillion worth of derivatives, so does Deutschebank, does this qualify as "leverage"? When the next panic comes, we are now too leveraged systemically for the current system to survive, but I digress.

The grand scheme problem as I see it is the "push-pull" effect. The central banks need to push money out and into the system. This would aid the real economy and bolster "asset" prices. Their catch 22 is they cannot make the decision "which" assets are levitated in value because they do not control which direction the money they have pushed will go. Ideally, the money will stay within the box and continue playing with other paper assets. Once the bleed into real assets really gets going, it will be noticed and attract other attention …and into other real assets. They must create more money and more liquidity to keep the paper game going, it is exactly this debt and liquidity creation which will end up making the decision to flee …to safer assets. In the end, the definition of "safer" will be not only what counts but the exact cause of the crisis. The central banks are collectively trying as hard as they can to reflate, if they get their wish they will lose their currencies…pretty simple!

***Bill Holter**, Miles Franklin associate writer*

The original source of this article is Global Research
Copyright © Bill Holter, Global Research, 2014

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: **Bill Holter**

About the author:

Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in late 2006 to avoid potential liabilities related to management of paper assets. In retirement he and his family moved to Costa Rica where he lived until 2011 when he moved back to the United States. Bill was a well-known contributor to the Gold Anti-Trust Action Committee (GATA) commentaries from 2007-present.

Disclaimer: The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: publications@globalresearch.ca

www.globalresearch.ca contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: publications@globalresearch.ca