

It's 11PM. Do You Know Where Your Money Is?

Part I - Financial Trends You Absolutely Positively Want To Be Aware Of

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There are two kinds of people in the world. Those who think the problems leading up to the financial crisis of 2008 have been fixed, and those who have their doubts. For the doubters the year 2016 may be worth paying attention to. Events occurring in the first month or two of this year are informing us to keep an eye on what's coming over the horizon. Caution signs are replete across the topics of economics, finance, society, and geopolitics. There are trends in place, and it may be wise to focus on how they unfold. This essay takes a brief look at just a few of the economic/financial trends shaping 2016.

The Tip of the Tip of the Iceberg

There's a lot going on in the world. Too much almost to get our arms around. It's a challenge to see things as they are *today*, right now, let alone get a good view of tomorrow. How do we predict what lies around the corner for the economy? Will the economy continue flirting with recession or will it finally take off in such a manner that the average person when polled will say the economy is 'in great shape'.

A partial answer to such questions may lie within an observation noted in past essays on this topic; the one single thing that can be predicted with any degree of certainty regarding our financial future is... *governmental intervention*. The intervening of government into the workings of the economy is the only constant. Try to name another. Who would have thought back in 2009 that the stock market would reach such lofty levels today? Who would have figured the price of oil would plunge to under \$30 a barrel? Nothing is predictable. But intervention, by both law makers and the Federal Reserve, has always been a factor, and it's reasonable to expect it will be in the future as well.

Given that, what does Big Brother have up its sleeve at this juncture? The trends tell us that the powers-that-be are expecting economic headwinds. And they are planning for them. We can't see all the plans, but if we squint real hard there are some interesting reveals.

Trend 1 - Negative Interest Rates

Unless you were a stowaway on the last Mars rover mission you are familiar with the notion of zero percent interest rates. A policy has been in place for years to keep rates artificially low, and in cases such as inter-bank lending, rates actually flatlined at 0%. It's called ZIRP (Zero Interest Rate Policy). The idea behind ZIRP is to make borrowing easy. The idea behind easy borrowing is that it should stimulate the economy as people and businesses borrow and spend more. We're not talkin' rocket science here.

Importantly, low interest rates have forced individuals and institutions to look elsewhere to grow their money. It used to be that a citizen could simply put money into a standard passbook savings account for a period of say, 40 years, and thanks to the miracle of *compound interest* that person would have enough money to live on at retirement age. ZIRP killed that strategy, and most everyone has been forced into higher risk investments in order to grow their nest egg. This is one of several reasons the stock market has risen so much.

Negative side effects notwithstanding, ZIRP hasn't fully realized its mandate, which was to help get the economy back up to full speed. Reason being, family finances were already stretched to the limit with existing debt. Plus, banks have been reluctant to lend—even at low rates—for fear of not getting paid back. Banks know that many people are over-stretched and under-employed. It has been pointed out that even a

child could be made to understand that the solution to too much debt is not... more debt. Too much of just about anything is not cured by more of the same. Yet that was the goal of ZIRP; more debt.

If dropping interest rates to historic lows fails to stimulate borrowing and spending, you're out of gas, right? Wrong. You can go lower... into the negative. You can introduce NIRP (Negative Interest Rate Policy). *NIRP means that you pay a fee to store your money in the bank.*

Depending upon where you get your financial news you may already understand that negative interest rates are not a conspiracy theory. NIRP has already happened in Japan and Europe. Moreover, the Chairman of the Federal Reserve Board (the folks that manipulate interest rates and print money out of thin air), testifying before Congress in February stated that negative rates in the US were "*not off the table*".

Could such a thing really happen in America, and what would be the ramifications? NIRP is an attempt to manipulate people's behavior. Super low interest rates on savings accounts weren't enough to get people to spend rather than save money, so maybe folks will start spending if they are penalized for keeping their spare cash in the bank. That's a simplified explanation but it's the basic logic. We are a consumer based economy and this is the degree to which governments may intervene in order to get consumers to spend.

