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MEDIA RELEASE

Wednesday, 2 October, 2019

Gaping black hole opens up in debt and derivatives bubble

The actions of the Australian government and central bank, and US Federal Reserve, betray real desperation about the state of the Australian and global financial system. There are signs that the global debt and derivatives bubble, which the world's governments and banks have manically propped up for a decade since the 2008 global financial crisis, is suddenly imploding into a financial black hole.

(This sudden crisis is the subject of the 27 September *CEC Report*. Click here to watch: "All signs point to financial meltdown under way".)

Last week the US Fed was again forced to escalate its response to the repo market crisis that started on the afternoon of 16 September, when the interest rate on overnight lending between US banks suddenly jumped from a bit over 2 per cent, to almost 10 per cent. (Repo is jargon for "repurchase agreement", the mechanism by which banks borrow overnight against collateral that they agree to repurchase the next day.) This rise indicated that one or more institutions—still unidentified—unexpectedly needed to borrow a lot of money fast, which the other banks were either unable or unwilling to lend. For the first time since the 2008 financial crisis the Fed was forced to intervene in the repo market; it injected US$53 billion immediately, and promised another US$75 billion the next day if it was needed.

The situation is now out of control. Not only was the next US$75 billion needed, the Fed had to keep doing it, eventually injecting almost US$300 billion by the end of the first week, and then pledging to inject US$75 billion per day into the overnight repo market until 10 October, and US$30 billion three times into the 14-day repo market. Even that hasn't worked. Now the Fed has upped its intervention to offer US$100 billion per day into the overnight market, and US$60 billion into the 14-day market.

The big question everyone is asking is why have the giant Wall Street banks, with their massive deposits, stopped lending into the repo market? Their unwillingness to lend indicates they know something big has happened, which might mean they wouldn't be paid back. This is how the collapse of Lehman Brothers triggered the credit crunch in 2008, which raises a more important question: does the mysterious black hole in the repo market mean another meltdown has started in the global derivatives bubble?

Panic in Australia

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On 1 October the Reserve Bank of Australia cut its official cash interest rate to 0.75 per cent, another all-time record low. While these rate cuts are becoming the new normal, they are actually extraordinary and extreme. The RBA has previously indicated it is prepared to go to zero and negative interest rates.

This is driving another desperate move, the Morrison government's push for legislation banning cash transactions over $10,000. The cash ban is intended not to reduce the so-called "black economy" as claimed, but to lock Australians into the banking system so they can't escape extreme measures to prop it up, such as negative interest rates and "bail-in" of deposits.

Australia's banks are on the edge. The Big Four banks have the highest exposure to housing debt of any banks in the world. Their loans are well over 100 per cent of their deposits, some close to 130 per cent, compared with a healthy loan-to-deposit ratio (LDR) of more like 90 per cent. A high LDR is an indicator banks may not have enough liquidity to cover emergencies—another reason for the cash ban to lock deposits in banks. With its rate cuts, the RBA is desperate to resuscitate the housing bubble cancer that has gripped the Australian economy for almost two decades. The deflation of the bubble in the past 18 months has threatened the banks with serious losses.

Even more concerning is the banks' massive and unprecedented increase in exposure to off-balance sheet derivatives. According to RBA figures, derivatives trading has skyrocketed by more than $10 trillion in just six months, from $38.2 trillion to $48.7 trillion. The banks claim that their derivatives trading is mostly hedging, or off-setting risks from other investments; however, this burst of growth in derivatives does not correspond to any equivalent activity in the financial system and economy. It is an alarming indicator of something amiss in Australia's banking system.

Derivatives fraud

The history of derivatives shows they can be instruments of fraud. They can be used to create artificial liquidity, and cover up losses, including losses caused by gambling in other derivatives. An infamous example of derivatives being used in this way is given in former Morgan Stanley derivatives salesman Frank Partnoy's 1997 book *F.I.A.S.C.O.: Blood in the Water on Wall Street*. Partnoy explains how the 1995 collapse of British bank Barings in a massive derivatives meltdown caused heavy losses in Japanese banks, so Wall Street banks made a killing by selling derivatives to the Japanese banks that were designed to hide the losses, and in fact make the losses appear to be

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profits.

The *CEC Report* includes a clip of Frank Partnoy, now a law professor, demonstrating that the practice of banks holding their derivatives off-balance-sheet means their balance sheets are fictional. The giant Wall Street bank Citigroup had a very healthy balance sheet all through 2006, 2007, 2008 and 2009, but in that time its market capitalisation collapsed to almost zero, it went from making tens of billions of dollars to losing tens of billions of dollars, and it required the single biggest bailout of any bank—over US$300 billion. The 2008 crisis proved that off-balance sheet accounting, and the practice of banks reporting only their net derivatives exposure, rather than their much larger notional principal (as done by Australia's Big Four banks except Westpac), is another f-word: fraud.

The 2008 derivatives meltdown was temporarily stopped by massive government bailouts and trillions in central bank quantitative easing (QE) money-printing. This only put off the inevitable implosion, however, which may be starting now. Whenever it may be, it is imperative that we stop policies like the cash ban, bail-in, negative interest rates, QE and helicopter money, and force governments to take back control of the banking system from central banks and implement comprehensive reforms. These must include a full Glass-Steagall separation of deposit-taking banks from all forms of speculation, and a national bank so that public credit can be directed into productive infrastructure and industries.

Keep fighting the cash ban!

The immediate fight against the cash ban is crucial. Click here to go to the new page on the CEC's website dedicated to the campaign to stop the cash ban law, with instructions on how to:

- make a submission to the Senate inquiry;
- join a delegation with other people in your electorate to visit your local MP;
- sign and share the Change.org petition.

Click here to sign the CEC's petition against bail-in: Hands off our bank deposits—stop bail-in!

Click here for a free copy of the latest issue of the *Australian Alert Service*.

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