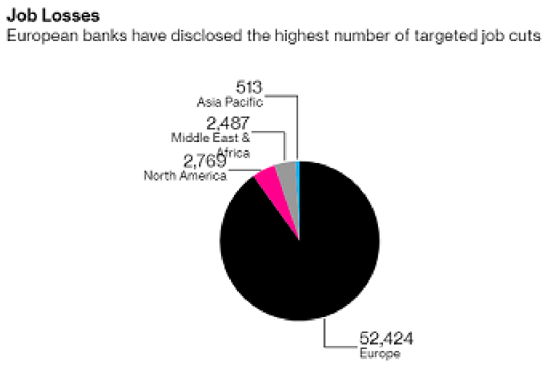
Is the Fed concealing a new global crisis?

The US Federal Reserve announced on 4 October that it will extend its daily interventions of offering up to US$75 billion per day into “repo” overnight lending market until at least 4 November. It will also continue offering two-week loans at regular intervals. The repo market consists of short-term lending based on the borrower agreeing to “repurchase” the collateral it puts up for the loan at an agreed time. The Fed began intervening to provide additional overnight liquidity to large US banks, who evidently could not find other banks willing to lend to them, on 17 September (“Pre-tremors of the next global banking meltdown?”, *AAS*, 25 Sept.).

These loans are offered to the Fed’s “primary dealers”, 24 too-big-to-fail banks with access to New York Fed borrowing windows. These dealers include “the securities units of foreign banks” such as Deutsche Bank and HSBC Securities, which are experiencing their worst year since 2008, according to Wall Street On Parade. The Fed has refused to disclose exactly who is seeking the loans because it says they are not “emergency” actions; rather—ignoring the fact this is the first time they have occurred since the GFC—they are just regular market operations.



This Bloomberg graphic shows 58,000 layoffs announced by banks. Another 10,000 layoffs were since announced by HSBC.

If regular market principles applied, banks with any available cash would have jumped to lend their reserves into the repo market at *up to 10 per cent rates*, making cool overnight profits. They didn’t. Many pundits try to put this down solely to tighter post-2008 regulations requiring big banks to stay highly liquid, which is a factor but by no means the whole story. Rumours abound regarding three major players, all of which have showed dramatic or subtle signs of trouble: Deutsche Bank, HSBC and JPMorgan Chase. HSBC and Deutsche have announced major layoffs, as have other banks.

A 2 October Reuters article, “Too big to lend? JPMorgan cash hit Fed limits, roiling US repos”, raised questions about JPMorgan Chase, one of America’s four largest banks (along with Bank of America, Citigroup and Wells Fargo). Citing rival banks and analysts, the article suggested the bank had a key role in the repo rate spike. According to publicly filed data, “JPMorgan reduced the cash it has on deposit at the Federal Reserve, from which it might have lent, by US$158 billion in the year through June, a 57 per cent decline”. This accounted for around one-third of the drop in banking reserves at the Fed during that period, Reuters reported. Given its stature, capital requirements and surcharges are bigger for JPM than for any other US bank. The bank may also have experienced “sudden demands by corporate depositors”, said Reuters. Other banks have also reduced Fed deposits, to lesser degrees, partly due to the Fed reducing its bond portfolio in its recent attempt to unwind quantitative easing.

The 1 October *Financial Times*, which averred that the reluctance to lend was about more than just regulatory compliance, one factor being the impact on profitability of zero interest rates, cited a chief financial officer at a top-10 US bank declaring, “We have plenty of liquidity. We are just choosing not to lend it out overnight to hedge funds.” With a high concentration of reserves in a handful of banks, taking one or two out of the equation at any time means “you are losing a major portion of your funding. Rates have to skyrocket. It’s simple math”, said Jim Tabacchi, chief executive at South Street Securities. The question is, why aren’t they willing to lend?

One suggestion is their funds are tied up in relatively illiquid speculation, which requires excess reserves to be held. Another clue is the supporting role of big insurance companies, which continue to facilitate dodgy derivatives deals—including AIG, which was one of the first agencies to be bailed out in 2008. When the Dow Jones dropped 838 points on 3-4 October, Pam Martens and Russ Martens wrote for Wall Street On Parade on 3 October, insurers were among those falling the most because they are counterparties to big banks in derivatives trades. The role of insurers can be catalytic, with vulture funds known to make money out of forcing companies into default. Hedge funds which insured against the default of British travel company Thomas Cook, for instance, made a mint from the US$250 million worth of credit default swaps it owned.

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