But wait a minute. Wouldn't people rebel against the idea of negative interest rates? Well, suppose NIRP was introduced as a necessary means toward a noble end? Consumers *have* to spend to keep the economy in motion, and NIRP gives you a bit of incentive. So be a good citizen and don't complain. Spend. Invest. Buy the latest iPhone and put your money in the stock market.

Trend 2 - Ban on Cash

If negative interest rates were to be introduced in the US there are a variety of ways NIRP might play out. It might begin with government securities like T-bond yields going negative (rather than earn money on a bond it would cost you to own it). Or perhaps inter-bank lending might get NIRPed. If negative rates were to leak down to the consumer level and be imposed on checking, savings, money market accounts, etc., one rather obvious reaction might be that people would start pulling their money out of the bank. Not to buy more goods. Not to put the money in the stock market. But just to keep it as cash.

How many people would do so and how much cash would be withdrawn? Who knows? But the herd mentality often takes over during panics, and it is not out of the question that a handful of people withdrawing their money might beget another handful doing the same. Then if enough people were to do so, others may fear there would not be enough cash for their own needs next trip to the ATM. So more withdraw. A rumor spreads that a limit may be put on withdrawals. So even more rush to the bank.

There's a name for such behavior. It's called a bank run.

To prevent a possible run on the banks (there's not enough hard cash in circulation to allow even a fraction of depositors to claim their dollars) the government could declare a ban on cash. If it were to become illegal for citizens to hold currency a bank run becomes a non-issue. Again, not a conspiracy theory. Many trial balloons are being floated in this regard. The €500 Euro has just been outlawed. Closer to home, the Washington Post ran an op-ed piece in February by one Larry Summers entitled "*It's time to kill the \$100 bill*" which argues for a moratorium on printing large bills, in order to "make the world a better place". If you don't know Larry Summers, as Treasury Secretary in the Clinton administration he was a key player in repealing consumer protection laws that directly enabled the 2008 financial crisis.

Cash is slowly being demonized by characterizing it as a tool for terrorists, drug runners, and tax evaders. Translation; in this world of easy and ubiquitous electronic financial transactions, law abiding citizens

have no need for cash. Well yes, terrorists, drug runners, and tax evaders use cash. Got it. But so do millions of law abiding citizens. The suggestion is like saying let's ban freeways to prevent auto accidents. The timing of Summers' article more likely relates to preparations for negative interest rates. Because people will soon realize that negative rates are in effect a TAX. A tax that can be easily raised. A tax that cannot be evaded. And how will people react once they realize their savings are being taxed? A ban on cash would preempt the one obvious exit.

Trend 3 - Bail-ins

Everyone is familiar with the term bail-out. A bail-out occurs when a troubled institution is given outside financial help, usually in the form of a loan or other type of cash injection. For example when General Motors declared bankruptcy in 2009 the US government stepped in with 50 billion dollars of taxpayer funded financing to resuscitate the auto maker.

Conversely, a *bail-in* occurs when funding for a distressed institution comes not from outside the organization, but rather from the *inside*. How would that work? Better put your seatbelt on if you haven't heard this before. To cut right to the chase, the next time around when banks get into trouble they could be legally bailed-in... **with depositor's money**. Believe it or not, you could log on to your bank one day and find that with no notice your checking account and/or savings account was empty. Instead, a text banner across the page would announce that your deposits have all been converted to shares in the holding company of the bank. Furthermore, you might find that the value of the shares were worth a fraction of the original balance.

This possibility is not speculation. It's a matter of law. How did such an abomination come into being? The taxpayer funded bail-outs in 2008 left a bad taste in people's mouths, and it was determined that taxpayers might not go for another round of footing the bill if financial Armageddon were to recur (it is widely understood that the aforementioned GM bail-out lost taxpayers about 11 billion dollars). Legislation known as the '*Dodd-Frank Wall Street Reform and Consumer Protection Act*' was enacted in part to address this issue. As high minded a sentiment as protecting consumers from bail-outs might be, and with respect to what the name of the bill connotes, the fact is this law is one of the most complex and corrupt pieces of legislation ever to pass through congress. Try and find a law maker who read the bill, which was written by the banking industry. Dodd-Frank, in effect, does the opposite of what it portends.

A key provision of the Dodd-Frank legislation (which was sponsored by democratic senators Chris Dodd and Barney Frank) reorders how creditors are paid off in the event a bank becomes insolvent. That may not sound so bad but keep reading. Before Dodd-Frank, the depositor was **first in line** to recover lost money if the bank failed. This process was administered by the Federal Deposit Insurance Corporation (FDIC). The FDIC has helped millions of Americans sleep well knowing their money was 100% safe.

Dodd-Frank however changed the definition of what customer deposits are. A customer's money on deposit is now *legally owned by the bank*. As a matter of law the customer has become an **unsecured creditor** of the bank for the amount of money on deposit. As shocking as that may sound the customer has also been moved from the front of the line to close to the rear when recovering funds in the event the institution goes bankrupt. Translation: the customer gets shares in what might be a defunct institution.

But wait. There's more. As bad as all *that* sounds, it turns out that Dodd-Frank did not prevent banks from making the kind of risky investments that led to the 2008 crisis. World-wide, the amount of **derivatives** –the so-called weapons of mass financial destruction– went from a total of 700 trillion dollars in 2007 to well over 1200 trillion dollars today. Dodd-Frank made it so that banks could continue to make highly leveraged, highly risky bets, while at the same hijacking depositor funds to fill the holes in the bank's balance sheet if the bets turn bad.

So at this point you're likely thinking of four letters. No, not *those* 4 letters. These: FDIC. Unfortunately the FDIC insurance fund has only enough money to cover less than 10% of cash on deposit. And as part of the Dodd–Frank legislation the FDIC is prohibited from tapping the taxpayers for a bail-out, which was Plan B in the past. The new Plan B, as already noted, is to tap the bond holders and customers of the bank. **This is real.** All it may take for the new deal to cut in is another economic downturn triggering a round of defaults and bankruptcies. In fact, there is an international version of Dodd–Frank that has already nailed bond holders and/or depositors in Cyprus, Italy, and Portugal. It's a trend folks. Bail-ins are a real possibility that few Americans are aware of.

Trend 4 - Bankruptcies

There are several trends in place that could trigger a significant number of bankruptcies in the not too distant future. Space remains for just one example so let's tackle the big one: domestic oil production. The sizable oil fracking industry in this country has been built on debt. The business model that produced the loans was based on an oil price of around \$75 a barrel, give or take. At \$30 a barrel the model breaks. The income produced from the fracking fields is not enough to service the loans. Rigs are shutting down because it's not cost effective to sell the oil at such prices. But whether frackers are producing or not the loans need to be serviced. Defaults are on the horizon. The defaults in turn will tend to destabilize the financial institutions that funded the industry.

You say you don't have an investment in the oil shale industry? How about your mutual funds? Your 401K? Or your bank? A lot of institutions jumped on the fracking bandwagon. Plus, bankruptcies in the energy sector could trigger a domino effect given how intertwined the entire financial system is. Furthermore, as people witness the carnage in energy, investor psychology could turn as everyone makes for the exits in fear of something happening with unrelated investments.

Trend 5 - Capital Controls

Any or all of the above trends could motivate people to move their money to a safer haven. The government is aware of this possibility. It knows that people liquidating investments en-mass, closing accounts with banks that are exposed to risky derivatives, moving money away from institutions charging a negative interest rate, etc., would all be highly disruptive. That's where a special form of intervention known as *capital controls* comes in. Capital controls either dissuade (through penalties and fees) or outright prohibit people from moving money around. A cash ban is certainly one form of a capital control. Other manifestations might include a ban on liquidating money-market or mutual funds, or other investments related to government debt such as T-bills or T-bonds. A prohibition on transferring money out of the country is certainly a possibility. In fact, such transfers are already restricted.

Summary

This essay is merely a scant look at the monetary trends unfolding across both the US and the world as a whole. Trends continue until they don't. The future is not set in concrete... it's more like wet cement, firming up as the future moves into the present. This may be a good time for people to remember the adage; *The Price of Freedom is Eternal Vigilance*. Stay tuned for Part II when some protective strategies will be discussed to counter these unfortunate trends.

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